Summary

Economic news for the week included the Federal Reserve keeping interest rates steady for the first time in a year. In other data, consumer price inflation decelerated but remained high, while producer price inflation decelerated even further. Retail sales rose, while industrial production fell back, and several regional manufacturing indexes were mixed.

Global equities saw strong returns last week, in keeping with the Fed pause, lower inflation, and an absence of otherwise poor economic news. Bonds were little changed, along with a quiet yield curve, with corporates and foreign outperforming. Commodities fared positively, with gains in agriculture and natural gas.

Economic Notes

(0) As noted earlier in the week, the **FOMC** held firm at a Fed funds rate of 5.00-5.25%. However, the post-meeting press conference was considered a bit hawkish in that further rate increases were noted as remaining on the table. The quarterly Summary of Economic Projections (SEP) release for June pointing to members expecting two additional hikes this year, which equates to a 0.50% higher ending rate than that of the March SEP. Then again, expectations for 2024 and 2025 imply over -2% in rate cuts. Importantly, Chair Powell noted that the Fed has "moved much closer to our destination," as well as observing that current rates are sufficiently restrictive, implying "almost by definition that the risks of sort of overdoing it and…underdoing it are getting closer to being in balance."

The messages obviously remain somewhat contradictory, with a hawkish inflation-battling tone this year, coupled with caution about the 'cumulative effects' of 5% worth of rate hikes (such as stress on the banking system), and an assumed return to normal over the next few years (at a rate-cutting pace that would seem to require recession). There isn't a good way to cleanly rectify these differing goals in such a tight timeline. This coming week, Powell will deliver his semi-annual testimony before the House Financial Services Committee, which may add additional color to where current policy stands.

(+) **Retail sales** for May rose by 0.3%, surpassing the -0.2% decline expected. Removing the most volatile components, core/control sales were little changed, up 0.2%; however, the report included several revisions downward for prior months. The May report showed underlying mixed results, with gains in auto sales (1%), general merchandise, and electronics, offset by declines in gas station sales (-3%) and misc. stores. From a year ago, retail sales are up 0.7%, which, when accounting for underlying price inflation, keeps 'real' sales in the negative, having formed a bottoming pattern in recent months.

(-) **Industrial production** fell back -0.2% in May, the first decline in six months, and ran contrary to expectations for a small 0.1% rise. Manufacturing production ticked up by a tenth of a percent with a larger gain in auto production; however, this was offset by mining down nearly a half-percent, and utilities production down -2%. The latter is largely a random variable, being primarily weather-dependent, with an absence of extreme temperatures the usual culprit in normalizing production numbers. Year-over-year, industrial production is still up 0.2%, having been on a steady downtrend. Capacity utilization ticked down a tenth to 79.7%.

(-) The **Philadelphia Fed manufacturing index** fell by -3.3 points to a further contractionary -13.7 in June, just ahead of the -14.0 level expected. However, several data points looked stronger than the headline, with shipments and employment gaining sharply into or near expansion, while new orders fell another several points to -11. Prices paid also fell slightly, but remained in expansion. Looking ahead six months, assumed business conditions rose by 23 points to a positive reading of 13.

(+) The **Empire manufacturing index** for the NY region, by contrast, rose a dramatic 38.4 points back to an expansionary 6.6 level in June, well above the contractionary -15.1 level expected. The strength was broad-based, with 30-40 point gains in new orders and shipments back into expansion; however, employment fell slightly further into contraction. Prices paid fell by -13 points, but remained expansionary. The 6-month ahead business conditions index rose by 9 points to a further expansionary 19 level. These two reports are regional in focus, and continue to show a wide divergence and unclear message around the economy, although the NY report was quite positive, and not a level one would expect with so many indicators pointing at recession.

(+/0) The **Producer Price Index** for May fell by -0.3%, further than the consensus expectation for a -0.1% drop, and continuing a stretch of several months of falling prices. Removing energy and food, core PPI rose 0.2%, with the single month being affected by energy prices falling -7% and food down -1%, offset by gains in other areas. Year-over-year, headline and core PPI are up 1.1% and 2.8%, respectively. The year's producer inflation largely mimicked economic growth changes, with services prices up nearly 3%, while those for goods fell over -2%. The positive is obviously the sharp deceleration in supply- and logistics-driven inflation.

(0/+) The **Consumer Price Index** for May rose 0.1% on a headline level and 0.4% for core, subtracting food and energy prices. These were largely in line with consensus expectations. Energy commodity prices, including gasoline, fell nearly -6% on the month, which worked their way through a variety of categories, pulling down inflation broadly. However, the core measure continued to remain sticky, with items such as used cars (up 4%), car insurance, and shelter continuing to rise at a half-percent rate or more (which translates to over 6% annualized, which adds up). Airline fares fell back several percent, while new car prices and medical care were essentially flat.

On a year-over-year basis, headline inflation decelerated by nearly a percent to 4.0%, while core inflation fell a few tenths to 5.3%. This was the slowest pace of year-over-year headline expansion in two years, which was taken positively, especially with the release being on the cusp of a Fed meeting. Energy commodity prices falling -20% over the past year helped dramatically, which offset continued strength in food prices, which gained another 7% over the year, and have been difficult on lower income consumers in particular. Shelter costs rose 8%, with rising rents and implied rents continuing to filter through CPI, although real time data points to deceleration in both data points. Other items have continued to weigh on consumers, including auto repair and insurance, each of which rose at a double-digit pace. Used car prices fell by -4% from last year, while prices for new cars gained 5%. The stickier parts of inflation continue to be problematic. Conditions are improving, though, just not quickly.

(+) **Import prices** fell -0.6% in May, led by a sharp drop in petroleum prices, as the ex-petroleum measure fell a meager -0.2%. In core segments, industrial supplies and food/beverages saw declining prices, not quite offset by gains in autos/parts, capital goods, and airfares. While not considered a major economic series, import prices declining is certainly preferred to rising prices in an already-elevated inflation environment.

(+) The preliminary June **Univ. of Michigan index of consumer sentiment** rose by 4.7 points to 63.9, exceeding the 60.0 level expected. Assessments of both current conditions and future expectations both increased, with the latter a bit more than the former. Inflation expectations for the coming year fell back sharply by -0.9% to 3.3%, while those for the coming 5-10 years ticked down a tenth to 3.0%. Lower gasoline prices appeared to help sentiment and lower inflation fears, while sentiment also seemed to be helped by resolution of the U.S. debt limit issue.

(0) **Initial jobless claims** for the Jun. 10 ending week were unchanged at 262k, but well above the 245k forecast. Continuing claims for the Jun. 3 week rose by 20k to 1.775 mil., slightly above the median forecast of 1.768 mil. Claims data continues to be interesting, with unique inputs from a variety of states, including improved anti-fraud verification in OH, changes in MN that allowed for a wider variety of education staff to file during summer, as well as the ongoing seasonal adjustment and distortion issues. Those aside, there has been a

steady increase in claims over the past several weeks, which points to a slight erosion in labor markets at the margin.

Market Notes

Period ending 6/16/2023	1 Week %	YTD %
DJIA	1.31	4.60
S&P 500	2.62	15.78
NASDAQ	3.26	31.35
Russell 2000	0.58	7.25
MSCI-EAFE	2.88	13.65
MSCI-EM	2.91	8.85
Bloomberg U.S. Aggregate	0.20	2.22

U.S. Treasury Yields	3 Mo.	2 Yr.	5 Yr.	10 Yr.	30 Yr.
12/31/2022	4.42	4.41	3.99	3.88	3.97
6/9/2023	5.37	4.59	3.92	3.75	3.89
6/16/2023	5.34	4.70	3.99	3.77	3.86

U.S. stocks steady gains last week. Every sector except energy ended positively, led by 'growth' areas technology, consumer discretionary, while industrials and materials also rallied. Real estate rose over a percent, with little change in interest rates on net. After an initial negative reaction to the FOMC meeting, as the hawkish tone alluded to more interest rate hikes than markets expected, mixed data later in the week settled nerves a bit, as did the realization that inflation is indeed improving.

Foreign stocks fared positively as well last week, with Europe outpacing the U.K., Japan, and emerging markets. While industrial data surprised to the upside, the ECB elected to raise rates again by 0.25% to 3.50%, continuing at a robust clip to combat inflation, which is running at a higher rate than in the U.S. The ECB was also forthright about likely hikes in July and beyond. Accordingly, this, and the FOMC's decision to pause, helped boost the value of the euro versus the dollar. Absent other factors in the near term, rising interest rates tend to elevate the attractiveness of a currency. The Bank of Japan, on the other hand, left their loose policy unchanged at a key rate of -0.1%, with no changes in forward guidance.

Chinese stocks rose 5%, as the People's Bank of China cut their key interest rate for the first time in a year, by 0.10%, in a sign of concern over weaker growth. China continues to run at a counter-cyclical nature to the rest of the world, with longer lockdowns punishing the economy—resulting in disappointing industrial data and especially high youth unemployment (over 20%, a political and social concern). Now, rather than hiking rates to combat inflation as in much of the rest of the world, Chinese officials have been stimulating. While concerns over this weakness have held risk sentiment back, such activity and valuations have tended to be bullish indicators looking ahead.

Bonds ticked slightly higher for the week, along with minimal changes in interest rates, with Fed estimates for higher rates this year already seemingly baked in. Investment-grade and high yield corporates outperformed treasures, as did floating rate bank loans, due to a yield advantage. (This has become more of a differentiating factor in bond returns over the past year.) Foreign bonds moved higher along with a weaker dollar, largely affected by the ECB rate hike last week. Emerging market bonds also gained in a continued 'risk-on' environment.

Commodities rose across the board last week, led by several agricultural commodities—corn, wheat, and soybeans—while energy also gained. Crude oil rose over 2% last week to $72/barrel, while natural gas prices rose 18%. Dynamics remain tied to ample supply, coupled with continued concerns over ongoing weaker demand. Higher gas prices were tied to a surprise spike in European prices along with the announced closure of an important gas field in the Netherlands, due to persistent earthquakes.

Have a good week.

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Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Associated Press, Barclays Capital, Bloomberg, Citigroup, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, Univ. of Michigan, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.