

## Wobble, Then Soar?

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Last weekend we went with “[Weebles Wobble](#)” and the week started with more “wobbling” for stocks. Stocks seemed poised to break much lower on Wednesday but managed to claw back much of the early losses, and then took off on Thursday and Friday (the Nasdaq 100 gained 3.5% in those two days).

**There was much to like about how stocks performed this week.**

- This rally occurred **even as markets priced in fewer rate cuts and moved rates higher** across the curve.
  - According to Bloomberg’s WIRP function (World Interest Rate Probability), the chance of a March cut dropped to 47% from 79% last Friday.
  - Total cuts for 2024 went from 6.7 cuts (of 25 bps each) to “only” 5.4 cuts.
  - The 10-year yield went from 3.94% to 4.12%.
  - **Stocks rallying as they downplayed the “Fed Pivot” is impressive.**
  - **My call remains** 3 cuts (of 25 bps, 50 bps, and 25 bps), most likely starting at the April/May meeting and ending in July, though starting in March is far more likely than starting in June. I continue to believe that the Fed will want to be quiet on monetary policy at the September and November meetings as monetary policy is likely to become a campaign issue probably long before then. I still have a 4.3% target on 10s and 0 on 2s vs 10s but think I may be low on both.
- **Earnings and the outlook for semiconductors seemed to be the biggest single spark.** It wasn’t just AI (like many of the bumps have seemed to be driven by in the last year), but it was also more demand, and the outlook for more “mundane” chips bodes well for cell phones and other consumer goods! There has been a lot of worry about a slowdown in consumer spending, especially in some tech areas (I’m in that camp), but if that narrative is not true (and this week’s data point suggested that it is not), then that is a legit reason to be bullish.
- **The consumer keeps spending and inflation is contained.** I’m less convinced on the consumer, but have been a big believer that much of what drove inflation has changed direction – rather dramatically for goods, and just starting for services (see [COVID Inflation Bumps](#)).
  - **Geopolitical, supply chain, reshoring, and even ESG** are all putting upward pressure on inflation, so now is not the time to be complacent.
  - Having said that, **the housing calculations in CPI are all but guaranteed to keep inflation lower.** The lags missed it on the way up (IOER, the main measure of housing inflation, was the highest when all signs pointed to rents dropping in the real world), so we are seeing the impact of rent declines that occurred months ago showing up in the data today and somehow treating it as relevant.
  - University of Michigan’s **CONsumer CONFidence** had inflation expectation dropping. I know the Fed looks at that, so it is important, but I struggle to figure out the value of the data as a reliable predictor of anything.

**I really liked that stocks could rally on good news, even as yields went higher,** and some of the data makes me question my outlook on the economy over the coming months.

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There are some things to pick on.

- Even after the bounce on Thursday and Friday, the **Russell 2000** finished lower on the week. I haven't been pounding the table for the so-called "laggards" since late December, but that inability to rally is striking. **What I find very "odd" is that ARKK** was down on the week. You can look at the major holdings and understand why (probably a peek at Bitcoin helps explain it too). But, for me, ARKK is one thing that I look to for signs of "aggressive" risk taking. I feel it should trade at a higher beta than the Nasdaq 100. **Bitcoin** was also weak, but I think that had more to do with far too many people running it up and positioning ahead of the launch of the ETFs.
  - On the bright side, there was differentiation indicating "thought" in the rally, though the negative, for me, is that we've reverted back, at least to some extent, to the trade that worked for much of last year. That seems too simple.
- **Pricing out a recession.** Interest rates are always tricky, but my view is that much of what occurred at the front end of the yield curve (the part driven by the Fed) resulted from far less concern of a recession. While I admit the data tilted in that direction, as a contrarian, I think the risk of something other than a "soft" or "no" landing is realistic. Stocks rose, even as rate cuts were priced out, because the market is back to "no" or "soft" landing as highly likely.
- **I remain convinced that none of the issues that made markets wonder "[Who Will Buy Treasuries Ever Again?](#)"** have been resolved and are likely to push longer yields higher, as those issues get more attention again. That is why I'm thinking that 4.3%, which seemed "bold" at 3.8%, seems insufficient here. Heck, 15 bps is like a day of trading. 😊
- **We seem back to a world where being right or wrong on a given day** can be incredibly meaningful. Having to be "right" every day is difficult (impossible, or there would be more day-trading billionaires). It weighs on individuals (less so on algos). It does tend, over time, to cause risk management to reduce risk (though many will have done so of their own volition, to manage the topsy-turvy markets). So, one thing I don't like about the price action (neither on up days, nor down days) is that it feels day-trader, or momentum, or simply "pile-on" driven, so the noise may be far greater than the signal.

## Bottom Line

Still **stuck on higher yields and less inversion**. Really want to move to a 4.5% target on 10s.

Still believe that **credit will do well**, and that we will be talking about "new" ranges for credit soon.

**On equities**, the performance was **almost enough to make me change my mind**. The drivers of the strength were more impressive than the issues I point out. I am not there yet, but positioning has to be small to medium here, more use of options, and some nimble trading is required. Commodities, commodity stocks, and now Chinese stocks (for a trade) top the list of what I like, and I'm increasingly bullish the former and starting to pound the table on the latter.

**One call, that I don't think you can disagree with**, is that I've managed to work out of the Carolinas for the next 3 to 4 weeks, which seems like a good macro strategy, from my perspective!

The Fed meeting on January 31<sup>st</sup> could be interesting, since no one is really listening to what the Fed says until then. Powell effectively contradicted himself at the last meeting, so why listen to anything from the Fed until he speaks after their decision? Expect more "excessive" volatility in the meantime as the trading year and positioning get ramped up!

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