Summary

Economic data for the week included a slight downward revision in first quarter GDP, positive durable goods orders, along with weaker new home sales data and consumer sentiment.

Global equity markets rose broadly last week, with U.S. stocks outperforming foreign. Bonds also fared positively, with interest rates pulling back upon a possible peaking in inflationary pressures. Commodities rose due to gains in crude oil and natural gas.

Economic Notes

(-) The second or 'preliminary' **U.S. GDP** report for Q1 was revised down a tenth from -1.4% to -1.5%, contrary to expectations for a small improvement to -1.3%. Under the hood, personal consumption was revised up by another 0.4% to 3.1%. However, this was offset by declines in business equipment, business structures, and residential investment. The overall decline remains driven by a large surge in net imports during the quarter (and negating any normal positive growth impact of exports by several percent). The core **PCE price index** was actually also revised down a tenth to an annualized rate of 5.1% for Q1.

According to the most recent Atlanta Fed GDPNow measure from Friday, Q2 growth is estimated to be 1.9%, and has steadily fallen in recent weeks. They've quoted the Blue Chip forecasts still running in a range of 1.5% to 4.0%, with the average at just below 3%. This isn't bad growth by any means, and doesn't look recessionary right now. There has been deceleration in certain segments, and mismatches between supply problems and high inflation resulting in some demand destruction, but overall expectations for this year remain in the rough 2.5-3.5% range. This is still above the 2.0-2.5% average pre-Covid trend level, and not indicative of the widespread deterioration often seen prior to a recession. Then again, recessions can be stealthy, especially the mild ones. However, those are far less damaging than some of the recessions we've become overly sensitive to over the past two decades, including a financial crisis. A possible scenario, although not discussed much now, is a natural ebbing of growth through the latter part of 2022 and early 2023, with supply chain improvement and Chinese imports resulting in a glut of goods arriving at once. This 'old school' inventory problem could eventually weigh on companies if consumer demand isn't there to absorb it. At the same time, though, it could also serve to depress inflation, and possibly quickly.

(0) **Personal income** for April rose by 0.4%, just short of the 0.5% growth expected, with the year-over-year gain reaching 3%. **Personal spending** rose 0.9%, exceeding the 0.8% expected, and reaching a 9% increase over the past 12 months. Increasingly, spending is seeing a movement away from goods seen during the pandemic into services, which reflects a more normal environment. Consequently, the personal savings rate fell back by -0.6% to 4.4%, which is actually the lowest level since 2008. The **PCE price index** rose 0.3% in April on both a headline and core level, a bit higher than expected. Year-over-year, headline and core PCE are up 6.3% and 4.9%, respectively, which represents a deceleration from rates of growth seen the prior month.

(+/0) **Durable goods** orders in April rose by 0.4%, just below the 0.6% median forecast expectation, and included a downward revision for March by nearly half of the reported increase. Removing the more volatile components, core capital goods orders rose a similar 0.3%, which was two-tenths below expectations. Core capital goods shipments rose 0.8% in April, on the other hand, beating expectations of 0.5%.

(-) **New home sales** for April fell by a sharp -16.6% to a seasonally-adjusted rate of 591k units, well below the -1.8% decline expected, and beyond a revised -10.6% the prior month. This was the lowest level in two years, and, in fact, just a percent above the bottom of the early Covid period. Every region experienced a decline, led by the South down -76k and West down -26k. Details of the new home data is more nuanced, though, with 'completed homes' remaining at very low levels, while 'homes under construction' are running at the highest levels in 16 years, and taking up the bulk of the activity.

Despite high demand, it appears fading affordability is starting to weigh on sales. For example, on a $400,000 home purchased with a 30-year fixed rate mortgage (assuming 20% down), an uptick from a 3.0% interest rate (seen around year-end) to a 5.3% rate (more recently) elevates the monthly payment from $1,349 to $1,777—a 32% increase. From the standpoint of the average American budget, this starts to become significant as the house price component rises.

(-) **Pending home sales** for April fell by -3.9%, further than the -2.1% decline expected. Year-over-year, pending sales have fallen by -12%. Sales rose in the Midwest by nearly 7%, but declined elsewhere, most dramatically in the Northeast by -16%. This tends to forecast existing home sales in coming months.

(-/0) The final May **Univ. of Michigan index of consumer sentiment** ticked down by -0.7 of a point to 58.4, which follows an initial early May drop of -6.1 points. This was below expectations of an unchanged 59.1 reading, and represents the poorest sentiment since 2011. Compared to the initial report, assessments of current economic conditions ticked down slightly, while expectations for the future fell by over a point. Expectations for inflation in the coming year fell back by -0.1% to 5.3%, while expectations for the next 5-10 years were unchanged at 3.0%. Could this be a peak in inflation expectations? That remains an important data point for markets and policymakers. As has been noted previously, poor sentiment has tended to be a contrarian positive signal for financial market recovery over the next 6 and 12 mo. (although it never feels quite so great at the time).

(0) **Initial jobless claims** for the May 21 ending week fell by -8k to 210k, below the 215k median forecast. **Continuing claims** for the May 14 week ticked up by 31k to 1.346 mil., above the consensus expectation of 1.310 mil. Initial claims were mixed, with small increases in IL and CA of a few thousand each, but no extreme results. Despite continued claims edging higher, overall levels remain very low as a share of overall eligible employment.

(0) The **FOMC minutes** from the May meeting showed strong consensus within the committee for several upcoming 0.50% fed funds rate hikes for June and July, and bringing that rate to 'more neutral levels' as an important goal. However, in a 'highly uncertain' environment, focusing on near-term data will become more important. (They occasionally have to reiterate their focus on 'data dependence', which is what they're normally doing, but can also be a code for 'we reserve the right to change our minds quickly and change course if we need to.') Additionally, a policy turning more restrictive may also become appropriate, although a pause in hikes might also be considered in order to re-evaluate conditions. Interestingly, it appeared the committee acknowledged that their prior communications had been effective in re-setting market expectations for a faster pace of rate hikes. In another interesting component, several committee members showed interest in proactive sales of the Fed's MBS portfolio following an initial balance sheet run-off. This remains less likely, but does show the FOMC is sensitive to the fact that the housing market is not really in need of stimulating.

Market Notes

Period ending 5/27/2022	1 Week (%)	YTD (%)
DJIA	6.28	-7.85
S&P 500	6.62	-12.21
NASDAQ	6.85	-22.21
Russell 2000	6.49	-15.51
MSCI-EAFE	3.48	-11.45
MSCI-EM	0.91	-14.63
Bloomberg U.S. Aggregate	0.78	-8.47

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
5/20/2022	1.03	2.60	2.80	2.78	2.99
5/27/2022	1.08	2.47	2.71	2.74	2.97

After 7 consecutive down weeks, U.S. stocks moved sharply higher. In fact, last week's strong snapback was one of 20 best-performing weeks since 1950. Every sector ended in the positive, led by consumer discretionary stocks up nearly 10% and energy over 8%, while health care lagged with only a 3% gain.

Following a decent Monday recovery, a warning from Snapchat about revenue conditions sent stocks (particularly more speculative growth) down sharply. The CEO of the firm noted that the macro environment had deteriorated further than anticipated after their earnings release last month. With revenues coming from advertising (and the app generally free to most users), the firm is sensitive to marketing spend from companies, which is often one of the early budget cuts during an economic downturn. This also affects far larger firms Alphabet/Google and Meta/Facebook. But how devastating was that statement? While the stock was down significantly, growth rates remain high, so it's possible this coming quarter or future quarters could be a 'kitchen sink' type of period, where all the bad news is thrown in under the category 'economic slowing', with hopes any stock-specific weakness can be swept under the rug. This is how it often happens. But is Snapchat a true bellwether of the U.S. economy? Many would argue probably not.

Foreign stocks also fared positively last week, but to a lesser degree than in the U.S. The ECB noted it intends to exit its zero-interest rate policy by Sept., which caused the U.S. dollar to fall back. The 'carry trade' has been one of the reasons for the dollar's strength this year, with the Fed acting in a more hawkish way than Europe, Japan, or the U.K., the primary currency pairs. Emerging market gains were largest in commodity-exporting Brazil, South Africa, and Mexico. Sentiment in China remains mixed, with reopenings commencing but internal debate about the zero-Covid policy and potential for a longer slowdown.

Interestingly, the U.K. introduced a 25% windfall tax on the energy industry, under the sentiment that oil and gas firms have profited overly from high commodity prices that have pressured inflation higher. Sentiment toward taxing the energy industry has occurred regularly over the years, particularly in years when high prices have resulted in high profits; on the other hand, lean years in the industry, where oil prices fall so low as to make extraction unprofitable or less profitable, little protection from bankruptcy is provided on the opposite site.

U.S. bonds experienced a positive week again as interest rates fell back from recent peaks, in keeping with general thoughts that economic slowing could dampen the Fed's hawkishness recently. Treasuries as a whole were less dramatically changed, while corporate bonds fared positively along with a strong week for equities. Foreign bonds fared positively, especially in emerging markets, helped by a weaker U.S. dollar.

Commodities fared well on the week, helped by a weaker dollar, with gains of 5% in energy outweighing mixed results in metals and little change in agriculture. The price of crude oil rose by over 4% to just over $115/barrel, and natural gas rose by 8% (bringing year-to-date gains to well over 100%).

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.

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