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Leaping from 2023’s Eye Openers to 2024’s Eyes on the Market

2023’s Eye Openers

1. **The U.S. recession remains elusive;** Q1 and Q2 brought an earnings recession, and the Fed's lending facilities post-SVB along with high fiscal spending prevented a full-blown recession.

2. **Fed macroprudential policies, the new Fed put;** The Bank Term Lending Facility post-SVB put the brakes on the runway to a full-blown banking crisis.

3. **The housing collapse that failed to surface;** While overall activity dropped, prices remained resilient. Being the most interest rate sensitive sector was able to have a no landing, can the rest of the economy too?

4. **Nothing breaks - US economy, consumer, stocks, all pass tolerance for high rates;** 5% US 10-year Treasury rates and over 500bps increase in the Fed’s policy rate. Bitcoin up 150%, S&P up 24%, NASDAQ up 43%! Corporate profitability managed through labor tightness and disinflation.

5. **High yield spreads tighten, despite bank lending standards tightening;** This has broken from multi-decade historical trends of wider high yield spreads on tighter bank lending standards.

6. **Two wars (Russia-Ukraine and MidEast) and no fright (flight) to quality;** Amidst this, China extends a handshake (Biden-Xi summit), Iran, Saudi Arabia stand back, and the US Congress fails to extend further support for Ukraine’s war efforts.

7. **Oil falls, despite MidEast tensions;** Supply dominates with US production hitting a new all-time high.

8. **China weakness;** On re-opening post-COVID, many expected a similar burst for demand like in the U.S., but China's aging demographics are shifting their needs from accumulating goods and real estate to senior care, suppressing global growth.

9. **BOJ remains dovish;** Emerging from 40 years of persistent deflation and Japan's rebounding economy, stocks and inflation are shifting the BOJ’s policy targets.

10. **Regulatory rulebook tightening;** To reshape the role of US banking for decades to come, post-GFC regulatory overhaul will shift credit creation channels, with the emergence of private credit, specialty lending and finance stepping in to fill the gap.

The Rithm Take

2023 was a year ruled by sentiment and positioning. Expectations of recession dominated the first half, while resilience of the consumer, corporate, and AI innovations dominated the second half. The year closed out with a consensus view for a soft landing, notably with 10-year Treasury yields and mortgage rates close to levels at the start of year. The focus has shifted from inflation to growth.

2024's Eyes on the Market

1. **Gross Domestic Product or Gross Domestic Income, which to believe?** The former flags resilience, the latter flags recession. Q3 GDP was reported at 2.9% YoY, while Q3 GDI was reported at -0.1%.

2. **NFIB (National Federation of Independent Business) Small Business Plans;** this has historically led PCE (Personal Consumption Expenditures). Recent data on NFIB Selling Prices is pointing to an upswing. This may bring the focus back to inflation and the Fed's rate path ahead.

3. **Employment composition, excluding health care and leisure and hospitality;** These two sectors have contributed to 1.39mm of 2023's total 2.03mm in private sector job gains. Both sectors draw our attention; health care leads in maturing leveraged loan debt, leisure and hospitality is key to services demand..

4. **Consumer staples vs discretionary spending;** Consumer resilience and excess savings has resulted in the consumer discretionary ETF outperforming consumer staples in 2023. Real wages are rising as inflation cools and employment is trending while excess savings normalize.

5. **Treasury auctions;** Relative to the budget deficit, the share of bond issuance has fallen whereas the share of T-bills has risen. A rising share of bond issuance stands to test clearing levels for what is an unstainable amount of US debt.

6. **Corporate margins;** Sustainability of higher margins into a lower inflation, higher wage growth environment.

7. **M&A activity in select sectors;** Leveraged loans up for refinancing span technology, health care, financials, services and retail. M&A appetite could indicate earnings power trumping rising debt costs.

8. **Leveraged loan default rates;** Ratings downgrades and knock on effects in the CLO (Collateralized Loan Market) market, notably to CLO equity and execution arbitrage.

9. **The BOJ liftoff amidst political turmoil;** The BOJ is the last major central bank left to begin tightening monetary policy. The majority of other central banks are set to ease monetary policy in 2024. Government approval ratings in Japan are low amidst corruption scandals and opposition pushback to fiscal spending.

10. **Wide ranging geopolitics;** This includes two ongoing wars intensifying, Saudi Arabia-Iran dynamics, the impact of climate change on India's food exports, China's growth trajectory and Taiwan relations, upcoming national elections in countries that comprise high shares of the worlds' populations and GDP, and more.

The Rithm Take

The recession versus resilience debate remains unresolved. The market's shift to growth from inflation merits continued focus. Our 2024 watch list is populated with "open items" to bear proof on the recession versus resilience debate. Risk premiums in rates and risk markets stand to be tested while this debate ensues. Eventual resolutions related to geopolitical tensions, inflation and employment dynamics, and rising debt costs stand to further help clear the picture. Until then, the year opens with the soft-landing view being tested to these "open items."