MARKET RECAP

January 2024

Rotman Commerce Trading Group

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GLOBAL MARKETS INSIGHT

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- Market Snapshot - The US economy has displayed resilience supported by strong consumer activity, with retail sales and personal spending surpassing expectations. Despite concerns about sustainability due to modest wage growth and record-low savings rates, consumer credit has surged, raising questions about long-term support for the economy amidst rising borrowing costs and inflation.

- Fixed Income Markets - The Bank of Canada (BoC) announced that the overnight interest rate would remain at 5%, with economists suggesting a potential rate cut in the coming Spring. Meanwhile, the FOMC is expected to maintain its federal fund rate at 22-year highs amidst inflation concerns, contributing to a 21.14% return on the S&P 500.

- Commodity Markets - In January 2024, two key events impacted global commodity markets: attacks by Iranian-backed Houthi rebels and reduced expectations of interest rate cuts.

- Equities - In January, US stocks saw modest gains, with the S&P 500 rising by 1.7%, the NASDAQ climbing 1.0%, and the Dow Jones Industrial Average increasing by 1.3%. The Eurozone is amongst the top regional performers this month, while UK equities took a dip due to falling retail sales.

MARKET SNAPSHOT

Equity Market Snapshot

***as of January 31st, 2024**

Index	MTD Returns	YTD Returns
S&P 500	1.59%	20.69%
NASDAQ Composite	2.27%	32.05%
Dow Jones Industrial Average	7.76%	7.08%
S&P/TSX Composite	4.62%	0.55%
FTSE 100 Index	(1.27%)	2.12%
Nikkei 225	7.98%	35.54%

Central Bank Watch

Central Bank	Current Key Interest Rate	Summay
Bank of Canada	5.0%	The BOC maintained its overnight policy rate at 5.00% noting stalling economic growth and excess demand flushing out.
U.S. Federal Reserve	5.25-5.50%	The Fed left the lower and upper bounds of its benchmark rates untouched at 5.25-5.5%; the US economy has shown undeniable resilience silencing talks of a March cut.
European Central Bank	4%	The ECB held rates steady at 4% against a small uptick in inflation for the month of December. Lagarde noted the increase as “expected” and cemented her views on a data-driven policy circuit against a calendar-based approach.

MARKET SNAPSHOT

Macro News Spotlights

Consumer Resilience

In contrast to its European counterparties, the US economy has seen unwavering support from the consumer through a wave of strong corporate earnings and robust economic data. Throughout the month of December, the US economy recorded retail sales growth of 0.6% MoM against expectations of a 0.4% increase, while personal spending came in strong at 0.7% MoM against market pricing of a 0.5% increase. Although the holiday season has adjusted for some spending growth, both wages and non-farm payrolls held relatively modest/stable for the month, possibly indicating slight unsustainability with current capital deployment activity.

Delving deeper into consumer behavior, outstanding consumer credit in the US rose $23.8bn for the month of November; an increase that blew expectations by >250%, while consumer savings rates hit all-time lows at around 3.7%. This calls into question the long-term ability of the consumer to support its economy as rates continue to take their toll on the cost of borrowing, while sticky inflation and strong economic data encourage the Fed to hit the pause button on rate cuts. Paired with an upcoming maturity wall of roughly $600bn in corporate debt across 2024-2025 needing to be refinanced at elevated costs of capital, both consumer and corporate balance sheets are to be watched carefully for signs of weakness and distress.

Rate Cut Pricing

Another strong theme through January was the market pricing (or mispricing) of rate cuts across 2024. While initially seeing optimism for rate cuts across both Canadian and US economies in early 2024, robust inventory drawdowns, consumer spending, sticky core inflation, and steady labor markets quickly had investors repricing rate cut probabilities for the mid-latter half of the year.

Across equity markets, the S&P 500 has been reaching higher and higher levels off impressive corporate earnings backed by energy, healthcare, and tech, while the market seems to be enjoying a resilient US economy and soft landing narrative.

MARKET SNAPSHOT

Similarly, while yields remain volatile, the front end continues to be supported by curve steepening as treasuries have been reacting to economic data of easing price pressures – enhancing the narrative of policy rates being tighter than necessary. It's important however for the market to be cautious of overexcitement as central banks have continuously reiterated their stance on a 2% inflation target, as well as the adamance to keep rates elevated until greater disinflationary trends have been experienced. Given upticks in growth figures across GDP, personal spending, and labor gains, excess supply across US and Canadian economies may be less prevalent than previously hoped by central banks, leading to less disinflationary pressures over time. While policymakers have moved past possibilities of rate hikes for now, they too will also be in no rush to cut rates until inflation data comes in flat/negative.

FIXED INCOME

Interest Rates and Policy Decisions

On January 22, 2024, the Bank of Canada (BoC) announced that the overnight interest rate will remain at 5%. Economists downplayed the odds of further rate hikes and forecast a rate cut may be coming soon in Spring.

In 2023, BoC's adjustments to interest rates to combat rising and persistent inflation led to the overnight lending rate hitting 5% and keeping the rates steady. Policies have a significant impact on Canadians, especially businesses, homebuyers, and homeowners who are carefully watching central bank decisions as they may affect the rate at which banks can lend money for loans and mortgages.

On the other hand, after pausing interest rate hikes in July, the Federal Open Market Committee (FOMC) will likely keep its federal fund rate target range at 22-year highs as inflation rolls over to 2024. The S&P 500 Index has notched a total LTM return of 21.14% on investor optimism about inflation trends.

Treasury Yields

In January, treasury yields experienced volatility and fluctuations influenced by various factors such as data releases, geopolitical tensions, and central bank policies. Overall, January saw a mix of upward movement in yields, driven by economic indicators and central bank signals, alongside intermittent periods of stabilization or slight declines amid market uncertainties due to economic data releases. Canadian 10-year government bond yields exhibited similar trends and movement to the US.

Although US 10-year treasury yields climbed just above 4% at the beginning of the month, they soon fell to a four-month low on January 17th after releasing sales data. US retail sales data and producer prices declined more than expected in December, driving expectations that the Federal Reserve could scale back the pace of its interest rate increases.

FIXED INCOME

After a period of steady growth, yields dipped again towards the month's end. On the last day of the month, one day before the Fed’s interest rate announcement, yields fell to below 4% as rates were expected to be held steady. Markets were pricing in an almost 50% chance of rates being cut at the Fed’s meeting in March.

Looking ahead, yields may be expected to rally as the Fed indicated that they would not reduce rates until inflation is moving sustainably towards their 2% goal. Investors are awaiting the data from the soon-to-be-released January employment report for more information on the US job market based on nonfarm payrolls and its effect on the Fed’s upcoming decisions.

Credit Spread

As of January 2024, the landscape of credit spreads reflects a nuanced interplay of economic and policy factors. The beginning of the year marked a period where credit spreads remained relatively compressed, mirroring the cautious optimism of investors about the global financial outlook. This compression was primarily attributed to the subsiding momentum of monetary tightening, an anticipated moderation in inflation rates, and the persistence of economic growth, albeit at a moderated pace. These elements collectively contributed to the expectation that credit spreads would hover within the lower bounds of their recent historical spectrum.

However, the financial ecosystem is bracing for a nuanced shift towards a milieu characterized by a higher cost of capital. This anticipated transition is poised to precipitate an escalation in financial distress and default rates, especially among entities burdened with excessive leverage and those highly susceptible to interest rate adjustments. This scenario is particularly pronounced in the context of the Eurozone, where the fourth quarter of 2023 saw a further tightening in credit standards for corporate loans and credit lines, a trend that extends from the preceding year’s fiscal policies.

Amidst these developments, the dual forces of potential risk and opportunity are at play. On the one hand, the prospect of earlier-than-anticipated monetary easing by central banks poses an upside risk to the baseline forecasts, potentially alleviating funding pressures. On the flip side, the specter of a protracted recovery in corporate earnings growth looms as a significant downside risk, threatening to exacerbate the fragility of corporate balance sheets.

FIXED INCOME

The narrative of credit spreads in early 2024 is thus a tale of cautious optimism entwined with vigilant awareness of emerging risks. Investors and analysts alike are keenly monitoring the evolving economic indicators and central bank policies, poised to navigate through the complexities of the credit market with a balanced perspective on the risks and opportunities that lie ahead.

COMMODITIES

Global Commodities Market Wrap-up:

The commodity market was tough in 2023, with gold (13%) and copper (1%) the only two commodities that ended the year in positive territory, while lithium (-81%), nickel (-45%), and natural gas (-43%) all witnessed a significant drop. Several factors determine the 2023 market, including rising interest rates, potential recession, and a weak China outlook.

January 2024 Key Event:

Two forces impact the global commodity markets this January - the Iranian-backed Houthi rebels and less expectation of interest rates cut shortly. Commodities prices, especially oil and gas, are subjective to the rebels as the rebels attack vessels on the Red Sea. Higher transportation costs and potential negative impacts on oil and gas production in the Middle East have increased commodity prices. On the other hand, the lower expectation of a rapid rate cut drove down the prices of most commodities (i.e., metal and energy), given the slower economic boom associated with ambiguous rate cuts.

Looking Forward:

In 2024, we will closely monitor China's growth outlook, interest rate cut expectations and decisions, and resulting geopolitical risk. All these factors would impact the supply and demand of the commodities market, which will determine the price.

EQUITIES

North America

US stocks began the year with only a slight increase. The S&P 500 gained 1.7%, the NASDAQ climbed 1.0%, and the Dow Jones Industrial Average increased by a modest 1.3%. In January, large-cap stocks performed better than small-cap stocks; the Russell 1000 index rose 1.4% while the Russell 2000 fell 3.9%. Across both indices, it is clear that growth outperformed value.

Only 5 of 11 sectors had a positive start to the year, compared to 10 in December. With gains of 4.4%, Communication Services emerged as January's sector leader. Financials trailed behind at a close second with a gain of 3.1%. Materials, Consumer Discretionary, and Real Estate did the worst in January. Real Estate came last, with a steep decline of 4.8%.

Europe and the Middle East

The Eurozone is amongst the strongest regional performers this month, with the EURO STOXX 50 hitting its highest since 2001, up 9.9% within the month, and the STOXX Europe up 6.8%. With the anticipation of future rate cuts, positive market sentiment has led economically-sensitive sectors such as information technology, consumer discretionary, and real estate to be top performers in January. Additionally, news following China's economic opening pushed luxury goods, mining, and automotive stocks higher due to their high revenue exposure and dependence on China.

Furthermore, the extraordinarily strong earnings from two of the Eurozone's biggest tech stocks have helped drive markets to this historical high. ASML Holding NV, a semiconductor equipment manufacturer, gained over 20% over the month as strong fourth-quarter results beat market expectations for sales and earnings. Additionally, the German software company, SAP SE, exceeded analyst consensus and announced the restructuring of 8,000 jobs to focus on the growth of AI. This strong outlook led to shares increasing 7% in one day, and a total of 17% in January.

EQUITIES

Unlike the Eurozone, UK equities slowed in January. FTSE All-Share fell 1.3% despite signs of growth momentum from increasing flash composite PMI and consumer confidence, which was offset by retail sales falling 3.2%.

In the Middle East, tension builds as Iranian-backed Houthi militants continue attacking commercial ships in the Red Sea to support Hamas in the war. The attacks began in November 2023, disrupting trade connecting China with Europe and the U.S. As a result, traffic ships are avoiding the Suez Canal, opting for alternative routes, increasing shipping time by more than 25% while increasing costs. However, this has benefitted shipping companies, as stock prices rally due to freight rates increasing. The Danish shipping company Maersk became the best-performing stock in the Morningstar Europe Index as shares rose over 15% in the first week of the year. Meanwhile, the blue-chip Israeli index, the Tel Aviv 35 index, has dropped 2% in January.

PICKS OF THE MONTH

STOCKS OF THE MONTH

Walmart Inc (NYSE: WMT):

It seems the reality of a soft landing grows ever more probable as economic data and earnings releases continue to demonstrate resilience on the part of consumers and producers. However, for the pessimists in the market, a soft landing is something of an impossible feat. To satisfy the contrasting economic outlooks, we recommend allocating a portion of your portfolio to consumer staples. More specifically, we advise a buy-hold for Walmart Inc. stock.

A momentum strategy entails buying stocks that have performed well over a 3- to 12-month time horizon. Since its 12-month low at $140.68, Walmart Inc. has continued to appreciate to a price point of $168.95, registering a YTD gain of 6.06% at the time of writing. To supplement the justification for a momentum strategy, Walmart will have its Q4 Earnings Release on February 20th. The recent positive economic data releases combined with greater-than-expected earnings will help to prolong the rallying of Walmart's price. Indeed, Walmart's fundamentals reveal an expensive stock with a high P/E ratio of 28.05. However, it must be noted that Walmart's P/E ratio comes in lower than its main competitor, Costco, which remains at 48.49 at the time of writing. Purchasing Walmart, even if at a premium, provides for an allocation of quality and value into a defensive sector. This is especially important considering the mixed messaging between market optimists and pessimists.

PICKS OF THE MONTH

STOCKS OF THE MONTH

Hershey Co. (NYSE: HSY):

With the current share price at about $197, Hershey's has experienced a decline since its peak at $275 last year in May. The primary concerns stem from commodity inflation, pricing power, volume decline, and dynamic consumer trends. Keeping these reasons in mind, Hershey's remains positioned for a strong year and long-term growth. We recommend a buy-hold strategy with a target price of $227.

Brands are here to stay. Hershey's brands including KitKat, Resse's, Skor, Twizzlers, and more, are consumer staples in North America. They are household names and are a key player in the confectionary product industry, providing Hershey's with consistent revenue. Hershey's has a very strong historical financial performance.

With its net income increasing 40% over the past 5 years and revenues increasing 34% over the past 5 years, Hershey's has made strong gains. The firm is known for paying dividends consistently, with their dividends growing at a strong rate as the current dividend pays almost more 50% than 5 years ago. Over the past 30 years, Hershey's has almost doubled the performance of the S&P 500 ETF Trust. And with a slight decline this past year, we believe that Hershey's has a lot of upside potential.

Hershey's M&A activity has helped them consolidate their presence within the confectionary product sector while they work to expand into the salty snack category. Hershey's operates in about 80 countries globally which can lead to synergies if they choose to acquire other businesses around the world. They can also leverage their larger existing business to scale operations for target firms effectively decreasing their costs. The acquisitions completed have provided Hershey with scalable potential as they work to expand their market share in the confectionary product sector.

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STOCKS OF THE MONTH

Year	2018	2019	2020	2021	2022
Dividends	2.99	3.154	3.41	3.874	4.456
Dividend Growth	8%	5%	8%	14%	15%

HSY	2866%
Total Return since 1993	

SPY	1514%
Total Return since 1993	

Amazon.Com Inc (NASDAQ: AMZN):

Once more, recent earnings have placed Amazon into the spotlight for its significant earnings beat and expectations for the future. Amazon, a global e-commerce business, dominates the market, being able to capitalize on the ever-growing online shopping segment. The share price has increased by 14.59% YTD, as Amazon's Web Services provided better margins and expectations for 2024. Amazon has continued to grow over the years, emphasizing a variety of revenue streams, with cloud computing taking up a considerable share of the overall revenue.

Looking forward to 2024, AWS is expected to regain its fast-growing capabilities within the cloud computing space, making it an attractive long-term investment for those seeking exposure in this space. Additionally, Amazon is financially strong through its positive cash flows and dominant market share, providing the company with the flexibility to look for innovative initiatives. In conclusion, with the expected economic data, Amazon's financial robustness and accelerating cloud computing capabilities place it on our stock to watch out for.

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