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China's growth

China's annual gross domestic product growth rose in the fourth quarter above policymakers' target.

Central bankers

European Central Bank President Christine Lagarde and US Federal Reserve Governor Chris Waller threw cold water on those hoping for quick rate cuts.

What's driving markets? Consumers, inflation, and central banks

Weekly Market Compass | January 22, 2024

Every week is a mosaic of economic data and market data. Last week, we received insight into US retail sales and jobless claims, China's gross domestic product (GDP) growth, UK and eurozone inflation, and central bank opinions. Here's how these data points contribute to the bigger picture and help show what's driving markets.

The US consumer is in good shape

For December, retail sales were better than expected and initial jobless claims were at their lowest levels since September 2022,¹ both of which are good signs for the health of the US consumer. And we're finally seeing signs that US consumers are feeling well themselves, with the University of Michigan reading of consumer sentiment at its highest level since July 2021.² The improvement over the last two months has been very significant.

China sees improved but uneven growth

China's annual GDP growth rose in the fourth quarter to an annualized rate of 5.2%, above policymakers' 5% target but narrowly below the 5.3% consensus estimate.³ Policymakers are likely to set a 5% growth target for 2024, which now seems achievable without significant easing. In addition, we saw year-over-year increases in industrial production (6.8%), retail sales (7.4%), and fixed asset investment (3%).³

There's concern that these better results could curtail any additional stimulus, but I doubt it. Word is that China is considering the issuance of special sovereign bonds, which has only happened three times before.⁴ I would anticipate targeted stimulus to areas like the property sector given that China's property investment fell by 9.6% in 2023.³

Inflation looks well under control

Some inflation-related data has spooked markets, but the reality is that inflation remains well under control and is poised to ease further in developed countries:

- **UK.** The UK's December Consumer Price Index (CPI) was higher than expected (4.0% actual versus 3.8% year-over-year) and higher than its November reading of 3.9%.⁵ However, that was largely driven by higher tobacco and alcohol prices. Core CPI (excluding energy, food, alcohol, and tobacco) rose by 5.1% year-over-year, the same rate as in the previous month.⁵ In a separate report, though, wage growth (excluding bonuses) was reported at the weakest pace in nearly a year.⁶
- **Eurozone.** We saw a similar pattern in the eurozone, where December's inflation rate was 2.9% year-over-year, up from 2.4% in

November.⁷ However, we have to remember it was 9.2% year-over-year just a year earlier.⁷ And inflation ex-food and energy was 3.9% year-over-year, down from 4.2% in the previous month.⁷

It's also important to look at survey-based expectations of consumers. Consumer expectations have been predictive of future inflation as they affect the consumption decisions of households, turning expectations into self-fulfilling prophecies. As Federal Reserve Chair Jay Powell acknowledged, "Inflation expectations are terribly important. We spend a lot of time watching them."⁸ And so recent results are encouraging:

- **US.** US consumer inflation expectations for the year ahead, as measured by the University of Michigan Survey of Consumers, have fallen dramatically in the last several months, from 4.5% in November to 2.9% in January.⁹ In addition, the Atlanta Fed Business Inflation Expectations Survey showed that businesses expect inflation in the year ahead to decrease substantially, down to 2.2% — getting closer to the Fed's inflation target.¹⁰
- **Eurozone.** The European Central Bank's (ECB) Consumer Expectations Survey showed that median consumer expectations for eurozone inflation for the next 12 months fell to 3.2% in November.¹¹ This was down significantly from the October reading of 4.0% and is the lowest rate since February 2022.¹¹

Japan is also seeing a decrease in inflation — although that's not what it's looking for. Japan's year-over-year inflation rate was 2.6% in December versus 2.8% in November, with core inflation at 3.7% versus 3.8% in November.¹² This helps confirm our expectation that the Bank of Japan will sit on its hands and not act at this week's meeting.

Central bankers sound hawkish

ECB President Christine Lagarde said rate cuts likely won't start until the summer, rather than the spring. And Fed Governor Chris Waller threw cold water on those hoping for a rate cut in March: "When the time is right to begin lowering rates, I believe it can and should be lowered methodically and carefully...I see no reason to move as quickly or cut as rapidly as in the past."¹³

I think it's important to point out that I haven't expected a Fed rate cut in March — and I've expected the ECB to start cutting after the Fed begins. So nothing that's been said changes my expectations for 2024. And, again, I have to stress that central bankers have an agenda in mind when they make these comments; they want to keep a lid on easing financial conditions.

A new record for the S&P 500 Index

Last week we saw the S&P 500 hit a new record closing high of 4839, breaking the record of 4796 set back on Jan. 3, 2022. But the correlation we have seen in the recent past between lower bond yields and higher stock prices was broken — at least temporarily. We saw significant volatility in bond markets last week — fueled by concerns that inflation is running hotter than expected, coupled with hawkish "central bank speak" — which sent yields higher.

For example, in response to the eurozone inflation print, euro bond yields rose significantly; the yield on the German 10-year rose from 2.18% to 2.34%.¹⁴ After the release of US retail sales data, US bond yields also rose materially. And bond yields were also pushed higher by hawkish central bank speak.

But that didn't stop stocks from advancing. The catalyst was enthusiasm around the tech sector. It started in semiconductors, with very positive guidance from Taiwan Semiconductor, and spread to tech stocks in general. The drivers were excitement over the potential for better tech earnings as well as more excitement over the potential for artificial intelligence. That then led to more bullish sentiment overall and helped pull up stock prices in a variety of sectors.

Week ahead

The coming week will be filled with central bank decisions, from the Bank of Japan to the Bank of Canada to the ECB. And we'll be looking to the most important inflation reading for the Fed, the Personal Consumption Expenditures report, to help foreshadow what we may hear from the Fed when it meets the following week.

But don't lose sight of the forest for the trees. In my opinion, it doesn't matter if we get some imperfect inflation data points, especially around headline inflation; disinflation is underway and will continue. In my opinion, it doesn't matter whether the Fed starts cutting in March or May — it will cut and cut materially this year, and other major Western developed central banks will start to cut as well. I believe we're headed for a bumpy but brief landing in the near term and then are likely to see a re-acceleration of economic growth later this year.

I still expect small caps and stocks outside the US, along with tech, to perform well in coming months — in addition to investment grade bonds — to name a few areas of opportunity. However, I believe it's critical to be well diversified across and within the three major asset classes — stocks, bonds, and alternatives. This new year of investing has only just begun and is likely to offer some twists, turns and surprises along the way.

Dates to watch

Date	Report	What it tells us
Jan. 23	Bank of Japan rate decision and press conference	Reveals the latest decision on the path of interest rates.
	ECB Bank Lending Survey	Provides information on the supply of and demand for loans to enterprises and households.
	S&P Global Japan PMIs	Index Indicates the economic health of the manufacturing and services sectors.
Jan. 24	S&P Global eurozone PMIs	Indicates the economic health of the manufacturing and services sectors.
	S&P Global UK PMIs	Indicates the economic health of the manufacturing and services sectors.
	S&P Global US PMIs	Indicates the economic health of the manufacturing and services sectors.
	Bank of Canada decision and press conference	Reveals the latest decision on the path of interest rates.

Date	Report	What it tells us
Jan. 25	German Ifo Business Climate Index	Assesses the current German business climate and measures expectations for the next six months.
	ECB decision and press conference	Reveals the latest decision on the path of interest rates.
	US Durable Goods Orders	Tracks new orders placed with manufacturers for long-lasting goods.
	US GDP	Measures a region's economic activity.
	US New Home Sales	Indicates the health of the housing sector.
	Bank of Japan monetary policy meeting minutes	Gives further insight into the central bank's decision-making process.
	UK GfK Consumer Confidence	Tracks UK consumers' views of their finances and the economy.
Jan. 26	US PCE Price Index	Tracks the path of inflation.
	US Personal Spending	Measures changes in the value of spending by US consumers.
	US Personal Income	Measures income that people get from wages and salaries, government benefits, dividends and interest, business ownership, and other sources.
	US Pending Home Sales	Indicates the health of the housing sector.
	US Crude Oil Inventories and Natural Gas	Helps indicate supply and demand for energy.

Notes

¹Source: CNBC, "Weekly jobless claims post lowest reading since September 2022," Jan. 18, 2024

²Source: University of Michigan Survey of Consumers (preliminary), Jan. 19, 2024

³Source: China - Office of National Statistics, Jan. 17, 2024

⁴Source: Bloomberg News, "Why China Is Considering Rarely Used Special Bonds to Stimulate Its Economy," Jan. 21, 2024

⁵Source: Consumer price inflation, UK - Office for National Statistics, Jan. 17, 2024

⁶Source: UK wage growth slows again, offering some relief to BoE (Bank of England), Reuters, Jan. 16, 2024

⁷Source: Eurostat, Jan. 17, 2024

⁸Source: Federal Open Market Committee Meeting Press Conference, Sept. 22, 2022

⁹Source: University of Michigan Survey of Consumers (preliminary), Jan. 19, 2024

¹⁰Source: Federal Reserve Bank of Atlanta, Business Inflation Expectations, January 2024

¹¹European Central Bank, Jan. 16, 2024

¹²Source: Japan Ministry of Internal Affairs and Communications

¹³Source: CNBC, "Fed's Christopher Waller advocates moving 'carefully' with rate cuts," Jan. 16, 2024

¹⁴Source: Bloomberg, as of Jan. 19, 2024

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

Should this contain any forward looking statements, understand they are not guarantees of future results. They involve risks, uncertainties, and assumptions. There can be no assurance that actual results will not differ materially from expectations.

Diversification does not guarantee a profit or eliminate the risk of loss.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Stocks of small and mid-sized companies tend to be more vulnerable to adverse developments, may be more volatile, and may be illiquid or restricted as to resale.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

Many products and services offered in technology-related industries are subject to rapid obsolescence, which may lower the value of the issuers.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

The Survey of Consumers is a monthly telephone survey conducted by the University of Michigan that provides indexes of consumer sentiment and inflation expectations.

Gross domestic product (GDP) is a broad indicator of a region's economic activity, measuring the monetary value of all the finished goods and services produced in that region over a specified period of time.

The European Central Bank (ECB) is responsible for the monetary policy of the European Union.

Yield is the income return on an investment.

Easing monetary policy includes actions by a central bank to stimulate growth in the economy.

Inflation is the rate at which the general price level for goods and services is increasing.

Disinflation, a slowing in the rate of price inflation, describes instances when the inflation rate has reduced marginally over the short term.

Core inflation is the change in the costs of goods and services but does not include those from the food and energy sectors.

Headline inflation is a measure of the total inflation within an economy, including commodities such as food and energy prices.

The UK Consumer Price Index (CPI) measures change in consumer prices as determined by the UK Office of Statistics.

The Federal Reserve Bank of Atlanta's Business Inflation Expectations Survey was created to measure the year-ahead inflationary sentiments of businesses in the Sixth District. About 300 panelists receive the survey each month, and represent businesses of various sizes headquartered within the Sixth District, which encompasses Alabama, Florida, Georgia, and sections of Louisiana, Mississippi and Tennessee. Survey responses are weighted by industry shares of national gross domestic product.

The European Central Bank's Consumer Expectations Survey is a monthly online survey of, currently, around 14,000 adult consumers (i.e. aged 18 or over) from six euro area countries: Belgium, Germany, Spain, France, Italy and the Netherlands.

Hawkish is to favor relatively higher interest rates if they are needed to keep inflation in check

Personal Consumption Expenditures (PCE) includes a measure of consumer spending on goods and services among households in the US.

The opinions referenced above are those of the author as of **Jan. 22, 2024**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.