HIGHLAND

Multi-Asset Solutions Weekly Commentary

February 5, 2024

What We're Watching:

- S&P US Composite Purchasing Managers Index (PMI) is expected Monday with the prior reading of 52.3 signaling expansion, another datapoint above expectations would suggest last month's beat is a broadening trend.
- Senior Loan Officer Survey data is due on Monday as well, with the prior reading showed a slowdown from the peak in July, continued decline would show loan officers, like financial conditions are moderating.
- Initial and Continuing Jobless Claims data is out on Thursday and after showing a substantial rise in January, a rise past the 1-year high in November would illustrate a continuation of the progress we've seen in the labor market.

Key Observations:

- The NASDAQ narrowly underperformed broader equities as large growth companies came under pressure on lackluster earnings despite a late-week rescue via Amazon and Meta results.
- Bonds rallied across the curve early in the week on better-than-expected labor data and treasury issuance trends, before the payrolls report cast doubt on the timing of monetary policy easing.
- The FOMC elected to leave rates on hold and talk down odds of a March rate cut. Corporate issuance was sparse around the Fed meeting, but issuers managed to surpassed January records for bond sales.

	Price/Yield	Total Return (%)					
	2/2/24	1 Week Ago	1 Month Ago	Year to Date	1 Year	3 Years	5 Years
S&P 500	4958.61	1.41	5.49	4.06	20.59	10.74	14.80
NASDAQ	15628.95	1.13	7.12	4.14	29.17	5.53	17.56
S&P Mid Cap 400	2767.15	0.15	2.22	-0.44	3.25	6.24	10.23
S&P Small Cap 600	1273.63	-1.25	-0.07	-3.30	-1.37	3.28	8.09
MSCI World ex US	312.01	0.92	3.69	1.91	13.76	5.60	10.44
MSCI EM	988.21	0.32	-1.45	-3.43	-3.02	-8.29	1.24
Bloomberg U.S. Aggregate	4.67	0.65	-0.22	-0.66	0.95	-3.26	0.81
Bloomberg Corporate	5.18	0.58	0.22	-0.50	2.83	-2.99	2.08
Bloomberg U.S.High Yield	7.76	0.10	0.91	0.03	7.59	1.79	4.42
Bloomberg EM USD Aggregate	7.18	0.70	0.23	-0.64	3.82	-3.11	1.07
Bloomberg Global Aggregate	3.65	0.37	-0.95	-1.97	-0.98	-5.71	-0.96
Bloomberg Municipal Bond	3.32	0.94	-0.12	-0.17	2.89	-0.67	2.07

	Price/Yield						
	2/2/24	1 Week Ago	1 Month Ago	12/31/22	1 Year Ago	3 Years Ago	5 Years Ago
SOFR (yield)	5.32	5.32	5.40	5.38	4.56	0.07	2.47
30 Year Mortgage (average rate)	7.06	6.99	7.05	6.99	6.32	2.84	4.39
2 Year Treasury (yield)	4.36	4.35	4.32	4.25	4.10	0.11	2.50
10 Year Treasury (yield)	4.02	4.14	3.93	3.88	3.39	1.10	2.68
30 Year Treasury (yield)	4.22	4.37	4.07	4.03	3.54	1.87	3.03
WTI Crude (closing price)	72.28	78.01	70.38	71.65	75.88	54.76	55.26
Gold (NYM $/oz)	2036.10	2017.30	2073.40	2071.80	1916.30	1830.50	1316.90

Source: Bloomberg (3- and 5-Year Returns Annualized)

What Happened Last Week:

Stocks: Magnificent Seven Under The Microscope, Slowing The NASDAQ; Federal Reserve Holds Rates, Downplaying Odds of March Move and Regional Banks Face Renewed Concerns

- **Growth Gets A Gut Check From AI Expectations.** The tech-heavy NASDAQ wobbled this week, underperforming the S&P 500 while managing to finish positive by 1.13% on a late week earnings surge. Highly anticipated earnings from top stocks were all over the board relative to ever-increasing expectations. While we were optimistic for results last week, volatility was also in the cards with the culmination of market events including tech earnings, the FOMC meeting, and month-end economic data coming at once. The first batch of 'Magnificent Seven' stocks came through on Tuesday with Microsoft and Alphabet, with both falling after announcing earnings despite beating on earnings and growth as lofty expectations around artificial intelligence impact on sales failed to live up to the hype. Thursday ushered in the second wave of high-profile reports with Amazon and Meta outpacing street estimates, while Apple lagged on weaker sales in China. All in, the mix of earnings reports in the largest index holdings should prompt investors to think twice about chasing the highfliers and encourage diversification when valuations soar, even as a select few manage to carry the cohort.

- **Federal Reserve Not Lacking In Reasons To Stand Pat.** The FOMC elected to keep both rates and pace of balance sheet run-off unchanged at the conclusion of its January meeting with minimal urgency to cut considering the strong growth and ongoing 'rebalancing' in the labor market. Markets have also been doing the work for the FOMC, as market-driven financial conditions have eased in recent months through declining rates and higher equity prices. In the post-meeting press conference Chairman Powell effectively talked down odds of a March cut, seemingly agreeing with Fed watchers that the limited data between now and then wouldn't meaningfully sway committee members. That delay in cuts had a greater impact on equities, as the S&P 500 posted a negative return of 1.6% on Wednesday, notching the worst day for the Index since September, but the carnage was short-lived as attention returned to earnings as late week earnings and strong payrolls data picked up the slack. Our position of four cuts this year starting somewhere in the summer months continues to gain traction with the market as futures now suggest the first cut could materialize in June versus May just a week ago.

Commercial Real Estate Concerns Cloud Select Banks. Lingering effects from last year's regional banking chaos resurfaced this week as the KRE Regional Banking Index ETF declined 7.2% on the heels of New York Community Bank's quarterly report that detailed provisions for loan losses upwards of $550M to compliment a dividend cut. The staggering adjustment in potential losses compared to analyst expectations of $45M on its mid-week earnings release left the stock down 38% on Wednesday, with those losses originating from their partial purchase of Signature Bank last year, where they were thought to be taking on troubled assets at steep a discount. The legacy impact renews fears for some that commercial real-estate holdings at regional banks could be the next pain point for the industry, but rather than a widespread default cycle, there's reason to believe persistent economic growth could offset some of the struggles in the sector. From our perspective, the NY Community Bank issue appears contained as management has been more aggressive in expansion efforts than peers, a risky stance to pursue when most of the industry is still in a holding pattern until a more normalized yield curve materializes.

Bonds: Reduced Treasury Borrowing and Progress In Job Openings Induces Rally, While Payrolls and Hourly Earnings Resist; High Grade Corporate Sales Break January Issuance Record

Job Openings and Treasury Refunding Trends Lead To Lower Yields. Long-end yields moved lower in the front half of the week on a combination of positive labor and treasury issuance data until the largest upside surprise in Average Hourly Earnings in nearly two years caused a backup in rates. That scorching hourly earnings number ultimately pulled yields back across the curve, with heightened volatility on the front-end of the curve as 2-year treasury yields jumped up over 20bps on Friday alone. The Aggregate Bond Index benefited from higher prices posting a 0.65% gain, while longer-maturity treasuries managed even better at 2.8% over the five-day period. The December JOLTS data was the first piece in the mosaic as the release exceeded estimates with over 9.026MM openings, sparking an uptrend in bond prices. The details of the report depict a similarly encouraging narrative as the prior month number showed upward revisions, and the quits rate continued its march lower. Claims data also cooled, providing yet another signal that inflationary pressures from labor market extremes continue to moderate, from various albeit imperfect data sources. The positive momentum in fixed income was furthered by the historically dull Treasury quarterly refunding statement, that's gained popularity with the run-up rates and burgeoning government deficits increasing its influence. This week's iteration depicted a reduction in federal borrowing for the quarter to $760B, a decline of $56B from the prior estimate, that sent 10-year yields into a tailspin down to 3.88% in midweek trading.

Nonfarm Payrolls and Average Hourly Earnings Pushback on Bond Returns. Friday's payrolls report abruptly called those lower yields into question as the Nonfarm Payrolls data crushed estimates with 353K jobs added, which was far more than the consensus 185K jobs anticipated, with upward revisions to last month's numbers. Average hourly earnings also went against the grain of early week data surging to a 4.5% year-over-year increase far exceeding the forecasted 4.1%. Those numbers fall in with recent excesses, depicting an economy on sure footing but average weekly hours worked came down in December and there is a high probability we're getting some seasonal adjustment noise in the data. There isn't a clear takeaway from the mixed data this week, and even if those blowout numbers are overstated, its unlikely they are directionally wrong. The payroll print adds to the complex picture of the economy and appears supportive of the Fed's decision to exercise patience when the crowd is clamoring for cuts.

Light Issuance to Close Record-Breaking January For Corporate Debt. Investment grade corporate bond issuance exceeded $188B in January, outpacing the prior highest first-month deal volume on record in 2017. Spreads widened modestly on the week for only the second time since November, leading the sector to underperform the broader bond market as the Investment Grade Corporate Index returned 0.58%. New deals were hard to come by as we've come to expect surrounding FOMC meetings, regardless of expectations around movement in monetary policy. Prior to this week, heavy refinancing in recent weeks has done little to curb demand as new bond sales are continually oversubscribed with spreads being bid down. February is set to be another strong month for issuance with another $165B on the agenda, but with rising bond volatility its reasonable to expect demand and spreads could continue to moderate.

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