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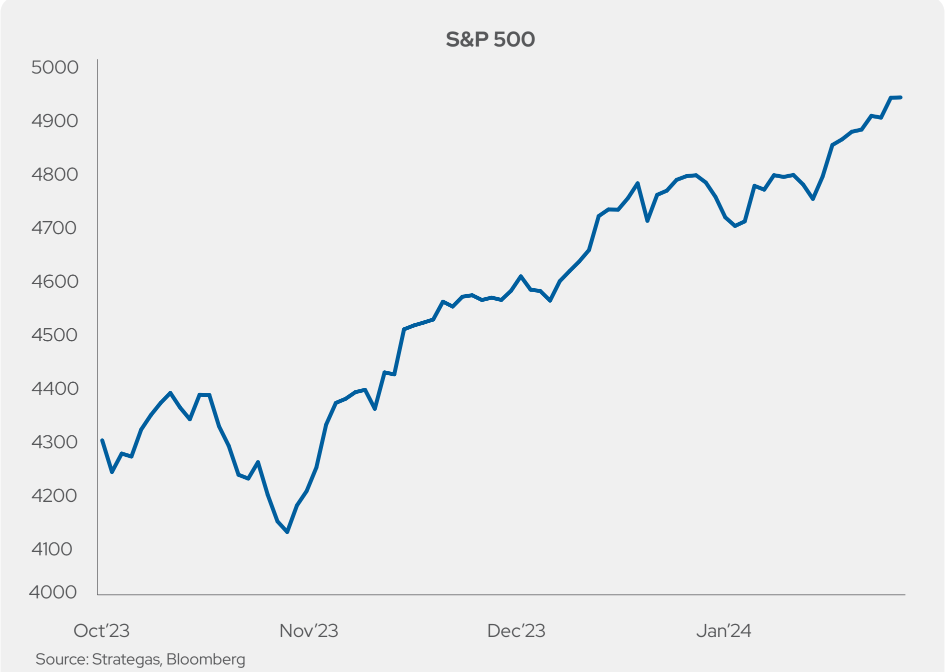
Room to Run

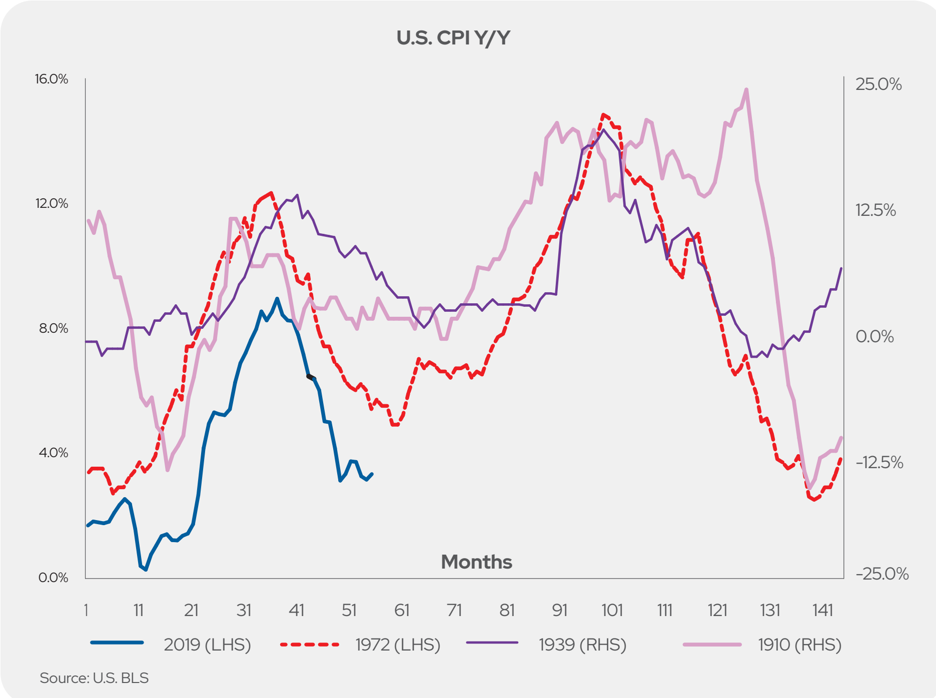
It may be hard to believe, but at the end of October last year, the S&P 500 was resting at a lowly 4,100 and the 10-year U.S. Treasury was yielding ~4.85%. Then over the ensuing ten weeks into year-end, and now another four into the New Year, the Index has rallied more than +20% to ~4,925 and the yield on the 10-year Treasury Note has fallen -85bps to ~4.05%. What happened? Put simply, the Treasury Department doubled down on issuing short-term debt in its Quarterly Refunding Statement— a position it has maintained in its 1Q release. This action marked the peak in 10-year yields last year by creating scarcity at the long-end of the yield curve.

From a tactical and political point of view, it was a masterstroke for the Administration, underlining the benefits of having a former Fed Chair as the Secretary of the Treasury (only the third such individual to have served in both roles.) Though prudence suggests some suspicion for the wisdom of the government funding massive long-term liabilities with short-term funding, a la Bear Stearns, it seems clear that it will be left for future generations to manage. If this boost wasn't enough, the market got another shot in the arm when Fed Chairman Powell effectively declared victory over inflation in mid-December, leaving behind concerns that an approach similar to the "stop-and-go" monetary policies of the 1970s could cause a similar multi-wave inflation phenomenon this time around. As we mentioned in our last note, in a study of 2,100 years of inflation data, across 24 countries, our chief economist Don Rissmiller found 62 instances in which annual inflation peaked above 6%. In all but eight (87%) price surges evidenced in multiple waves.



Source: Strategas, Bloomberg

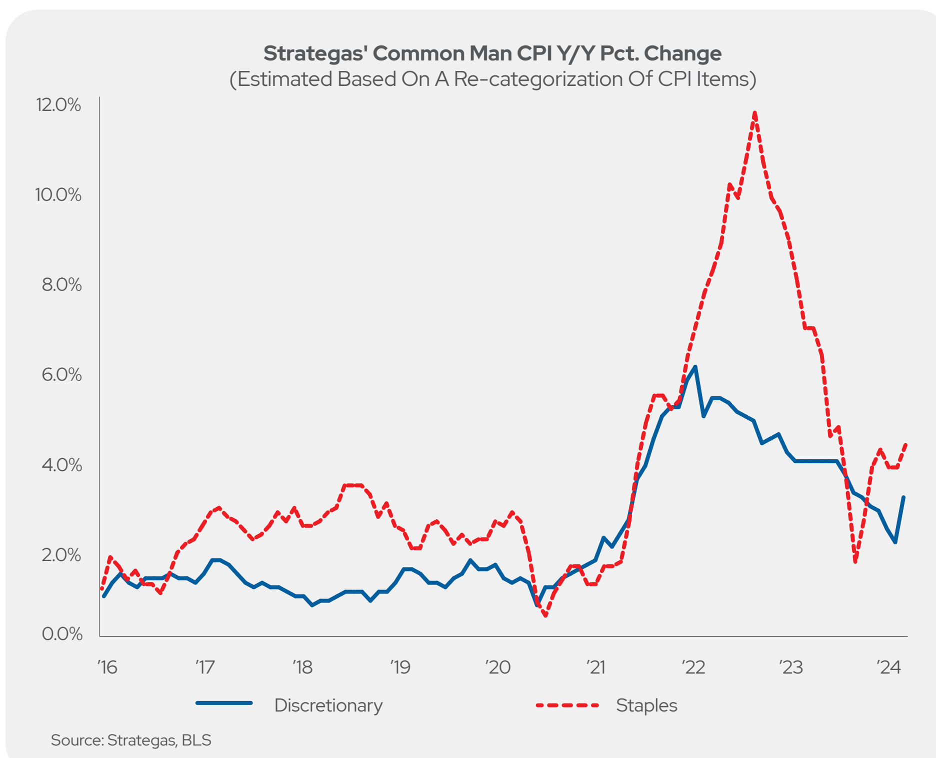
It cannot be denied that the rate of inflation has fallen markedly since reaching its peak in mid-2022, but the idea that policy makers believe they have arrested inflation back to an acceptable level and are now advertising easier monetary policy, prompted Strategas strategists Jason Trennert and Ryan Grabinski to look at inflation in a different way. The team divided the myriad components of the



Labor Department's headline measure of inflation, the Consumer Price Index, into two categories: the first, called "staples," i.e., goods consumers need, and the second, "discretionary," i.e., goods consumers want. The results are interesting. They reveal a far greater spike in the rate of inflation for the Staples measure in 2022 and a far greater decline to 1.6% in Jun'23. That said, our Staples measure of inflation has reaccelerated to 4.2% in the latest reading, whereas the Bureau of Labor Statistics (BLS) headline CPI currently rests at 3.4% y/y. (Strategas' measure of Discretionary inflation bottomed in Nov'23 at 2.1% and now stands at 3.1%; items we mark as discretionary are helping to pull the BLS measure lower.) Most importantly, the spread between wage gains and the Strategas measure of Staples inflation was widened to almost 700bps. Said another way, the increase in the cost of things we need is outpacing the increase in our wages by 7% since 2019. As our chief strategist, Jason Trennert, highlighted, this could in part explain the Administration's weak poll numbers despite full employment and near-record asset prices.

The market seems intent on cutting a volatile path higher. The policy backdrop– additional fiscal stimulus and the anticipation of easier monetary policy– that fueled animal spirits into year-end remains in place. The Administration has doubled down (as any administration would) on maintaining a positive, if not expanding, economic backdrop for the President's re-election campaign. The Fed, Chair Powell in particular, continues to signal a pivot to rate cuts. By our lights, the current data do not support a cut before 2Q. The market, however, continues to expect rate cuts beginning in March (though this is decreasing). June is our best guess. The Fed either: 1) knows something the market doesn't– unlikely; 2) is playing politics– perhaps (and unfortunately) increasingly likely; or, 3) is overconfident– most likely. If anything, it seems fiscal stimulus may be more supportive than first thought, while the excitement over near-term rate cuts may prove been premature.

Absent the exogenous, however, the equity market's path of least resistance seems to be higher until the consumer pulls back and/or the labor market buckles. Don Rissmiller notes only moderate cracks in the labor market: downward revisions of



-71,000 jobs to prior months in the Dec'23 Payroll release; an uptick in the "under-employment" to 7.1%, and a concerning drop in the U.S. labor force participation rate to 62.5%, etc. As Don describes it, "...small cracks, but not large, in the employment situation." The strong footing on which the consumer finished 2023 appears to have carried into 2024. The real test will come in February, when the lagged effects of holiday credit card debt growth hit household budgets. This could lead to another seasonal "soft patch" in late-winter and spring, giving the Fed some room to eventually ease.

About Strategas

Strategas is a global institutional brokerage and advisory firm. The Firm provides macro research, capital market and corporate advisory services, and investment management solutions to institutional investors and corporate executives in more than twenty countries around the world.

Founded in 2006 by Jason DeSena Trennert, Nicholas Bohnsack, and Don Rissmiller, the Firm was acquired by Baird Financial Group in 2018. Strategas operates independently as a wholly-owned subsidiary of Baird and offers institutional securities services through Strategas Securities, LLC, a broker-dealer, and investment management solutions, including this commentary, through Strategas Asset Management, LLC, a registered investment advisor.

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Index Overview & Key Definitions

Fed, The Fed or FED refers to the Federal Reserve System, the central bank of the United States. Fed Funds Rate, the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The Gross Domestic Product (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. Real Gross Domestic Product (GDP) is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year. Nominal Gross Domestic Product is gross domestic product (GDP) evaluated at current market prices. The S&P 500 Index is an unmanaged index comprised of 500 widely held securities considered to be representative of the stock market in general. The Russell 1000 Index is a market capitalization weighted benchmark index made up of the 1000 largest U.S. companies in the Russell 3000 Index. The Russell 2000 Index is an unmanaged index considered representative of small-cap stocks. The PCE (Personal Consumption Expenditure) Index of Prices is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data including U.S. Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures; essentially a measure of goods and services targeted towards individuals and consumed by individuals. The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services. FAANG is an acronym for the five of the market's most popular tech stocks, namely Facebook, Apple, Amazon, Netflix and Alphabet's Google. The North American Free Trade Agreement (NAFTA) is an agreement signed by Canada, Mexico, and the United States, creating a trilateral trade bloc in North America. The Seasonally Adjusted Annual Rate (SAAR) is a rate that is adjusted to take into account typical seasonal fluctuations in data and is expressed as an annual total. SAARs are used for data affected by seasonality, when it could be misleading to directly compare different times of the year. The Atlanta Fed GDPNow forecasting model provides a "nowcast" of the official estimate prior to its release by estimating GDP growth using a methodology similar to the one used by the U.S. Bureau of Economic Analysis. GDPNow is not an official forecast of the Atlanta Fed. Rather, it is best viewed as a running estimate of real GDP growth based on available data for the current measured quarter.

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