Weekly Market Update

January 8, 2024

Market Commentary

U.S. Highlights

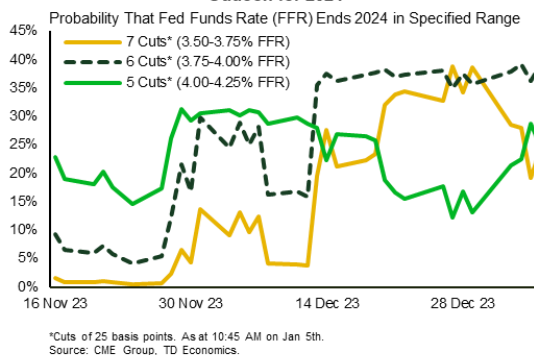
- Minutes from the December FOMC meeting confirmed that monetary policy was “likely at or near its peak” for this tightening cycle, but showed no meaningful discussion on rate cuts.
- The U.S. economy added a better-than-expected 216k jobs in December, but downward revisions to the prior two months kept a cooling trend intact. The unemployment rate held steady at 3.7%, while wage growth accelerated slightly.
- The ISM surveys overall signaled softness. Manufacturing remained in contractionary territory in December, albeit slightly less negative, while activity in the services sector slowed but remained in expansionary territory.

Canadian Highlights

- As the Canadian economy continues to gear down, the focus turns to when the Bank of Canada (BoC) will cut interest rates. Our view of a 25 basis-point cut at the BoC’s April rate setting date currently aligns with market expectations.
- Getting inflation back to the Bank of Canada’s 2% target remains the key consideration. We expect inflation to durably get below 3% in 2024 with a return to 2% in 2025.
- Canada’s job market is continuing to find its balance as job growth stalled in December. Meanwhile, preliminary housing market data showed surprising strength to end the year.

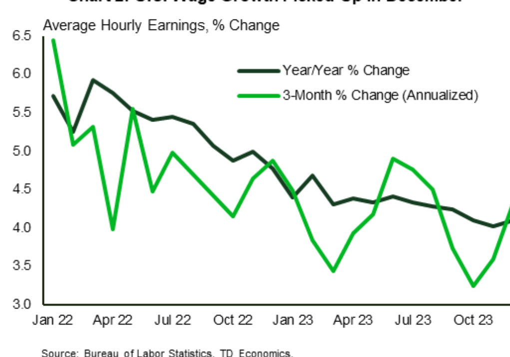
U.S. – Rate Cut Expectations Ease Slightly at the Start of 2024

After a festive December where a sharp pullback in long-term yields sent risk assets higher, markets have gotten off to a much more sober start in 2024. Investors have seemingly adjusted their New Year's resolutions, resulting in more moderate expectations for interest rate cuts this year. Cuts totaling 150 basis points by the end of 2024 remains the dominant scenario. The probability for more aggressive policy loosening (i.e., 7 cuts) has fallen sharply, while the probability of slightly less aggressive loosening (i.e., 5 cuts) has increased (Chart 1). In line with these developments, the 10-year Treasury yield has recouped some of the lost ground, rising from 3.8% at the end of December to near 4% recently, and equity markets have pared back year-end gains, with the S&P 500 down 1.6% from its recent peak.



The minutes from the December FOMC meeting contributed to the softening in expectations for interest rate cuts last week. After the Fed signaled that the policy rate would head lower in 2024, there was an anticipation that rate cut talk may have featured heavily at the last meeting. Committee participants confirmed that the policy rate was "likely at or near its peak for this tightening cycle", given the reduction in inflation in 2023 and "growing signs of demand and supply coming into better balance in product and labor markets". But, meaningful debate on rate cuts was missing. Instead, the discussion was somewhat more balanced, touching on both the risks of maintaining rates in a restrictive position for too long and the risks of prematurely easing policy. Participants noted that their outlooks were associated with an "unusually elevated" degree of uncertainty and stressed the importance of maintaining a data-dependent approach to setting monetary policy.

Speaking of data, this morning's payrolls report showed that hiring unexpectedly accelerated in December, with the U.S. economy adding 216 thousand jobs. However, a downward revision of 71 thousand jobs to the prior two months limits some of the enthusiasm of this upward surprise. On a three-month moving average basis, hiring is still trending lower, which suggests that restrictive monetary policy continues to work as intended, cooling labor demand. Nonetheless, other aspects of the report still play in favor of showing some caution on easing monetary policy. The unemployment rate held steady at 3.7%. With the labor market still tight, wage growth gained some ground in December (Chart 2). A recent pullback in the job 'quits' rate – a leading indicator of labor costs – suggests that wage growth is nonetheless poised to cool ahead.



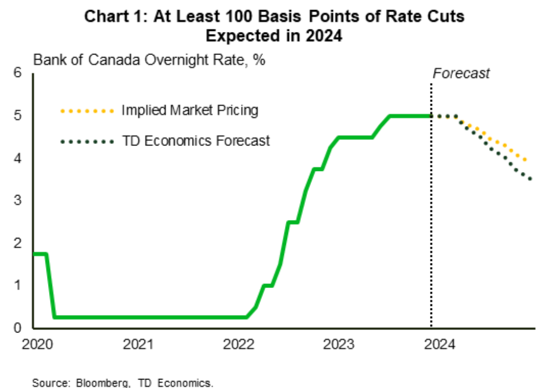
Other data reports were a mixed bag. Consumers increased vehicle purchases in December (up 3.2% to 15.8 million annualized), although this appears to be partially related to the return of year-end discounts. Meanwhile, the ISM indexes signaled softness. There was a slowdown in the expansion of the services side of the economy, and the manufacturing sector remained in contraction for the 14th month in row in December, albeit slightly less so on the month.

All factors considered, a loosening in monetary policy is coming, but we anticipate the Fed will show a bit more caution, with the first rate cut not likely to come until the second half of the year.

Sourced from TD Weekly Bottom Line on Friday, January 5th, 2024
Chart 1: Markets Pare Back Aggressive U.S. Interest Rate Cut Outlook for 2024. Sourced on Friday, January 5th, 2024
Chart 2: U.S. Wage Growth Picked up in December. Sourced on Friday, January 5th, 2024

Canada – The Year of the Cut

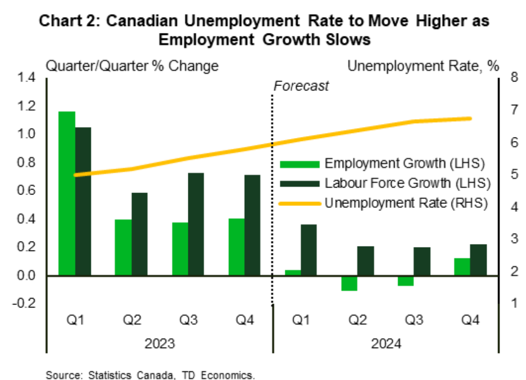
The new year is less than one week old, but the theme that will govern the next 12 months is firmly in place. After the most aggressive interest rate hiking campaign in over 40 years, the Bank of Canada's (BoC) focus is now shifting towards rate cuts. The burning questions are when the first cut will occur and how many cuts will be delivered. Markets had ended the year preparing for a loosening in conditions, with equities up over 10% from late-October and both Canadian and U.S. yields sliding almost 100 basis points (bps) from their fourth-quarter peaks.



The BoC will meet eight times in 2024 with their first policy decision on January 24th. For the last six months, the Bank has held the overnight policy rate at 5.00% as it continues to assess the incoming data. Markets are pricing the first rate cut to occur at the BoC's April meeting (Chart 1), in line with our forecast. We expect measured 25 bp cuts to occur over the remaining meetings, bringing the end-point to 3.50%, slightly lower than market expectations of 3.75%. Still, this rate is notably tighter than pre-pandemic levels.

Make no mistake, the effects of the cumulative 475 bps of interest rate hikes are taking hold. Consumers are reeling in their spending, and growth is evolving in a manner consistent with inflation inching closer to the BoC's 2% target. But the job is not done yet, as inflation remains elevated and wage growth is still running hot. Thus, we sit at a critical crossroads between prematurely cutting rates and potentially reigniting inflation, or keeping conditions too tight, causing more economic pain than necessary.

Recall that Canadian inflation printed on the hotter side in November, with headline and core measures above 3%. The next inflation release, due out on January 17th could see inflation accelerate on the back of base-effects that saw weak inflation a year-ago. However, inflation is trending in the right direction, and we forecast it will durably break below the 3% level in 2024.



On the data front, Canadian employment was flat in December while the unemployment rate held steady at 5.8%. We are seeing signs that the job market is gradually losing momentum, but further cooling is needed to give the Bank of Canada comfort to pull the trigger on rate cuts. Over the year, we expect labour force growth to continue outpacing employment gains, pulling the unemployment rate higher from current levels (Chart 2). Meanwhile, job vacancies are declining across the country, although it is not occurring evenly across provinces, and wages remain elevated in the in 4-5% range.

Preliminary housing market data for the month of December pointed to strong sales activity and declining listings, tightening conditions in major markets. The greater-than-expected drop in yields, and subsequently mortgage rates, in the fourth quarter partially explains this uptick in activity. The BoC will be watching the housing market as seasonally strong spring homebuying will to fall directly in line with the expected timing of interest rate easing.

Sourced from TD Weekly Bottom Line on Friday, January 5th, 2024
Chart 1: At Least 100 Basis Points of Rate Cuts Expected in 2024. Sourced on Friday, January 5th, 2024
Chart 2: U.S. 10-Year Yield Down Significantly from Mid-October Highs. Sourced on Friday, January 5th, 2024

Market Summary

The first week of 2024 saw moderate declines in stocks following the strong Q4 rally as economic data pushed back on the idea of imminent rate cuts. The S&P 500 fell 1.01% on the week.

Stocks declined to start the year last Tuesday amid a disappointing Chinese PMI report while a downgrade of AAPL amplified selling pressure on big tech. The S&P 500 fell 0.57%.

The selling continued on Wednesday amid some hawkish commentary out of the Richmond Fed’s Barkin (a voting member of the FOMC) and mostly in-line JOLTS and ISM Manufacturing PMI data. The market attempted to stabilize midday but rolled over in the wake of the December Fed meeting minutes, which noted “unusually elevated uncertainty” about future policy. The S&P 500 declined another 0.80%.

An early attempt at a bounce in the market on Thursday was thwarted by a reversal higher in Treasury yields on the back of some hot economic data including a 0.5% rise in headline German CPI, solid jobless claims numbers, and better-than-expected ADP private payrolls data. Another AAPL downgrade left mega-cap tech to bleed lower over the course of the day while the rise in yields pressured the market broadly and the S&P 500 fell 0.34%.

Stocks opened flat on Friday as traders digested the December jobs report which came in on the “hot” side with a better-than-expected headline, lower-than-anticipated unemployment rate and a surprise uptick in wage growth. The ISM report released shortly after the open was soft with a drop in the headline, easing price figures, and a plunging employment subindex that saw some of the week’s hawkish money flows dialed back. The S&P 500 peaked mid-morning before pulling back into the European close and chopping sideways into the end of the day amid quiet newswires, ending with a slight gain of 0.18%.

Why Did Stocks Drop to Start 2024?

Markets started 2024 with a relative “thud” as the S&P 500 fell 1% while widely held tech names traded even worse, with the Nasdaq falling more than 3% last week. But the reason for the declines wasn’t so much because something bad happened and instead just because the first data points of 2024 didn’t validate aggressive (and possibly unrealistic) expectations for 2024.

First, we must acknowledge that the S&P 500 rallied more than 11% in the Q4, but virtually all of that rally came from late October through December. An 11% gain in a year is a big return, never mind in essentially two months; so it’s reasonable we’d have “give back” at the start of the year and we have.

But there are reasons stocks declined last week other than just being short-term overbought. First, inflation data bounced back and while no one is doubting disinflation, in the context of the market entering 2024 with a 100% probability of a March rate cut, that buoyant inflation data pushed back on that assumption. Second, growth data was “ok” but not good enough to validate the market’s full belief in a “no landing” economic scenario. So, while the growth data wasn’t bad, it didn’t meet the current market assumptions.

Put simply, none of the economic data published last week was that bad, but it just wasn’t good enough for the S&P 500 to be valued at 19.5X next year’s earnings. To that point, if more data this week (including CPI) doesn’t meet the dual market expectations of 1) A March rate cut and 2) Continued aggressive disinflation, expect a further pullback in the S&P 500, potentially to 4,600 or lower.

Sourced from SIA Charts on Monday, Jan 8th, 2024

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Estate Planning and You

Estate planning is an essential part of every Wealth Plan. However, it is often left until the very last minute simply to avoid the difficult discussion with loved ones or delay planning for something that seems far out.

Many assume that without a Will, everything will go to the spouse and/or children upon passing, which might not be the case. If you were to pass away without a Will, it is referred to as "Intestacy". This is important to avoid because a Will is a legal document in which you:

1) Designate someone to administer your property referred to as an "Executor"
2) Instruct the Executor on how your assets will/should be distributed
3) If appropriate, additional expressions of your wishes for minor children or charitable donations

Even if you currently have a Will, it would be wise to review and update it according to any lifestyle changes. For example, your Will must be made according to the law of the province where you live. Often these facts/changes are overlooked but our team will always be available to guide you in your Estate Planning process and serve as a reminder to set the proper planning in place.

Please do not hesitate to reach out if you have any questions or would like to get started on the Estate Planning process today.

Portfolio Managers

Hanan Duchon, CIM®

Portfolio Manager & Senior Investment Advisor

TD Wealth Private Investment Advice

Hanan has over 17 years of experience working in the Canadian investment industry alongside some of the country's most prominent investment professionals. He received his Bachelor of Commerce in Finance from Ryerson University, holds a Chartered Investment Manager (CIM®) designation, and obtained his Portfolio Manager title. Hanan is one of the leading Investment Advisors of the BRiTE Wealth Management team.

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Portfolio Manager & Senior Investment Advisor

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Shahin has over 29 years of relationship management experience worldwide, including the UAE and Switzerland. He received his MBA in Global Banking and Finance from Zurich, Switzerland, holds a Chartered Investment Manager (CIM®) designation and obtained his Portfolio Manager title. He returned to Canada in 2012, joined TD Wealth and is one of the leading Investment Advisors for BRiTE Wealth Management.

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