Current Events in the Markets and the Economy SLIDE 1

I. Markets SLIDE 2

A. Recent Performance – Stocks

1. The S&P and Nasdaq were each up for the sixth straight week – the longest win-streak in four years. **SLIDE 3**
    a. The S&P 500 is only 5% below its all-time closing high (from Jan. 2022). **SLIDE 4**
2. The VIX has dropped from 22 in October to 13. **SLIDE 5**
3. The Magnificent Seven (AAPL, MSFT, GOOGL, AMZN, NVDA, TSLA, META) + NFLX account for ~28% of the S&P 500. **SLIDE 6, 7, 8, 9**
4. November was an incredible month: DJIA +8.77%, S&P 500 +8.92%, Nasdaq +10.70% and volatility fell to pre-pandemic levels. **SLIDE 10,11,12,13**
5. Year-to-date – large-cap and growth have outperformed **SLIDE 14, 15**

B. Recent Performance – Bonds

1. The 10-yr UST yield dropped to 4.12% last week but increased back to 4.23% after the employment report. Today, it was near 4.20%. **SLIDE 16**
2. Who would have ever guessed that the government can't issue an infinite amount of debt? **SLIDE 17, 18**
3. Spreads on investment grade bonds and junk bonds are not showing much fear of recession. **SLIDE 19**

II. Connecting the Economy to the Markets

A. Connection between the Economy and Stocks

1. Stronger growth…higher earnings…higher stock prices **SLIDE 20**
2. Employment is a good proxy for growth **SLIDE 21**
    a. Payrolls increased by 199K (175K expected). **SLIDE 22**
    b. The unemployment rate moved down from 3.9% to 3.7%. **SLIDE 23,24**
    c. The participation rate increased .1% to 62.8%; highest since Feb. 2020.**SL 25,26**
3. We continue to struggle with hard data that shows a strong economy and anecdotal evidence that shows fear and misery.

B. Economy Affects Bonds

1. 2-year yield – **SLIDE 27**
2. 10-year yield – could be thought of in the same way + a term premium (inflation volatility) **SLIDE 28**
    a. Practitioners tend to think of it as reflecting nominal growth
    b. Of course, the market is changing

C. How Inflation and Rates Affect Stocks

1. People tend to say lower inflation and lower rates are good for stocks **SLIDE 29**
2. But, I think a better way of saying it is to divide inflation and rates into four quadrants

III. Looking to the Future

A. Strategists – Be Careful!

1. Market strategists have turned bullish on the stock market for 2024. **SLIDE 30, 31**
2. That's good news until you remember…

B. The Fed

1. Fed Gov. Waller said that policy rates should follow inflation rates coming down. **SL 32**
2. Fed Chair Powell said that the labor market is coming into better balance and that inflation is moving in the right direction.
   a. NY Fed Pres. Williams noted that unemployment has been below 4% for 21 months, the longest since the 1960s. **SLIDE 33**
3. Atlanta Fed Pres. Bostic expects continued disinflation due to lag effects. **SLIDE 34**
4. Fed Gov. Michelle Bowman seems to be the most hawkish member of the FOMC. **SL 35**
5. Market is pricing in four rate cuts for next year **SLIDE 36**

C. What do Bulls Believe?

1. Disinflation continues
   a. Inflation cooled faster than the Fed predicted. **SLIDE 37**
   b. Corporate profits were a key driver of inflation in 2022, but pricing power seems to be fading.
   c. Most investors believe that inflation has been beaten.
2. Peak Fed
   a. Disinflation allows FOMC to lower rates
   b. Maybe the **Fed put** has returned.
3. Soft landing
   a. Strong earnings -- $246 next year

D. What do Bears Worry About?

1. The economy is growing above trend and disinflation may not continue
2. Peak Fed is different than aggressive rate cuts.
   a. Neutral rate may be higher
   b. Easing of financial conditions may discourage Fed from lowering rates
3. Earnings expectations are too high – 12% in a disinflationary environment.
   a. Bottom-up analysts are expecting that S&P 500 earnings of $246.30 in 2024.**SL 38**
4. Valuation concerns
   a. Multiples are high, given how high interest rates are
   b. Concentrated market leadership
5. Other economic and market concerns:
   a. The inverted yield curve
   b. The resilience of Treasury demand
   c. China's anemic recovery
   d. An overbought market – nearly 1/3 of S&P 500 stocks have an RSI >70.
6. Geopolitical concerns (even though they haven't seemed to impact the market)