Commerce Trust Market Brief with Scott Colbert

Positive Market Momentum From 2025 Carries Over, Nomination for Next Fed Chair

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Scott Colbert: Good morning. It's Monday, February 2nd, and the markets are open. So far, one month into the year, the positive momentum from last year's financial markets have carried over.

The S&P 500 (Index) is up 1.44% year-to-date so far, and we've seen a broadening out of the market, with the average stock up closer to 3.38% (as measured by the S&P 500 Equal Weight Index). And as you go down in capitalization, the Russell 2000 (Index) is up a rather remarkable 5.39% so far year-to-date.

International stocks have also continued that positive outperformance. Larger-cap (capitalization) developed markets, up 5.22% by the Morgan Stanley Indexes (MSCI EAFE Index), and emerging markets, a whopping 8.85% (as measured by the MSCI Emerging Market Index). Bonds have also carried over positively (as measured by the Bloomberg Aggregate Index and the Bloomberg Municipal Index), although we haven't seen interest rates drop so far this year, as basically positive economic momentum has discounted the number of likely Fed (Federal Reserve) rate cuts as the year progresses.

And as we just mentioned, the broadening out of the domestic market, you can clearly see here that the average stock is outperforming the S&P 500. And of course, it gets even bigger as you go down in capitalization. The primary driver for that this year is, even though the S&P 500 is likely to have awfully good earnings growth on a year-over-year basis, as you move down in capitalization, we're likely to see even bigger increases on a percent year-over-year.

And we can also see that most sectors of the market are up, with eight out of the 11 broad sectors generating positive returns so far. And it's kind of interesting to note one of the worst performing sectors is that information technology, where some of those mega-cap stocks lie.

And of course, we mentioned international stocks continue to do exceptionally well. This has been sparked, of course, by the decline in the U.S. dollar, down about 10% or 11% so far over the last 13 months. But it's also been sparked along by what else?

Some deficit spending in Europe, particularly on defense stocks. And within the emerging markets, 70% of the equipment that goes into these AI (artificial intelligence) data centers and the build out of the AI infrastructure come from the emerging markets, spurring those markets along as well.

But both the fixed income and municipal markets are modestly positive. In the long run, of course, this year you're likely to return your coupon. Coupons in the investment grade market are north of 4%, but less than 5%, and in the municipal market, closer to 3%. And we think those are targeted returns as the year progresses.

While we're positive on the outlook for fixed income, we're a little more sanguine on the outlook for credit risk. Note that the average spread that you're getting, whether you buy a high yield bond or an investment grade credit, is about the lowest it's ever been, about 3% extra for taking on credit risk in the high yield sector, and less than 1% for taking on credit risk in the investment grade sector.

Some of the biggest recent news, of course, is President Trump's nomination of Kevin Warsh for the Federal Reserve chairmanship. We would note five things about Kevin Warsh's history.

Number one, he's been on the Federal Reserve before, served during the subprime crisis from 2006 to 2011. So, he's somewhat battle-tested. Secondly, historically, he's also been rather hawkish, meaning he's been focused on bringing inflation down and keeping interest rates relatively high to make sure that's accomplished.

Third, of all the nominees, he was likely the most independent. Fourth, though recently he has this thesis working that he thinks that basically rates can be lower because of the advances in technology have likely increased the productivity curve, meaning that forward inflation is likely to be relatively benign.

And then finally, he's probably the most vocal critic of the four nominees with regard to the Federal Reserve and the way that it's operated in the past. I would expect a smaller Federal Reserve going forward, perhaps one that's less intrusive in the markets.

This leads us to where the markets are headed. And even though the market now knows who in the next Federal Reserve chairman is likely to be, the market hasn't changed this perception on the number of rate cuts coming this year and has held relatively steady at about two rate cut expectations: one beginning on or around mid-year and another towards year-end.

This comes because the balance of economic risk has improved. Inflation expectations have come down a bit, but at the same time, employment growth has improved. And of course, this month's employment number, generally the number that impacts the markets the most, is expected to accelerate a little bit relative to November and December's relatively modest employment prints.

This probably comes because joblessness has declined just a bit, and business expectations for hiring have improved, particularly with the recent PMI. That's the Purchasing Managers' Index, on both the service and the manufacturing side, having moved up into positive territory.

Well, obviously, that's a lot of financial market news to digest just one month into the new year. And we'll keep you up to speed on all the news and how it's impacting the financial markets on a going-forward basis.

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