

Mixed Data Feeds Market Volatility

Bond yields climbed across the curve in a holiday-shortened week full of economic releases, Fed talk and evolving geopolitical events. On the whole *it suggested no clear direction for the economy*, which supports a cautious approach for policymakers less than two weeks from the January FOMC meeting.

Yesterday afternoon, Congress passed a continuing resolution to keep the federal government open into early March, giving lawmakers additional time to negotiate a long-term government funding plan. It's a little unnerving that our political leaders continue to delay the hard budget decisions, but at least the two parties were in agreement. The Senate passed the bill by a decisive 77-18 margin on Thursday afternoon, followed by a 314-108 vote in the House. The latest of three stopgap measures since October pushes the dual funding deadlines to March 1 and March 8, allowing the financial markets to focus attentions elsewhere for another six weeks.

This morning, existing home sales for December unexpectedly fell -1.0% to an annualized 3.78 million unit pace, the lowest seasonally-adjusted level since summer 2010. *For all of 2023, it was the housing market's worst year since 1995.* That being said, the outlook going forward has brightened. The National Association of Home Builders Market Index showed significant improvement in January, while mortgage applications for new purchases reached a six-month high last week. Demand for homes is still strong; the problem has been affordability and lack of supply. Rising inventories of new homes, along with a decrease in lending rates has sparked recent optimism.

Also this morning, the University of Michigan Sentiment Index indicated consumer outlook continues to improve, although still well below the pre-pandemic level of 101 from February 2020. The January 2024 measure of 78.8 follows confidence readings of 69.7 and 61.3 in the previous two months. Much of the recent rise can be attributed to expectations for lower inflation. Wednesday's release of the Import Price Index supported those expectations. The median forecast was for a -0.5% decline but the actual measure was unchanged, *still very positive for the overall inflation picture.* On a year-over-year basis, import prices are down -1.6% indicating that the U.S. is *importing deflation.*

On Tuesday, the Empire State Manufacturing Index (the NY Fed's general conditions index) for January collapsed to its lowest level since May 2020 during the worst of the pandemic. This index has been wildly volatile, but it was positive just two months ago at 9.1. Now in January, it's at -47.7 (below zero indicates contraction.) The Philadelphia Fed Index, also released this week, was worse than expected and signals contraction for the 16th consecutive month.

The Fed enters its 10-day "quiet period" this weekend in front of the January 30-31 FOMC meeting. Committee members, sorting through the same mixed data as investors, have taken a wait-and-see approach with no indication that a March rate cut will be seriously considered. Fed Governor Christopher Waller, speaking Tuesday, pushed back on market expectations for a first quarter rate cut and questioned the wisdom of easing when

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2012
greg.warner@hilltopsecurities.com

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the economy is doing so well. Yesterday, Atlanta Fed President Raphael Bostic said he doesn't expect the FOMC will begin lowering the overnight funds rate until the third quarter, although he'd be open to moving sooner if inflation surprises to the downside. Both Waller and Bostic are voting members.

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This week's backup in yields has reduced market expectations for 2024 rate cuts from just under seven to just over five. The selloff has also whittled down the probability of a March move to 50%, although in reality that likelihood has always been extremely slim. Fed officials will ease monetary policy in 2024, but not quite as soon or as aggressively as the markets had concluded a week ago.

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There is another full slate of economic data on tap for next week, with the most important being Thursday's release of the Fed's preferred inflation measure, *personal consumption expenditures* (PCE). Although unlikely to sway committee members just days before discussions begin, a downside surprise, in particular an annual core reading below +3.0% for December, would be positive for bonds.

Market Indications as of 12:36 P.M. Central Time

DOW	Up 335 to 37,804 (NEW HIGH)
NASDAQ	Up 189 to 15,245 (NEW HIGH)
S&P 500	Up 43 to 4,824 (NEW HIGH)
1-Yr T-bill	current yield 4.86%; opening yield 4.80%
2-Yr T-note	current yield 4.41%; opening yield 4.36%
3-Yr T-note	current yield 4.19%; opening yield 4.15%
5-Yr T-note	current yield 4.08%; opening yield 4.05%
10-Yr T-note	current yield 4.16%; opening yield 4.15%
30-Yr T-bond	current yield 4.36%; opening yield 4.37%

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