HIGHLAND

Multi-Asset Solutions Weekly Commentary

January 29, 2024

Key Observations:

- Information Technology and Communication Services sector earnings bolstered equities, while firmer than expected GDP and PMI data also contributed to the S&P 500 making new highs on the week.
- Chinese equities snapped a three-week losing streak as The People's Bank of China cut reserve requirements for banks amounting to roughly 1 trillion yuan in newly accessible funds. Government officials are also said to be weighing another 2 trillion yuan in rescue plan funds for equity markets to restore both domestic investor sentiment.
- The 10-year treasury yield briefly surged as high as 4.18%, cresting above its 50-day moving average for the first time since November before moderating on promising inflation data surfaced in the GDP and Core PCE numbers.

What We're Watching:

- The JOLTS Job Openings data is set to be released on Tuesday with 8700k openings anticipated, a slight decline from the prior month reading and the quits rate expected to hold steady at 2.2%, below pre-pandemic levels.
- FOMC rate decision is expected to go unchanged with guidance around quantitative tightening in focus for the January meeting on Wednesday, with Fed Chair Powell set to address the media in the post-meeting press conference.
- The Institute for Supply Management (ISM) survey data for New Orders, Employment, and Manufacturing, are due on Thursday to provide further insight on economic activity in manufacturing and services sectors.
- Average Hourly Earnings month-over-month are expected on Friday with the consensus projecting a decline to 0.3% from 0.4% in the previous month, while average weekly hours and the unemployment rate are expected to remain flat at 34.3 and 3.7%, respectively.

	Price/Yield	Total Return (%)					
	1/26/24	1 Week Ago	1 Month Ago	Year to Date	1 Year	3 Years	5 Years
S&P 500	4890.97	1.07	2.38	2.62	22.43	10.02	14.85
NASDAQ	15455.36	0.94	2.38	2.98	35.37	5.10	17.63
S&P Mid Cap 400	2763.77	0.84	-1.50	-0.59	7.72	6.03	10.48
S&P Small Cap 600	1290.07	1.56	-3.56	-2.07	5.66	3.13	8.62
MSCI World ex US	311.74	1.31	0.96	0.98	15.16	5.01	10.56
MSCI EM	985.10	1.47	-2.41	-3.74	-3.96	-8.53	1.53
Bloomberg U.S. Aggregate	4.74	0.10	-1.60	-1.30	1.09	-3.56	0.78
Bloomberg Corporate	5.23	0.22	-1.38	-1.08	3.33	-3.33	2.14
Bloomberg U.S.High Yield	7.75	0.61	-0.12	-0.07	9.08	1.79	4.57
Bloomberg EM USD Aggregate	7.26	0.13	-1.36	-1.33	4.18	-3.32	1.05
Bloomberg Global Aggregate	3.70	0.08	-2.63	-2.33	-0.16	-6.09	-0.92
Bloomberg Municipal Bond	3.47	-0.09	-1.07	-1.10	2.30	-0.93	1.96
				Price/Yield			
	1/26/24	1 Week Ago	1 Month Ago	12/31/22	1 Year Ago	3 Years Ago	5 Years Ago
SOFR (yield)	5.32	5.31	5.35	5.38	4.30	0.03	2.40
30 Year Mortgage (average rate)	6.99	7.03	7.00	6.99	6.45	2.87	4.53
2 Year Treasury (yield)	4.35	4.38	4.35	4.25	4.18	0.12	2.61
10 Year Treasury (yield)	4.14	4.12	3.90	3.88	3.49	1.03	2.76
30 Year Treasury (yield)	4.37	4.33	4.05	4.03	3.64	1.79	3.07
WTI Crude (closing price)	78.01	73.41	75.57	71.65	81.01	52.61	53.69
Gold (NYM $/oz)	2017.30	2029.30	2058.20	2071.80	1930.00	1850.90	1298.10

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

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What Happened Last Week:

▲ Stocks: Early In Earnings Season, The Usual Suspects Shine In Tech and Communication While Small Companies Soar on Cyclicals; China Enacts 'Kitchen Sink' Approach to Stimulus Boosting EM Index

US Equities Make New Highs On Earnings and Sales Growth From Early Results. The S&P 500 saw a tapered gain of 1.07% compared to weeks prior but closed at a new high of 4,890, marking its third consecutive weekly advance. Positive economic data piled up over the course of the week with manufacturing PMI surprising to the upside and crossing into expansion while the initial read on 4th quarter GDP and the underlying consumption data also registered as a boon for equities. Technical conditions on the verge of overbought for the large-cap index suggests sideways price action would promote more sustainable gains going forward, but these considerations are likely on the backburner until markets get a more complete view of corporate earnings. Tech earnings have surprised to the upside thus far with 16/18 companies beating estimates but guidance around growth has been mixed highlighted by a handful of household names including Tesla and Intel. Next week five of the Magnificent Seven report earnings and should provide a more all-encompassing view of how management teams view the landscape within last year's heavyweights. The energy sector was a surprise standout, outpacing all other sectors returning 5.15%, within the Oil and Gas industry group 4/5 companies bested analyst estimates and we could see strength persist here if global growth expectations turn out better than expected.

▲ **Small Company Segment Sees Value Rally Take Hold.** The S&P 600 Small Cap Index finished the week up 1.56% the top performer across major asset classes we track, largely due to positive movement in more value-oriented, cyclicals including Energy, and Industrials. Higher returns in the energy sector proved to be a theme across the cap spectrum returning 4.06%, with far fewer earnings announcements to go on here it remains to be seen if this is a fundamental rally or momentum trade. The surge in industrials was more earnings oriented, as 85% of companies reported thus far surprised to the upside, making the subset a heavy contributor with the second largest weight in the index at 17.4%. All told, the environment continues to shape up nicely for small companies with a valuation bent as growth continues to impress above expectations, while lower rates would ease financing pressures and a steepening yield curve could improve the outlook for financials more broadly.

▲ **China's Central Bank Lowers Reserve Requirement With Further Stimulus In Tow.** Monetary policymakers captured headlines and propelled Chinese equities to a 3.35% gain last week in the Chinese government's latest attempt to stimulate the economy with self-described 'forceful' measures, including lowering reserve requirements for banks. The 0.5% cut to reserve requirements amounts to roughly 1 trillion yuan in newly accessible funds for lending, and government officials are said to be mulling another 2 trillion yuan in stock market rescue funding aimed at restoring domestic confidence that currently stands at the lowest reading on record. The most tangible representation of on the ground sentiment is rampant Chinese investor interest in US equity funds driving them to substantial premiums as high as 18% on certain days this month. Local asset managers have taken measures resembling a 'soft-close' where applicable and limited daily purchases, but the ETF versions are still able to be bought directly. In 2015 the Chinese government enacted similar stimulus to stem the equity market decline, but it wasn't until sweeping economic reforms were implemented that markets regained confidence. For now, the government maintains its nationalist 'retail first' mentality, but from our perspective they may be undervaluing the confidence international investors can bring to domestic markets.

Bonds: Treasury Yields Experience On-Going Tumult As Spending and Inflation Sway, Credit Resumes Tightening Trend; Caution Cuts May Be Closer Than They Appear With The ECB

- **Treasury Yields Trend Marginally Higher On Spending and Inflation.** Fixed income markets were nearly flat on the week with the Aggregate Bond Index losing 1bp as yields bounced around before landing modestly higher at 4.14% on the 10-year note. Bond traders had a host of economic data to parse through this week, with the initial reading of fourth quarter GDP besting forecasts at 3.3%. This datapoint alongside better than anticipated PMIs suggests that growth may not hit the wall some expected heading into 2024. Core PCE inflation, the FOMC's preferred gauge, fell to just 2.9% on the week but was seemingly offset by higher than consensus personal spending numbers. While those datapoints send mixed signals, the broader trend of lower inflation and continued spending despite subdued income shouldn't meaningfully alter the path of monetary policy heading into their meeting this week. The January 31 meeting isn't expected to result in a change to the policy rate, but insight around changes to quantitative tightening and the dispersion of opinions amongst Fed officials are well worth monitoring.

- **Demand For Corporates Pushing Spreads Tighter On Lean Issuance.** Investment grade corporate bonds eked out positive performance of 0.22% last week, a trend reversal from the week prior, as spreads tightened by 2bps to just 0.92% over comparable treasury securities. That sinking spread is the culmination of slow issuance over the week as only $18.5B in new deals came to market, well short of the $25B projected with slightly better volume anticipated in the following week. In all fairness, corporate borrowers still have strong pricing power and are likely just pausing to catch their breath with issuance still on track to break prior January records. Strong demand was another determining factor in tighter spreads, illustrated by investors demanding just 37bps of spread on Proctor & Gamble's debt deal this week, the smallest premium on a 10-year corporate bond since 2000. Below investment grade bonds outperformed on the week returning 0.61% due to their more modest duration profiles and stronger ties to corporate earnings, but also saw spreads drift lower alongside high-grade debt.

- **ECB Still Cautioning on Cut Expectations But Can't Delay For Long.** The European Central Bank elected to keep rates unchanged last week as expected but struck a more dovish tone in the statements with language around 'declining trend' inflation and prior remarks around price pressures were omitted this go around. Hawks remain at the helm for the ECB and President Lagarde continued to stonewall on when cuts could occur, ruling our March for now but keeping April and June in play. A downdraft in either inflation or wages could increase the odds of an April cut, with markets squarely undecided on implied policy rates, refraining from pricing a full cut in April but pricing in more than one cut by June. The euro declined over the course of the week to 1.08 on the dollar, a continuation of its trend thus far in 2024. The euro's stall could turn around should the ECB hawks win out and hold cuts while the FOMC begins easing policy. Both institutions are likely paying more attention to what the other is saying than they let on, and we tend to think the ECB has less flexibility and a greater necessity to cut compared to the Fed.

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