Summary

Economic news for the week included the Federal Reserve raising interest rates sharply in their fight with inflation. Data was mixed, with the index of leading economic indicators and retail sales softer, while industrial production improved. Producer prices remained high, but showed some deceleration. Housing starts and sentiment continued to decline, not helped by rising mortgage interest rates.

Global equity markets responded negatively to persistent worries over high inflation, rate hikes, and rising recession risks. Bonds fell back on higher yields globally, and pressure on credit. Commodities fell broadly with a pullback in crude oil and natural gas prices.

Economic Notes

(0) As noted earlier in the week, the **FOMC meeting** provided some unexpected tightening of 0.75% to 1.50-1.75%, with markets quickly absorbing the ramped-up pace. As is usually the case, the post-meeting press conference allowed Chair Powell to provide some clarity and fine-tuning to the formal statement.

Some notable quotes from Powell alluded to the committee's feelings about current conditions, and reiterated the focus on getting inflation under control. Sometimes the humility and dose of reality in these Q&A sessions can be a refreshing reminder that Fed operations aren't entirely rigid and formulaic.

- "Clearly people don't like inflation...a lot. Some folks are experiencing it for the first time."
- "We don't seek to put people out of work...we never think that too many people are working and that fewer people need to have jobs, but we also think you really cannot have the kind of labor market we want without price stability."
- "Price stability is the bedrock for a healthy economy."
- "It (a soft landing) is not going to be easy."

In looking at the Fed's projections, assumptions point to fed funds hikes of 0.75% in July, 0.50% in Sept., as well as 0.25% in Nov. and Dec.—all getting to a range of 3.25-3.50% by year-end. The long-run median fed funds rate remains at 2.50%, which consists of the 2.00% inflation objective and a historically-appropriate amount of real yield. Current concerns are focused on how high interest rates will need to go, and whether such as level will tip the economy into recession.

(-) **Retail sales** in May fell by -0.3%, short of the 0.1% increase expected by consensus. Removing autos boosted the result to a 0.5% increase. The core/control retail sales measure, removing the classic more volatile components, brought the monthly change back down to flat. In the specifics, gas station sales rose 4% due to higher prices, and food/beverage rose 1%, while autos/auto parts fell back by -4%. A continued backlog in specific parts, notably semiconductors, has been holding back auto sales activity and keeping prices high, as mentioned in a variety of anecdotal stories about large lots of 'almost finished' new vehicles. Other durable goods sales have also fallen back a bit.

(0/-) **Industrial production** rose 0.2% in May, but decelerated from the prior month, and came in at half the consensus forecast of 0.4%. Manufacturing production declined by a tenth, although auto production rose by 0.7%, offset by over -2% declines in machinery and wood products. Mining and utilities production each rose by over 1%, due to higher oil prices and usage of air conditioning in warm conditions nationally. **Capacity utilization** ticked up a tenth to 79.0%, which was the highest level in over three years.

(0) The **Empire manufacturing index** rose by 10.4 in June to a still-contractionary level of -1.2, but below better expectations of a positive 2.3 reading. New orders, shipments, and employment indicators all improved further into expansion. Additionally, delivery times fell by over -5 points, to the lowest level in over a year. Prices paid rose again by nearly 5 points to a continued high level, reflecting still-pronounced goods inflation. Expectations for business conditions 6 months out fell back by -4 points to a two-year low.

(-) The **Philadelphia Fed manufacturing index** for June showed a decline of -5.9 points to a now-contractionary level of -3.3, and below the positive 5.0 level expected. This was the first negative reading since May 2020. The index of new orders fell into contraction, falling by -35 points, with shipments falling nearly that much but remaining in expansion. Employment remained positive, however. Prices paid fell back from highs but remained at an elevated level, while delivery times improved to the best reading in two years. Expectations for growth over the next six months fell back as well, by -9 points now into contraction. In the special question section for the month, just two-thirds of respondents noted that labor supply and supply chain disruptions were a moderate or significant constraint on capacity utilization/production, which was actually an improvement from the prior few months.

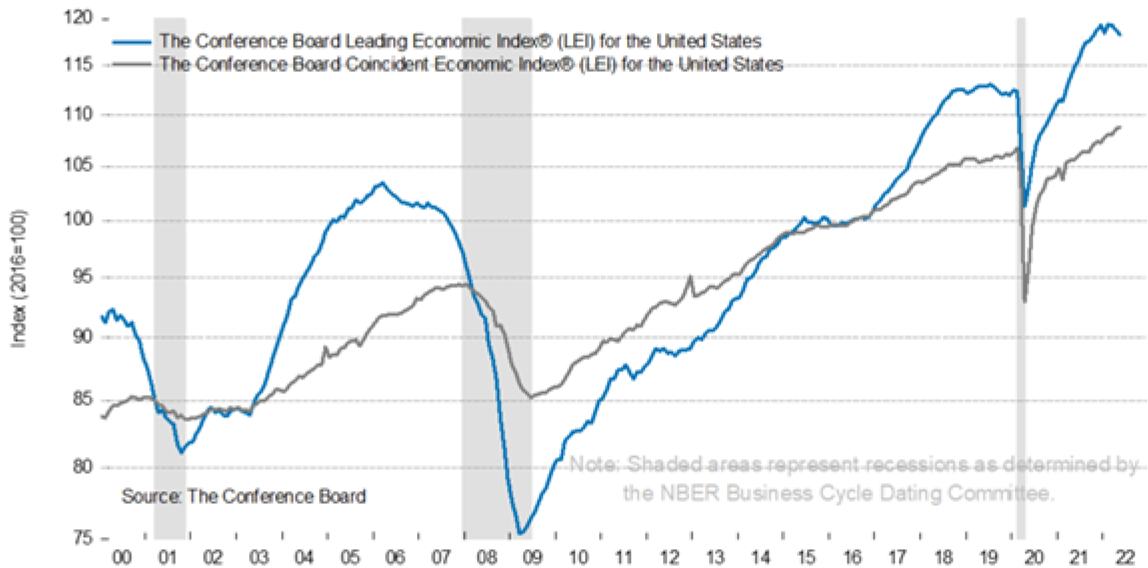
(-/0) The **producer price index** for May rose 0.8% on a headline level, with was in line with expectations. Energy prices rising 5% accounted for a good deal of the increase, as removing energy and food, core PPI rose a more muted 0.5%, led by transportation and warehousing. The May result represented a year-over-year increase of 10.8% on a headline level, and 8.3% for core PPI; the headline 12-mo. result represented a decline (improvement) from the prior several months, so some peaking is perhaps being experienced in this measure that tends to run ahead of CPI.

(-) **Import prices** rose 0.6%, which wasn't as bad as the 1.1% increase expected. Removing petroleum prices brought the number down to -0.1% on the month. Food and consumer goods prices fell slightly, but were offset by gain in industrial supplies and other capital goods, including autos. Year-over-year, headline and ex-petroleum import prices are up 12% and 7%, respectively. This represents a continuation of imported 'bad' inflation, despite the influence of a strong dollar.

(-) **Housing starts** in May fell back by -14.4% to a seasonally-adjusted annualized rate of 1.549 mil. units, well below the -1.8% decline expected. Single-family starts fell by -9% while the more volatile multi-family claims category fell by -24%. Regionally, the South and West experienced declines of -15% to -20%, while starts in the Northeast rose by 15%. **Building permits** fell -7.0%, also below expectations of a -2.5% decline. Multi-family permits also led the decline, as did numbers from the Northeast.

(-/0) The **NAHB housing market** index fell back by -2 points in June to 67, which matched consensus expectations. Prospective buyer traffic fell back by -5 points, as the most negative input, while current and future sales only lost a point or two each. Regionally, the Midwest gained 3 points, while all others fell back, led by the Northeast and West, down around or beyond the double-digit level. No doubt, higher mortgage rates have weighed on housing market sentiment, with housing sales stalling in some higher-priced regions.

(-) The Conference Board **Index of Leading Economic Indicators** for May declined by -0.4%, which matched the decline for April. Similarly, the index declined by -0.4% for the six months from Nov. 2021 to May. Per the Conference Board, weakness in stock prices, housing starts, and consumer sentiment were behind the change. However, the coincident indicator and lagging indicator each rose, by 0.2% and 0.8%, respectively. Each remains positive over the last six months. While the leading index is still running at a high level, there is some apparent deterioration at the margin. This is in keeping with rising recession risks, but the index has also fallen back during less severe slowdowns in past years. Further months will be watched closely, although the data within this index is already well-known by the time the LEI is released.



(0) **Initial jobless claims** for the Jun. 11 ending week declined by -3k to 229k, above the 217k median forecast. **Continuing claims** for the Jun. 4 week ticked up 3k to 1.312 mil., which surpassed the 1.304 mil. expected. In going deeper into the data, however, the non-seasonally-adjusted initial claims rose by 18k, which was higher than in recent weeks. The overall insured unemployment rate based on total covered employees remained below 1%.

Market Notes

Period ending 6/17/2022	1 Week (%)	YTD (%)
DJIA	-4.73	-16.91
S&P 500	-5.75	-22.33
NASDAQ	-4.76	-30.72
Russell 2000	-7.43	-25.37
MSCI-EAFE	-5.73	-20.63
MSCI-EM	-4.67	-17.61
Bloomberg U.S. Aggregate	-0.92	-11.48

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
6/10/2022	1.39	3.06	3.25	3.15	3.20
6/17/2022	1.63	3.17	3.34	3.25	3.30

U.S. stocks began the week poorly, with declines approaching -4%, a pace that continued despite attempts at a comeback. The prior week's high CPI number seemed to be contemplated further over the weekend, with negative sentiment carrying through. Markets improved a bit Wed. in a 'relief rally' of sorts after the Fed came through with the rumored 0.75% hike. However, rising worries over a looming recession challenged markets again later in the week, as it is clear the Fed is prioritizing inflation fighting over recession avoidance.

Every sector was in the negative last week, led by energy stocks which corrected by over -15%, following a sharp drop in the price of crude oil, upon which the group's fate is obviously most heavily tied. Normally defensive utilities also fell back by nearly -10%. Real estate declined by around -5%, in keeping with other major sectors on the week.

The total bear market decline from the Jan. 3 high has now reached -23% for the S&P 500. This is in keeping with the median pre-recession drop in the post-war period (around -24%), so conditions aren't off-base from historical norms during these types of 'potential recession on the horizon' periods.

Foreign stocks fared a bit better than U.S. equities, despite the negative headwind of a persistently-strong dollar. Emerging markets fared marginally best of all, with minimal declines in China leading the group 'upward'. Conditions in China have started to improve from dire levels, both with lockdowns but also based on government stimulus help; in fact, China's cycle is already ahead of the rest of the world in a new cycle beginning.

The ECB put in 'anti-fragmentation' measures in place last week, meaning a greater flexibility in bond-buying to ensure spreads between bonds of various countries (like Italy and Spain) don't widen to less desirable levels relative to Germany and France, for example. ECB rate hikes are expected for the fall, as policy continues to lag that of the U.S., with economic conditions weaker. The Bank of England raised rates by 0.25%, with a hawkish path expected ahead as well. The Japanese yen has been in free-fall as of late, as the government there has insisted on a dovish policy and cap on long-term interest rates. This has been due to demographic factors as well as high debt-to-GDP levels.

U.S. bonds continued to fall back, as interest rate rose, absorbing the Fed's actions and hawkish tone. The 10-year treasury almost reached a yield of 3.5%, its highest level in a decade; however, futures markets looking out several years don't see much upward movement baked in beyond this point. Treasuries fared a bit better than corporates, especially high yield, which fell back sharply with rising rhetoric and fears of a recession. Recessions obviously challenge highly-indebted marginal firms, with higher financing rates coupled with lower revenues. Foreign bonds also pulled back due to a nearly half-percent rise in the U.S. dollar on the week. (The dollar index has gained nearly 10% against major developed market currencies thus far in 2022, and reached a two-decade high last week.)

Commodities saw a pause in their winning streak last week, with all segments falling back, notably energy and industrial metals. The price of crude oil fell back by over -10% to $108/barrel, with fears of rising recession risk negatively affecting demand outweighing ongoing supply constraints. Natural gas results were more extreme, with prices down -22%, in an unusual response to a fire in a Texas LNG shipping facility that will pause exports until later this year. This boosts supply that can be stashed in the U.S., while European prices responded upward. This an indication of the careful supply/demand balances in today's commodities markets, and sensitivity of domestic supplies (causing some countries to pause exports altogether).

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.