

Big Picture

Hopes for Less Aggressive Fed Grow As U.S. Inflation Slows in December

U.S. stocks pared some of their early Monday gains, with investors still unsure about the Fed's future path of rate hikes. The S&P 500 ended flat, the Dow fell 113 points, while the tech-focused Nasdaq gained 66. The TSX rose on Monday to its highest closing level in nearly four weeks, up 42 points, as investors went bargain shopping.

On Tuesday the World Bank cut its growth forecast for the global economy in 2023 as inflation has elevated the risk for a worldwide recession. The bank expects global growth to slow to 1.7% in 2023, down from its estimate of 3% growth in June. U.S. stocks took the news in stride, with all three major U.S. indexes registering modest gains. In Canada, the TSX added another 42 points in Tuesday's session.

It was an even stronger session for U.S. stocks on Wednesday, as investor optimism grew that Thursday's inflation data would lead to a less hawkish path for the Fed. The S&P 500 gained 50 points, the Dow added 269, while the Nasdaq jumped 189 points. The TSX rose 126 points, buoyed by a strong performance in the real estate sector.

Thursday's U.S. inflation data showed that U.S. inflation fell to 6.5% in December year over year, down from 7.1% in November and well below the 9.1% peak seen in June. Meanwhile, Core CPI, which strips out food and energy prices, climbed 5.7% in December, down from November's 6% gain. Thursday's Labor Department data has raised expectations that the Fed will opt for a smaller 25-basis-point hike in February.

The latest U.S. inflation numbers helped North American markets to solid gains on Thursday, with the energy sector posting a strong performance. By Thursday's close, the Dow was up 216 points, the S&P 500 added 13, and the Nasdaq rose 69 points. In Canada, the TSX kept marching higher, posting a gain of 186 points. Finally, investors snapped up U.S. Treasuries, lifting bond prices and weighing on U.S. 10-year yields, which declined to 3.48% on Thursday.

Markets Gain Ground

For the four trading days covered in this report, the Dow gained 560 points to close at 34,190, the S&P 500 added 88 points to settle at 3,983, while the tech-heavy Nasdaq rose 432 points to close at 11,001. In Canada, the TSX jumped 397 points to end at 20,211.

Strategy

U.S. headline inflation retreated for the sixth consecutive month

Price pressures in the U.S. showed further signs of cooling in December as the headline consumer price index (CPI) advanced 6.5% year-over-year (YoY) from 7.1% previously, according to data released by the Bureau of Labor Statistics (BLS). Price pressures also contracted on a month-over-month (MoM) basis, down 0.1% compared to November. The drop in gasoline prices (-9.4% MoM) was the main driving force behind lower prices, along with durable (-0.8%) and non-durable goods (-1.2%). Food prices advanced by 0.3% MoM, though the pace of increase has moderated since July. Conversely, shelter, which is the largest weighted component in the CPI basket, continued to cast upward pressure on prices as it rose 0.8% compared to November. Owner's equivalent rent, defined as the hypothetical amount a homeowner could get for their house if they rented it out, rose 0.8% on the month while hotel costs were up 1.7%. Finally, core inflation, which excludes the volatile food and energy categories, was up 5.7% YoY (6.0% previously) and 0.3% MoM (0.2% previously). Meanwhile, the Department of Labor also released its weekly report on jobless claims, which showed initial claims were little changed at 205,000 for the week ending January 7 while continuing claims fell to 1.634 million from 1.697 million previously. The data indicates that employers are hesitant to let go of workers despite concerns about a looming economic slowdown. Those who are let go from their place of employment are not having difficulty in finding new employment, as evidenced by the relatively low figure for continuing claims.

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