Summary

Economic data for the week included the Federal Reserve raising short-term interest rates by a half-percent, an amount not seen in over two decades. The employment situation report for April continued to show a strong improvement in jobs, while the unemployment rate remained unchanged at a tight level. ISM manufacturing and services fell back a bit, but remained solidly in expansionary territory.

Global equity markets experienced another volatile week, with U.S. stocks outperforming foreign markets. Bonds also declined along with rising interest rates, prompted by the Fed policy move. Commodities ended higher, driven by tight crude oil supplies.

Economic Notes

(0) As noted earlier in the week, the **Federal Reserve** raised the key fed funds rate by 0.50% to a range of 0.75-1.00%. In his post-meeting press conference, Fed Chair Jerome Powell took an initial moment to address the American people directly about how seriously the Fed is taking the current bout with high inflation. This points to the prioritization of their various objectives, notably as higher prices weigh on low-income citizens to an increasing degree, particularly through gasoline and food prices. While mentioning influences from China and Ukraine, he also noted that 'our tools don't really work on supply shocks, they work on demand...however, there's plenty to be done there.' In fact, he mentioned the willingness to take the fed funds rate higher than the long-term neutral rate, which had been an open question in recent months.

He also essentially took a 0.75% rate hike off the table, which ran counter to market-based expectations of such a hike of that magnitude in June (per CME Group futures markets). In fact, the comment was seen as dovish by many observers, referred to as a 0.25% 'rate cut', although that might be an exaggeration. Nevertheless, it was taken as dovish and markets reacted to the news with a sigh of relief (per the Wed. post-meeting rally), but later realized a series of 0.50% hikes could be just as restrictive (per the Thurs. pullback). But, as is often the case, the Fed has 'clarified' comments that have caused volatility in financial markets. Again, this points to markets in a continued period of 'price discovery' with new assumptions undergoing faster revision than normal.

Questions remain about what the 'terminal rate' will be for fed funds, the level at which this contractionary policy stage ends. To point out the distinction, the 'neutral rate' is the longer-run rate where monetary policy is deemed to be neither expansionary nor contractionary—it's as much theoretical as actual, as it's a consistently moving target. That neutral rate has been noted in recent months (an average of the dots on the published March dot plot) at 'around' 2.50%, with a range of estimates being between 2.00-3.00%. This is a wide disparity, but possibly not surprising considering how imprecise the measurement of any neutral rate is over time. If inflation needs to be controlled, the accepted theory is that the terminal policy rate needs to rise *above* the neutral rate for a time, to counteract the earlier loose policy effects. This terminal rate expectation varies, but the same CME Group estimate from July 2023 (the furthest-out figures currently) has a central tendency of 3.25-3.75%. However, there is some skepticism about this rate being followed through on if the economy continues to slow, and especially if inflation begins to normalize lower in the meantime.

(0/-) The **ISM manufacturing index** for April fell back by -1.7 points to 55.4, falling short of expectations calling for 57.5. Despite falling to the lowest monthly reading in a year and a half, being over 50, this reading is still solidly expansionary. Under the hood, production and new orders fell back a bit, as did employment. Prices paid fell by several points, but remained at a high level. (Normally that would be a seen as a sign of economic slowing, which it is here most likely, but also some relief from accelerating inflation trends.) On the other hand, supplier deliveries rose further. All but one of the 18 industries reporting showed expansion for the month, with respondents generally optimistic. From anecdotal comments, it appeared that supply constraints and labor

shortages continued to weigh on results, as did impacts from the war in Ukraine, while consumer demand remains high.

(-) The **ISM services/non-manufacturing index** for April fell back by -1.2 points to 57.1, below the expected small increase to 58.5. The underlying components were generally weaker, with new orders falling by over -5 points but remaining expansionary, while employment fell by nearly that much, but dipped below 50 into the contractionary zone. The latter appeared to be driven by labor shortages as opposed to slower activity or demand. Supplier deliveries and prices paid each rose again more firmly in expansion, and to near record levels. Business activity overall gained nearly four points to a reading of 59, which remains firmly in expansion. As noted on a variety of occasions, the demand for services has been rising, taking over leadership from goods that fared so strongly during the pandemic, but held back by labor and other 'supply' considerations.

(0) **Construction spending** rose 0.1% in March, far short of the 0.8% gain expected; however, several prior months were revised higher. Additionally, when adjusted for construction cost inflation for the month, the real spending number was about -1%. Back to nominal terms, private and public residential spending each rose up to a percent in March, while non-residential construction spending fell back, most notably on the private side.

(+) The **JOLTs** government job openings report for March showed a gain of 205k to 11.549 mil., exceeding the expected decline to 11.200 mil., and included a prior month revision. In fact, the jobs-to-workers gap has reached 3.4% of the labor force (5.6 mil.), representing another all-time high for the series. By segment, professional/business services rose 103k, followed by manufacturing (75k) and financial (52k); on the other hand, hotel/food services jobs fell back by nearly -60k. The job openings rate rose a tenth to 7.1%, while the hiring rate was unchanged at 4.5%. On the other side, the layoff rate was unchanged at 0.9%, while the quit rate rose another tenth to 3.3%, which is near an all-time high for that metric. These results obviously suggest high labor market tightness.

(-/0) The **ADP private employment** report rose by 247k in April, falling well short of the 383k expected. However, the March number was revised upward. Services jobs rose by 202k, more than a third of which were in leisure/hospitality. Goods-producing jobs also gained, by 46k. The overall number has now exceeded the pre-Covid peak, as measured from Dec. 2019 data, while subcomponents such as leisure remain lagging. This jobs model will vary a bit from the government nonfarm payrolls figures, but has reflected a deceleration in new jobs, not for lack of these being needed, but rather lack of workers.

(+) **Initial jobless claims** for the Apr. 30 ending week rose by 19k to 200k, above the median forecast calling for 180k. **Continuing claims** for the Apr. 23 week fell by the identical -19k to 1.384 mil., below the 1.400 mil. level expected. In fact, this was the lowest continuing claims report since early 1970, not including the fact that the size of the labor force has doubled since that time, making these readings more impressive. Claims were mixed by state, with individual changes fairly minimal. Overall continuing claims remained near a historical low of total covered employment, as low claims levels have held back even further improvement.

(+) The employment situation report for April was considered robust, and in line with already tight labor market conditions. Areas most challenged by the pandemic, notably leisure, hospitality, etc. have shown consistent improvement along with business reopenings and consumer reengagement, but still are operating at labor levels roughly 5-10% below pre-pandemic levels. As a whole, fewer employees have reported being affected by the pandemic, as would be expected at this point, with some metrics having returned to their pre-pandemic/early 2020 levels. A key question is how much further can these improve? There is likely room left, probably in the most-affected areas such as hospitality and travel.

Nonfarm payrolls rose by 428k, matching last month's number with revisions, and higher than the 380k expected by consensus. Additionally, February and March gains were revised down a bit, but not significantly. Job gains were described as widespread, with increases in leisure/hospitality (78k, although a slower pace than

expected and in recent months), manufacturing (55k), transportation/warehousing (52k), professional/business services (41k), and retail (29k). Segments such as construction and government changed to a lesser degree in the month.

The **unemployment rate** was flat at 3.6%, versus expectations for a decline of a tenth to 3.5%. The U-6 underemployment rate, on the other hand, actually ticked back up by 0.1% to 7.0%. The labor force participation rate ticked down by -0.2%, in contrast to a rise of a tenth, which played a role in these metrics. In the household survey portion of the report, the number of jobs fell by -353k. This measure is calculated differently, including a broader range of employment options (nonfarm payrolls counts jobs, while the survey counts people). **Average weekly earnings** rose 0.3%, bringing the year-over-year change to 5.5%—notably below that of inflation. The **average workweek** length was flat at 34.6 hours.

(-) **Nonfarm productivity** fell by an annualized rate of -7.5% in Q1, in a sharp reversal from a gain the prior quarter. This was further than the forecast of -5.3%, not to mention the largest quarterly decline since 1947. The year-over-year productivity rate declined by -0.6%. **Unit labor costs** rose by an annualized 11.6% in Q1, exceeding the median forecast calling for 10.0%. The year-over-year rate of unit labor costs doubled to 7.2%, in keeping with overall wage inflation quoted elsewhere and tight labor markets.

Market Notes

Period ending 5/6/2022	1 Week (%)	YTD (%)
DJIA	-0.21	-8.92
S&P 500	-0.18	-13.07
NASDAQ	-1.50	-22.19
Russell 2000	-1.29	-17.77
MSCI-EAFE	-2.83	-14.49
MSCI-EM	-4.12	-15.77
Bloomberg U.S. Aggregate	-1.11	-10.51

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
4/29/2022	0.85	2.70	2.92	2.89	2.96
5/6/2022	0.85	2.72	3.06	3.12	3.23

U.S. stocks experienced more volatility last week, largely surrounding the Federal Reserve meeting and future tightening expectations noted earlier. Markets reacted tentatively early in the week, prior to the meeting, but rallied on Wed. after the 0.50% hike—especially after mention in the press conference of confidence in achieving inflation goals and also that a 0.75% hike is not actively being considered. This reassured markets to a large degree, perhaps due to the fact that such a dramatic hike is not seen as needed. However, Thursday's equivalent decline offset that positivity, before things settled down a bit by Friday. The S&P remains near its -15% correction level, while the Nasdaq and small caps remain down more than -20% from highs. Within each index, stock dispersion remains greater, with half of the stocks in the Nasdaq now down over -50% from 52-weeks highs, as reported by Bloomberg.

Interestingly by sector, the majority of returns were little changed on the week, in keeping with the index. Energy was the largest contributor to returns on the week, up 10% due to gains in oil prices upon supply concerns, while utilities also provided positive returns. Consumer discretionary stocks lost several percent due to weakness from Nike and Amazon. Real estate also fell sharply along with rising interest rates.

Foreign stocks fell back by several percent, with emerging markets faring the worst of the group. European markets were largely driven by negative sentiment surrounding the U.S. Fed, and potential for more hawkish policy in their own region, despite economic struggles related to Ukraine and Russia. The Bank of England hiked rates by 0.25% to 1.00%, with policy trajectory falling somewhere between the hawkish U.S. and far less hawkish Europe. Chinese stocks fell back by over -5%, with concerns over Covid levels now in Beijing continuing. Concerns also remain about policy easing, specifically ensuring it remains targeted toward consumption and core business activities, as opposed to instead fueling housing speculation (which has contributed to current credit problems in the real estate sector).

U.S. bonds declined across the board, as the Fed rate hike pushed interest rates higher generally—the 10-year treasury tipped over 3% for the first time in four years. High yield and senior loans fared slightly better, although were also negative along with mixed equity results. With a stronger dollar, foreign bonds also lost ground.

Commodities rose by several percent last week, again negatively correlated to equity and bond prices. However, this was entirely due to energy, as industrial metals, precious metals, and agriculture lost some ground. The price of crude oil rose by 5% to just under $110/barrel, as markets weighed the impact on a further government bans on Russian oil outright—which would tighten global supplies further as OPEC+ nations have not been willing to open the spigots further. Natural gas prices also gained by over 10% again. The European Commission this week rolled out even more sanctions on Russian energy last week, including phasing out all crude oil imports over the next six months (25% of their oil used) and refined petroleum by year-end. (However, natural gas will continue to be imported for the time being.) Considering Europe's reliance on Russian petroleum, this was seen as ambitious.

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, Seeking Alpha, 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.