SWS Capital Management
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Economic Commentary – February 2024

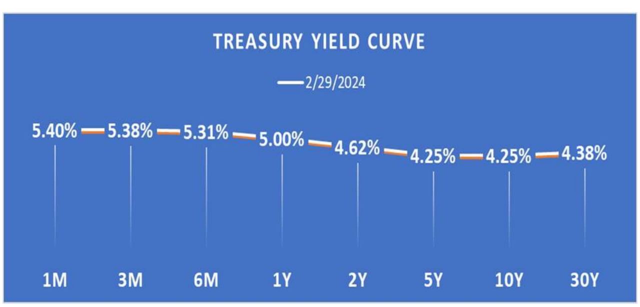
Following the January 31 FOMC decision to leave its overnight lending rate unchanged at 5.25% - 5.50%, and more pointedly, non-dovish remarks from Fed officials throughout the course of the month, the interest rate futures market had become more aligned with December's FOMC Summary of Economic Projections which outlined three rate cuts in 2024. In addition to the recalibration of rate cuts, the market had priced in the first rate reduction to occur in June/July as opposed to at the upcoming March meeting.

Justifiably, based on anecdotal and empirical evidence, Fed policymakers are concerned with a reacceleration in inflationary pressures. As we have alluded to in previous commentary pieces, which have been substantiated by price index and personal consumption economic releases over the past 18 months, disinflationary forces have undoubtedly been at work. However, it is the terminal stage (which is the current phase) of suppressing inflation to the Fed's 2% objective that will prove to be the most arduous. As certain components of services inflation remain sticky, the labor market displays its unyielding tightness, consumption continues at a steadfast pace, corporate balance sheets (less those of certain regional banks) exhibit soundness, and many S&P 500 companies' earnings and fundamentals appear stable, there is a clear lack of immediate incentive for the FOMC to lower its federal funds target rate.

Although repetitive, and at times monotonous, all Fed officials have recently been consistently harmonious in their positions that they need to obtain "greater confidence that inflation is on a sustainable path to the committee's 2% inflation objective" before an interest rate cut is enacted. In an attempt to avoid and repeat the missteps by Fed policymakers in the early 1980s by prematurely declaring victory over inflation, the current FOMC constituents have chosen to administer a patient approach. This patience, more colloquially referred to as "data dependence", has allowed the Fed to evaluate the full extent of its policy restraint on economic activity and developments.

It is also important to note that the Fed has intentions to taper its ongoing pace of quantitative tightening in 2024 that currently entails a $95 billion/month balance sheet runoff. In essence, this will add a degree of accommodation to the economy that may not necessarily function as a replacement for rate cuts, but rather as a complement in the easing of the Fed's perceived restrictive policy stance.

In the 15 months preceding 2024, there were pervasive grumblings from economists and market practitioners that the U.S. economy could not withstand an overnight lending rate with a "5-handle" without assuredly inducing an economic contraction. As a recession has yet to materialize, 2023's annual real economic growth has registered +2.5%, and equity market indices have recorded all-time highs, the Fed's patient approach presently appears to have been warranted, but only time will tell if the central bank's patience will ultimately be validated.



U.S. Treasury yield curve underwent a bear steepening as longer-dated yields increased, shrinking inversions between key short-dated and long-dated tenors.

2-year/10-year spread: -37 basis points
3-month/10-year spread: -113 basis points
2-year/5-year spread: -37 basis points
3-month/30-year spread: -100 basis points

U.S. Treasury Yield Curve Source: Bloomberg

February 2024 Macroeconomic Highlights

Inflation, Expectations, and Consumer Sentiment[1]:
CPI: 3.1% year-over-year (0.3% month-over-month); ***Core CPI***: 3.9% year-over-year (0.4% month-over-month)
PCE: 2.4% year-over-year (0.3% month-over-month); ***Core PCE***: 2.8% year-over-year (0.4% month-over-month)
PPI: 0.9% year-over-year (0.3% month-over-month); ***Core PPI***: 2.0% year-over-year (0.5% month-over-month)
Core PPI less trade services: 2.6% year-over-year (0.6% month-over-month)
Inflation Expectations: 1-year horizon: 3.0%, 3-year horizon: 2.4%, and 5-year horizon: 2.5%
Consumer Sentiment: 76.9 vs. 79.0 in January; ***Current Conditions***: 79.4 vs. 81.9 in January
Consumer Expectations: 75.2 vs. 77.1 in January

Labor Market[2]: The U.S. economy added 353,000 nonfarm payrolls in January, immensely eclipsing the 185,000 expected by economists surveyed by Bloomberg. Notable job gains occurred in professional and business services (+74,000), health care (+70,000), retail trade (+45,000), government (+36,000), and social assistance (+30,000).

- U-3 ***official*** unemployment rate: 3.7% vs. 3.8% expectation: unchanged from December 2023.
- U-6 unemployment rate (marginalized, part-time workers for economic reasons): 7.2% (+0.1%).
- Labor force participation rate: 62.5% (unchanged); Employment-to-population ratio: 60.2% (+0.1%).
- Average hourly earnings for private nonfarm payrolls rose 19 cents to $34.55 (+0.6% month-over-month, +4.5% year-over-year).
- Employment revisions: December 2023 boosted +117,000 to 333,000; November 2023 lifted +9,000 to 182,000.

Gross Domestic Product (GDP)[3]: According to the ***second*** estimate, real GDP increased at annual rate of 3.2% in the fourth quarter of 2023 vs. 4.9% in the third quarter of 2023. Real GDP increased 2.5% in 2023.

- *Fourth Quarter 2023:* GDP Price Index: +1.6%; PCE Price Index: +1.8%; Core PCE Price Index +2.1%.
- Real disposable personal income: +2.2% vs. +0.3% in the third quarter of 2023.
- Personal savings rate as a percentage of disposable income: 3.9% vs. 4.2% in the third quarter of 2023.

Housing Market[4]: Existing-home sales grew +3.1% (month-over-month) from December 2023 to a seasonally-adjusted annual rate of 4.00 million in January 2024. Month-over-month sales in the West, South, and Midwest advanced 4.3%, 4.0%, and 2.2%, respectively, while sales in the Northeast were unchanged.

- Year-over-year sales slid -1.7%, down from 4.07 million in January 2023.
- Total housing inventory registered 1.01 million units, +2.0% from December 2023, and +3.1% from one year ago (0.98 million units). Unsold inventory sits at a 3.0-month supply at the current sales pace.
- The median existing-home price for all housing types was $379,100, +5.1% from January 2023 ($360,800), as prices rose in all four major U.S. regions.
- Average commitment rate for a 30-year, conventional, fixed-rate mortgage: 6.94%.
- New Home Sales: 661,000 (+1.5% 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 Surveys of Consumers
[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