WEEK IN PERSPECTIVE

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Friday's rally leaves market higher for the week

The stock market was able to close out the first week of 2023 with decent gains thanks to a rally effort on Friday. The S&P 500 briefly dipped below 3,800 on Tuesday before pushing above 3,900 on Friday.

With Wednesday's higher finish, the market logged a net gain over the Santa Claus rally period (the last five trading sessions of the year and the first two trading sessions of the new year), which, historically has been regarded as a positive sign for the start of the new year.

The major indices experienced some choppy action this week, though, driven by expectations surrounding the Fed's rate hike path. Those expectations were influenced by notable economic releases this week.

A stronger-than-expected ADP Employment Change Report for December and initial jobless claims for the week ending December 31, which hit their lowest level since September, indicated that the labor market remains tight. Simultaneously, a sharp narrowing in the November trade deficit that was led by declines in both exports and imports reflected weakening global demand.

Investors are aware that the Fed considers a weakening of the labor market to be an integral step in bringing down inflation, so strong labor data left market participants fearful about the Fed continuing to raise rates and not entertaining a pivot to a rate cut cycle anytime soon.

Minneapolis Fed President Kashkari (a 2023 FOMC voter) said that he sees the Fed pausing its rate hikes at 5.40% before cautioning that rates could be taken potentially much higher from wherever the Fed pauses if there is slow progress in lowering inflation after the Fed pauses.

The FOMC Minutes from the December 13-14 meeting, which were released on Wednesday following Mr. Kashkari's remarks, indicated "No participants anticipated that it would be appropriate to begin reducing the federal funds rate target in 2023."

Kansas City Fed President George (not an FOMC voter), meanwhile, told CNBC in an interview on Thursday that she sees the fed funds rate reaching 5.0% and staying there “well into 2024.” The same day, St. Louis Fed President Bullard (not an FOMC voter) said, “While the policy rate is not yet in a zone that may be considered sufficiently restrictive, it is getting closer.”

The market languished on Thursday following the ADP and initial claims numbers, leaving participants fearful about the December Employment Situation Report being stronger than expected.

It turned out that the employment report was not as strong as feared, but it also was not weak. Nonetheless, the market took a liking to the understanding that average hourly earnings growth moderated to 4.6% year-over-year in December versus a downwardly revised 4.8% in November.

That report was subsequently followed by the December ISM Non-Manufacturing Index, which fell into contraction territory (i.e. a sub-50 reading) for the first time since May 2020. The downturn reflected a clear slowdown in economic activity that is a byproduct of rising interest rates and weakening demand.

The takeaway for the Treasury and stock markets in the wake of this softer data was that the Fed won’t be able to take the target range for the fed funds rate much higher before it decides to hit the pause button. Accordingly, both markets enjoyed substantive rallies to finish the week.

The 2-yr note yield fell 15 basis points for the week to 4.27% and the 10-yr note yield fell 32 basis points for the week to 3.56%.

The bulk of the weekly gains came in Friday’s rally. Nine of the 11 S&P 500 sectors closed with a gain led by communication services (+3.7%), materials (+3.5%), and financials (+3.3%). Meanwhile, the energy sector closed flat and health care fell 0.2%.

The mega cap stock had a roller-coaster week fueled by notable news catalysts. Tesla disappointed with Q4 deliveries and reportedly cut prices again in China for its Model Y and Model 3 vehicles. Apple reportedly told suppliers to build fewer components for several devices in Q1 due to weakening demand. Amazon.com announced plans to cut ~18,000 positions.

Another story stock of note was Dow component Salesforce, which announced it will be pursuing a restructuring effort that will include the elimination of roughly 10% of its staff and select real estate exits and office space reductions.

- S&P Midcap 400: +2.4% for the week / +2.4% YTD
- Russell 2000: +1.8% for the week / +1.8% YTD
- S&P 500: +1.5% for the week / +1.5% YTD
- Dow Jones Industrial Average: +1.5% for the week / +1.5% YTD
- Nasdaq Composite: +1.0% for the week / +1.0% YTD

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