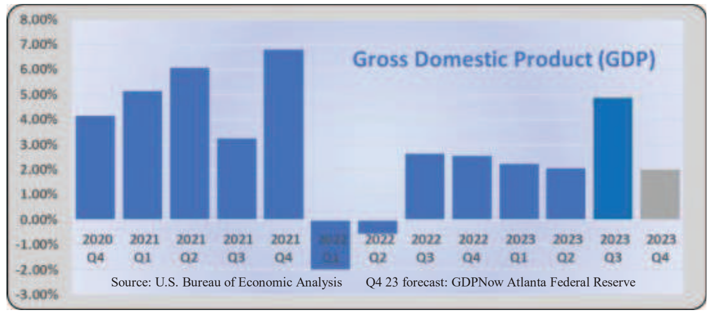
Investment Watch

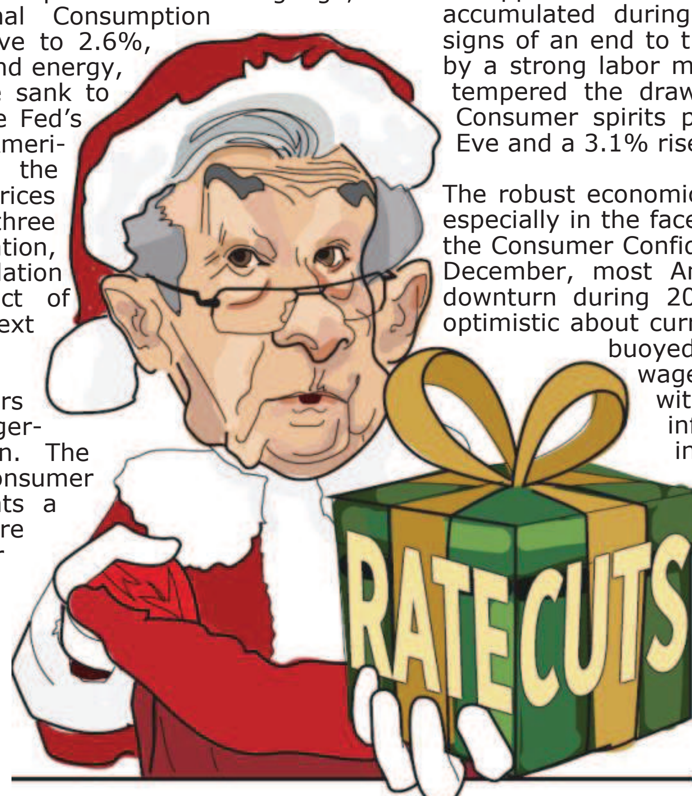
4th Quarter, 2023

Santa Came Early



The **Santa Clause Rally** usually occurs during the last five trading days of the year. However for investors, **Santa Came Early** this year! He kicked off the rally with one of the best Novembers on record for both the stock and bond markets. Historically, November is the best month of the year for stocks and this November didn't disappoint returning 9.13%, while bonds had their best month in almost 40 years earning 4.5%. Right on the heels of November's excess returns, Federal Reserve Chairman Jerome Powell donned his Santa suit and handed investors the present they had waited for - the end of rate increases and the prospect for significant rate reductions in the New Year.

The Fed's *"higher-for-longer"* rate strategy appeared to crumble under the weight of this holiday season's good cheer, but in actuality surprisingly positive economic trends prompted the Fed's unexpected U-turn signaling lower rates ahead. Call it a Christmas miracle, inflation tumbled around the world much faster than expected. As measured by the Fed's preferred inflation gauge, the year-over-year Personal Consumption Expenditures (PCE) dove to 2.6%, while, excluding food and energy, the six month average sank to 1.9%, falling below the Fed's 2% target. Although Americans are still feeling the pinch of higher prices driven by the past three year's elevated inflation, the lower current inflation heightens the prospect of more stable prices next year.



Other leading indicators also bode well for longer-lasting, lower inflation. The December Michigan consumer sentiment survey paints a positive inflation picture concluding consumer fears over rampant inflation have plunged amid declining energy prices, the drop in mortgage rates, and the Fed's expectations of rate cuts next year. Dampening inflation was unexpected as our economy sizzled with higher labor costs normally stoking inflation. However, the recent surge in productivity squelched the likelihood of an expected wage-price spiral. Worker productivity soared 5.6% in the third quarter, the fastest pace in three years, after a 3.6% gain in the prior quarter resulting in more goods produced for less wages, even though workers reaped the benefits of actual wage gains.

American economic resilience has thwarted the pundits' predictions of an economic slowdown. The recession that experts had agreed was imminent never came. Now the experts' prophecy of a soft landing or mild recession in 2024 also seems cynical in light of our country's underlying fiscal strength. Our economy is pumping out around 200,000 jobs per month while the unemployment rate hovers around 3.7%, suggesting that there is still juice in the labor market for further fiscal growth.

U.S. consumers, representing nearly 70% of the GDP, are the main key to growth and they have shown remarkable resilience. Some pundits feel the consumer is tapped out and has run out of the excess savings accumulated during the pandemic, but there are no signs of an end to the consumer spending spree driven by a strong labor market with real income gains which tempered the drawdown of their pandemic stimulus. Consumer spirits perked up with a record Christmas Eve and a 3.1% rise in retail holiday spending.

The robust economic growth this year was unexpected, especially in the face of drastic Fed rate hikes. Although the Consumer Confidence Index hit a five-month high in December, most Americans still expect an economic downturn during 2024. Consumers are growing more optimistic about current and future business conditions, buoyed by the strong labor market with wages outpacing inflation. Strong jobs with real wage gains and falling inflation will help support GDP growth into 2024.

Americans spent most of this year worrying about higher prices and interest rates and the media's persistent threat of recession. These fears have waned with the prospects of sustained economic growth, tamer inflation, and lower interest rates. Now with strong economic winds at his back, Chairman Powell's Fed is more likely to pull off the remarkable feat of squelching inflation, while maintaining full employment. The **Santa Claus Rally** didn't happen when expected, but **Santa Came Early** this November filling our stockings. If the Fed delivers on the gift of those projected rate cuts, our economy will benefit and investors can welcome this New Year with optimism.

December 31, 2023

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4940 Washington Blvd.
St. Louis, MO 63108