

## *Summary*

In economic news, the Federal Reserve raised interest rates for the first time in several years, by a quarter percent. In other data releases, retail sales and industrial production increased, as did housing starts, while jobless claims also came in better than expected. Producer prices continued their rise, and the index of leading economic indicators improved.

Global equity markets rose last week with a tempering in commodity prices, a Fed that acted on the more tempered side, and rumors of progress in Ukraine-Russia peace talks. U.S. bonds fell back as interest rates ticked higher, along with hawkish Fed language. Commodities fell back due to concern over lower demand in China, due to Covid lockdowns.

## *Economic Notes*

(0) As noted earlier in the week, the **Federal Reserve Open Market Committee** raised key short-term interest rates, beginning a new tightening regime. Interestingly, in the formal statement, 'Covid' and/or 'pandemic' were removed, now replaced by Ukraine and commodity prices as exogenous events affecting the U.S. economy. Regardless, the well-awaited move was seen as a positive step toward normalcy, as much as investors or consumers can ever cheer higher interest rates.

The Fed 'dot plots' implied about seven hikes in 2022, and about three for 2023. This might include at least one 0.50% hike at some point, which could be well-telegraphed to the market in advance to avoid price disruptions. (It's hard to imagine going back to a place decades ago when Fed moves were never hinted in advance.) This seems to be more aggressive than broader markets have been implying, while, at the same time, it seems perceptions of ongoing inflation as 'transitory' are evolving into a status of 'structural' (at least according to Bloomberg data, per the BofA Global Fund Manager Survey). Despite an upward revision in inflation projections for 2022 by over a percent, Fed expectations for 2023 and 2024 remain surprisingly contained, in a range around 2.5% percent. There continues to be a strong view at the Fed and among a variety of mainstream economists that today's high inflation will fall off toward the end of this year, due to base effects and an improvement in ongoing supply/transportation disruptions, although the Ukraine situation has put that timeline a bit more in flux (especially for Europe).

At the post-meeting news conference, Fed Chair Powell also discussed the shrinking of the \$9 tril. Fed balance sheet to a more ideal place, which he's mentioned could take up to three years. It's presumed this could include \$2-3 tril. in bond runoff over that time, mostly from letting existing bonds mature and not reinvesting the proceeds, although there has been some speculation over the outright sales of treasuries and agency MBS. While possible to a limited degree, the latter is seen as less likely, due to potentially negative bond market signaling effects from sales, which could disrupt a gradual adjustment in long-term yields. While the fed funds rate is the benchmark for short-term markets, the balance sheet owns bonds of intermediate- to long-term maturities. Importantly, this is the first time the Fed has tightened both tools at the same time, and stated that effects of the policy experiment remain untested. So, a more conservative approach wouldn't be surprising.

Is the Fed 'behind the curve' when it comes to fighting inflation? Some watchers think so, while other mainstream economists understand the difficulty in aligning the opposing cross-currents of high inflation and slowing economic growth using monetary policy. The Powell press conference was tough on inflation, perhaps to address these concerns, but emphasized the robustness of the U.S. economy, and especially labor markets, in the wake of the recovery from Covid lockdowns. With such strength, in his view, it should be able to handle a series of quarter-point rate hikes. Indeed these hikes are fairly small and starting from a very low base (zero), and even the stated neutral rate (2.5% or so) is really not that 'high' from a historical perspective. From a 30,000-foot view, the Fed's message is that economy is in a good place, albeit with some inflation pressures caused by a variety of sources, but is certainly no longer in need of emergency stimulative measures.

It's not necessary a negative for risk assets, like equities, either. The strong economy has translated to strong earnings results (which tend to drive stock prices), with an apparent lack of overleverage and excesses, which had been troublesome in prior cycles.

(0/-) **Retail sales** for February rose by 0.3%, short of the median forecast of 0.4%, and sharply lower than January's figure. Removing cars and gas from the headline number turned the gain into a -0.4% decline, while the core/control number was down a further -1.2%. The overall monthly increase was led by gas stations (up 5%, as gasoline prices drive sales), restaurants/bars, and autos. Declines were seen in non-store/online retail (down nearly -4%), health/personal care, and furniture. Year-over-year, overall retail sales are up nearly 18%, which is robust, although some of that nominal figure includes the impact of higher inflation. Recent data shows strength in 'Covid recovery' areas, as concerns over the delta and omicron variants dissipated.

(0) **Industrial production** in February rose 0.5%, matching market expectations, but a deceleration compared to the prior month's growth. The manufacturing production component rose by over a percent, with gains in business equipment, while auto production and utilities each fell by several percent (the latter largely based on weather in the near-term). Industrial production on a year-over-year basis is up 7.5%, and has risen 2.2% above the pre-Covid benchmark of Feb. 2020. **Capacity utilization** also rose by 0.3% to 77.6%.

(-) The New York Fed **Empire manufacturing survey** fell by -14.9 points in March to a contractionary level of -11.8, in contrast to an expected increase to 6.4. This was the lowest level since the early months of the pandemic (May 2020), with new orders and shipments both falling into contractionary territory. Employment also fell back but remained solidly in expansion. Prices paid fell, but prices received rose slightly (both staying at elevated levels), and delivery times slowed. On the positive side, expected business conditions for the coming six months rose over 8 points further into positive territory.

(+) The **Philadelphia Fed manufacturing index**, on the other hand, rose by 11.4 points to a more strongly expansionary 27.4, beating expectations calling for 14.5. Shipments, new orders, and employment all rose further into positivity. Prices paid and prices received also both rose to elevated readings, along with longer delivery times. However, the assessment of business conditions six months in the future fell by over -5 points, but still remained solidly in expansion. Answers to the anecdotal question for the month noted that most respondents expected supply-chain disruptions to worsen over the next quarter, while two-thirds expected energy-based production constraints to worsen.

(-) The **Producer Price Index** for February rose by 0.8% on a headline level, which was a slightly decelerated pace compared to January, and a tenth of a percent below expectations. Core prices less food and energy, however, were only up 0.2%. Monthly prices for final demand goods, up 2.4%, offset no change in final demand prices. Energy prices gaining 8+% for the month were the primary driver, no doubt, not only directly, but as inputs into the costs of other goods (plastics, fertilizer, etc.). This is demonstrated by the exorbitant price spikes for energy materials in the intermediate goods measure, while other items have been far less impacted by inflation. Year-over-year, final demand prices overall moved up 10.0%, while removing food, energy, and trade services brought the number down to 6.6% for the trailing period. By segment, goods prices were up 14.4% for the year, while services rose a less extreme 7.8%.

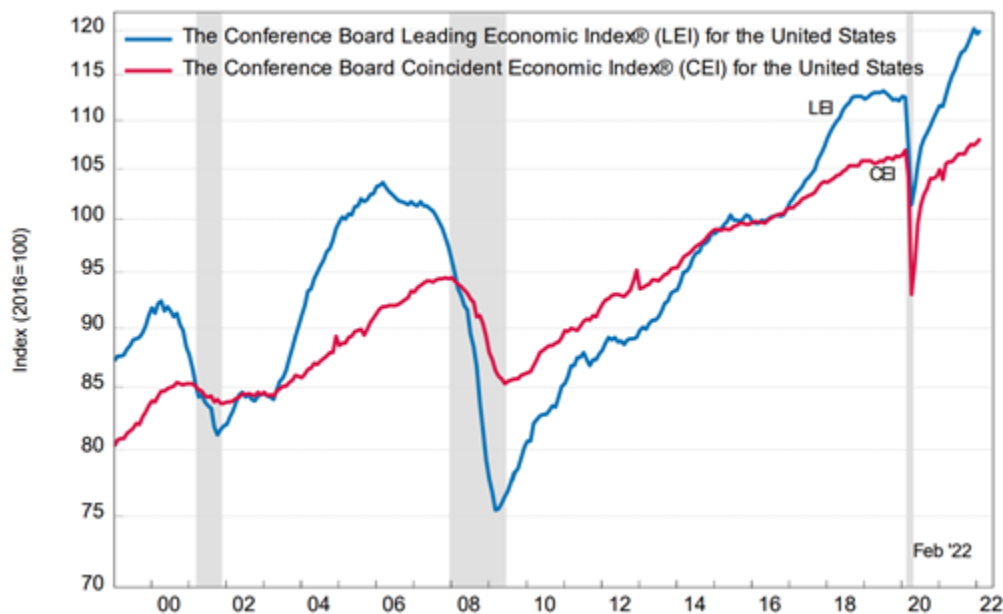
(-) **Import prices** rose 1.4% in February, which was a few tenths below expectations. Removing petroleum, prices rose by a lesser 0.7%, pointing to fuel's strong influence in recent pricing of goods in global trade. Prices rose for a variety of items, with petroleum up 8%, industrial supplies up 4%, and food up nearly 2%; consumer goods and autos were barely changed. Year-over-year, import prices are up 11%. Imported inflation always represents the 'bad' inflation that is not related to the corresponding domestic growth often accompanied homegrown inflation.

(-) **Existing home sales** in February fell by -7.2% in February to a seasonally-adjusted annualized rate of 6.02 mil., below the -6.2% drop expected and reversing a gain from January. Single-family and condos/co-ops fell by similar degrees, with declines in every national region. Over the trailing year, existing sales are down -2%. The median sales price rose 1.4% in February to \$357,300, which represents a 15% rise over the past year. The months' supply of homes stayed flat at 1.9, but is extremely low, with short listing times. With interest rates higher, mortgage rates are over 4% for the first time in a few years, on top of expensive house prices, affordability has become a greater issue despite low housing supplies. However, demographic demand continues to rise on a secular level.

(+) **Housing starts** in February rose by 6.8% to a seasonally-adjusted annualized rate of 1.769 mil. units, which exceeded the 3.8% gain expected. Both categories rose for the month, with single-family up 6%, and multi-family up 9%, as weather improved from January. Over the past year, the overall starts number are up 22%, with the bulk of that driven by a gain in multi-family building. **Building permits** fell back by -1.9% to a seasonally-adjusted annualized rate of 1.859 mil., better than the -2.4% drop expected, as both categories declined—more so in the more volatile multi-family segment. In fact, homes under construction are at their highest levels in nearly 50 years, although the projects are taking longer due to a lack of available workers.

(-) The **NAHB housing market index** fell by -2 points in March to 79, bucking expectations calling for no change. However, the index remains at a robust level. The underlying metrics were mixed, with current sales falling, prospective buyer traffic rising slightly, while future sales fell back sharply. Regionally, the Midwest outperformed the other segments, especially the Northeast. Federal Reserve actions in raising interest rates play a large role in housing sentiment from builders and brokers.

(+) The Conference Board's **Index of Leading Economic Indicators** for February rose by 0.3%, in a positive rebound from a decline the prior month. The coincident index rose by a similar 0.4%, while the lagging index was unchanged. In the leading indicator group, seven members showed positivity, led by manufacturing hours and low jobless claims; these offset declines in consumer business sentiment, stock prices, and building permits. Over the prior six months, the leading index grew at a 4.3% annualized rate, which was down from the robust 11.1% annualized growth from over the previous six months ending in Aug. 2021. The impact of the Russian invasion of Ukraine in late Feb. wasn't much reflected in this data, but will likely do so in March. As it stands, due to inflation and labor shortages, the Conference Board revised down their 2022 GDP forecast to 3.0%, which is still above trend growth of around 2%.



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

(+) **Initial jobless claims** for the Mar. 12 ending week fell back by -15k to 214k, below the 220k expected. **Continuing claims** for the Mar. 5 week also fell, by -71k to 1.419 mil., well below the 1.480 mil. median forecast. The most significant declines in initial claims were in NY, while claims rose most in MI and OH. Overall, this measure continues to point to extremely strong labor market conditions.

### ***Market Notes***

<b>Period ending 3/18/2022</b>	<b>1 Week (%)</b>	<b>YTD (%)</b>
DJIA	5.53	-3.89
S&P 500	6.19	-6.05
NASDAQ	8.20	-11.05
Russell 2000	5.43	-6.86
MSCI-EAFE	5.60	-7.26
MSCI-EM	3.50	-8.59
Bloomberg U.S. Aggregate	-0.39	-5.16

<b>U.S. Treasury Yields</b>	<b>3 Mo.</b>	<b>2 Yr.</b>	<b>5 Yr.</b>	<b>10 Yr.</b>	<b>30 Yr.</b>
12/31/2021	0.06	0.73	1.26	1.52	1.90
3/11/2022	0.40	1.75	1.96	2.00	2.36
3/18/2022	0.42	1.97	2.14	2.14	2.42

U.S. stocks rebounded last week, to their best single week in over a year, seeming to look beyond the initial Fed rate hike and commodity price inflation exacerbated by the war in Ukraine. Nearly all groups were positive for the week, led by growth sectors consumer discretionary and technology, while energy stocks fell back by nearly 4% along with lower oil prices. Real estate also gained, despite the higher rates.

Foreign stocks fared positively, similar to U.S. equities, but helped a bit more by the weaker dollar. The Bank of England also raised rates from 0.50% to 0.75%, which was a slower pace than expected, in addition to more dovish language about ongoing hikes. Europe is obviously less hawkish than the U.S. Fed at this point. Emerging markets also experienced solid gains, with Russian equities now excluded from the index, led by a double-digit recovery in Chinese stocks, as additional economic support measures were announced. Stocks there had fallen back significantly, as Covid cases picked up sharply in several key cities, resulting in lockdowns, and an obvious lack of economic activity. Potential de-listing of Chinese companies from foreign exchanges due to lack of compliance with audit requirements remains a concern. Additionally, concern over China's potential trade relationship with Russia, which could complicate sanctions activity, weighed on sentiment. However, markets rebounded quickly as the government appeared more open to lightening up on technology crackdowns. Questions continue to surround the potential for aid to Russia, which could benefit the Chinese (cheaper commodities), but alienate them from the West.

U.S. bonds declined again as investor digested the Fed's aggressive stance to combat inflation, causing longer-term rates to rise. Interestingly, at the 'belly' of the treasury yield curve, the 5-year rate have now risen to meet the 10-year rate, and the curve itself continues to flatten. Corporate credit outperformed, as spreads again tightened, with high yield and senior floating rate bank loans earning positive returns for the week. Foreign bonds were mixed, with little change in developed markets, but strong recovery returns for emerging markets of nearly 3%, along with a weaker U.S. dollar.

Drama surrounding Russian sovereign bonds has continued, in terms of whether these will officially default (it appears they haven't yet). While the funds appear to be available, political segmentation between 'sanctioners' and 'non-sanctioners' became an issue, as was the physical ability to transfer funds, given that Russia has largely been cut off from traditional payment networks like SWIFT. Russian bonds have also been removed from major indexes, now representing a very small market weight now that they're trading for pennies on the dollar. Sovereign debt defaults can be damaging for nations seeking global funding down the road, which almost all countries do. Assuming sanctions are someday removed, a recent default could mean a lack of access to global markets altogether, or a prohibitively high interest rate demanded by investors. Neither are great options for an emerging market economy.

Commodities fell back to earth last week, with slowdowns in China threatening to weigh on overall global demand—creating the organic 'demand destruction' often needed to contain commodity prices. The price of crude oil fell back by -6% on net to just over \$103/barrel, with industrial metals, precious metals, and agriculture down several percent as well. In addition to the Chinese influence, crude oil reacted to rising supply as the U.S. has engaged Iran and Venezuela in efforts to bring more crude online.

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, 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.

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