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Monthly Market Commentary: December 2023

In their final meeting of 2023, the Federal Reserve signaled a dovish pivot by updating their interest rate projections, indicating multiple rate cuts for both next year and 2025[1]. The updated forecast suggests a lower path for the federal funds rate, with the Federal Reserve expecting multiple rate cuts in 2024, 2025, and 2026[1]. During the press conference, Federal Reserve Chair Jerome Powell acknowledged potential discussions about rate cuts, leading to a market-friendly tone. The market reacted as if the Fed had eased policy, with the S&P 500 gaining nearly 1.4% and yields on 10-year government bonds falling on the day of the release. Some officials are cautiously optimistic about achieving a potential soft landing, however, Fed Chair Powell cautioned against premature speculation on policy changes as some investors anticipate rate cuts starting as early as next spring[2].

The job market, which has shown signs of gradual cooling over the last several months, exceeded expectations in November. Jobs grew by 199,000 as the unemployment rate fell to a four-month low of 3.7%[3]. However, the rise in average hourly earnings may pose a challenge to the Federal Reserve's efforts to control inflation. Speaking of the consumer, consumer sentiment sharply improved as inflation expectations fell[4]. While consumers still face higher prices and a gradually cooling job market – that occasionally shows signs of renewed life – improved sentiment may support continued spending during the holiday season. Overall, consumer attitudes have been volatile throughout the year, with recent improvements possibly influenced by easing gas prices.

In November, retail sales defied expectations by increasing 0.3%[5], contrary to the consensus estimate of a 0.1% decline[6]. This unexpected boost was attributed to lower gasoline prices, enabling consumers to spend more as the holiday shopping season kicked off. Despite the positive sales, concerns linger about consumers' financial health with a notable rise in credit card balances, up more than 10% since the start of the year[7]. Worries that retail sales are being supported by increased borrowing could mean a post-holiday spending hangover due to rising debts.

The bottom line: The economic landscape reflects a delicate balance between the Federal Reserve's dovish pivot, a resilient, even if gradually cooling, job market, and fluctuating consumer sentiment. The Fed's cautious optimism in a potential soft landing amid improving inflation together with positive employment figures, would be welcome if it can be maintained. However, challenges and risks persist, particularly in navigating inflation and managing market expectations, which can quickly ripple through stock and bond markets.

Sources:

1. Federal Reserve
2. CME FedWatch Tool
3. Bureau of Labor Statistics, https://www.bls.gov/news.release/empsit.nr0.htm
4. University of Michigan’s preliminary December Consumer Sentiment survey, http://www.sca.isr.umich.edu/
5. Retail Sales https://www.census.gov/retail/sales.html
6. Consensus estimate from Bloomberg’s survey of economists
7. Credit Card Balances https://fred.stlouisfed.org/series/CCLACBW027SBOG