



MARKET UPDATE

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Market Update – March 18, 2024

I. Markets

A. Stocks

1. **Last week:** DJIA -.02%; **S&P -.13%**; Nasdaq -.70%; **IWM -2.14%**
 - a. Hotter than expected CPI, but lower OER and supercore than Jan.
 - b. 2-yr UST 4.72% (+24 bps); 10-yr 4.31% (+22 bps)
2. **Why are stocks doing well despite high interest rates?** Maybe due to liquidity (draining of the Fed's reverse-repo facility), heavy deficit spending, easing financial conditions, market was oversold in Oct. 2022.
 - a. Liquidity is likely to slow and it's unusual to have 6 – 7% deficits outside of recession.
 - b. We don't know why earnings growth is tepid despite a strong economy. Market being driven by multiple expansion. ([MarketWatch](#))
3. **Why stock market is shrugging off rates:**
 - a. Traders feel like they understand the Fed's reaction function – rate cuts will eventually come
 - b. Tech profits have turned up significantly
 - i. Big tech has a profit margin of 23.4%, more than double the rest of the S&P 500. Tech sector's margins almost doubled over the past 25 years while remaining flat for other sectors. ([Bloomberg](#))
 - c. Momentum – S&P hasn't had a 2% peak-to-trough pullback since Oct. – longest streak in six years
 - d. Broadening market rally – equal-weight starting to outperform
 - e. High-yield spread compression
 - f. Fixed income volatility could decline further ([Bloomberg](#)) ([MarketWatch](#))
4. **Divergences scare investors:**
 - a. DJIA vs. Dow Jones Transportation Average
 - b. HY bonds and high-beta stocks not outperforming USTs and low-volatility stocks
 - c. Tech / S&P 500 no longer trending up ([MarketWatch](#))

B. Other Interesting Articles About Stocks

1. A recent paper noted that **data used for Fama and French's three-factor model were found to be "noisy"** – changing depending on when downloaded. This changes the historical record of value investing. Fama and French say that these were corrections to historical market data and adjustments related to accounting rule changes.
2. **Optimism doesn't necessarily hurt stocks, but it increases the risk when sentiment starts to decline.** Extreme optimism makes markets more vulnerable to economic or earnings disappointments. ([MarketWatch](#))

C. Rates and Gold

1. **Rates:** 2-yr UST 4.72% (+24 bps); 10-yr 4.31% (+22 bps)
2. **Fed funds futures:** ~60% chance of a June rate cut; pricing three cuts by end of year
3. According to Freddie Mac, the **30-year fixed-rate mortgage** was 6.74% this past week. The 15-year mortgage rate was 6.16%. Separate data by Mortgage News Daily said that the 30-year rate was 6.94%. ([MarketWatch](#))
4. The **refinancing penalty** for replacing junk bonds would add 177 bps to the yield, but it was 463 bps in Oct. 2022. ([Bloomberg](#))
5. S&P Global Ratings says that **corporate defaults** are happening at the fastest pace since the GFC. There have been 29 corporate defaults since the start of 2024; this is the highest tally since 2009. In the US, there were 17 defaults (slightly less than 18 at this point in 2023). ([MarketWatch](#))
6. Why has **gold been hitting new highs despite higher real rates?**
 - a. Drop in consumer sentiment and moderate inflation data – raised hopes of rate cut
 - b. Overseas buying of gold – geopolitical issues; central banks; Chinese demand (falling real estate and stocks); inflation hedge in India ([WSJ](#))

II. Inflation

1. **CPI: +.4% MoM, +3.2% YoY in Feb; core +.4% MoM; +3.8% YoY** (slowest since May 2021). Over past three months, core rose at annualized rate of 4.2% (highest since June). May mean less confidence that we're approaching 2%.
 - a. **Shelter** (rent and OER both +.4%) and gas contributed over 60% of monthly advance. Used cars, car insurance and airfare also added to inflation.
2. **Supercore** (services ex-housing, energy and food) +.5% (dropped from .85% to .47%, but still too high).
 - a. Inflation is now driven almost entirely by **services**. Housing costs are a large part of this. Supercore, the Atlanta Fed's sticky price measure, and the Cleveland Fed's trimmed mean all seem to be stabilizing.
 - b. Core goods +.1% (first advance since August) ([WSJ](#)) ([Bloomberg](#)) ([Bl.](#)) ([Bl.](#))
3. A NY Fed survey showed that **inflation expectations** increased for the medium and longer-term. Three-year expectations rose to 2.7% (from 2.35%) and 5-year expectations rose to 2.9% (from 2.5%). ([Bloomberg](#))
4. **Fears:**
 - a. The **fire in the Texas Panhandle** has burned over 1MM acres in Texas. 85% of Texas' cattle population is on ranches in this area. 21% of nation's beef calves are in Texas and Oklahoma. US beef inventory is already at a 73-year low. This could push beef prices to record levels. Drought also impacting hay and grain quality (cattle feed). ([MarketWatch](#))
 - b. The **Panama Canal** (drought) usually has 36 crossings per day. It was cut to 24 in November. Crossing costs increased from around \$500K to \$2MM – 4MM extra. In the Red Sea (**Suez Canal**), there have been more than 50 attacks on vessels since November. Some shippers have suspended voyages through the Red Sea. ([WSJ](#))
 - c. **Airlines** are cutting flight capacity and slowing hiring due to fewer Boeing jet deliveries. ([WSJ](#))

III. The Fed and the Economy

A. The Fed

1. The **employment report** showed +275K jobs, but the last two months were revised down by 167K. In addition, wage inflation was low and unemployment was higher. It was really a **great report for anyone who wants the Fed to cut rates**. ([MarketWatch](#))
2. But the Fed is struggling with **discrepancies in the data**:
 - a. **HH survey** averaged loss of 89K jobs/month over past six months while **payroll survey** has added 231K jobs/month
 - i. HH survey is considered better at inflection points
 - b. Headline **CPI** +3.2% YoY vs. headline **PCE** 2.4%
 - i. **Services and goods** also on different trajectories ([Barron's](#))
3. The **Fed's "December pivot" provided a tailwind to growth**. Then, January's inflation report came in hot. Housing prices are the main barrier to the Fed's 2% inflation goal. Atlanta Fed Pres. Bostic's "one rate cut and a pause" is probably the best-case scenario for anyone who wants lower rates. Maybe the Fed will cut in June and then pause until after the election. ([Mauldin Economics](#))

B. The Economy

1. As jobs and GDP surpass expectations, **economists are abandoning their recession calls**.
 - a. But the Chicago Fed National Activity Index (which incorporates 85 variables) has below-zero reading which is consistent with GDP growth of ~1%. The NY Fed survey shows that consumers' confidence in getting another job has slumped, particularly for those earning over \$100K / year. The NFIB says that small businesses are scaling back hiring plans. The BLS's household survey is consistently less rosy than the establishment survey. ([MarketWatch](#))
2. The **argument that we're still far from a soft landing**: labor market is still unsustainably hot (275K jobs added in Feb., close to 3X what is expected in a soft landing), Q1 GDP could still be hot, core PCE is at 3.8%. In addition, looser financial conditions could result in higher growth and higher inflation.
 - a. On the other hand, new capital goods orders slowed, retail sales fell .8% in January, and credit card delinquencies are rising. Also, job openings are decreasing and that is even more important than the employment numbers. ([Project Syndicate](#))
3. Paul Krugman suggests that **inflation isn't a fear**: we should annualize the six-month change in prices excluding food, energy, used cars, and shelter. This is running at a 2.8% annual rate. In addition, he suggested that average hourly earnings are up less than 4% annualized over the past six months. Productivity is up 1.6% annualized since pre-pandemic, so that suggests a 2.5% inflation rate.
 - a. Krugman is worried that **unemployment is increasing**. The **Sahm Rule** suggests that a recession is likely if the three-month average unemployment rate rises more than .5% above the prior 12-month low (of the three-month average). He believes that high rates could be impacting the labor market. ([NYT](#))
4. JPM's Jamie Dimon warned of an economic hurricane and Bridgewater's Ray Dalio predicted a debt crisis and a "perfect storm." So far, neither has been right. ([WSJ](#))
 - a. This week, JPM's Jamie Dimon said that the world is pricing in 70% - 80% chance of a soft landing. He believes it's a 50% chance with the other 50% being stagflation. He believes that the Fed should wait for more clarity before lowering rates. ([Bl.](#))

IV. Immigration and Border

A. Immigration Numbers

1. In US, **3.3MM** net migrants arrived last year vs. 2010s average of **900K**
 - a. There has been a **surge in encounters** (from 72K/month in 2021 to 301k in December).
 - i. Lifting Covid restrictions
 - ii. Perception of easier entry under Biden
 - iii. Economic and social strife in some countries (e.g., Venezuela)
 - b. The number of **border apprehensions** rose from 1.86MM in FY 2021 to ~2.5MM each of the next two years
2. Despite the increase in immigrants, the **number of border control staff** has been relatively constant
 - a. The US border enforcement budget is now \$25.9B; more than 2X the FBI
3. There are **49.5MM immigrants** living in this country (both legal and undocumented)
 - a. **15%** of population
 - b. Foreign-born workers made up **18.6%** of the civilian workforce in 2023
 - c. Mexicans comprise 24% of immigrant population; was 30% in 2000
 - i. India and China are 6% and 5%
4. US: 75% of **farmworkers** are migrants; 30% of construction and mining workers
 - a. Also needed in slaughtering and meatpacking, cleaning, child and eldercare, hospitality, warehousing, distribution and transport
5. Currently **3.36MM cases pending in immigration courts** with **682** immigration judges
 - a. ~4,900 pending cases per judge
 - i. Last fiscal year, each judge closed an average of 975 cases
6. CBO says that the increase in immigration will **add \$7T to the economy** over the next 10 years and boost federal tax revenue by \$1T

B. Rich Countries Need Low-skilled Foreign Workers

1. They have aging populations (shrinking labor force)
2. This helps to avoid costly investments (e.g., robots)
3. This keeps inflation low (vs. higher cost domestic labor)
4. This allows people from poor countries to pursue better lives

C. Problems With Low-Skilled Immigration

1. Can stifle productivity
 - a. This slows productivity growth (in contrast to high-skilled immigrants)
2. Can allow low-productivity businesses to survive
3. Allows businesses to delay the search for more sustainable solutions
4. Prevents wages from rising for low-skilled domestic workers

D. Competing Narratives:

1. **Right:** compares illegal immigration to an invasion, facilitated by criminal cartels and accepted by “open borders” liberals
2. **Left:** surge in immigration is driven by poverty, violence and other misery in origin countries; migrants are refugees in need of protection
3. **Both narratives ignore the need for lower-skilled labor**
 - a. There is absence of legal channels to accommodate this; immigrants are searching for these jobs
 - b. 9MM open jobs; 1.4 vacancies / unemployed person
 - c. We don’t want our own children to work in certain industries, yet we don’t want immigration

E. Restrictive Border Enforcement Doesn’t Change the Supply / Demand Story

1. It has **driven migration underground** and made migrants dependent on smugglers
 - a. It has also resulted in using more dangerous routes
2. Immigration restrictions have backfired by **pushing temporary migrants into permanent settlement** (if it’s difficult to cross border, you have to stay)
 - a. Research: border militarization transformed undocumented Mexican migration “from a circular flow of male workers” going back and forth, mainly to TX and CA, “into an 11MM person population in 50 states”
 - b. We have lowered barriers for the temporary immigration of skilled workers, intracompany transferees, students, investors, and family members

F. Three Foundations of Credible Comprehensive Immigration Reform

1. Some form of migrant amnesty is inevitable. We’re not going to be able to round up and deport 11MM undocumented migrants
2. Need to open up more legal channels for lower-skilled workers to move back and forth across the border. This will also reduce asylum applications.
 - a. Need to discuss “**workforce solutions**” rather than “immigration”
3. Serious investments so that asylum claims can be processed efficiently

G. WSJ Polling Numbers

1. **74%** support pathway for those in US many years who pass background check
2. **66%** support pathway for Dreamers brought to US illegally as children
3. **58%** support increasing legal immigration levels
4. **55%** support building a wall
5. **20%** rank immigration as top issue

Sources: ([WSJ](#)) ([WSJ](#)) ([Bloomberg](#)) ([WSJ](#))