

## *Summary*

Economic data for the week included gains in retail sales, as well as improvement in consumer sentiment, and continued healthy jobless claims. However, producer and consumer price inflation continued to come in at multi-decade high levels.

In a holiday-shortened week, global equity markets were mixed to lower, as high inflation readings and negative sentiment about Ukraine weighed on risk-taking. Foreign outperformed the U.S. slightly due to a weaker dollar. Bonds continued to lose ground as interest rates climbed higher in keeping with high CPI and PPI readings. Commodities also gained, with crude oil and natural gas prices rising sharply.

## *Economic Notes*

(-) **Retail sales** in March rose 0.5%, just short of the median forecast calling for 0.6%. Removing the more volatile components from the measure, notably a 9% gain in gas station sales, core/control sales declined by -0.1%. This included 3-5% gains in electronics and general merchandise offset by a -6% drop in online/non-store retail. Overall though, 10 of the 13 categories were positive for the month. Year-over-year, retail sales were up nearly 7%, which actually lags the pace of headline inflation a bit (which is embedded into these nominal results). Overall retail sales have been heavily driven by high gasoline prices, which will affect this metric if/when normalization occurs. Importantly, rising financing rates could pressure retail sales to some extent as well, tightening conditions.

(+) **Industrial production** for March rose by 0.9%, beating expectations of 0.4% and ending Q1 gaining an annualized 8.1% rate. The single month's results were led by mining (including energy extraction in the high price environment), as well as over-1% gains in business equipment and consumer goods. Auto manufacturing was up 8% in the month, the strongest month in over a year. **Capacity utilization** ticked up by 0.6% to 78.3%.

(+) The **Empire state manufacturing survey** for April surged from contractionary levels by 36.4 points to 24.6, beating expectations of a far lesser gain to 1.0. Under the hood, new orders and shipments saw strong growth, as did inventories. Delivery times lengthened, but decelerated from prior months, while prices paid reached another record high level. Labor conditions showed minor improvement, with indicators already running at strong levels. Expectations for the next six months fell by over -20 points, however, but remained positive.

(-) The **producer price index** for March accelerated further by 1.4%, exceeding consensus expectations calling for 1.1%. Energy prices rising nearly 6% in March represented a key part of the headline increase. Removing food and energy, core PPI came in at 1.0%, about twice as high as expectations. On a year-over-year basis, PPI reached a multi-decade high of 11.2%, led by a 37% gain in energy, while core PPI rose 9.2% over the trailing 12 months. The commodity inflation input into these numbers is significant, with PPI calculated under earlier methodologies surpassing highs from the late 1970s-early 1980s Volcker Fed era, acting much more like the 1973-74 Arab oil embargo period.

(-) **Import prices** rose by 2.6% in March, exceeding the 2.3% median forecast. Removing petroleum, which rose 16% for the month, core prices rose a more tempered 1.1%—with still high gains in industrial supply prices. Year-over-year, total import prices are up over 12%. While inflation is high by any measure as of late, the imported variety is especially less productive, as exporting countries receive the benefit, to the detriment of importing countries. This has caused a dramatic chasm in results globally, with exporters such as Australia, Canada, Latin America, parts of resource-heavy Southeast Asia, and even the U.S., being subsidized by higher costs on importers including Europe, Japan, China, and India. These relationships have been exacerbated by the Russia-Ukraine conflict.

(-) The **consumer price index** for March came in 1.2% higher on a headline level, and 0.3% higher for core, when subtracting food and energy prices. Headline CPI was largely on par with consensus expectations, as energy prices rose 11% in the single month (with gasoline up 18%), and food rising 1%. Core prices rose a bit less than expected, as price rises for some categories decelerated, in addition to used cars falling by nearly -4%. This was largely expected (at some point) as auto inventories began to see a return to normal. However, airfares rocketed 11% higher for the month (24% for the past year), as fuel costs and higher passenger demand were offset by lower supply of flights and other problems (noted in the news regularly). Year-over-year, headline and core CPI came in at 8.5% and 6.5%, respectively, which represented an acceleration upward from last month. Again, these high numbers have set 40+ year records not having been seen since the early 1980s Volcker Fed era.

When is the peak? The timeline for higher-than-desired inflation continues to be pushed out, but many mainstream economists don't believe we'll be in a troublesome inflation spiral indefinitely. Several headwinds remain, the most important of which appears to be the zero-Covid policy in China that has again ramped up lockdowns in Shanghai and other cities, causing a backlog of manufacturing activities and hundreds of ships. This will take time to unwind, as it has in the port of Los Angeles. Markets have been persistent believers of a return to inflation normalization, which, when measured by the 5y-5y inflation rate is only 2.5%. (This is expected inflation, 5 years from now, for the following 5 years, based on nominal and real treasury and TIPS yields, calculated by the Federal Reserve Bank of St. Louis.) So, while agreement on an eventual normalization in prices seems to be the base case, current high gasoline and food inflation in particular has angered voters. Regardless of fault, high inflation presents the current administration with added challenges not to mention very low approval ratings. Mid-term election years can offer surprises and reversals of prior trends regardless of this.

(+) The preliminary **Univ. of Michigan consumer sentiment index** for April rose by 6.3 points to 65.7, exceeding an expected slight decline to 59.0. Assessments of current conditions rose by nearly a point, while expectations for the future improved by nearly 10 points. Inflation expectations for the next year were unchanged at an elevated 5.4%, as were those over the next 5-10 years at 3.0%. This represented a sharp and perhaps surprising rebound from pessimistic sentiment in March, with anecdotal commentary pointing to lower gas price increase expectations leading to the improved mood.

(+/-) **Initial jobless claims** for the Apr. 9 ending week rose by 18k to 185k, above the 170k level expected. **Continuing claims** for the Apr. 2 week fell by -98k to 1.475 mil., below the 1.500 mil. level expected by consensus. Initial claims rose in CA, MO, and MI, but were little changed in other states. Overall, continuing claims remain very low, in fact close to an all-time low when measured relative to total employment.

### ***Question of the Week***

#### ***What are the merits of U.S. Treasury-issued 'I Bonds'?***

An I bond is a type of savings bond issued directly by the U.S. government to consumers. In contrast to well-known EE savings bonds with a form of fixed coupon, I bond yields are inflation-linked. They're an interesting vehicle, with a few caveats. Purchases have to be made directly through the U.S. Treasury's Treasury Direct website, an online portal created to maintain electronic records of government securities offered to the public, as paper securities have been phased out. (A person could also use the account for buying EE savings bonds, Treasury bills, notes, TIPS, etc.—intended for long-term holdings, as it's not a standard trading platform.)

Pricing of I bonds consists of a fixed interest rate (currently 0.00%, updated semiannually) plus a variable inflation rate, which is also calculated semiannually and pegged to trailing CPI (announced in May and Nov. each year). Therefore, the total yield credited will change every six months. After living in relative obscurity since their inception in 1998, the recent inflation crediting rate of 7.12% (annualized, through 4/30/22) has caused I bonds to gain some attention in the press.

#### Pros:

- The inflation rate is variable. Therefore, like TIPs in a sense, credited interest rates rise directly with recent CPI. The higher the inflation, the more favorable the rate. This makes these different than other savings bonds and traditional fixed income, and even TIPs, which actually pay a fixed rate and the principal being the part that changes.
- Market values don't change as with other bonds and TIPs—just the interest rate—so principal is protected. Savings bonds have this unique quality, as non-marketable government debt.
- Interest earned automatically reinvests as new principal. Technically, these are considered 'zero-coupon' debt due to this characteristic.
- Interest from U.S. government obligations is state income tax-free. (It's taxable on a Federal level, with some exceptions when principal is used for qualified higher education expenses.)
- Taxes on interest can be deferred until redemption or maturity (but can be claimed annually if desired).
- U.S. treasury debt is considered 'risk-free' from the standpoint of credit rating agencies and markets generally when assessing risks of default, so it appeals to those seeking absolute safety.

#### Cons:

- The inflation rate is variable. The credited rate is a combination of a fixed rate and inflation-based variable rate. If period-over-period inflation goes negative—which is not common, but has happened several times since 1998—the rules state that the 'deflation' rate will subtract away from the fixed rate. (However, overall crediting interest rates have a floor of zero, so can't ever go negative.) If CPI deflated now, for instance, the bond would pay zero interest for six months or longer, since the fixed crediting rate is 0.00% (hence, no buffer). This is the risk/return trade-off you get with any inflation-linked securities.
- Purchase cap. Investments are limited to \$10,000 per person per year (\$20,000 married/joint), plus an extra \$5,000 cap if tax refund money is used to buy I bonds directly.
- Liquidity. The bonds are tied up for at least 12 months. If they're cashed out within the first 5 years, one forfeits the last 3 months of interest. The stated maturity is 30 years.
- This involves some extra work, including setting up an account with Treasury Direct, with the additional tax reporting, etc.

For broader concerns about inflation, in the context of a total portfolio, certain assets provide stronger protection than others, as we've seen over the past few years. Again, the fact that this being discussed to such a degree in the mainstream media could mean we're closer to the end than the beginning.

- Commodities, while volatile individually in their own right, have a very high inflation 'beta' of roughly 10x. This means they 'punch above their weight', so to speak, in a portfolio, due to the fact that various commodity items are both driven by inflation as well as can be causes of inflation themselves (such as crude oil, grains, and industrial metals).
- Real estate has the reputation as a solid inflation hedge, due to the fact that real asset price appreciation can follow inflation and landlords have the ability to raise rents as needed to keep up with broader price pressure.
- Equities have been effective while inflation remains contained to moderate, as companies have often been able to raise prices and keep margins intact as inputs costs rise. However, extreme inflation episodes (as in higher single-digits) have been more challenging for equities, since such environments can dampen economic growth overall and reduce the ability to pass on high input costs.

- With the exception of TIPs, traditional bonds have generally not fared well under high inflation, unsurprisingly due to the fact that interest rates have historically risen in these environments. However, shorter-duration bonds, including floating rate bank loans, have fared far better as interest rates are able to ‘float’ upward with market interest rates.

### ***Market Notes***

<b>Period ending 4/15/2022</b>	<b>1 Week (%)</b>	<b>YTD (%)</b>
DJIA	-0.78	-4.68
S&P 500	-2.11	-7.45
NASDAQ	-2.62	-14.50
Russell 2000	0.53	-10.41
MSCI-EAFE	-0.93	-8.51
MSCI-EM	-0.83	-8.84
Bloomberg U.S. Aggregate	-0.70	-8.54

<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
4/8/2022	0.70	2.53	2.76	2.72	2.76
4/15/2022	0.79	2.47	2.79	2.83	2.92

U.S. stocks were mixed in the holiday-shortened week, with high inflation numbers a bit below worst fears led hopes for a possible peak, while Q1 earnings season began. ‘Value’ sectors materials, industrials, and energy eked out minor gains, significantly outpacing large declines of 2-3% seen in technology, financials, communications, and health care. Real estate also fell back upon higher interest rates. Coming weeks should offer much more clarity on closely-watched Q1 company earnings.

Foreign stocks fared a bit better, with fewer losses than U.S. stocks for the week, helped by a weaker U.S. dollar. European market sentiment appeared to be helped by the fact that the ECB kept monetary policy language from becoming overly hawkish in fighting inflation pressures, instead keeping to schedule a Q3 end to its stimulative taper. Other key items of interest included the French presidential election and negative GDP growth in the U.K. Europe has been on the edge of low growth to a possible minor recession in 2022, fueled by higher natural gas prices and Russian energy reliance. However, the U.K. remains on an interest rate tightening path due to inflationary pressures, which outweigh the economic slowing at this point. Emerging markets were mixed, performing similar to developed markets on net with no clear unique story during the week. The Covid situation in Shanghai, however, continues to deteriorate, with the highest infection levels since the start of the pandemic and a two-week lockdown resulting in a variety of business and social strains.

U.S. bonds fell back again last week, as interest rates ticked higher in keeping with high CPI and PPI inflation reports. High yield debt outperformed, with flat results. Foreign bonds were held back in developed and emerging markets by a stronger dollar for the week.

Commodities continued a run of gains last week, led by strength in energy and agriculture; precious metals also increased a bit for the week, as gold maintains its popularity in 2022. The price of crude oil rose by over 8% to \$107/barrel. Natural gas prices rose even further, by 17%.

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.