Summary

Economic data for the week included producer and consumer price inflation reports that continue to run hotter than expected—disappointing markets. Retail sales were little changed, although core sales saw slight nominal gains.

Global stock markets lost ground as concerns continued around high inflation and potential recession, especially abroad. Bonds also declined as interest rates rose again in keeping with higher CPI readings. Commodities fell back due to higher anticipated domestic crude oil supplies.

Economic Notes

(0/-) **Retail sales** in September were unchanged on a headline level, below the expectation of a 0.2% gain. Removing autos from the measure bumped it up to a 0.1% increase, while core/control sales (which excludes the most volatile components), ended up showing a 0.4% rise, which slightly performed expectations. Half of the industries reported saw gains, led by non-store/internet commerce and general merchandise, each up a half-percent or so; gas stations declined over a percent along with lower petroleum prices. However, as sales are reported on a nominal basis, 'real' sales after inflation continue to be far weaker in recent months—actually in decline. Year-over-year, sales are up 8.2% on a headline basis and 7.5% for core, with inflation eating away almost all of that 'gain'.

(-) The **producer price index** for September rose by 0.4%, above the median forecast of 0.2%, while core PPI excluding food and energy rose 0.3%. This was a bit of a disappointment for those looking for significant cost input relief. Core intermediate producer prices declined by -0.6%, however, pointing to varying contributions of different inputs. Year-over-year, headline PPI is up 8.5%, while core is 7.2% higher. Between the primary categories, goods prices rose 11%, while services prices are 7% higher on a trailing 12-month basis.

(-) The **consumer price index** for September rose by 0.4% on a headline level, and 0.6% for core, excluding food and energy prices—each about 0.2% higher than expectations. Headline results were led by a food prices rising nearly a percent on the month, while energy prices fell by -2%. In other items of concern, used car prices fell by -1.1%, but the rest of core CPI was driven by gains of 0.7-1.0% for shelter, new cars, and medical care services. Transportation services, including car insurance, gained 1.5-2.0% on the month, due to creep from price pressures elsewhere. Several of the core items reflect the movement of inflation pressures moving from goods into services, which tend to be 'stickier' and more of concern to economists and markets in the intermediate-term.

This month's result lowered headline year-over-year CPI number a bit to 8.2%, while core CPI increased to 6.6%. The core figure represented another 40-year high. Importantly for retirees, Social Security COLA will see rise of 8.7% for 2023, which is the largest annual increase since 1981. This builds on the sizeable 5.9% increase of 2022. While welcome for payees, questions have begun to arise again about the timeline of the program's financial longevity. Interestingly, annual COLA increases only began in 1972 as part of amendments to the program during a period of rising inflation; previously, benefit increases were made only through special legislation. Recently high year-over-year inflation readings will no doubt carry through to a variety of upcoming 2023 IRS dollar limits announced later this year, depending on which are legislatively chained to trailing inflation (some are, some aren't).

(+) **Import prices** fell -1.2% in September, which was a tenth below expectations. Removing the significant petroleum component reduced this decline to -0.5% (with petroleum import prices falling by over -7%), as industrial supplies also fell to a still-substantial -4%, while other goods were little changed. Year-over-year, import prices were up 6% and 4% ex-petroleum, slightly below broader CPI.

(+) The preliminary October **Univ. of Michigan index of consumer sentiment** showed an increase of 1.2 points to 59.8, above the forecast of a flattish 58.8. This was the 4th consecutive monthly increase in sentiment. The Oct. change was led by a substantial rise in assessments of current economic conditions (up over 5 points), while expectations for the future fell back by -2 points. The improvement in current conditions appeared to be due to supply constraints easing in durable goods especially, which has been long-awaited. Inflation expectations for the coming 12 months rose by 0.4% to 5.1%, in keeping with higher energy prices. Those for the next 5-10 years ticked up by 0.2% to 2.9%, but remained well contained relative to long-term averages.

(0) **Initial jobless claims** for the Oct. 8 ending week rose by 9k to 228k, just above the median forecast of 225k. **Continuing claims** for the Oct. 1 week rose by 3k to 1.368 mil., above the consensus estimate of an unchanged 1.365 mil. Initial claims were mixed by state, with a more sizable decline in MO offset by an 11k increase in FL—no doubt driven by Hurricane Ian impacts and closures. Natural disasters unsurprisingly bring on higher jobless claims for a few weeks in affected areas, but the impact is often short-lived. Overall, national claims levels remain low relative to the size of the labor force, and continue to point to job market strength. While job openings have fallen back, layoffs have not commenced to any degree.

(0) The **FOMC minutes** from the Sept. meeting were released, and continued to show hawkish sentiment. However, there were signs at the margin that the Fed intends to pause once rates reach a 'sufficiently restrictive' place. The key question is: where is that place? A critical item from the meeting that markets reacted to was discussion surrounding a terminal rate for this hiking cycle, which was seen to be 4.50-4.75%. This remains over a percent beyond the current level, but provides a workable roadmap with more certainty about the process. The committee continues to believe that economic growth will remain relatively tempered over the next few years, which could affect views of where policy rates need to be following the current inflation-based episode. In the near-term, the committee continues to communicate that the cost of and damage from taking too little action is far more dangerous long-term than doing too much. The second question is: what is the threshold for potential rate cuts? The answer to this looks less clear, but seeing a combination of inflation having peaked yet still-deteriorating economic growth is not a bad guess based on history.

Market Notes

Period ending 10/14/2022	**1 Week (%)**	**YTD (%)**
DJIA	1.17	-17.13
S&P 500	-1.53	-23.87
NASDAQ	-3.11	-33.62
Russell 2000	-1.15	-24.28
MSCI-EAFE	-1.35	-26.68
MSCI-EM	-3.81	-28.17
Bloomberg U.S. Aggregate	-1.19	-15.84

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
10/7/2022	3.45	4.30	4.14	3.89	3.86
10/14/2022	3.81	4.48	4.25	4.00	3.99

U.S. stocks fell back to start the week, as new restrictions by the Biden administration limit Chinese access to American semiconductor technology, on top of global demand weakness already in the space. As the week progressed, concerns over inflation reports and the start of Q3 earnings season continued to weigh on sentiment. By sector, defensive health care and consumer staples fared best, with positive returns of over 1%, while consumer discretionary and technology each lost over -3%. Utilities and real estate also fell back upon higher interest rates.

Markets experienced an especially odd day on Thursday, coinciding with the closely-watched CPI report. Inflation continued to 'run hot', especially on the core side, and didn't show the improvement investors have been hoping for. However, some economists have referenced this phase as likely peaking or close to peak, as opposed to no end in sight. The monthly CPI data has become the market's key metric recently, being the catalyst for Fed expectations, then interest rates, and flowing to economic health and earnings. Early stock futures gains (with hope for a decent report), sentiment turned sharply lower upon release of the report (down over -2%), yet reversed and ended the day gaining over 2.5%. This was described as one of the most volatile intra-day changes in decades. The reasons for the sudden turnaround remain vague, but some signs point to computer trading based on technical support indicators. For example, the round level of 3500 for the S&P, which also fell very close to the spot where 50% of the Mar. 2020-Jan. 2022 rally had retraced back to (considered by technicians to be an important place). Investor sentiment is especially low, pointing to high levels of overall bearishness, which, similar to what happens with extreme bullishness on the other side, can lead to a fatigue in negativity. The question remains: where is the stock market low? As usual, it's highly unlikely for anyone to get the timing right, but repeated tests of bottoming around the -25% mark without further deterioration are a positive sign.

Foreign stocks fell back to a similar degree as domestic in developed markets, with increasing concerns over a near-term recession in Europe continuing to dominate sentiment. To some extent, this has raised hopes for a pullback in central bank hawkishness. Emerging market equities were down more sharply, as Chinese stocks in particular fell by over -7% on the week. While the Communist Party Congress meeting having started and resulted in few surprises, a noted continuation of their zero-Covid policy into next year negatively weighed on global sentiment, as this keeps the risk of future economic closures high and unpredictable.

U.S. bonds fell back last week as the 2-year treasury yield reached 4.5% (a 15-year high) and 10-year treasury note rose to 4.00%, before leveling off. As credit spreads widened, governments outperformed corporates generally, with floating rate bank loans faring best. Foreign bonds lagged domestic, hampered by continued strengthening in the U.S. dollar.

The Bank of England continued its bond-buying program last week in an effort to pull down long-term yields to more manageable levels. The lack of stability has aligned closely with the lack of policy consistency, which has troubled markets. Several nations in Europe have been caught between the sharp desires to provide fiscal relief to citizens, particularly due to high energy prices, but realizing markets are no longer providing a free pass for unlimited government spending. The sharp rise in rates was deemed to pose a serious risk to financial stability, notably the large ownership of bonds by pensions and other institutional entities. This situation in England may be the first in a series of 'cracks' that could give global central banks pause. Already, several banks have slowed the pace of hikes down to quarter-percent increments, which was below expectations. This may provide signs of a potential peak in rate hike regimes, as fears of economic slowing have traditionally caused banks to reverse course (despite their protests this cycle that they'll be hawkish until inflation is tamed).

Commodities fell back across the board last week, led by energy and precious metals. The price of crude oil fell by -8% to just under $86/barrel. Last week, fears of a Biden fuel export ban, intended to bring down gasoline prices, resulted in higher domestic inventories. This was coupled with continued concerns over the extended zero-Covid policy in China, which has the potential of keeping demand fragile into 2023. Ironically, as we know, lower commodity prices have a dampening effect on inflation readings, so this becomes a double-edged sword.

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.