Summary

Economic data for the week included a rise in industrial production, mixed regional manufacturing indexes, and a variety of weaker housing sales and sentiment reports. The index of leading economic indicators continues to lean towards a recession in coming months.

U.S. equity markets saw sharp gains last week, due to stronger earnings and rising hopes for a Fed potentially slowing down on rate hikes, with foreign stocks also positive. Bonds fell back due to still-rising long-term yields. Commodities were mixed.

Economic Notes

(+) **Industrial production** for September rose by 0.4%, beating expectations calling for 0.1%. The manufacturing component grew in line with the headline figure, led by business equipment and mining, which includes energy extraction. Utilities production fell back by -0.3%, being a segment that tends to be weather-related. **Capacity utilization** ticked up by 0.2% to 80.3%. Overall, this was fairly good news from a growth standpoint.

(-) The **Empire state manufacturing index** for October fell by -7.6 points to -9.1, further into contraction, and below the consensus expectation of -4.0. Within the report, though, new orders were unchanged, labor markets were little changed, yet shipments fell back by -20 points to just into contraction. Prices paid also ticked up by 9 points. The index for future business conditions fell by -10 points to -2, indicating pessimism about the coming six months. It appears that recessionary fears have crept into these indexes, creating a higher degree of pessimism.

(-) The **Philadelphia Fed manufacturing index**, on the other hand, rose 1.2 points to a still-contractionary -8.7, and below the -5.0 level expected. Underlying components were mixed here as well, with improvement in new orders (although still in contraction) and employment (further into expansion), while shipments declined a bit, remaining expansionary. Prices paid ticked up further into expansion (around the 36 level), but not at prior extremes. Assessments of 6-months-ahead business conditions fell back by -11 points to a further-contractionary -15.

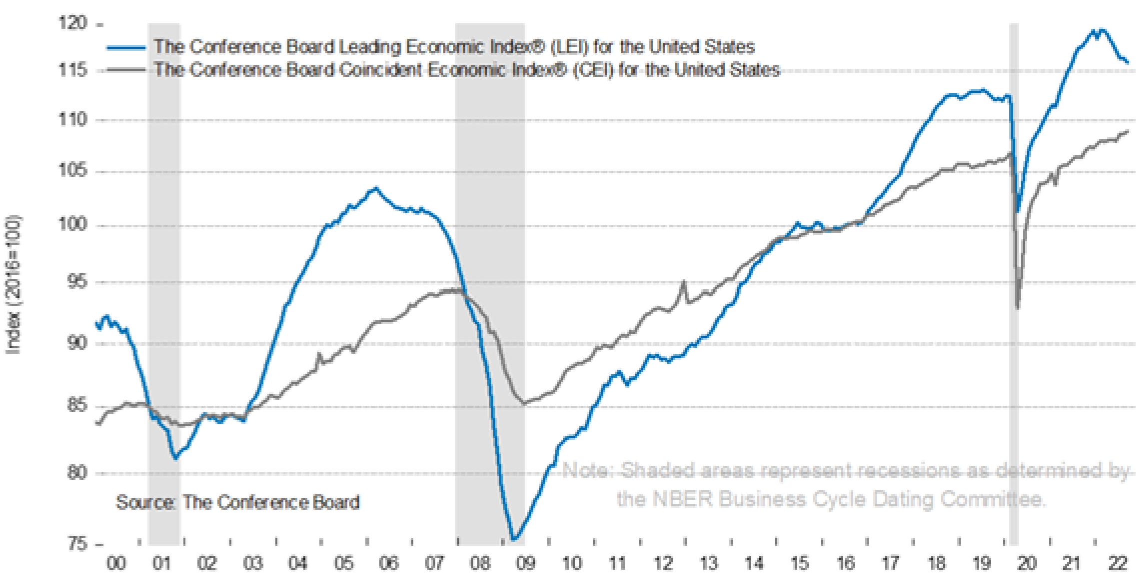
(0) **Existing home sales** for Sept. fell by -1.5% to a seasonally-adjusted annualized rate of 4.71 mil. units, slightly better than the -2.1% drop expected. This represented the 8th straight month of negative readings, and results in a decline of -24% on a year-over-year basis. Monthly activity saw a drop of -1% in single-family and -6% in the smaller condo/co-op category. Regionally, the West fared best with no change, while all other areas saw declines. The median sales prices rose to $384,800, which is still over 8% from a year ago, albeit with a deceleration in the pace of change. However, the median price has fallen back over the last few months to $413,800. Inventory also declined, to a pace of 3.2 months' supply. Unsurprisingly, the National Association of Realtors noted the sharp rise in mortgage rates as a key factor in challenging sales, noted by other data showing a drop-off in mortgage applications. However, due to timing differences in contract closings, Sept. sales may not reflect the sharp rise in rates over the past two months.

What is the appropriate mortgage rate? The U.S. 30-year fixed rate is the primary financing benchmark, which has been tied closely to the level and movements in the 10-year U.S. treasury note. The connection is due to the duration of a 30-year mortgage being closer to 10 years, as the result of homeowner sales activity and refinancings (which were common during the multi-decade stretch of falling rates). Since the beginning of Freddie Mac fixed rate data in mid-1971, mortgages have been priced at an average spread of 1.7% above the 10-year treasury (Source: Freddie Mac, Federal Reserve, FocusPoint solutions calculations). With a calculated standard deviation of 0.5% in that spread over that timeframe, there has been decent variability in the relationship. Therefore, today's spread of ~2.7% (based on Freddie Mac rate of ~6.9% and 10-year treasury yield of 4.2%), appears wide compared to history, and is likely partially due to lender concerns over the forward treasury rate path, but also largely impacted by the ending of Federal Reserve MBS purchases, which have now lowered demand/prices and driven up supply/yields. On the positive side, U.S. home borrowers are in better shape to some extent than borrowers abroad, notably in Europe and the U.K., where variable rate mortgages are far more common—this has intensified the pressure on foreign consumers on top of everything else.

(-) **Housing starts** declined by -8.1% in September to a seasonally-adjusted pace of 1.439 mil. units, a bit further than the -7.2% drop expected. Both segments saw declines, with multi-family down further, at -13%, while single-family starts dropped -5%. Regionally, the West saw a 5% expansion in starts, while all other regions experienced declines. **Building permits** fell by -1.4% to a seasonally-adjusted rate of 1.564 mil., including an upwardly-revised Aug. number. Here, multi-family rose 8%, while single-family fell -3%. Starts activity tends to be volatile month-to-month, but there are apparent cracks due to higher mortgage rates, which have spooked builders and buyers both.

(-) The **NAHB homebuilder** index fell by -8 points to 38 in October, the 10th straight decline, and well below the median forecast of 43. All categories saw erosion, with prospective buyer traffic faring a bit better than future sales, which fell into the double-digits. The Northeast was the only positively-performing region, up a point, while all others fell—the most so in the South. Along with rising financing interest rates and slowing or even declining home prices, homebuilders have no doubt become more cautious on future projects. This tends to be a boom-and-bust industry, with extremes in sentiment more common than smoother transitions.

(-) The Conference Board's **Index of Leading Economic Indicators** for September fell by -0.4%, continuing a stretch of declines over the past six months (-2.8%), which stand in contrast to minor gains over the prior six months ending in March 2022. Per the Conference Board, based on historical tendencies, a recession is expected before year-end, especially with weakness becoming more widespread across the indicators. Based on historical trailing 6-month and 12-month measures over the past several decades, the LEI falling between -1% and -5% has tended to occur just before recessions. Regardless, expectations of full-year 2022 1.5% real GDP growth remain—which is not far from the multi-year average prior to the pandemic.



(0) **Initial jobless claims** for the Oct. 15 ending week fell by -12k to 214k, well below the median forecast of 233k. **Continuing claims** for the Oct. 8 week, on the other hand, rose by 21k to 1.385 mil., just above the 1.378 mil. expected. Initial claims were mixed by state, with less than expected hurricane impact. Nationwide, levels remain low.

Market Notes

Period ending 10/21/2022	**1 Week (%)**	**YTD (%)**
DJIA	4.93	-13.04
S&P 500	4.75	-20.25
NASDAQ	5.22	-30.16
Russell 2000	3.57	-21.58
MSCI-EAFE	0.55	-26.28
MSCI-EM	0.21	-28.03
Bloomberg U.S. Aggregate	-1.07	-16.74

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
10/14/2022	3.81	4.48	4.25	4.00	3.99
10/21/2022	4.09	4.49	4.34	4.21	4.33

U.S. stocks saw gains last week with corporate earnings reports coming in better than expected. Additionally, a large batch of options expiring by the end of the week added to volatility. While comments from Fed members earlier in the week pointed to ongoing hawkishness, these were talked back later in the week with possible indications the Fed may slow or pause hikes pause early in 2023 to assess their impact thus far. Of course, such Fed comments aren't made in a vacuum, and tend to be carefully worded when they are shared. Financial markets took this as a positive sign for better clarity on long-term yields. Every sector ended the week in the positive, led by energy stocks up 8%, followed by materials and technology. Real estate rose nearly 3% despite higher interest rates.

Earnings season for Q3 has begun, with several large firms in the financial sector having already reported. So far, rising loss provisions (a discretionary earnings item to a large degree) in expectation for recession have resulted in lowered earnings in that sector. Per FactSet, 20% of S&P members have now reported, with another half of the index reporting this coming week. Expectations have become more variable, with 115% earnings growth in energy barbelled by double-digit declines in financials, materials, and communications. As a whole, S&P 500 estimates for Q3 have fallen by a percent, but remain a positive 1.5% on a year-over-year basis, although nearly three-quarters of firms have surprised positively on an earnings and revenue basis. For the full 2022 calendar year, earnings growth is expected to be 6-7%, and rising to 7-8% for 2023. The current 12-month forward P/E is 15.6, just below the 10-year average, and right around the long-term average number.

Foreign stocks performed largely in line with U.S. equities, led by Europe along with a stronger euro and pound, while Japan lagged. The sudden, if not totally unexpected, resignation of U.K. PM Truss after only 45 days in office seemed to help sentiment slightly as chances for further inflationary fiscal stimulus have waned. While some recent fiscal measures were largely reversed, including a corporate tax cut, a planned energy price cap for six months remains in place. Such a cap may artificially dampen inflation in the near-term, but later effects on pricing remain unclear. The energy crisis in Europe remains an event on the level of multi-decade extremes, most akin to the experience of the early- to mid-1970s, which ended up being a difficult time for foreign currencies and stock investments—hence today's depressed sentiment. In emerging markets, the Chinese Communist Party congress has been progressing along with no major announcements, with policy largely in line with expectations, but financial markets hoping for some evolution away from their unpredictable zero-Covid policy. However, China did delay the release of some Q3 economic data, which raised suspicions about its potentially disappointing level of growth (which came in over the weekend at 3.9%, beating the expected 3.4%, but well below the 5.5% government target).

U.S. bonds fell back by nearly a percent last week as interest rates continued their path higher, in keeping with markets' ongoing assessment of where the terminal fed funds rate will land in this cycle. The 10-year treasury yield ticked up to 4.2%—a level last seen in 2007. Investment-grade corporates fared slightly better, due to spreads tightening, while high yield and floating rate bank loans saw gains. A weaker dollar helped push developed market foreign bonds into the positive, while emerging market debt was little changed on the week.

Commodities fell slightly on net, with losses of 1-2% percent in energy, agriculture, and metals. The price of crude oil fell slightly to $85/barrel; however, natural gas prices fell by nearly -25% due to milder U.S. weather expected. President Biden extended releases from the U.S. Strategic Petroleum Reserve from an original Oct. ending point now into Dec. This is designed to buffer short-term price volatility based on lower announced OPEC+ production, but has also pulled domestic oil reserves down to their lowest level since the early 1980's.

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.