SWS Capital Management
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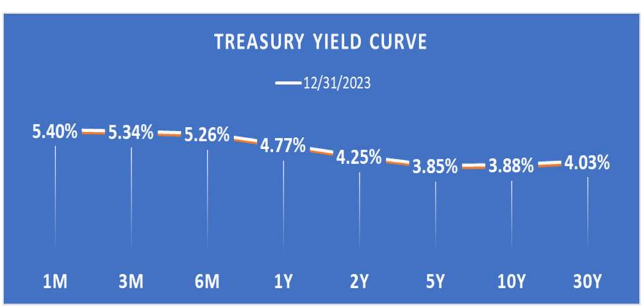
Economic Commentary – December 2023

Similar to November's market theme, December saw the extension of positive correlations amongst risk assets and cash-yielding products as equity and fixed income markets finished the month (and year) in positive territory, highlighted by a pronounced cross-asset Santa Clause rally.

On December 13, the Fed wrapped up its eighth and final policy meeting of the calendar year. Affirming the rate market's expectations, the FOMC unanimously voted to undertake its third consecutive (fourth of 2023) pause of its 22-month rate-hiking crusade, maintaining the federal funds target rate range at 5.25% - 5.50%. Unlike the three previous pauses that were deemed as hawkish due to the Committee's restrictive policy stance, this particular suspension was perceived to carry a dovish connotation as accommodative inferences were detected in policymakers' rhetoric. Moreover, while acknowledging that rates have moved sufficiently into restrictive territory, job gains have moderated, and inflation has eased, it was the addition of the word "any" preceding "additional policy firming that may be appropriate…" in the FOMC statement that led market participants to believe the Committee had reached its peak overnight lending rate, culminating rate hikes in the current cycle.

More intriguing, and quite frankly more anticipated than the widely expected rate pause, was the release of the Fed's updated Summary of Economic Projections as it provided deeper insights into the Committee's assumptions and forecasted trajectory for the conclusions of 2023 and 2024. Revised from September's projections for 2023, the change in real GDP was boosted to 2.6% from 2.1%, headline PCE inflation was pared to 2.8% from 3.3%, core PCE inflation was lowered to 3.2% from 3.7%, the unemployment rate was unchanged at 3.8%, and the federal funds target rate was slated to be kept at its current level of approximately 5.4%. Parsing through 2024's forecasts, the updated projections for the change in real GDP, the unemployment rate, and PCE figures were essentially in accord with September's projections (1.4%, 4.1%, and 2.4%, respectively), but it should be noted that the federal funds rate at the end of 2024 is now projected to be 4.6%, revised down from 5.1%, indicating the FOMC expects to make three, 25 basis point rate cuts throughout 2024. The next release of updated economic projections will come after the conclusion of the March 2024 policy meeting.

Paradoxically, the interest rate futures market is not only at odds with the Fed, but has also priced in five to six rate cuts in 2024, essentially prognosticating that the FOMC was too conservative in its own assumptions. However, as we alluded to last month, the recent drawdown in yields has in effect loosened financial conditions, potentially making FOMC 2024 penciled-in rate cuts less imminent, situating rate-cut doves completely offsides in their forecasts. For reference, 2-year and 10-year Treasuries were yielding 5.09% and 4.93%, respectively, at the end of October. At the close of December, 2-year and 10-year Treasuries were yielding 4.25% and 3.88%, respectively. 2024 is already positioning itself to be a compelling year for economists, investors, and traders alike.



U.S. Treasury yield curve continued to flatten, enduring widened inversions in key tenors as longer-dated yields broadly declined more than shorter-dated yields.

2-year/10-year spread: -37 basis points
3-month/10-year spread: -146 basis points
2-year/5-year spread: -40 basis points
3-month/30-year spread: -132 basis points

U.S. Treasury Yield Curve Source: Bloomberg

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December 2023 Macroeconomic Highlights

Inflation, Expectations, and Consumer Sentiment[1]:
CPI: 3.1% year-over-year (0.1% month-over-month); ***Core CPI***: 4.0% year-over-year (0.3% month-over-month)
PCE: 2.6% year-over-year (-0.1% month-over-month); ***Core PCE***: 3.2% year-over-year (0.1% month-over-month)
PPI: 0.9% year-over-year (0.0% month-over-month); ***Core PPI***: 2.0% year-over-year (0.0% month-over-month)
Core PPI less trade services: 2.5% year-over-year (0.1% month-over-month)
Inflation Expectations: 1-year horizon: 3.4%, 3-year horizon: 3.0%, and 5-year horizon: 2.7%
Consumer Sentiment: 69.7 vs. 61.3 in November; ***Current Conditions***: 73.3 vs. 68.3 in November
Consumer Expectations: 67.4 vs. 56.8 in November

Labor Market[2]: The U.S. economy added 199,000 nonfarm payrolls in November, modestly exceeding the 185,000 expected by economists surveyed by Bloomberg. Notable job gains occurred in health care (+77,000), government (+49,000), leisure and hospitality (+40,000), and manufacturing (+28,000).

- U-3 ***official*** unemployment rate: 3.7% vs. 3.9% expectation: -0.2% from October 2023.
- U-6 unemployment rate (marginalized, part-time workers for economic reasons): 7.0%.
- Labor force participation rate: 62.8% (+0.1%); Employment-to-population ratio: 60.5% (+0.3%).
- Average hourly earnings for private nonfarm payrolls rose 12 cents to $34.10 (+0.4% month-over-month, +4.0% year-over-year).
- Employment revisions: October 2023 unchanged at 150,000; September 2023 clipped -35,000 to 262,000.

Gross Domestic Product (GDP)[3]: According to the ***third and final*** estimate, real GDP increased at annual rate of 4.9% in the third quarter of 2023 vs. 2.1% in the second quarter of 2023.

- *Third Quarter 2023:* GDP Price Index: +3.3%; PCE Price Index: +2.6%; Core PCE Price Index +2.0%.
- Real disposable personal income: +0.3% vs. +3.5% in the second quarter of 2023.
- Personal savings rate as a percentage of disposable income: 4.2% vs. 5.2% in the second quarter of 2023.
- Average of Real GDP and Real GDI: +3.2% vs. +1.3% in the second quarter of 2023.

Housing Market[4]: Existing-home sales inched up 0.8% (month-over-month) from October to a seasonally-adjusted annual rate of 3.82 million in November. Month-over-month sales in the South and Midwest increased 4.7% and 1.1%, respectively, while sales in the West and Northeast retreated 7.2% and 2.1%, respectively.

- Year-over-year sales slid 7.3%, down from 4.12 million in November 2022.
- Total housing inventory registered 1.13 million units, -1.7% from October, but +0.9% from one year ago (1.12 million units). Unsold inventory sits at 3.5-month supply at the current sales pace.
- The median existing-home price for all housing types was $387,600, +4.0% from November 2022 ($372,700), as prices rose in all four major U.S. regions.
- Average commitment rate for a 30-year, conventional, fixed-rate mortgage: 6.61%.
- New Home Sales: 590,000 (-12.2% month-over-month).

[1]Source: Bureau of Labor Statistics (BLS), U.S. Department of Commerce, Federal Reserve Bank of New York – Survey of Consumer Expectations, and University of Michigan Consumer Sentiment Index
[2]Source: Bureau of Labor Statistics (BLS)
[3]Source: Bureau of Economic Analysis (BEA)
[4]Source: National Association of Realtors (NAR), U.S. Census Bureau, and The Department of Housing and Urban Development

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