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Market Update

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This week on Tuesday, February 13, 2024, we saw the biggest decline in the Dow Jones Industrial Average since March 2023 (per CNBC). The cause of this decline was a disappointing CPI report released in the morning. The result was the S&P 500 declining 1.37% and the Russell 2000 by a whopping 4.11%! The question is, was it really that bad? The short answer is no. There was some "noise" in the report, such as insurance premiums and shelter costs (more on that below), that contributed to the headline & core number being higher, but the overall trend of disinflation remains intact. The sell off was further accelerated by a spike in the VIX which saw a 30% intraday surge to put it at a high for the year. This does bear watching but for now appears to be an isolated event.

Per Tom Essaye at The Sevens Report, the market since Q4 2023 has rallied on: 1) Sooner -Than-Expected Fed rate cuts, 2) Continued Falling Inflation, and 3) A decline in the 10-Year Treasury. All 3 of these have somewhat reversed as of late but earnings, which along with economic growth, have come in stronger than expected which has kept things up and will most likely act as a floor for the market and keep it from suffering from a more severe 10%+ pullback.

Turning to earnings, per Tom Lee at FSinsight, this earnings season has been a good one.

Here is the rundown so far:

Of the 360 companies that have reported so far (72% of the S&P 500):

- Overall, 80% are beating estimates, and those that "beat" are beating by a median of 7%.
- Of the 20% missing, those are missing by a median of -5%.
- On the top line, overall results are beating estimates by a median of 4% and missing by a median of -3%, and 64% of those reporting are beating estimates

Furthermore, regarding yesterday's pullback, Tom Lee has the following observations: The bond market is selling off sharply (yields up) with 10-yr yields now 4.285%, and way up from 3.865% just a week ago. And after this CPI report, we are hearing some economists/pundits suggest the Fed could even further delay rate cuts because of today's report.

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In our view, this is an over-reaction to a singular CPI print. And the stock market reaction is also overdone as well. Why?

- Foremost, there are really 4 culprits behind today's "hot" CPI:
    - Shelter increased
    - Auto insurance increased
    - Miscellaneous personal services increased
    - Hospital Services increased
    - 3 of the 4 are not really stuff that "scares Fed now" but are lingering issues
- We do not think the downward trajectory of inflation has been halted. Core CPI is still tracking lower and there is noise in today's report. Consider the following:
    - Core CPI Month over Month for January increased by +0.39%
    - Shelter's contribution to growth of inflation was +0.26%
    - Auto insurance contribution to growth of inflation was +0.05%
    - Core CPI ex-both Shelter and Auto was +0.08%, or +0.96% annualized
    - Excluding those 2 items, CPI is annualizing at 1%. It is still falling like a rock.
- We also think it is too early to "call a top" for the market in the near-term. It is still showing overall strength and breadth has indeed been improving.
    - But more telling, in our view, is the still low level of New York Stock Exchange margin debt. These figures need to surge to mark a near-term top:
        - Current level is $700 billion (end of Dec)
        - Recent peak was $710 billion (Jul 2023)
        - Jul peak was followed by -11% drawdown in stocks
    - There is just too much dry powder on the sidelines. Thus, we think this sell-off dip will be bought. The next key data points are:
        - U Mich inflation expectations mid-Feb on Friday 2/16
        - Nvidia reports quarterly results 2/21

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Thank you to both Tom Essaye of the Sevens Report and Tom Lee of FSInsight for their data points that bring clarity to crazy days like yesterday. As always, we welcome any comments or questions.

Regards,

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