Back on Economic Track

January 29, 2024

Last week's inflation data showed that price changes have retreated near the Fed's annual target of 2%. Specifically, the annualized consumer price index for December was 3.6% and the personal consumption expenditures index was up 2.6%, not too far from the magic 2%. Another important measure of future inflation, the producer price index, fell in December by 0.1%. Economists are expecting to see further weakening in inflation in the months ahead based on an increasing supply of goods and services as the bottlenecks in production attributable to the pandemic dissipate. The good news is that the Federal Reserve is likely to begin a plan to slowly lower interest rates since inflation fears are receding. According to Forbes magazine, the S&P 500 gained 16.8% on average in the 12 months following the prior six conclusions to Fed tightening cycles—far outperforming the index's historic 12% annual return. History tells us that when the Fed stops raising interest rates or even cuts rates as many economists predict, equity markets tend to do well.

Another piece of good news is that presidential election years have been generally good for stock investors. Since 1928, the average return on the S&P 500 has been a healthy 11.8%. The average return has been quite volatile but usually ends in the green. The best return was in 1928 when the S&P 500 rose 43.5% when Herbert Hoover was elected. The worst performance occurred in 2008 when the market fell 37% -- due to the financial crisis. Of the 24 presidential election years, 15 had double-digit rates of return.

Recently the S&P 500 reached an all-time high. Another piece of good news is what has happened to the S&P 500 in the twelve months following a new high. According to J.P. Morgan, nearly 85% of the time, one-year forward returns were positive. In fact, since 1988 one-, two- and three-year forward returns were more favorable when investing after all-time highs as compared with random market returns.

The last quarter of 2023 surprised economists with a forecast for growth of 3.1%. The GDPNow estimate for economic growth for the first quarter is up to 3% whereas the consensus of the Blue-Chip economic forecasters is only 1%. However, the GDPNow forecast has been more accurate than the economic consensus for the past few quarters. A stronger economy translates into higher corporate profits, an important factor in driving stock prices higher. We are still early in the earnings reporting season for the fourth quarter of 2023 and the trend has been that company profits have exceeded analysts' expectations. Moreover, according to a recent article from CNBC, 84% of companies around the world either increased or maintained their dividends compared to the same quarter in 2020. Much of the growth was attributed to companies restarting frozen payouts and issuing higher special dividends on the back of strong earnings.

There are no guarantees of future stock market returns but evidence continues to build that the equity markets will enjoy another good year in 2024. Stay Tuned!

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