Summary

Economic data for the week included gains in retail sales and industrial production. On the other hand, regional manufacturing sentiment fell back, as did several housing metrics as activity slowed along with historically-low residential home inventories.

Global equities were mixed on the week, with U.S. stocks down sharply once again, while foreign stocks gained ground. Bonds fared positively, with interest rates backing off of peaks. Commodities gained a bit, led by industrial metals rather than oil.

Economic Notes

(0) **Retail sales** rose 0.9% in April, just short of the median forecast of 1.0%, and a deceleration from the prior month, although it contained an upward revision. Nearly 70% of industries saw improvement in April. Removing autos from the headline number brought growth down to 0.6%, while the core/control number, removing all of the more volatile monthly components including autos, gasoline, and building materials, ended at a similar 1.0% (a few tenths better than expected). By category, misc. stores gained 4%, followed by gains in non-store/online motor vehicles/parts, and food/drinking places; on the other hand, sporting goods/hobby stores fell back. A positive is that core retail sales are up 9% from last year, with the index now up 27% from the pre-pandemic Feb. 2020 baseline—so improvement has been pronounced—keeping in mind that high inflation readings have been a decent proportion of the total nominal figure, leaving 'real' growth far lower. That adjustment isn't something we've had to really consider until the last year or so.

(+) **Industrial production** rose 1.1% in April, continuing a string of four straight positive months, surpassing the prior month's rate of change, and exceeding the 0.5% median forecast. IP is now up 4% over pre-pandemic levels. The manufacturing production component of the total rose 0.8%, as business equipment saw strong gains, including a 4% gain in auto production. Gains were also robust in utilities and mining production, each of which rose over 2%, with higher oil prices prodding drilling activity and higher rig counts. **Capacity utilization** rose by 0.8% to 79.0%, which is the highest reading in over four years.

(-) The **Empire manufacturing survey** fell back by a dramatic -36.2 points in May to a contractionary -11.6, well below the positive 15.0 expected and representing the lowest reading in two years. It appears the negativity continues to be related to lockdowns affecting manufacturing and deliveries from China, not to mention the war in Ukraine. Within the report, new orders and shipments both declined deeply into contractionary territory (under 0). On the other hand, employment gained nearly 7 points to a positive 14 reading. Delivery times improved, lengthening for a smaller number of manufacturers, while prices paid fell back although remaining at elevated levels. Expected business conditions six months out rose by several points, further into expansion.

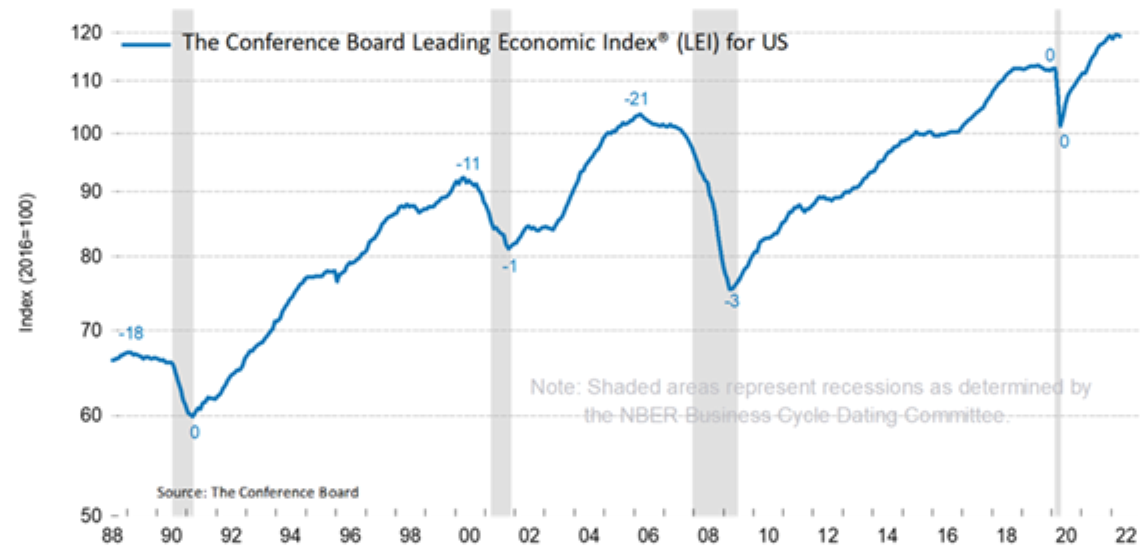
(-/0) The **Philadelphia Fed** manufacturing survey also fell, by -15.0 points to a still-expansionary 2.6 for May, well below the 15.0 reading expected and also the lowest reading in two years. Within the details, however, new orders and shipments improved significantly, while employment fell back but remained in expansion. Delivery times ticked down as well, noting that long lead times were problematic for a smaller number of survey respondents. Prices paid also improved (fell), but remained at a very high level, reflecting inflation. Assessments of business conditions six months in the future fell back by over -5 points but remained in expansionary territory. The special question for the month asked about inflation expectations over the coming year, the result for which ticked up to 6.5%, which was nearly 2% higher than the report in Feb. 2022. For the next 10 years, the inflation assumption ticked up a half-percent to 3.5%. As with other sentiment surveys, the current inflation bout is not expected to be long-lasting, which shows that deeply-embedded inflation concerns have not become anchored.

(-) **Existing home sales** in April fell back by -2.4% to a seasonally-adjusted annualized rate of 5.61 mil. units, a tenth below the expected -2.3% drop, but a lesser decline than in March. Results by type were similar, with single-family a bit weaker than condos/co-ops. Regionally, the West and South fell back by -5%, while the Midwest sales rose by 3%. Overall, sales are down -6% from a year ago. Over the past 12 months, the median sales price rose by 15% to $391,200, a strong but decelerated pace compared to the prior month. In fact, this also represented 122 consecutive months of year-over-year home price increases, which is also a record. The months' supply ticked up a tenth to 2.1, which remains near historical lows, with supplies down -10% from last year and running about half of 2019 average months' supply. This continues to reflect extremely tight inventory conditions relative to still-high purchase demand. Per the National Association of Realtors, it was noted that 'housing supply has started to improve, albeit at an extremely sluggish pace.' Also noted in the report, from data from Freddie Mac, the average mortgage commitment rate on a conventional 30-yr fixed rate mortgage had risen from 4.17% in March to 4.98% in April. This also represents a substantial increase from the average 2021 rate of 2.96% for a standard loan package. The tight inventories continue to vie with rising financing pressures in housing markets.

(0) **Housing starts** for April fell by -0.2% to a seasonally-adjusted annualized level of 1.724 mil. units, better than the median forecast calling for a decline of -2.1%, in addition to a downward revision for the prior month. Underlying results were mixed, with multi-family starts up over 15%, while single-family starts fell back by -7%. Regionally, starts in the South and West increased, while those in the Northeast and Midwest each fell back by over -20%. On a year-over-year basis, starts are up 15%, led by multi-family development as higher rents have encouraged more apartment building. (Far higher apartment rents, up 16% per data from Zillow, likely have also helped push demand for new supply.) **Building permits** fell by -3.2% in April to a seasonally-adjusted annualized rate of 1.819 mil. units, just beyond the expected decline of -3.0%. With permits, multi-family permits fell by -1%, while single-family were down -5%. Permits in the South rose by a percent, while they fell back in the other three areas.

(-) The **NAHB housing market index** fell back by -8 points to 69 in May, compared to a smaller drop to 75 level expected. All underlying segments declined, led by future sales coming in a bit below current sales and prospective buyer traffic. Regionally, the Midwest and West each fell back by -11 points, while the Northeast saw a small increase. While not considered a poor report by any means, the overall index has fallen to pre-Covid levels last seen in late 2019, perhaps in keeping with higher mortgage rates in recent weeks, which have historically thrown a wet blanket over housing sentiment.

(-) The Conference Board's **Index of Leading Economic Indicators** for April declined by -0.3%, following a minor increase the prior month. It was reported that April data was pulled down by weaker consumer sentiment and residential building permits. Overall, The Conference Board noted that recent results were essentially 'flat', negatively impacted by inflation, higher interest rates, supply chain disruptions, and pandemic shutdowns (such as in China). Over the past six months, the LEI was 1.8% higher on an annualized basis. Assessments of Q2 and beyond, though, remained positive from an economic growth standpoint, and most importantly, pointing to an absence of recession based on current observations. The coincident and lagging indicators for April, by contrast, each rose by 0.4%.



(-/0) **Initial jobless claims** for the May 14 ending week rose by 21k to 218k, higher than the 200k level expected. **Continuing claims** for the May 7 week fell back by -25k to 1.317 mil., below the 1.323 mil. consensus expectation. Half of the initial claims gains were due to KY, CA, and PA, while continuing claims continue to run at an extremely how historical level.

Question of the Week

What does the second wave of this year's stock market drawdown imply?

After peaking on Jan. 3, the S&P 500 fell by -13% to a first wave low on Mar. 8. This was followed by a quick 11% upward rally to reach a new lower high point on Mar. 29. Since then, stocks have again fallen, by -16%, resulting in a full-cycle decline of -19% from the peak Jan. 3 close. (They briefly touched -20% 'bear market' status intraday on Friday before closing a bit higher, to levels last seen in Feb. 2021.) Investors have tended to see such round percentage declines as key inflection points, noted by a few reversals taking place over the past month around the -15% to -20% marks.

Other than persistent high inflation and Ukraine war, which characterized the first wave, the most current concern is the rising chance of recession. The Federal Reserve's tone has become increasingly hawkish (Fed Chair Powell noting last week that 'some pain' could be needed), with the rising interest rate environment expected to continue for the foreseeable future. With that, the realization has set in that monetary policy might become so contractionary as to push the economy over the edge. (This has happened in the past during hiking episodes, so the concern is not unfounded.) Higher energy costs and Chinese lockdowns have compounded on these worries. Recent weakness in retail profits and a flattening in residential housing data have pulled these concerns closer to the surface. One might say there is no longer a sense of denial about possible downside as may have been the case in January.

In retail, a specific concern this past week was that the consumer, which has been a reliable booster of economic growth via pandemic goods buying, is waning, and could exacerbate a slowing economy faster than currently anticipated. While the Walmart results weren't as bad as the headline suggested (with same-store sales rising for the year), the company has found it harder to not pass on higher costs to consumers, proving a traditional fear about stocks during higher-inflation periods. It appears that consumers have also begun to move away from higher-margin items, such as appliances and TVs, toward staples, which are far less profitable. This is due to inflation price spikes to some degree, no doubt, but also the fact that intensive goods buying that was pushed forward during the at-home pandemic period is falling off more sharply. (As in, how many durables does a household need?) It also seems retailers have beefed up inventories to self-insure against overseas supply disruptions, but this can be a double-edged sword when demand declines. This is in contrast to the just-in-time inventory systems widely adopted during the last few decades that keep inventories slim, but also proved problematic during hiccups in re-supply. The recent higher inventories are more reminiscent of an earlier era—where the economy behaved more cyclically and was more sensitive to slowdowns.

A recession is loosely considered to be at least two back-to-back negative GDP quarters, but is qualitatively defined officially by the NBER in the U.S. Most importantly for stock markets, recessions have generally resulted in negative earnings growth (a median decline of -13%, per Goldman Sachs data since World War II, but followed by a 17% median gain by four quarters later). Over the 12 recessions since 1945, the S&P 500 has fallen by a median of -24% peak-to-trough. The average drawdown is -30%, being pulled down by a handful of more extreme episodes in 2000 and 2008. In over half of those pre-recession cases, the drawdown fell between -14% and -22%. Also on average, the market has appeared to price a recession 7 months prior to the official start of a recession. As a general rule, the market has tended to peak prior to a recession, but also trough before the recession is over. This reflects the well-noted tendency of the market to look ahead by several quarters, as opposed to obsessing about what's happening at the moment.

So, being at the threshold of a -20% bear market, debate continues about what probability of recession the market is pricing in, but it does appear to be doing so. The volatility and 'bear rallies' have certainly made the drawdown this year seem far worse than it is, especially from a media perspective. Therefore, the current decline has not seemed to price in a severe recession. (It's important to note that earnings growth remains strongly positive, in fact, is running above average.) Critical to remember is that recessions aren't the end of the world. They represent a normal conclusion to a business cycle, although we've been profoundly sensitized by the last few recessions that were coupled with more extreme circumstances: a surprise global pandemic and global financial crisis. Not all historical recessions are this dramatic. A minor recession (if one even comes to pass in the near-term) could serve as a 'pause to refresh', one might say, creating a new potential phase of upward economic growth. No doubt, by the time such a scenario becomes obvious, markets will have already priced it in, making 'waiting' for 'good times' a futile exercise, per usual.

Market Notes

Period ending 5/20/2022	1 Week (%)	YTD (%)
DJIA	-2.78	-13.29
S&P 500	-3.00	-17.67
NASDAQ	-3.77	-27.20
Russell 2000	-1.05	-20.67
MSCI-EAFE	1.50	-14.43
MSCI-EM	3.13	-15.39
Bloomberg U.S. Aggregate	0.59	-9.18

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
5/13/2022	1.03	2.61	2.89	2.93	3.10
5/20/2022	1.03	2.60	2.80	2.78	2.99

U.S. stocks started the week on a down note, with Chinese retail sales falling over -10% from a year ago, as well as a lowering of stock market estimates from well-watched Wall Street strategists. After another subsequent rally, stocks fell back again sharply mid-week along with several high-profile earnings reports in the retail space—notably Walmart and Target. After some false starts, stocks remained negative through the end of the week.

Results were again strangely mixed by sector, with energy up over a percent, followed by minor gains for defensive health care and utilities. However, consumer stocks (both cyclical discretionary and defensive staples sectors) were punished on the order of 7-8% on the week, in keeping with retail concerns noted earlier. Industrials and technology also fared poorly, each down over -3%, while real estate fell by nearly -2%. In consumer discretionary specifically, Target shares dropped close to -30% as earnings and outlook showed the impact of goods inflation and difficulty in achieving balance between consumer demand/supply. Tesla shares were also hit following the removal of the firm from the S&P 500 ESG Index, as apparent problems with culture and working conditions outweighed the focus on fossil-free electric vehicles. Consumer staples, traditionally a stalwart of defensiveness serving as a port in the storm of market volatility historically, suffered due to Walmart's -20% decline, and a similar negative reaction with Costco.

Foreign stocks outperformed U.S. equities in local terms, with minimal change, but this turned positive with a decline in the U.S. dollar. News in Europe has been as mixed as that in the U.S., with U.K. inflation surging to 9%, although other fundamentals, such as labor markets, appear decent. Economic growth for the Eurozone was revised up a tenth to 0.3%, actually surpassing that of the U.S., while estimates for growth over the rest of the year have been lowered. The Japanese economy, on the other hand, fell back by -1% in Q1, more akin to the U.S., although inflation is far lower. Emerging markets also gained on net, with strength in Brazil, Mexico, and China. Chinese assets were boosted by the central bank decision to cut the prime lending rate in efforts to stimulate the economy out of recent pandemic stagnation, as well as hopes that the Shanghai lockdown's ease will continue.

U.S. bonds fared positively on the week, as interest rates continued to fall back from highs and investors moved away from equities into the recently higher-yielding bond market. Treasuries outperformed all corporates, as spreads also widened. Foreign bonds performed positively across the board in developed and emerging markets, helped most by a decline in the dollar.

Commodities ticked up slightly across most sectors, but were led higher by both industrial metals (copper and aluminum) and precious metals (silver). The price of crude oil was little changed on net, settling at just over $110/barrel, although natural gas rose another 5%. The prior week's ban of wheat exports by India drove the price significantly higher, resulting in a Chicago market trading limitation, as global supplies were already strained. While nowhere near a major a player as Russia or Ukraine in the world grain markets, the quick ban due to low supplies rattled commodity market sentiment before falling back to earth by the end of the week as concerns over Europe's supply were described as 'overblown'.

Have a good week.

Ryan M. Long, CFA
Director of Investments
FocusPoint Solutions, Inc.

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, National Association of Realtors, 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.

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