December Market Commentary: Rates – Lower and Sooner?

November Recap and December Outlook

After a year in which Federal Reserve Chairman Jerome Powell managed to hold everyone's attention, it comes as no surprise that here we are waiting for the outcome of the last FOMC meeting of the year. A few weeks ago, with the narrative of rates being higher for longer taking firm hold, the upcoming December meeting would likely have been less of an attention-grabbing event. But that was last month.

While the likelihood of a rate cut at this meeting is small, the focus will be on the language in the accompanying statement and what Powell says in the press conference after the meeting.

The prevailing sentiment at the end of November, as measured by Fed funds futures and the CME FedWatch Tool, is that rates could begin to come down as early as March and could be lower by a full percentage point by the end of 2024.

What has to happen for Chairman Powell to shake off the ghost of Fed Chairman Paul Volker (who famously presided over the super-high interest rate regime of the 1980s that finally broke the back of inflation) and declare the job done? Evidence that inflation is on a clear, sustainable downward trend and a slowing economy.

Let's get into the data:

- **GDP is expected to moderate.** The OECD (Organisation for Economic Co-operation and Development) puts estimates for 2024 U.S. GDP at 1.5%.
- **Labor markets are strong but continue to slow.** Private payrolls data for November, released by ADP, showed private sector job creation was slower in November at 106,000, and the 5.6% increase in annual pay was the smallest gain since September 2021. Alternatively, the Labor Department reported that employers added 199,000 jobs in November, while the unemployment rate dropped to 3.7 percent, from 3.9 percent.
- **Consumers have the holiday spirit.** The Conference Board reported that the Consumer Confidence Index® increased in November to 102.0, after three straight monthly declines.
- **Fears of recession are receding.** The Expectations Index rose to 77.8. A reading below 80 historically signals a recession within the next 12 months, but consumers' fears of recession are at the lowest levels seen this year.

What Does the Data Add Up To?

The market turned positive in November, as a slew of data supported the belief that the Fed would abandon “higher for longer” and move more quickly to cut rates in order to prevent a recession as the economy slows down.

However, the Fed, as reported in the minutes to the November FOMC meeting, is still concerned about inflation and showed no indication it would cut rates soon. Having invested so much effort into message discipline that rates would remain high until inflation was under control, can the Fed do an “about face” – without losing face?

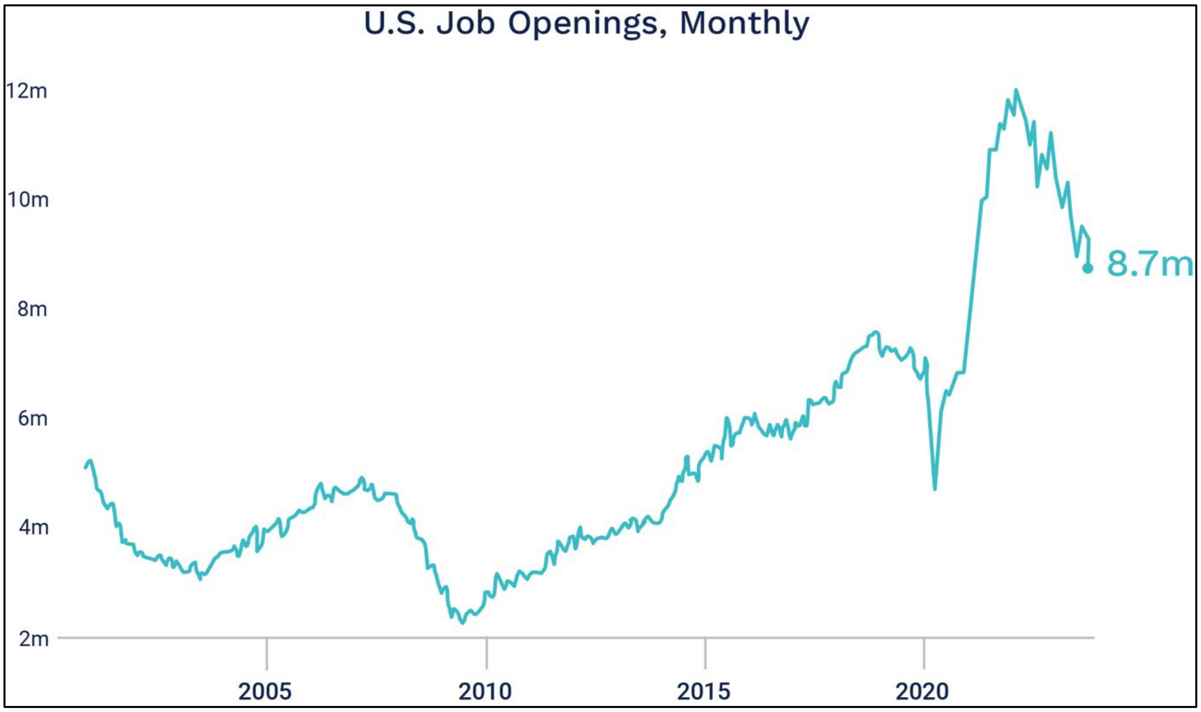
It seems clear that a key element of the Fed’s monetary policy goal is in place as the economy is slowing, despite the third quarter’s massive GDP number of 5.1% (revised upward from 4.9%). Chairman Powell in press conferences and the official Fed statements, continually referenced that the already enacted rate cuts would eventually begin to slow the economy. That appears to be finally underway, and inflation is getting closer to the Fed’s preferred level of 2%. The pause on rate cuts that started in July looks more like an inflection point.

How does cutting rates earlier in 2024 square with the scenario of keeping rates higher to ensure inflation doesn’t bounce back up? The worry for the Fed is that a change in monetary policy stance will create an outsize impact and the economy will heat back up on exuberance from investors.

There is another way of looking at it that doesn’t track each move by the FOMC. The monetary policy regime can be described as “restrictive” in that rates are higher than the Fed’s stated neutral rate of 2.5%. This rate is the estimate at which the Fed believes the economy and inflation are not being either stimulated or slowed by monetary policy. Even if rates come down 100 basis points in 2024 and hit 4%, monetary policy is still restrictive.

Chart of the Month: Another Look at a Softening Labor Market: Job Openings

Job openings are declining, but the unemployment rate isn't drastically changing and layoffs are low. The quits rate is also stabilizing to pre-pandemic levels. This would indicate a rebalancing to more sustainable levels.



Source: U.S. Department of Labor data from December 2000 to October 2023. Chart: Axios Visuals

Equity Markets in November

- The S&P 500 was up 8.92%
- The Dow Jones Industrial Average rose 8.77%
- The S&P MidCap 400 increased 8.33%
- The S&P SmallCap 600 was up 7.98%

Source: S&P Global. All performance as of November 30, 2023

November saw ten of the eleven sectors notch gains, with Information Technology turning in the strongest performance. The three-month performance of the index was in positive territory, and as we head into December, the year-to-date return has almost recovered all of the index's loss in 2022. Volatility remains elevated, with more than 60 of the 230 trading days so far moving 1% or more, and 2 days of 2% moves.

Bond Markets

The 10-year U.S. Treasury ended the month at a yield of 4.34%, down from 4.92% the prior month. The 30-year U.S. Treasury ended November at 4.50%. The Bloomberg U.S. Aggregate Bond Index returned 4.53%, pushing the year-to-date return into positive territory at 1.27%

The Smart Investor

There's still time to accomplish a lot for your financial plan before 2024, and there are some housekeeping things you should be sure to do before the calendar turns.

- Do you need to take a required minimum distribution from a retirement plan? The SECURE Act 2.0 raised the age to 73, and lowered the penalties for failing to take one. RMDs are taxable income, so you may want to revisit your tax planning to be sure you keep your taxes as low as possible. You may also consider converting to a Roth account to eliminate RMDs.
- Can you max out your 401(k)? Putting aside as much as possible lowers your taxable income and boosts the compounding of your long-term savings. The IRS catch up provision for those 50 and over increased this year, to $7,500.
- If you are considering gifting, be sure to make your donations before year end. If you haven't determined a giving plan, it can be a lovely family activity.

There's a lot to be thankful for as we head into holiday season and the turn of the year. Take some time to revisit your plans and goals for the future, and be sure you are on track with saving, investing, and protecting yourself and your family.
