Summary

Economic data for the week included retail sales that came in higher than expected, as well as gains in industrial production, mixed regional manufacturing sentiment and housing metrics, and a slight pullback in the index of leading indicators.

U.S. and foreign equity markets fell back last week, as tensions over Russia and Ukraine wavered (generally rising), in addition to continued strong U.S. inflation rhetoric. Bonds were mixed, with yields little changed, but credit spreads widened. Commodities were also mixed, with gains in metals offset by a pullback in oil prices by several percent.

Economic Notes

(+) **Retail sales** for January reversed the prior month's decline by rising 3.8%, surpassing the median forecast calling for 2.0%. This was unchanged when autos/gas were excluded, although the core/control sales measure, which also removed building materials, saw a gain of 4.8%, compared to the meager 1.3% forecast. Being January, some of these gains were based on seasonal factors, with December being one of the strongest months for spending (even though they attempt to account for this via seasonal adjustments). Omicron was also not as destructive to sales as feared, although restaurant spending fell by -1%, offset by gains in non-store retail and department stores, which rose in a range of 10-15%. Year-over-year retail sales were up 13%. While inflation has played a role in higher prices, which elevates the gross retail sales number, most was due to stronger 'net' activity as Covid conditions steadily improve.

(+) **Industrial production** for January rose by 1.4%, beating expectations calling for 0.5%. This represents a 4% change from last year, and over 7% from Feb. 2020, the pre-Covid benchmark. The January number was driven by the utilities segment, which gained 10% (highest monthly result in over 80 years, in keeping with the dramatic warm-to-cold weather change for the month), as well as mining production (including petroleum) up 1%. On the other hand, manufacturing only gained a few tenths of a percent, while auto production declined—due to assumed supply and labor issues. **Capacity utilization** ticked up by 1.0% to 77.6%.

(0) The **Empire manufacturing index** rose 3.8 points in February to an again-positive 3.1, but below the 12.0 level expected. Under the headline report, employment, new orders, and shipments all rose by several points. However, prices paid ticked down by a tenth of a point, while remaining at a high level, as were delivery times. However, expected business conditions six months out fell back by nearly -7 points, although the level remains higher than prior to Covid.

(0) The **Philadelphia Fed manufacturing index** fell back by -7.2 points in February to a still-expansionary 16.0 level, although lower than the median forecast of 20.0. Under the hood, shipments and new orders fell back by several points, while remaining expansionary, while employment expanded further. Interestingly, prices received rose, while prices paid fell back a bit—although both remained at historically high levels. Delivery times also appeared to improve slightly, which was encouraging. The assessment of business conditions six months out ticked down by under a point, but remained at a highly expansionary level.

(-) The **producer price index** for January rose by 1.0%, beating expectations calling for a less-severe 0.5%. Core PPI, removing food and energy inputs, gained 0.8%. Various sub-components of the index continued to show strength, with services prices up 0.7% and goods up 1.3%, with a bump from auto parts as well as a 2% increase in energy—reversing a drop from the prior month. The year-over-year PPI rate rose by a strong 9.7%, which actually was a deceleration of a tenth of a percent from the pace of the prior two months. Core PPI gained 7.2% over the past 12 months.

The good news is that inflation by this measure seems to be peaking, or at the very least, stabilizing. This doesn't mean the bad news is completely past, but if indications begin to point to a deceleration in pricing, this may be taken positively by financial markets. As it stands, companies have been able to pass costs on through to consumers in most sectors, as seen in Q4-2021 results, which has kept profit margins at cyclically-high levels.

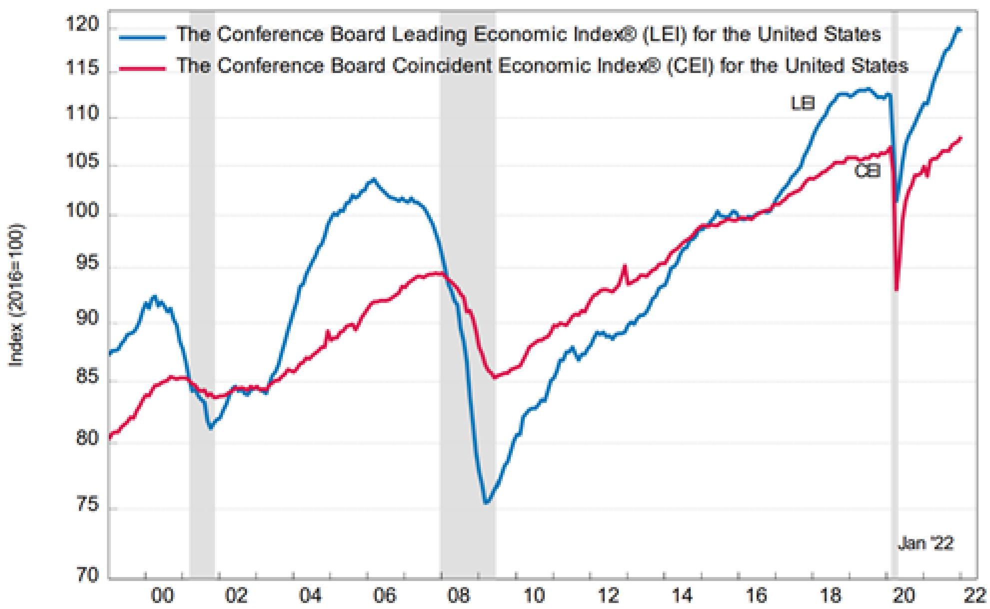
(-) **Import prices** rose 2.0% in January, exceeding the median forecast of 1.2%. Petroleum prices up 10% were a large factor, with prices ex-petroleum up a lesser 1.4%. Other gains included industrial supplies and food up 4-5% each. However, other capital and consumer goods were less than a percent higher, and auto prices were only a tenth higher. The year-over-year rate of overall increase was 10.8%, far higher than inflation by other standard measures, and reiterates the supply chain/logistics story (and surging oil prices).

(+) **Existing home sales** in January rose by 6.7% to a seasonally-adjusted annualized level of 6.50 mil. units, beating consensus expectations of a -1.3% drop, but also included a downward revision from the prior month. Condos/co-ops slightly outperformed single-family for the month, up 9% vs. 7%. All four regions gained, led by the South and Northeast in the high single-digits. This resulted in a -2.3% decline on a year-over-year basis. The median home price rose by 1.8% in January to $350,300, which represented a 15.4% gain over the past year. The National Association of Realtors noted that inventories are at their lowest levels in modern history (well, at least since 1982), with months' supply down to 1.6.

(-) **Housing starts** in January fell back by -4.1% to a seasonally-adjusted annualized level of 1.638 mil. units, further than the -0.4% decline expected. Multi-family fared better, down only -1%, while single-family fell back by -6%. The West experienced an 18% rise in starts, while the Midwest saw a sharp drop of -38%. **Building permits** rose 0.7% for the month, which was a deceleration from the prior month but far better than the median forecast calling for -7.2%. Here, single-family rose by 7%, offset by a drop of -8% in multi-family. The West and South saw double-digit gains, while permits in the Northeast fell back by nearly -50%. Based on a warmer-than-normal December nationally, and dramatically colder January, these were no doubt weather-driven, along with some impact from the Covid omicron variant. The backlog of homes to be built remains extremely high, in fact that highest in over 20 years, by the measure of homes approved but 'not yet started'.

(0/+) The **NAHB housing market index** fell back by -1 point to 82 in February, matching expectations, and remaining at a historical peak (based on the last 35 years of data). Current sales gained a point, while future sales and prospective buyer traffic each fell back by several points. Regionally, the Northeast and West experienced gains, while the Midwest and South fell back slightly. Homebuilders continue to feel confident about forward-looking demand for homes and building activity.

(-) The Conference Board's **Index of Leading Economic Indicators** fell back by -0.3% in January, bucking a trend of recent economic strength, although the release also contained annual benchmark revisions. Negative influences were led by higher jobless claims, weaker consumer sentiment, stock prices, and manufacturing hours—which offset positive results from the other six factors. The coincident index and lagging index fell back as well, by -0.5% and -0.7%, respectively. The past six months saw the leading index rise at a 5.2% annualized rate, which was slower than the 9.4% annualized rate of the prior six months, which ended in July 2021. The LEI noted the monthly results were highlighted by omicron concerns, higher inflation, and supply disruptions, while indicators continue to point to positive economic growth heading into the spring—albeit at a more tempered rate than recent quarters. The index of leading indicators doesn't provide any information we don't already know, but the carefully-constructed combination of data has correlated well to future economic conditions—and whether or not recession risks have changed.



Source: The Conference Board. Shaded areas indicate recessions, as defined by the NBER.

(-/0) **Initial jobless claims** for the Feb. 12 ending week rose by 23k to 248k, well above expectations of 218k. **Continuing claims** for the Feb. 5 week fell by -26k to 1.593 mil, below the 1.605 mil. expected. Claims rose in MO, KY, and OH, but fell back in CA; no trends were apparent. Despite the week-to-week changes, claims continue to run at low levels, particularly for continuing claims.

(0) The January **FOMC meeting minutes** were closely reviewed for further clarification on the committee's earlier formal comments that rate hikes would 'soon be appropriate' and most members thought it should happen more quickly than the last hiking cycle. This was in addition to more recent Fed member informal comments, after the meeting, about potential rate hikes along the lines of 0.50% at a time also being in the cards. However, the minutes themselves noted caution about a too rapid hiking pace, which can cause financial conditions to over-tighten too soon. (Financial conditions refer to the broader environment, which includes not only fed funds rate action, but also changes in credit, liquidity, risk asset/stock prices, and value of the dollar.) In regards to the large balance sheet, it was agreed upon that reducing its size at a faster pace than in the past (2008) would be desirable.

The Fed remains in a difficult position, in trying to 'thread the needle', so to speak. Inflation remains a concern, though, mainly because of its unpredictability and potential to alter consumer expectations surrounding future prices and wages. If the Fed raises rates too soon, to combat the inflation threat, the tighter financial conditions raise the risk of a shock to the economy and asset prices, and can lead to unintended recession risks. (This has happened in the past, a situation they're no doubt keenly aware of). On the other hand, taking too long to normalize policy could perpetuate inflationary pressures through the current easy policy and raise chances for asset bubbles and build-up of financial excesses down the road. Added to the inflation element is the fact that economic growth itself is decelerating from unsustainably strong recovery levels in 2021 to more normal trend levels in 2022, and especially in estimates for 2023-24. A slowing economy offsets the need for the sharp rate hikes, all else equal. Getting this call right will be a key theme for 2022 and 2023.

Market Notes

Period ending 2/18/2022	**1 Week (%)**	**YTD (%)**
DJIA	-1.77	-5.97
S&P 500	-1.52	-8.57
NASDAQ	-1.73	-13.32
Russell 2000	-1.00	-10.42
MSCI-EAFE	-1.86	-4.20
MSCI-EM	-0.67	0.07
Bloomberg U.S. Aggregate	-0.24	-3.68

U.S. Treasury Yields	**3 Mo.**	**2 Yr.**	**5 Yr.**	**10 Yr.**	**30 Yr.**
12/31/2021	0.06	0.73	1.26	1.52	1.90
2/11/2022	0.36	1.50	1.84	1.92	2.24
2/18/2022	0.35	1.47	1.82	1.92	2.24

U.S. stocks were again largely driven back-and-forth by concerns and uncertainty over the Russia-Ukraine conflict, as well as additional comments from St. Louis Fed President Bullard that a full 1% in rate hikes would be appropriate by summer. Nearly sector was in the negative last week, led by communications and energy, down by around -3%; consumer staples was the only positive sector, rising a percent for the week, with strong results from Walmart and Procter & Gamble in particular. Real estate also fell back by nearly -2%.

Foreign stocks fell back across the board, to about the same or slightly lesser degree than U.S. equities, with the Russia-Ukraine issue remaining the primary focus (especially due to the close proximity and effect on trade and natural gas markets). Emerging markets were mixed, with gains in India and Brazil offset by mixed results in China, and declines in Russia, due to negative sentiment surrounding possible war (and sanctions). Mexican stocks were also held back by economic weakness, as well as an unexpected and brief U.S. ban of avocados from a certain region (now resolved).

U.S. bonds fell back again last week by a fraction of a percent, with little change in treasury yields, offset by wider spreads for corporate credit. International bonds were mixed, with developed markets down and emerging markets experiencing sharper gains.

Commodities were mixed, as gains of several percent in both industrial and precious metals were offset by a decline in energy. The price of crude oil fell back by over a percent to just above $90/barrel, while natural gas prices rose by 11%. While the Russia-Ukraine tension has kept price pressure higher, further work towards a U.S.-Iran nuclear deal and the potential for the addition of their production, kept conditions in check somewhat.

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

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