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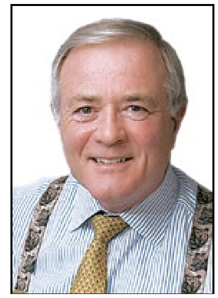
William Rutherford

Markets experience a melt-up; Goldilocks is everywhere| Opinion

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Stocks rose for a third straight month in January. The S&P 500 advanced 1.6 percent between Dec. 29 and Jan. 31. At one point it was up as much as 3.4 percent but fell sharply to end the month. The Nasdaq-100 and Dow Jones Industrial Average also climbed, with all three benchmarks achieving new highs.

Technology stocks still dominated, surging to new records as news about widespread adoption of AI tools permeated company results. Microsoft edged ahead of Apple as the world's most valuable company. In January, Microsoft traded above its 2023 highs, while Apple traded slightly below its all-time high reached in December. The market rally did not broaden out across other sectors, as many market pundits had been predicting.

Most economic news was stronger than expected, including job growth, gross domestic product (GDP) and retail sales. This was on top of inflation numbers continuing to moderate. Corporate earnings reports were robust. All this is positive for sentiment in the longer run and certainly for stocks, yet it gives the Federal Reserve less reason to cut interest rates. The realization that a rate cut is unlikely to happen in March contributed to the market pullback in late January.

The January jobs market report was an unexpected blowout, with an expansion of 353,000 – twice what economists had predicted. Unemployment remained stable at 3.7 percent, staying below 4 percent for 26 months now. January's seasonal drop in employment was the smallest since 2012, except for 2021 and 2023.

Consumer delinquency rates have normalized. All this allays fears that the consumer, 70 percent of the U.S. economy, is overstretched and will not continue to spend. However, there is evidence of weakness in lower-income households, who are struggling the most with the effects of the past years of high inflation. Even though the national unemployment rate is not rising, 85 percent of states report unemployment rising. Temporary employment is falling, which means employers are finding the people they need, and there is less upward pressure on wages for lower-income workers. The Federal Reserve Bank of Atlanta estimate for annualized GDP growth is currently 4.2 percent.

The longer interest rates stay "higher for longer," the more risk there is to the economy, particularly in the real estate sector. Community banks have greater risk exposure to office and commercial loans, as they represent a significantly higher portion of their loan portfolios than for money center banks. Problems in the banking sector foretell problems in the economy, so it is important to keep an eye on them. Federal Reserve Chair Jerome Powell says the strong economy gives him time to assess more months of data to see if inflation is really moderating. If uncertain, he is likely to delay cuts so as not to stoke a resurgence in demand and inflation. Higher for longer rates for commercial real estate loan maturities could result in increased defaults.

Global markets have also experienced a melt-up in January, indicating a global soft landing, according to the IMF. This is good for U.S. markets, because most of the companies in the S&P operate in many countries and export to them.

The market capitalization weight S&P continued to outperform the equal weight S&P, with seven stocks comprising 28 percent of the cap weight index. They accounted for 45 percent of January market gains. Without Tesla, they would have represented 71 percent of the gain. However, five of the 11 S&P sectors gained in January. The communications services sector did the best, rising 4.84 percent, and real estate did the worst, dropping 4.79 percent – and 26.24 percent since the close of 2021. This follows on 2023 full-year gains of 56.1 percent, 53 percent and 39.8 percent in technology, communications, and consumer discretionary, respectively, with losses in energy, consumer staples and utilities at the other end of the spectrum. Choosing the right sectors to overweight drives an equity investor's performance.

Historically, as go the equity markets in January, so goes the year, 67.4 percent of the time. In addition, this is an election year. Presidential election years have averaged a 7 percent return in the S&P 500 since 1952, and 12.2 percent in presidential re-election years. The long-term investor should remain fully invested.

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