Summary

Economic data for the week included consumer price inflation coming in high in keeping with expectations. Consumer sentiment remains challenged, at its lowest levels in decades, due to high inflationary pressures, notably with gasoline. Jobless claims were little changed, when adjusted for seasonal effects.

Global equity markets fell back last week, as high inflation reports and poor consumer sentiment dampened risk-taking. However, emerging market stocks fared better as pandemic conditions in China appear to be improving. Bond markets fell back again with interest rates rising across the board. Commodities were mixed overall, but oil and natural gas prices continued to move higher.

Economic Notes

(-) The **consumer price index** for May rose by another 1.0% on a headline level, and 0.6% for core, after removing food and energy prices. These were higher than the expected 0.7% headline and 0.5% core increases. During the month, gasoline prices rose again by 4%, partially reversing a -6% pullback in April. Within the core segment, shelter costs, a large piece of the overall pie, rose 0.6%. The prices of new and used cars again rose, by 1.0% and 1.8%, respectively. Transportation services rose by well over a percent, affected by fuel costs, as were airline fares, which gained another 13% (and up 38% over the past 12 months).

This brought the trailing year-over-year figures to 8.6% and 6.0% for headline and core CPI, respectively. The headline number represents an acceleration from the prior month, while core prices are down from the March peak pace of 6.5%. The energy category, up 35%, is the primary culprit, with energy commodity prices up by 50%—naturally, these have trickled through to a variety of spending categories. Food prices being up 10% have also weighed heavily on consumers, particularly on those of lower income. Shelter costs for the trailing 12 mo. are nearly 6% higher, on the back of both stronger rents and home prices. A significant portion of total CPI, housing price pressures could remain persistent for a longer time than the others, as some economists have warned.

The Atlanta Fed puts out more detailed inflation reports each month, labeled 'Sticky CPI' and 'Flexible CPI'. Sticky goods and services are those that don't tend to change frequently, such as both rent and owners' equivalent rent, restaurant food, recreation, household furnishings, and medical care. Flexible items, by contrast, tend to be in more constant flux, and include new and used cars, hotel lodging, groceries, and petroleum of all types. Sticky prices are 'only' up 5.2% for the past year, while flexible prices have gained 18.5%. Like headline CPI, the latter index is obviously driven by energy, but to an even more dramatic degree. For comparison's sake, going back to the starting date for these measures in 1967, the year-over-year sticky and flexible price gains have averaged 4.3% and 4.0%, respectively, as both positive and negative volatility in flexible prices has largely been self-correcting over time.

Economists and investors have been searching intently for signs of the ultimate peak in this inflationary episode. It's been surmised that we've just about reached it, absent more pandemic-related shutdowns or other supply-driven hang-ups. However, we haven't seen a true drop-off towards normalcy, primarily due to the persistent impact of rising commodity prices. This doesn't mean the elevated inflation regime is over, but there is hope the absolute worst could be almost over (with fingers crossed globally). Estimates for CPI heading into later 2022 are expected to eventually ease toward the 5% range (the Congressional Budget Office has estimated a 4.7% CPI rise for 2022 in total), with those for 2023 still elevated in the 3-4% range. However, relief hopes have already been pushed out several times.

So, the condensed story is that inflation is anticipated to improve, just not quickly. This should keep the Fed in the hawkish camp, which we'll learn more about following their meeting mid-week. The minutes from the May FOMC meeting mentioned 'inflation' 66 times, which was actually down from the March meeting. There are other side effects of continued-high inflation aside form the obvious consumer and business pain. Political leaders, rightly or wrongly, often receive a lot of the blame during such episodes—for not doing enough to ease the burden, particularly with gasoline prices. (However, this is a much deeper story related to low capital spending incentives in the energy industry and a lack of adding refinery capacity, for financial and environmental reasons.) As a result, the Biden administration has already been compared to that of President Carter of the late 1970s—which could have mid-term election ramifications in November. At the same time, headline numbers such as high gasoline prices cast perhaps an overly negative light on overall prices. The Federal Reserve Bank of Cleveland offers a dashboard of various measures, with the average being about a 5% inflation pace.

(-) The preliminary June **Univ. of Michigan index of consumer sentiment** fell by -8.2 points to 50.2, a -14% drop, and well below expectations for a minor decline to 58.1. This represented an all-time low for the survey since its inception in the 1950s. As noted by the survey's director, such pessimism similar to that last seen during the 1980 recession. Assessments of current conditions fell -7.9 points (-12.5%), most notably due to inflation—specifically, high gasoline prices were mentioned by half of respondents. Expectations for the future also fell, by -8.5 points (-15.2%) for the month. Interestingly, despite the negative sentiment around today's price environment, expectations for inflation over the coming year only ticked up by 0.1% to 5.4%. Inflation expectations for the next 5-10 years rose by 0.3% to 3.3%, after having stayed in the 2.8-3.0% range over the past year. The latter is likely of concern to the Fed, which keeps a close watch on inflation expectations.

(0/-) **Initial jobless claims** for the Jun. 4 ending week rose by 27k to 229k, above the median forecast of 206k. However, the change was minimal (1k) on a non-seasonally adjusted basis, rendering the change likely related to the Memorial Day weekend. Claims rose by over 5k in CA and PA, while declines were seen in several states. **Continuing claims** for the May 28 week were unchanged at 1.306 mil., just above the 1.303 mil. expected. The level of claims relative to the total insured universe remains near all-time lows. While some job openings have fallen back, claims, which are more related to layoffs, have remained in a holding pattern.

Market Notes

Period ending 6/10/2022	**1 Week (%)**	**YTD (%)**
DJIA	-4.56	-12.78
S&P 500	-5.04	-17.60
NASDAQ	-5.59	-27.26
Russell 2000	-4.37	-19.39
MSCI-EAFE	-4.65	-15.80
MSCI-EM	-0.53	-13.58
Bloomberg U.S. Aggregate	-1.52	-10.65

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
6/3/2022	1.21	2.66	2.95	2.96	3.11
6/10/2022	1.39	3.06	3.25	3.15	3.20

U.S. stocks ended on another dour note last week, as any hopes for improvements in inflation were dashed. Markets were mixed through Thursday, when a sharp decline was driven by higher jobless claims and worries over the Friday CPI release, which turned out to be higher than expected. The World Bank has downgraded its global growth forecast from 4.1% earlier in the year, down to 2.9%, based on the impact of higher food and energy prices. This has raised the fears of rising recession probabilities, despite the still-high growth rates in the U.S. and moderate growth for Europe.

All sectors were negative last week to varying degrees, with energy faring best, with minimal losses, followed by more defensive and low-beta consumer staples and healthcare. Real estate also fell back by -6% along with higher interest rates and an anticipated negative impact on near-term financing sentiment.

While stock splits are fairly normal occurrences, the more unusual 20-for-1 split with Amazon shares caused a short-lived rally for the company, and consumer discretionary sector, of which it's a significant component. What's the big deal? A split doesn't change a company's overall market value, just rearranges the price and shares (1 sh. @ $2500 = 20 sh. @ $125). However, it has been thought to make investment in a company more accessible to smaller investors, and can also increase the appeal for inclusion into the Dow Jones Industrial Average, a price-weighted relic which uses a complicated sizing multiple that becomes more difficult with extreme share prices outside the normal range of $50, $100, etc. But, there is some cache involved with being part of the DJIA.

Foreign stocks suffered similarly to those in the U.S., with Europe coming in worst, and better results from Japan and the emerging markets. The ECB announced last week that asset purchases will end this month. This was in addition to committing to a 0.25% rate hike next month, a pace which could be raised to a 0.50% by early fall—finally moving away from their current -0.50% key deposit rate. This was more hawkish than the bank had been in some time, as concerns over inflation finally surpassed those about slow economic growth caused by pandemic supply issues and now the Ukraine war/Russian energy costs.

There had been some early speculation that they could actually raise rates this month, to combat rising inflation, but the more conservative route was taken instead, by implying that quantitative easing will be ending by July. Rate hikes of a quarter-percent each are expected to occur later in the summer. At the same time, European growth is weaker, and closer to recession than is the U.S., making a rate hike narrative more difficult. In the emerging market world, the less negative week was led by gains in China, as reopenings from lockdowns continued and the government appeared to be easing restrictions on technology companies. Coupled with substantial stimulus, investors are hoping recent poor results have troughed.

U.S. bonds were held back by the strong CPI report and ECB tightening language, causing yields to shoot higher by the end of the week. Notable is the growing flatness of the treasury curve from the 2y point all the way out to 30y; this reflects the expectations for Fed policy over the next few years in addition to an expected 'cap' of the neutral rate due to the expected cumulative negative impact on the economy over that time. Again, the 3m-10y part of the curve remains positively sloped, while the 2y-10y component is barely so. Strategist preferences tend to be split between those two points when assessing any curve inversions. Corporates fared a bit worse than treasuries, with yield spreads widening along with economic concerns. Foreign bonds fared especially poorly, with similar influences but also the negative impact of a 2% rise in the U.S. dollar.

Commodities were mixed on net, with gains in the energy sector offset by declines in industrial metals. The price of crude oil rose over a percent to just under $121/barrel, while natural gas prices increased another 4%. Oil price strength has been driven by expectations of higher inventories not coming to pass, coupled with the letting up of Chinese lockdowns, which has unfurled a large amount of pent-up demand. Of course, future prices aren't possible to predict, but the combination of factors have re-accelerated these upward pressures, as drilling and refining activity continues to fall behind demand.

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, 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.