

Morgan Stanley

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The Heartland Group at Morgan Stanley Investment Insights

Love and inflation in the air

So far, by the middle of February, the markets have continued to perform well, and investors are still in love with stocks. Which is appropriate given I am writing this on Valentine's Day morning. The S&P 500 hit a record high of, eclipsing 5000 for the first time ever, up 2.3% so far this month, and the tech heavy NSADQ up 1.6%. On Feb 12th the S&P 500 hit an Intraday high of 5048.¹

However, the market did retrace quite a bit for a one day move on the 13th. The worst day since March of 2023, down 1.4% in a single day. Why did the market drop so much? In my opinion, this is because CPI was reported, and investors guided higher on inflation concerns, which in turn, also means investors believe the Fed will postpone rate cuts for fear of reigniting inflation.

CPI came in at .39% month over month vs .28% (consensus expectations was .3%). On a 3-month annualized rate, core CPI increased from 3.3% to 4%, coming back to levels we saw in 1H23. Most of this inflation increase data was in housing, goods, and services.² It appears the consumer is still spending, and prices have not affected consumption...yet. But PCI and PCE isn't the only thing the Fed looks at. Employment and wage growth, as I said last month, are important contributing factors. The 3-month rolling Wage growth avg is slightly lower at 5% vs 5.2% last month.³ But still strong and on Friday, the Bureau of Labor Statistics reported an increase of 353,000 headline nonfarm payrolls in January, exceeding expectations.⁴ With strong wages and surprisingly good employment numbers like these, the Fed's task of returning to a nonrestrictive interest rate still seems far away, meaning rates will stay elevated for a bit longer than expected.⁴

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The pullback on the 13th is a good example on how investors are interpreting the Fed's current rate pause, and the expectations of when they may ease. But it still does not appear that the market is expecting a rate increase. Fed funds futures do not currently reflect an increase this year.⁵

Despite the pullback on the 13th, upside momentum in the market is still intact and 5200-5400 is where I think this market may be heading. Positive earnings growth expectations and the Fed Put (a term used by financial professionals that imply the fed will not let the economy go into a deep recession) is what is continuing to drive the market higher. And until either of those move to a more bearish outlook; for example, earnings guidance wain from higher input costs and a weaker consumer, or the inflation data makes the Fed think twice about quantitative easing. Until either of these happen, this market should continue to climb higher. Although one should keep an eye out for a reversal in momentum stocks that have led the way so far.

¹ Dow Jones/ Reuters news and Thompson One

² [CPI Data Imply 0.29% Core PCE](#)

³ [Wage Growth Tracker - Federal Reserve Bank of Atlanta \(atlantafed.org\)](#)

⁴ [Daily Positioning: Early 2024 Insights from January's Labor Data \(ms.com\)](#)

⁵ [Market Probability Tracker - Federal Reserve Bank of Atlanta \(atlantafed.org\)](#)



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<https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions>

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1 Dow Jones/ Reuters news and Thompson One

2 [CPI Data Imply 0.29% Core PCE](#)

3 [Wage Growth Tracker - Federal Reserve Bank of Atlanta \(atlantafed.org\)](#)

4 [Daily Positioning: Early 2024 Insights from January's Labor Data \(ms.com\)](#)

5 [Market Probability Tracker - Federal Reserve Bank of Atlanta \(atlantafed.org\)](#)