



Market Gauge

February 2024

GAUGE SHIFTS HIGHER AS MULTIPLE CATEGORIES IMPROVE

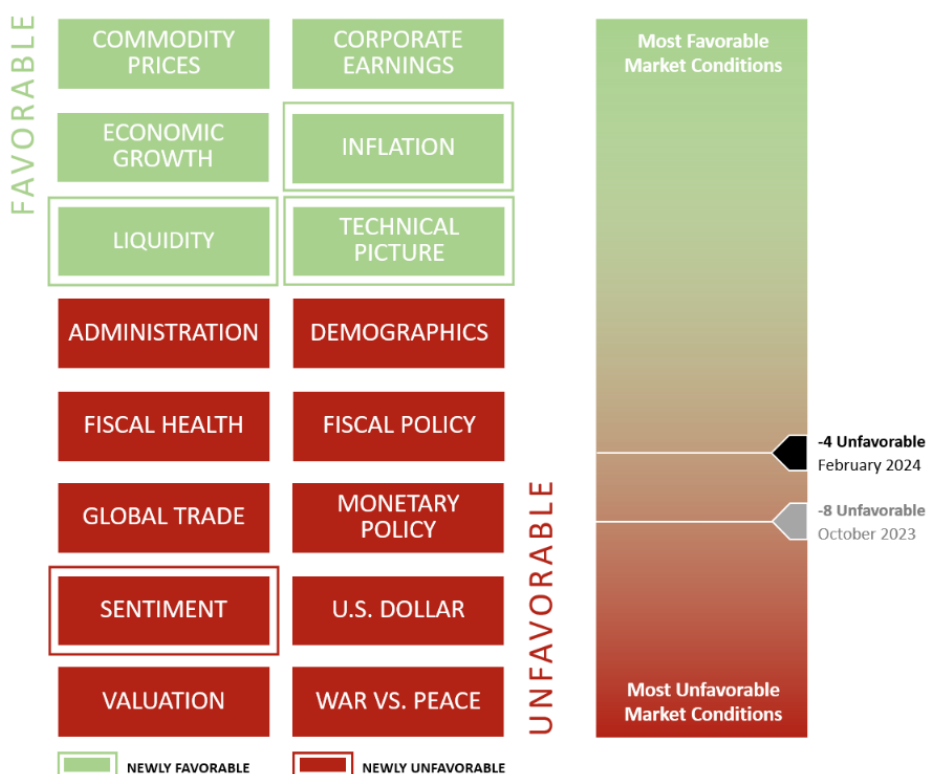
We've moved **Inflation**, **Liquidity**, and **Technical Picture** to Favorable in this update (while downgrading **Sentiment** to Unfavorable). Despite improvement, the Gauge remains negative overall given bullish Sentiment, extended Valuation, restrictive Monetary Policy, and looming Fiscal headwinds.

Inflation has moderated over the last year but the January CPI report was a reminder that the "last mile" for the Federal Reserve won't be easy. The Fed is still likely to ease policy this year but perhaps not as much as the market expected only a short time ago.

At one point last year, we had ticked 6 of the 8 items on our Recession Checklist, with only unemployment claims and credit spreads failing to confirm the likelihood of a contraction. Today, unemployment claims remain low and credit spreads remain tight. In our opinion, the most likely damper on bullishness is the potential for higher long-term interest rates.

Still, the weight of the evidence of this exercise suggests prudence when it comes to future market returns, especially when one considers already-rich **Valuation** and growing bullish **Sentiment**. It's been quite some time since the concept of valuation has seemed to matter so little to investors. Last year, **Corporate Earnings** were flat, long-term interest rates rose, and yet the S&P 500 rose 26%. Enthusiasm regarding the potential of generative A.I., massive budget deficits, and some fancy footwork on the part of the Fed and the Treasury department all seemed to secure a good outcome for investors in 2023.

With 40% of the world's population participating in national elections this year, it seems reasonable to assume that policymakers will once again use all the tools at their disposal to avert economic or financial market pain.



FAVORABLE or UNFAVORABLE?

This table shows the 16 factors we monitor to understand the current market environment for U.S. stocks. When there are 8 factors in each group, that is a neutral market environment. Our latest category changes make the Gauge less negative, putting it at **-4, Unfavorable** (-4 is the sum of **+6** and **-10** as seen in the table) amid an improving inflation picture, flush liquidity environment, and strong market technicals. Sentiment and valuation are a drag on the overall picture.

Strategas, a Baird Company's, Market Gauge is meant to be a snapshot of a moment in time, and not a predictive tool. See page two for more on our 16 building blocks, and what we look for to label each one "Favorable" or "Unfavorable."

HOW DO WE CATEGORIZE EACH COMPONENT OF MARKET HEALTH?

Administration: Are White House and Congressional priorities market-friendly? How do they view taxes, regulation, trade, etc.?

Commodity Prices: Do commodity prices (e.g., gold, copper, oil) reflect economic growth or contraction?

Corporate Earnings: Are the earnings of U.S. companies growing or falling? Are profit margins expanding or contracting?

Demographics: Is the demographic trend (population growth, average citizen age, worker-to-retiree ratio) positive or negative?

Economic Growth: What is the recent trend in GDP growth? Are leading indicators rising or falling?

Fiscal Health: Is the budget deficit growing or shrinking? Is federal spending commensurate with long-run economic growth?

Fiscal Policy: Are the major policy initiatives from the White House and Congress pro-growth and market-friendly?

Global Trade: Are current attitudes pro-globalization and free trade or pro-nationalism and protectionism?

Inflation: Is there price stability around the Fed's target? What are the drivers of inflation? How are consumer expectations?

Liquidity: How are measures of money stock growth? What do real rates, credit spreads, and broader financial conditions look like?

Monetary Policy: Are interest rates accommodative or restrictive? Are other central bank programs market-friendly?

Sentiment: Are investors broadly optimistic (a negative) or pessimistic (a positive) about the market?

Technical Picture: What is current price action telling us? What do market breadth, trend, and momentum look like?

U.S. Dollar: Is the dollar strengthening or weakening versus other world currencies? What are the factors causing the move?

Valuation: Do stocks look expensive or cheap vs. historical averages given the current environment?

War vs. Peace: What do the world's geopolitical tensions look like? Are they inhibiting global economic growth?

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