Ropes Wealth Wonders When the Freeze Will Thaw

Baby, it's cold outside, and there's more bad weather ahead as temperatures across the country plummet and storms challenge many communities. The stock market too, is in a bit of a freeze, struggling to gain traction in the new year as investors are looking for when a "real" bull market will take hold. Gains are being added, erased, and then added back such that the market is overall flat to only modestly positive year-to-date. This week semiconductor stocks were the market's darlings as Taiwan Semiconductor's (TSMC) outlook for capital spending and revenue lifted hopes of a broad tech recovery in 2024. TSMC is the main chipmaker to Apple and Nvidia and reported capital expenditures of $28 billion to $32 billion in 2024 and revenue growth expectations of at least 20% for the year.

That forecast was hot enough to thaw the market's frosty start to the week, as investors were struggling to reconcile the latest economic data that showed strong retail sales, declining industrial production and manufacturing activity, a bounce back in home construction and home builder sentiment, but mixed messages from the Fed's Beige Book survey of economic activity from the twelve reporting Fed districts. Economic data is likely to continue to present the same kind of mixed bag in the weeks ahead. However, the fact that the data is holding up overall is a win for investors certain that the sharp increase in interest rates would inevitably lead to a recession.

No question though that the market's whole focus these days is on Fedspeak, and trying to interpret when and how much rates will fall in this cycle. For their part, Fed officials are trying to chill investor hopes of a "shock and awe" pivot to accommodative policy and impart a more realistic message. Fed Governor Christopher Waller provided the most eloquent example of this in his recent comments to the Brookings Institution this week: *"I will need more information in the coming months confirming or (conceivably) challenging the notion that inflation is moving down sustainably toward our inflation goal…The data we have received the last few months is allowing the committee to consider cutting the policy rate in 2024. However, concerns about the sustainability of these data trends requires changes in the path of policy to be carefully calibrated and not rushed."* In other words, investors should not be holding their breath for a March rate cut.

2023 was a good start on the market's road to recovery from 2022 and post-pandemic overhangs, but there are more hurdles to clear before a durable and broad bull market begins. An economic weak patch could threaten the earnings outlook. Current valuations for large-cap stocks arguably look high, even with optimistic earnings assumptions. Geopolitical risks abound, and we are in the middle of a contentious election year. Congress is only able to pass budgets in six-week increments (for the record, my 17-year old's budget cycle lasts at least twelve weeks before it is up for review). And much of 2023's market rally centered around a belief not only that the Fed was done raising rates, but also that rate cuts would come sooner in 2024 than previously expected.

Rate cuts will not come because the Fed chooses to be magnanimous. Instead, cuts are likely to occur in the context of a deteriorating economic environment, or in response to rising financial risks. I have noted recently to clients that this is why the stock market has not typically had a positive reaction to the first central bank rate cut. Maybe this time will be different, but those are often famous last words. On the flip side, if current restrictive policy is in place for six months or more, investors should be prepared for markets to be tested by that disappointment as well.

None of this murkiness calls for alarm or anxiety if you have a good plan. There is no question that at some point in the near future, the tide will turn toward more accommodative monetary policy. Whether this Fed pivot may be in response to economic weakness or geopolitical risk remains to be seen. And investors will eventually look ahead to what easy money will bring: a multiyear economic expansion, rising liquidity, and a better profits environment. This will likely prompt a true bull market, not just a great year for a handful of stocks. We are anticipating this coming expansion and are using this moment to fine tune the underlying investments in your portfolio to benefit from a market broadening beyond the hot themes of AI and weight loss drug therapies. Some stocks with solid fundamentals have been left out in the cold in this period, and we are warming up to adding to them further when the time is right.

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Ropes Wealth Advisors
800 Boylston Street Boston, MA 02199-3600