

Economic Highlights

Executive Summary

- The December US PCE reflects a resilient US economy and a continuing disinflation trend.
- Leading indicators, such as those published by the conference board, indicate a low probability of recession in the US economy in the near term.
- Although the January CPI report was above expectations, it does little to dispel the overall disinflationary trend in housing, which should continue to weigh on the headline number.
- The Fed has implemented a dovish policy pivot that will likely result in rate cuts over the next twelve months, but the exact timing and magnitude of cuts are in doubt.
- China is moving towards an easing policy, historically supporting global liquidity conditions and returns for risky assets and commodities.
- The recent jump in productivity growth reduces the pressure on corporate margins.
- Fourth quarter earnings season is turning out to be relatively strong overall, with estimates approaching 9% for the S&P 500 and 10 out of eleven sectors beating estimates.
- Corporate operating margins have remained stable but show some signs of stagnating. Historically, markets struggled as operating margins turned south.
- Companies face higher costs, and while higher rates have demonstrated minimal impact this far, the average maturities of debt in the index are pointing to a greater likelihood of companies increasingly being forced to refinance.

Top 5 Drivers of the US Real Economic Cycle

Growth	Previous Value	Latest Value	Previous Signal	Latest Signal
OECD Composite Leading Indicator	99.6	99.7	⬆️	⬆️
Consensus NTM Real GDP Δ	-190bps	-190bps	⬇️	⬇️
Inflation	Previous Value	Latest Value	Previous Signal	Latest Signal
Headline CPI YoY	3.1%	3.4%	⬇️	⬇️
Consensus NTM Headline CPI Δ	-70bps	-110bps	⬇️	⬇️
Employment	Previous Value	Latest Value	Previous Signal	Latest Signal
Unemployment Rate	3.7%	3.7%	⬆️	⬆️
Consensus NTM Unemployment Rate Δ	50bps	50bps	⬆️	⬆️
Corporate Profits	Previous Value	Latest Value	Previous Signal	Latest Signal
Consensus NTM/TTM S&P 500 Sales Growth Rate	3.4%	3.4%	⬇️	⬇️
Consensus NTM/TTM S&P 500 EPS Growth Rate	-4.0%	-4.0%	⬆️	⬆️
Fiscal Policy	Previous Value	Latest Value	Previous Signal	Latest Signal
Sovereign Fiscal Balance/Nominal GDP Ratio	-6.3%	-6.5%	⬇️	⬆️
USD Real Effective Exchange Rate	108.4	106.6	⬆️	⬆️

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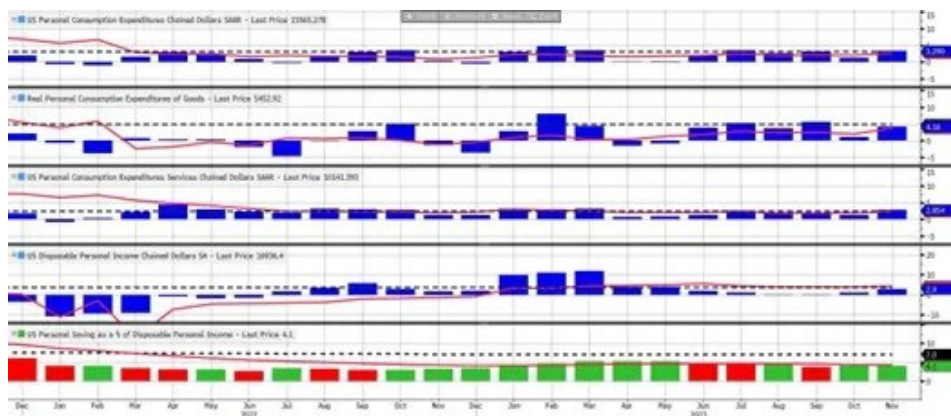
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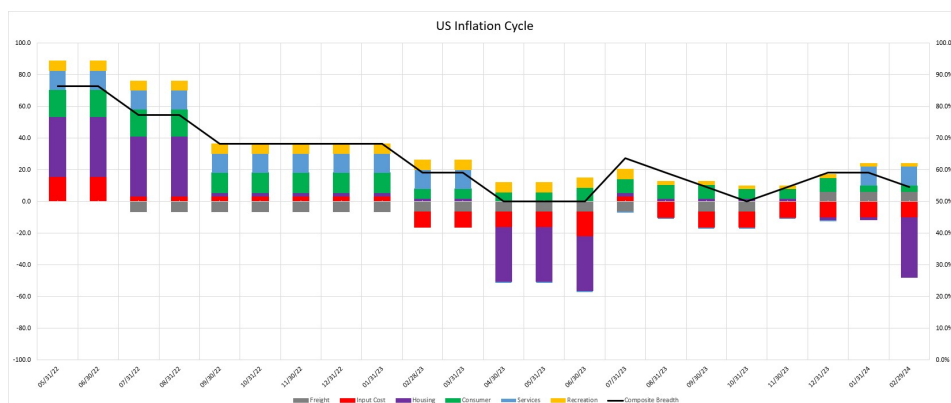
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US & Global Economic Highlights

The December US PCE report adds evidence of a resilient US economy and a continuing disinflation trend. Persistent growth in disposable personal income and wages further supports the resilient economy view. The persistent declines in the PCE report and the Super Core PCE deflator below trend lend evidence to the disinflation trend. Further, leading indicators, such as those published by the conference board, indicate a low probability of recession in the US economy. The q/q PCE SAAR print reported above the y/y print in expenditures, goods, and services, while income increased but was cyclically lower.



The market response to what was widely cited as an upside surprise in inflation was quite negative. We respectfully disagree. The monthly US CPI reported 0.31% versus the median forecast of 0.29%, and the DOL notes that the sampling error on these estimates is +/- 0.03%. In other words, any reported number between 0.28% and 0.34% contained no significant information. This highlights that monthly data is far less helpful than a y/y comparison. Digging more deeply into the weight and the amount within each category of the CPI index that is higher or lower can be more revealing about where inflation is likely headed. Presented in this way, it is much easier to ascertain that the disinflationary trend persists in all but services, and more timely measures of housing inflation, like rents, which comprise 33% of the total CPI index, are expected to weigh down the headline number.



Nonetheless, at least the short-term specter of sticky services inflation does make real growth in the US harder to achieve; for example, private weekly earnings were down slightly y/y. Nowcast estimates for US real

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Critical points for economic cycle drivers:

- Leading indicators are positive, while consensus on economic growth is still negative.
- Both headline and consensus estimates are negative for inflation
- Labor markets remain healthy.
- Corporate sales have begun to slow while profits are strong.
- Fiscal policy continues to be supportive of the US economy.

Critical points for the economy:

- The message from the recent PCE report is that the economy remains resilient.
- Annualized quarterly measures for consumer expenditures, goods, and services were above y/y measures, while incomes did decline.
- The savings rate was roughly in line with income.
- Services caused the m/m CPI report to be

GDP in Q1 2024 have broadly been above 3% q/q. Should inflation begin to stick at or above 3% or even reaccelerate stubbornly, that will cause the Fed to remain higher for longer. In addition, despite the resiliency of the US economy, consumers with no real wage growth don't like inflation in consumer goods and services. Consumption at 67-68% of GDP expenditure with stagnating incomes could begin to weigh on growth later in the year.

Policy Highlights

The monthly economic highlights have pointed to the risks of the market discounting too many rate cuts and too soon. The aggressive reaction after the announcement was to recalibrate rate cut expectations. Looking back, just six weeks ago, the expectation was for 6-7 rate cuts in 2024. The fed fund futures market has repriced rate cut projections after releasing January and February CPI/ PPI data, factoring in a maximum of four rate cuts and not beginning until June. There is now only a 9% chance of rate cuts starting in March 2024, down from 90% six weeks ago. The Fed is in a challenging position now. If they are going to cut rates, they should likely do it before June/ July. The summer begins the election cycle, which includes the DNC and RNC conventions. The FOMC would likely wish to avoid even appearing to meddle in the upcoming election.

CME FEDWATCH TOOL - MEETING PROBABILITIES										
MEETING DATE	300-325	325-350	350-375	375-400	400-425	425-450	450-475	475-500	500-525	525-550
3/20/2024					0.0%	0.0%	0.0%	0.0%	10.5%	89.5%
5/1/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	2.1%	26.3%	71.6%
6/12/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.4%	18.5%	57.1%	23.0%
7/31/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.9%	12.6%	43.6%	34.9%	8.0%
9/18/2024	0.0%	0.0%	0.0%	0.0%	0.7%	9.9%	36.5%	36.9%	14.2%	1.8%
11/7/2024	0.0%	0.0%	0.0%	0.4%	5.4%	23.4%	36.7%	25.3%	7.9%	0.9%
12/18/2024	0.0%	0.0%	0.3%	3.8%	17.8%	32.5%	28.9%	13.4%	3.1%	0.3%
1/29/2025	0.0%	0.1%	2.2%	11.5%	25.9%	30.5%	20.3%	7.7%	1.5%	0.1%
3/12/2025	0.1%	1.9%	10.3%	24.0%	29.9%	21.6%	9.3%	2.3%	0.3%	0.0%

There is a ~63% chance that interest rates will be unchanged through May 2024. The implication for markets and investors is that the terminal fed funds rate and cyclical inflation are the dominant drivers of returns in US stocks. The Fed has implemented a dovish policy pivot that will likely result in rate cuts over the next twelve months, but the exact timing and magnitude of those cuts are in doubt. Rate cuts are all but guaranteed.

Globally, Beijing is guiding policy easing with lower policy rates, which is thought to support the Chinese economy. Investors should expect stimulus in early 2024 from the CCP, which historically has been a tailwind to risky global asset prices. Japan, India, and Australia have some of the most attractive growth and inflation dynamics abroad. While fiscal policy was the dominant driver for the economy and markets in 2023, it is unlikely to remain as supportive. The US economy is unlikely to experience a fiscal cliff in a general election year with an incumbent

above survey, and housing is expected to weigh on the index looking forward.

Critical points for policy:

- Markets expected too many rate cuts and too soon and now have to recalibrate expectations.
- The overall message appears to be that rate cuts may still happen later in the year, but investors should expect higher for longer.
- Globally, China is looking to ease policy. The CCP will most likely do so by allowing the Yuan to depreciate.
- Japan, Australia, and India have the most favorable growth and inflation dynamics.
- Fiscal policy drove economic strength in 2023 but will begin to wane in 2024.

Critical points for corporate profitability:

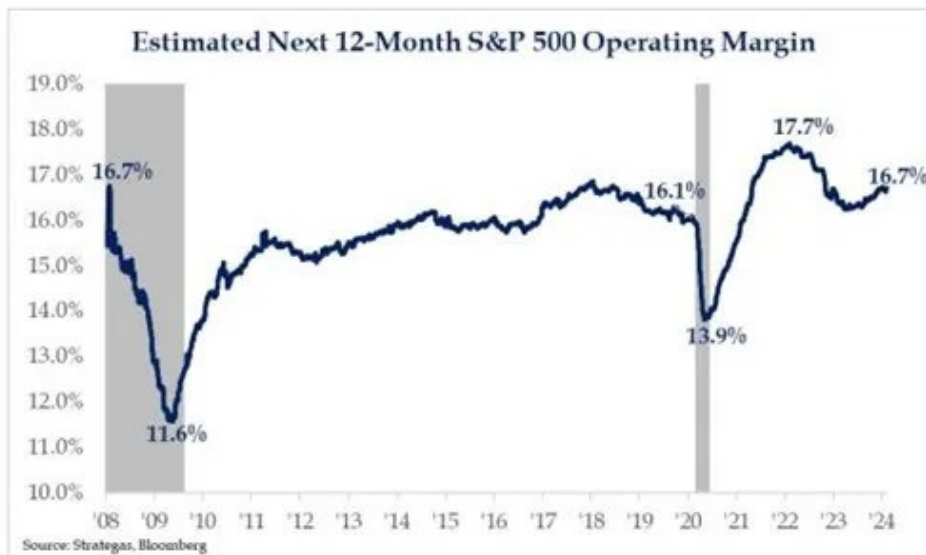
- Productivity reduces pressure on corporate margins.
- Q4 2023 earnings are strong.
- Operating margins are stable but starting to stagnate.
- Higher rates have had a minimal impact but should be expected to eat into net incomes as businesses are

president on the ballot.

forced to refinance.

Corporate Profitability Highlights

The recent jump in productivity growth reduces the pressure on corporate margins, which reduces the risk of corporations “shedding costs,” a politically correct form of announcing layoffs. On profitability, the fourth quarter earnings season is turning out to be relatively strong overall, with estimates approaching 9% for the S&P 500 and 10 out of eleven sectors beating estimates. The S&P 500 is expected to grow 3.4% in revenues, just short of the 3.6% estimate at the start of the calendar quarter. Operating margins, however, are showing some signs of stagnating. Historically, the market tends not to get into trouble unless operating margins roll entirely over -which is not happening. Companies face higher costs, and while higher rates have demonstrated minimal impact this far, the average maturities of debt in the index are pointing to a greater likelihood of companies increasingly being forced to refinance. The concern at that point is whether the increase in interest costs erodes net income.



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