Summary

Economic data for the week included a consumer price inflation report that came in hotter than expected, while producer price inflation was mixed. Retail sales rose, while industrial production and several regional manufacturing indexes fell back.

Global equity markets reacted to the still-strong August U.S. consumer inflation report and expectations for continued hawkish central bank policy with sharply negative results. Bonds similarly fell, as interest rates continued to tick higher. Commodities also fell back, with concerns over near-term demand but fewer supply hurdles in the near-term.

Economic Notes

(+) **Retail sales** for August rose by 0.3%, exceeding the median forecast calling for a -0.1% decline, although the report featured some prior month revisions downward. Removing the autos trimmed the result to a -0.3%, while removing all volatile components, core/control retail sales ended up unchanged for the month. Over half of underlying industries saw a gain, which included a 3% gain in motor vehicles/parts, misc. retail, and eating/drinking establishments; declines in gasoline prices pulled down gas station sales by -4%, in addition to declines in furniture and non-store/internet retail. Retail sales are up 9% from last year, although, as has been the case for recent reports this past year, higher inflation readings have played a larger role in nominal sales results, taking the 'real' retail sales gain into the negative in recent quarters.

(-) **Industrial production** for August fell by -0.2%, disappointing relative to the median forecast of no change. The manufacturing component rose 0.1%, led by business equipment up 0.7%, but also was pulled down by auto production. Utilities production fell back by over -2%, a category that tends to be weather-dependent. Total industrial production levels are up 4% from a year ago, and nearly 3% above pre-Covid index levels. In fact, the year-over-year change levels have been fairly consistent over the past year (not recessionary). **Capacity utilization** fell by -0.2% to 80.0%.

(-) The **Philadelphia Fed manufacturing** index for September fell by a sharp -16.1 points from expansion to a contractionary -9.9 reading—lower than a still-positive 2.3 level expected. Underlying data included similarly sharp drops in new orders (which fell into contraction), as well as shipments and employment, which fell sharply but stayed in expansion. Prices paid fell back sharply, but stayed expansionary, although the sub-index has dramatically improved from extremely high prior levels. Prices received, on the other hand, ticked higher, although delivery times shortened. Expected business conditions six months in the future rose by nearly seven points, but still remained slightly negative.

(+/0) The September **Empire manufacturing index** moved in the opposite direction, rising 29.8 points, but remained slightly negative at -1.5, stronger than the -12.9 level expected. Within the report, shipments and new orders rose sharply, back into expansion, while employment ticked slightly higher, further into expansion. Prices paid and prices received each declined, lowering the pace of expansion, but considering the extremely high disruptive levels, a sharp improvement over the prior few months. Expectations for next-6 month business conditions rose by 6 points to over 8, further into expansion.

(0) **Import prices** fell by -1.0% in August, which was slightly below the median forecast calling for a -1.3% decline. Removing petroleum reduced the decline to -0.2%, as petroleum prices fell by -7%. Year-over-year, import prices were up just under 8%, which is in line with rates of inflation by other measures. Import prices continue to represent the 'bad' inflation imported in from abroad, other than the domestically-produced inflation, which can accompany growth (of course, the current environment features inflation well above levels that are desirable).

(0/-) The **Producer Price Index** in August declined by -0.1%, on par with expectations. On the other hand, core PPI, ex-food and energy, rose by 0.4%, a tick above expectations. Energy prices falling back -6% played a key role, seen by core intermediate producer prices falling back by -0.8% and core crude materials down -1.0%. On a trailing 12-month basis, headline and core PPI remain up 8.7% and 7.3%, respectively. Broken out into consumables, good prices were up 12%, while prices for services gained just under 7%.

(-) The highlight of the week was the **Consumer Price Index** release for August. On net, it was slightly down on an unadjusted basis, but rose 0.1% based on seasonal adjustments—exceeding expectations calling for a -0.1% decline—but not a radical change in itself. Core CPI excluding food and energy rose by 0.6%, exceeding the expected 0.3%, with a key differentiator between the two being energy prices falling by -5%, while food price gained 0.8%. Shelter costs rose 0.8%, in both rent and owner's equivalent rent, which accounts for well over a third of core CPI. Additional contributors were new cars, household furnishings, medical services, and education—all of which were up 0.5-1.0% for Aug. On the other hand, airfares, electronics, and used cars fell back a bit, as it appeared continued supply chain improvements were taking place (albeit slowly in some cases).

On a trailing 12-month basis, headline and core CPI now lie at 8.3% and 6.3%, respectively. This represented a decline in the headline pace by about 0.25%, while the core pace reaccelerated upward by about 0.40%. There were widespread expectations that the August report would show stronger signs of inflation falling back, but this didn't happen, and disappointed financial markets. We'll have to wait yet another month for (hopefully) better evidence. The Atlanta Fed's sticky price indexes showed mixed results, with the flexible price items decelerating from 12-mo. pace of 20.0% to 14.5% in recent months, while sticky price inflation continued upward by several tenths, to 6.1% on a trailing 12-mo. basis.

On the positive side, though, a variety of supplemental measures have shown some improvement, such as those produced by several Federal Reserve Banks. For instance, the San Francisco Fed's Covid-Sensitive price basket is well down from an early year peak, while the Covid-Insensitive basket has flattened out and also shows signs of some decline. Wages, as measured by the Atlanta Fed, have also paused, albeit at a high level. The good news takeaway here is that broader goods and wage inflation aren't worsening, but are taking longer to filter through the system than expected. Consumer expectations for inflation in the coming years have also fallen back, which is positive from the standpoint that these are less likely to become 'entrenched' in consumer psychology (as they did in the 1970's), but also because the Fed looks closely at this specific measure when reviewing inflation pressures broadly.

(0) The preliminary Sept. **Univ. of Michigan index of consumer sentiment** rose by 1.3 points to 59.5, just below the 60 level expected. Assessments of both current conditions and future expectations rose, with future more so than current. Inflation expectations for the coming year fell by -0.2% to 4.6%, along with falling gasoline prices that tend to drive consumer moods. Inflation expectations for the next 5-10 years fell by another tenth to 2.8%.

(+) **Initial jobless claims** for the Sep. 10 ending week fell back by -5k to 213k, below the 227k median forecast. **Continuing claims** for the Sep. 3 week rose 2k to 1.403 mil., well below the 1.478 mil. expected by consensus. Initial claims were mixed with small gains/losses in a number of states with little net change. Overall levels remain low, indicative of a continued strong labor market.

Market Notes

Period ending 9/16/2022	1 Week (%)	YTD (%)
DJIA	-4.11	-13.85
S&P 500	-4.73	-17.80
NASDAQ	-5.46	-26.40
Russell 2000	-4.46	-19.16
MSCI-EAFE	-2.72	-21.71
MSCI-EM	-2.64	-21.54
Bloomberg U.S. Aggregate	-0.93	-12.38

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
9/9/2022	3.08	3.56	3.45	3.33	3.47
9/16/2022	3.20	3.85	3.62	3.45	3.52

U.S. stocks experienced their most difficult week in three months, as the recent bear market rally took a pause. On Tuesday morning, stock futures showed a better than half-percent gain, which was dependent on a CPI report coming in weaker than last month. This didn't happen, and losses compounded immediately, upwards of -2%, then to -4% for the S&P. This ended up being the worst market day in over two years. Single-day major shocks like this tend to be a one-time market reassessment of the new 'discount rate' for risk assets, which can sometimes be the extent of it, with Wednesday acting calmer.

However, by Friday a FedEx earnings and pre-recessionary corporate strategy warning late in the week soured sentiment again, raising fears of worsening consumer conditions; this was coupled with the higher volatility that often accompanies a big stock option quadruple-witching expiration date. In addition to several tech firms hinting about layoffs, a potential railroad strike also weighed on the shipping network, with certain goods, such as coal, ethanol, and feedstock potentially affected to a larger degree than other goods. This could have impacted up to a third to a half of all U.S. freight, should a strike have gone into effect, but it seemed the Labor Department was able to find a compromise later in the week.

Every sector lost ground for the week, with energy and health care leading the way, with declines of 2-3%; on the other end, communications, technology, industrials, and materials all fell well over -6%. Real estate lost over -6% as well, as interest rates continued to move upward.

Foreign stocks fared slightly better than domestic, despite the headwind of an even stronger U.S. dollar for the week. Returns were generally similarly negative by region, and between developed and emerging markets. Economic results in Europe and the U.K. continued to worsen, as the impact of energy prices weighed on activity, and inflation overall remained at high levels.

U.S. bonds fell back as well last week, with higher interest rates pulling prices downward. Treasuries outperformed investment-grade credit a bit, as corporate spreads also widened—shown by the weak performance of high yield. Developed market foreign bonds were down in line with U.S., while emerging market debt was negatively impacted by both wider risk spreads and the stronger dollar. There has been enhanced talk about the shape of the yield curve, in both the U.S. and Europe. While the 10y-3m treasury curve remains positive (which is the most closely-watched pair for near-term recession risks), the spread has narrowed steadily as Fed expectations are priced in the front end prior to another FOMC meeting next week. The 2-year part of the treasury curve remains the high point (assumed peak in Fed activity), causing the rest of the curve to have remained inverted. Expectations for next week have moved from a 50 bp hike to 75 bp being the most likely case, and even 100 bp a rising possibility. Sentiment toward fixed income could be turning a corner, though, as higher yields have continued to see buyers enticed by the highest intermediate-term treasury yields in years.

Commodities fell back across the board last week, led by energy and precious metals. The price of crude oil fell by -2% to just over $85/barrel, with natural gas down slightly further. The drop appeared to be due to higher U.S. rig counts, which raises supply; however, falling Chinese demand continues to weigh on expectations.

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.