

## When push comes to shove

Thomas Garretson, CFA – Minneapolis

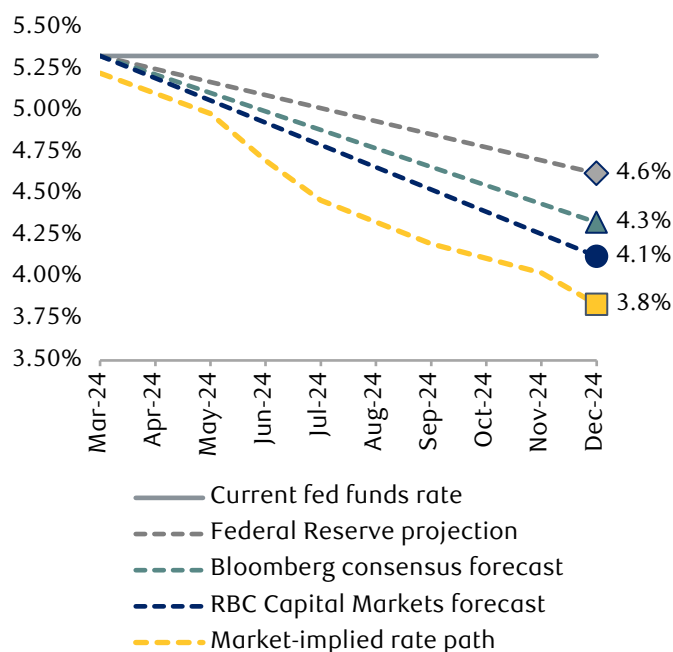
Fed Chair Jerome Powell tried to push back on near-term rate cut expectations this week, but markets shoved right back. Pricing this week suggests markets remain concerned that if the Fed waits too long to start cutting rates policymakers will only have to cut them more.

What was widely expected to be a rather uneventful first Federal Reserve meeting of the year proved to be anything but. Though heightened market volatility around it may have been amplified by other events this week, the Fed's relative reluctance to formally open the rate cut window sparked some interesting market reactions.

While most would probably argue that the Fed was a bit late to the rate hike party in 2022, the underlying risk for markets—and the economy—is that it could also be late to the rate cut party. To be sure, Powell this week acknowledged the risks of cutting too late, especially as inflationary pressures have receded more rapidly than policymakers had expected late last year. But the market reaction this week suggests that risk remains—if not even more elevated.

Powell's comments were successful in culling market pricing of a March rate cut with probabilities fading to roughly 30 percent from a peak closer to 90 percent in January. But markets simply took that and ran with the idea that a later start to rate cuts might only mean that a greater number of cuts are ultimately needed. Prior to Powell's comments, markets were pricing in about five 25 basis point rate cuts to around 4.1 percent by the end of the year; now markets are pricing deeper cuts to around 3.8 percent.

### When rate cuts start doesn't matter; where rates end up does



Source - RBC Wealth Management, Bloomberg; data as of 2/1/24, forecasts shown for Q4 2024

For perspectives on the week from our regional analysts, please see [pages 3–4](#).

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Priced (in USD) as of 1/31/24 market close (unless otherwise stated). Produced: 2/1/24 4:40 pm ET; Disseminated: 2/1/24 4:50 pm ET

And this dynamic is pressuring Treasury yields lower. The benchmark 10-year Treasury note yield has faded to just 3.8 percent (in line with rate cut expectations) from a 2024 peak of 4.2 percent achieved one week ago, and notably down from the 2023 high of five percent. A break below 3.8 percent would mark the lowest level since this past July.

### Ghosts of banking stress past

We would be the first to concede that getting a clean read on the market's interpretation of the Fed meeting this week was certainly clouded by market stress elsewhere. Specifically within regional banks as New York Community Bancorp's (NYCB's) stock price fell by half following its Q1 earnings report where the dividend was cut by 70%.

A drop of that magnitude sparked broader selling pressures within the regional banking sector, raising investor concerns that the ghosts of banking stress that visited markets last spring could be coming back to haunt again.

However, our early read is that this is a localized event and not a harbinger of another round of broader regional banking stress on par with what markets weathered last year. RBC Capital Markets analysts noted: "Results had several negative surprises, including a higher-than-expected provision and reserve build, a meaningfully lower margin and outlook, and a dividend cut announcement. We believe that many of these trends are related to the company crossing the \$100 billion asset mark and becoming a Category IV financial institution, which is driving increased liquidity and compliance needs, though in aggregate the results were less than expected. The 2024 outlook also suggests some further margin and expense pressures due to these themes."

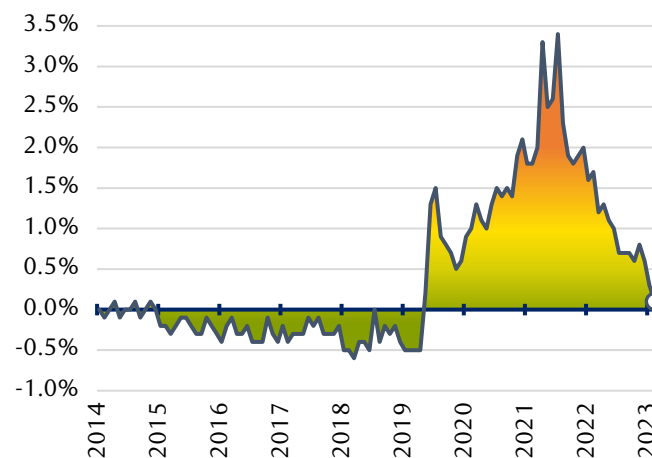
### The confidence game

Turning back to the Fed and where things might go from here, we think inflation is still the name of the game. This is perhaps also where the greatest disconnect between Powell's comments and current market sentiment lies.

We think the clear takeaway is that the Fed still wants even more evidence, and greater confidence, that inflation is on a firm path back to two percent. In our view, it is. Core Personal Consumption Expenditures Inflation (excluding food & energy) has been running below the Fed's two percent target over the past three and six months, at 1.5 percent and 1.9 percent annualized,

### Consumer inflation expectations are essentially back to normal

Deviation of consumer expectations from 2014–2024 median



Source - RBC Wealth Management, Bloomberg, Conference Board Consumer Confidence Survey; monthly data, 12/31/14–1/31/24

respectively. While Powell somewhat dismissed those numbers and fell back to highlighting the year-over-year pace at a still-elevated 2.9 percent, we do think the Fed is closer to the point of declaring victory than policymakers are letting on. We remain highly certain the Fed won't wait until annual inflation is back to two percent, as by then it would be far too late. Markets perhaps just wanted more acknowledgment of recent inflation progress.

Other data released this week showed another sharp drop in consumer inflation expectations. As shown in the last chart, one-year inflation views have almost unwound all of the rise over the past two years, and are now in line with historically standard levels.

The Fed's goal of approaching the "highly consequential" decision to begin cutting rates "methodically and carefully," as various policymakers have recently suggested, may seem prudent on the surface, we—and the market—clearly want a more deft and flexible approach if the Fed is going to pull off a soft landing for the economy. We think the Fed will get there, even if it has stumbled out of the gate.

We think there is 50 percent chance a March rate cut will occur based on the incoming data, but, at a minimum, the meeting will likely set the stage for a May cut, with more to follow this year.

## UNITED STATES

Tyler Frawley, CFA – Minneapolis

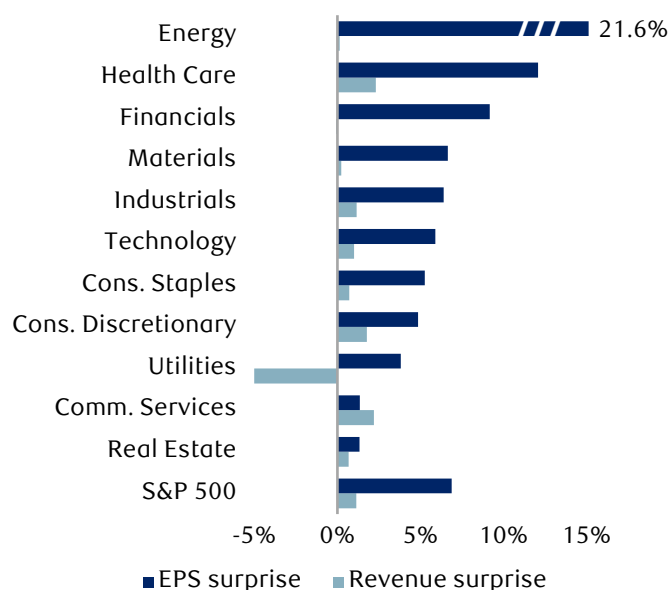
■ **U.S. equities are on track for mixed results on the week as quarterly earnings continue to come in and investors digest the Federal Reserve's decision to hold rates steady once again.** The Dow Jones Industrial Average is higher on the week, up 0.79%, while both the S&P 500 and Nasdaq Composite are lower, falling 0.11% and 0.95%, respectively. Sector leadership is evident in Consumer Staples, which has returned 1.89%, and Health Care, which has returned 1.82%. Communication Services has lagged, falling 3.01%, as disappointing earnings from Alphabet Inc. weighed on the sector.

■ **Fourth-quarter earnings season is well underway with over 40% of the S&P 500 having already reported.** Approximately 53% of companies have reported sales that exceeded analyst expectations, beating by an average of 1.1%. From an earnings perspective, 79% have beaten expectations by an average of 6.9%, the latter of which is slightly lower than the 8.5% five-year average beat rate. **Relative to consensus expectations, Energy and Health Care companies have seen the strongest results,** beating earnings expectations by 21.6% and 12.1%, respectively. As earnings reports continue to roll in over the next few weeks, we think the sectors to keep an eye on will be Utilities and Real Estate, as only 13% and 23% of companies, respectively, have reported so far.

■ **Equity markets sold off sharply Wednesday afternoon following comments by Federal Reserve Chair Jerome Powell indicating he didn't believe the Fed was likely to begin cutting interest rates in March.** The

## S&amp;P 500 earnings report card

Earnings per share (EPS) and revenue surprises by sector



Source - RBC Wealth Management, Bloomberg; surprise data is market capitalization weighted, data through 10:00 am ET 2/1/24

comments rattled investors—reigniting fears that the Fed isn't quite ready to move away from its "higher-for-longer" stance. According to the CME FedWatch tool, markets now see only a 35% chance that the Fed will lower rates at its next meeting, down from over 73% a month ago.

## CANADA

Matt Altro &amp; Richard Tan, CFA – Toronto

■ **The S&P/TSX Composite has started the year in green territory** after ending 2023 with a rally to sprinkle some optimism back into the equity markets. Gains at the close of last year were driven by the Information Technology, Financials, and Industrials sectors, all of which outperformed the 11.8% earned by the S&P/TSX Composite Index for the year. In January 2024, gains were led by Information Technology (+6.7%), Telcos (+2.84%), Industrials (+2.1%), and Consumer Staples (+1.87%). On the flip side, Materials and Health Care dampened overall performance with losses of 6.3% and 4.1%, respectively. **As volatility continues in 2024, focus remains on the health of the consumer, the path of interest rates, and inflation expectations** as investors evaluate the likely impacts of a potential economic slowdown.

■ **The Energy sector has outperformed the S&P/TSX Composite on a year-to-date basis, driven in part by the rebound in global oil prices and softening bond yields.** With respect to the former, physical market conditions have tightened, suggesting buyers have been purchasing barrels of oil at a faster pace. However, RBC Capital Markets thinks growing geopolitical risks (e.g., rising tensions in the Red Sea) are yet to be reflected in global oil prices. Closer to home, the Trans Mountain Pipeline Expansion (TMX) project has been delayed yet again by a technical hiccup. The expansion will increase the pipeline's capacity to 890,000 barrels of oil per day from the original 300,000 barrels per day, and should allow the Canadian economy to benefit from higher heavy oil prices over time. All-in, we believe oil producers are increasingly attractive due to their stronger balance sheets and return-of-capital programs (i.e., dividends and share repurchases).

## EUROPE

Rufaro Chiriseri, CFA &amp; Thomas McGarrity, CFA – London

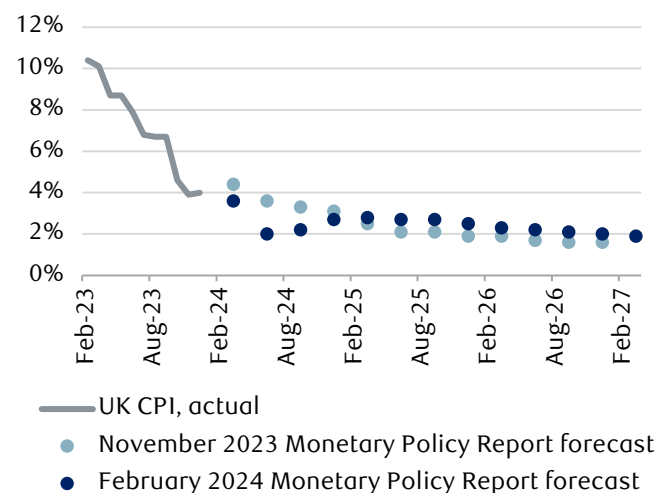
■ **The Bank of England (BoE) kept interest rates unchanged at 5.25%, but the vote split came as a surprise to us.** Despite inflation falling below the November Monetary Policy Report (MPR) target, two members opted for a hike, one for a cut, and the majority of six opted for no change—highlighting deep division within the committee. Given inflation has fallen below the November MPR forecast, the removal of a tightening bias from the policy statement seems reasonable, in our view.

■ **While the policy statement and overall tone are dovish, the February MPR inflation forecasts are somewhat hawkish, in our view.** Based on a 4.2% market-implied year-end Bank Rate, the BoE projects inflation to reach its 2% target by Q2 2024, but more notably expects prices to reaccelerate to 2.8% at the beginning of 2025. This implies the central bank thinks the market has gone too far pricing in cuts for 2024. Furthermore, during his press conference, in a bid to keep market expectations under control, BoE Governor Andrew Bailey refrained from endorsing the current market pricing of rates cuts. He instead chose to reiterate the removal of the hiking bias in the statement and stated that the committee opts to “reserve judgement” and remain data-dependent. Market expectations for cuts in May and June eased while 2-year Gilt yields initially rose to intraday highs of 4.30% before settling around 4.20%.

■ **Danish pharmaceutical group Novo Nordisk (Novo) became only the second European company ever to surpass a market capitalization of \$500 billion.** Its stock gained around 5% in the two trading days after it reported 2023 results. Novo’s sales grew 36% y/y (at constant exchange rates [CER]), driven by GLP-1-related growth in diabetes treatment (+52% y/y at CER) and obesity care (+154% y/y at CER). For 2024, the company forecasts CER sales growth of 18%–26% and profit growth of 21%–29%. The company noted that this guidance reflects the possibility of periodic drug shortages for Wegovy (obesity care) and Ozempic (diabetes treatment) in different geographies, given the strong demand for these therapies.

### Bank of England expects inflation to fall to target in Q2 2024 before rising slightly again

UK Consumer Prices Index (CPI) and forecasts



Source - Bloomberg, Bank of England

## ASIA PACIFIC

Emily Li – Hong Kong

■ **Stock indexes in Hong Kong and China experienced a brief rally last week after the Chinese government announced some new measures**, including lowering the required reserve ratio (RRR) for banks by 50 basis points starting from Feb. 5 and enhancing credit support for property developers. The RRR cut will inject RMB 1 trillion into the economy. Apart from that, China halted the lending of certain shares for short selling from Jan. 29 in a move to support the country’s slumping stock markets. However, the markets retreated afterwards. We think the government needs to deploy more stimulus to boost growth and rebuild investor confidence.

■ Artificial intelligence (AI) continues to play a key role in the earnings reports and trading patterns of chip stocks. **Recent results from industry leaders TSMC (2330 TT) and ASML Holding (ASML US) suggest a significant boost from customers’ use of AI.** This has sparked investor interest in companies that provide advanced chip equipment and services that can enable AI functions. Consensus earnings estimates for TSMC and ASML have increased, while those for others in the industry have experienced a slight decline. Reports from U.S. chipmakers Advanced Micro Devices (AMD US) and Intel (INTC US) have tempered expectations regarding AI, highlighting the ongoing challenges in the PC and data center markets. We think the full benefits of AI may only be realized when major corporations begin to leverage its potential.

■ **In January, manufacturing activity in Asia demonstrated a notable improvement**, primarily due to stronger demand from key markets, which helped offset the decline in China. According to the Manufacturing Purchasing Managers’ Indexes (PMI) released on Feb. 1, most factories across the region experienced higher production and export sales. Notably, **South Korea and Vietnam witnessed a long-awaited turnaround in their manufacturing sectors.** South Korea recorded a Manufacturing PMI of 51.2, marking its first reading above the threshold level of 50 since June 2022. The nation saw growth in both domestic and international orders, resulting in increased factory output and higher employment rates, fostering optimism for the future.

## MARKET Scorecard

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,845.65	1.6%	1.6%	18.9%	7.3%
Dow Industrials (DJIA)	38,150.30	1.2%	1.2%	11.9%	8.6%
Nasdaq	15,164.01	1.0%	1.0%	30.9%	6.5%
Russell 2000	1,947.34	-3.9%	-3.9%	0.8%	-4.0%
S&P/TSX Comp	21,021.88	0.3%	0.3%	1.2%	-0.4%
FTSE All-Share	4,173.06	-1.4%	-1.4%	-1.9%	-0.4%
STOXX Europe 600	485.67	1.4%	1.4%	7.2%	3.6%
EURO STOXX 50	4,648.40	2.8%	2.8%	11.6%	11.3%
Hang Seng	15,485.07	-9.2%	-9.2%	-29.1%	-34.9%
Shanghai Comp	2,788.55	-6.3%	-6.3%	-14.3%	-17.0%
Nikkei 225	36,286.71	8.4%	8.4%	32.8%	34.4%
India Sensex	71,752.11	-0.7%	-0.7%	20.5%	23.7%
Singapore Straits Times	3,153.01	-2.7%	-2.7%	-6.3%	-3.0%
Brazil Ibovespa	127,752.28	-4.8%	-4.8%	12.6%	13.9%
Mexican Bolsa IPC	57,372.77	0.0%	0.0%	5.1%	11.8%
Gov't bonds (bps change)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Treasury	3.912%	3.3	3.3	40.6	213.6
Canada 10-Yr	3.322%	21.2	21.2	40.6	155.1
UK 10-Yr	3.794%	25.7	25.7	46.2	249.2
Germany 10-Yr	2.166%	14.2	14.2	-12.0	215.5
Fixed income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	4.68%	-0.7%	-0.7%	1.6%	-6.9%
U.S. Investment-Grade Corp	5.18%	-0.5%	-0.5%	3.8%	-5.9%
U.S. High-Yield Corp	7.74%	0.1%	0.1%	9.4%	3.7%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	2,039.52	-1.1%	-1.1%	5.8%	13.5%
Silver (spot \$/oz)	22.96	-3.5%	-3.5%	-3.3%	2.2%
Copper (\$/metric ton)	8,511.75	0.6%	0.6%	-7.5%	-11.1%
Oil (WTI spot/bbl)	75.85	5.9%	5.9%	-3.8%	-14.0%
Oil (Brent spot/bbl)	81.71	6.1%	6.1%	-3.3%	-10.4%
Natural Gas (\$/mmBtu)	2.10	-16.5%	-16.5%	-21.8%	-56.9%
Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	103.5090	2.1%	2.1%	1.4%	7.2%
CAD/USD	0.7444	-1.4%	-1.4%	-0.9%	-5.4%
USD/CAD	1.3434	1.4%	1.4%	1.0%	5.7%
EUR/USD	1.0816	-2.0%	-2.0%	-0.4%	-3.7%
GBP/USD	1.2684	-0.4%	-0.4%	3.0%	-5.7%
AUD/USD	0.6566	-3.6%	-3.6%	-6.9%	-7.1%
USD/JPY	146.9000	4.2%	4.2%	12.9%	27.6%
EUR/JPY	158.8900	2.0%	2.0%	12.4%	22.9%
EUR/GBP	0.8528	-1.6%	-1.6%	-3.3%	2.1%
EUR/CHF	0.9320	0.3%	0.3%	-6.3%	-10.5%
USD/SGD	1.3405	1.5%	1.5%	2.0%	-0.8%
USD/CNY	7.1689	1.0%	1.0%	6.1%	12.7%
USD/MXN	17.2058	1.4%	1.4%	-8.7%	-16.6%
USD/BRL	4.9554	2.0%	2.0%	-2.4%	-6.7%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Tuesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.74 means 1 Canadian dollar will buy 0.74 U.S. dollar. CAD/USD -1.4% return means the Canadian dollar fell 1.4% vs. the U.S. dollar year to date. USD/JPY 146.90 means 1 U.S. dollar will buy 146.90 yen. USD/JPY 4.2% return means the U.S. dollar rose 4.2% vs. the yen year to date.

Source - Bloomberg; data as of 1/31/24



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			Count	Percent
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Hold [Sector Perform]	575	39.66	154	26.78
Sell [Underperform]	46	3.17	6	13.04

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