Summary

Economic data for the week included Q3 GDP showing positive growth, slightly better than expected. Durable goods orders also experienced a positive month, as did personal income and spending for September. On the other hand, new home sales and various housing price metrics continued to see weakening trends.

Global equity markets gained ground in developed countries last week, while emerging market indexes fell back, led by China. Bonds also fared positively last week, as longer-term interest rates eased from recent highs. Commodity prices were mixed.

Economic Notes

(+) The initial release of U.S. **GDP** for the 3rd quarter came in at a surprisingly positive 2.6%, exceeding expectations of 2.4%. Per the BEA, the increase was led by gains in net exports (despite the strong dollar), consumer spending, nonresidential fixed investment, federal government spending, and state and local government spending. These were partially offset by declines in residential fixed investment (single-family homebuilding being a key negative factor, down by an annualized -25% in the quarter) and private inventory investment. The contribution of nearly 1% from personal consumption was entirely driven by services (health care and transportation being key areas), while goods consumption removed about 0.25% from overall GDP (mostly from motor vehicles). The GDP price index rose at an annualized 4.1% rate in Q3, and 7.0% on a year-over-year basis, which shows some tempering of pressures. The core PCE price index rose by an annualized 4.5% rate in Q3, which was a few tenths below the Q2 and the unchanged expectations.

This followed two straight negative results of -1.6% for Q1 and -0.6% for Q2, raising assumptions that a recession was imminent or at least not too far off. Instead, the Q3 preliminary figure generally removes that likelihood, although the probability that a recession arrives in the next 6-12 months still remains high, with the possibility of one over the next 24 months even higher. The positive growth result could serve as reassurance to the Federal Reserve, which might take the strength as reinforcement that the economy is able to absorb its current aggressive rate hiking path. At the same time, the 'good news is bad news' paradigm is always lurking, in that a stronger economy provides a lesser chance of the Fed pausing or even reversing hikes in early 2023, keeping interest rates high and pressuring asset valuations.

The Atlanta GDPNow model showed that a positive result of that magnitude for Q3 was likely (3.1% in their estimate), although many private economists had been lowering their forecasts. In the initial reading for Q4, the GDPNow model is showing an early indication of similar 3.1% growth. The Blue Chip consensus median for Q4 is just above 0% based on early October readings, with a wide range of estimates ranging roughly between -1.5% to 1.5%.

(+) **Personal income** rose 0.4% in September, in keeping with expectations, and included a wage income gain of 0.6% while transfer payments fell by -0.1%. **Personal spending** rose 0.6%, which match the prior month and surpassed expectations of 0.4% (with 'real' after-inflation spending still up 0.3%, with both goods and services spending rising by similar levels). Combined, this pulled the personal savings rate down to 3.1%. The PCE price index rose 0.3% and 0.5% on a headline and core level, respectively. These brought the year-over-year changes to 6.2% for headline and 5.2% for core, a pace little changed from the prior month, with core ending up slightly higher.

(0) **Durable goods orders** in September rose by 0.4%, which was an improvement from August, but disappointed relative to the expected 0.6%, with mixed revisions. The transportation segment, led by commercial aircraft, rose over 20%, which, when removed, brought orders down by -0.5% for the month, as metals and electrical equipment fell back. Core capital goods orders fell by -0.7%, contrary to expectations for a 0.3% gain. On a year-over-year basis, total orders are up 11%, while excluding transportation orders pulled that down to 5%. Core capital goods shipments fell back by a similar -0.5% rate as well.

(-) The **S&P/Case-Shiller home price index** fell -1.3% in August, nearly double the -0.8% expected. All 20 cities saw declines, led by weak West Coast results in San Francisco (-4%), Seattle (-3%), San Diego (-3%)—all of which have been described as richly valued. Nationally, the year-over-year rate of change decelerated further by -2.9% to 13.1%.

(-) The broader **FHFA house price index** for August fell -0.7%, near the -0.6% expected by consensus. Seven of the nine U.S. regions fell back, led by Mountain (-2%) and Pacific (-1%), while New England saw prices rise a few tenths of a percent. The national year-over-year rate of change decelerated further by -2.0% to 11.9%. August was the first month to reflect truly higher 10-year treasury rates, which continued in September. These have a direct impact on the pricing of 30-year fixed rate mortgages, rendering home prices less affordable. It appears this has been finally coming to fruition, notably in hot housing markets on the two coasts. Mortgage rates for the 30-year fixed had been hovering just below 7%, but finally rose above that level last week for the first time since 2002. This has obvious continued implications on housing affordability, with some estimates that mortgage payments as a percentage of gross monthly income are how higher than during the prior 2006 housing peak.

(-/0) **New home sales** in September declined by -10.9% to a seasonally-adjusted annualized level of 603k units, but better than the forecasted decline of -15.3%. This also featured a downward revision for the prior month. By region, the South saw significant declines, while the Northeast saw a minor increase for the month.

(-) **Pending home sales** in September fell by -10.2%, well below the -4.0% consensus expectation. Every region experienced a decline, led by the Northeast and West. Interestingly, the year-over-year pending sales number is down over -30% from a year ago, reflecting the challenged conditions, and bodes poorly for future existing home sales results.

(0) The final **Univ. of Michigan index of consumer sentiment** for October was revised up by a tenth of a point to 59.9, above the decline to 59.6 expected. Assessments of current conditions were revised higher, while future expectations were unchanged. Median inflation expectations for the coming year ticked down by -0.1% to 5.0%, while those for the next 5-10 years were unchanged at 2.9%. In the anecdotal commentary, it appeared that consumers were happy with an easing of prices and improving availability for durable goods, although expectations for recession in the near-term also remain high.

(-) The Conference Board **index of consumer confidence** for October saw a drop of -5.3 points to 102.5, well below the median forecast of 105.9. Assessments of present conditions fell back by over -11 points, to the lowest level in a year and a half, while expectations for the future only fell by a point. The labor differential, which measures job markets, ticked down by over -5 points as well.

(0/-) **Initial jobless claims** for the Oct. 22 ending week rose by 3k to 217k, below the 220k level expected. **Continuing claims** for the Oct. 15 week rose by a more robust 55k to 1.438 mil., above the 1.390 mil. expected. Claims gains were strongest in CA and NY, while MO, FL, and PR saw declines, so the state-by-state results were mixed. Overall levels of claims relative to the overall labor market remain little changed, however.

Market Notes

Period ending 10/28/2022	1 Week (%)	YTD (%)
DJIA	5.72	-8.06
S&P 500	3.97	-17.09
NASDAQ	2.25	-28.59
Russell 2000	6.02	-16.85
MSCI-EAFE	4.13	-23.23
MSCI-EM	-2.24	-29.64
Bloomberg U.S. Aggregate	1.65	-15.36

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
10/21/2022	4.09	4.49	4.34	4.21	4.33
10/28/2022	4.18	4.41	4.19	4.02	4.15

U.S. stocks were mixed on the week, with results largely driven by company earnings—last week being a high-volume week for those reports. Thursday's positive GDP report turned early stock gains into losses as investors expected the strength to further show the Fed that the economy can 'handle' rate hikes at a rapid pace, although hopes were still high otherwise that the Fed may pause sooner than later given the slowing in other data. The Elon Musk takeover of Twitter seemed to dominate financial news, but had minimal impact on broader markets.

Every sector but communications rose last week, led by financials, industrials, and defensive utilities—an unusual mix of cyclicals and defensives. Earnings reports for Q3 continued, with a third of S&P firms missing estimates thus far—technology and tech-related stocks hit especially hard. This included disappointing earnings results from Alphabet/Google and Microsoft, but Meta/Facebook even more so, with the stock price falling -25%. Amazon also fell back by nearly -15%, with a disappointing revenue and earnings outlook. In the case of Meta specifically, concern about revenue sensitivity has risen, with such a dependence on clicks, coupled with a rise in 'anti-tracking' sentiment from consumers, relative to Apple, for example, which manufactures physical products. Such distinctions become more important when the economy is slowing and the margin for error tightens. Revised forward-looking adjustments for revenue and profit margin, translating to earnings, can result in sharp reactions when earnings are announced at times like these.

According to FactSet, which analyzes transcriptions of executive language, two of three calls mentioned inflation (in fact we're a bit surprised it wasn't higher, due the high-profile nature of the issue, even if not every firm is affected to the same degree). In most S&P groups, the irony is that higher inflation has boosted nominal earnings higher, keeping growth in the positive in many cases, while real earnings growth has become more challenged.

Foreign stocks in developed market fared positively last week, while emerging markets were held back by sharp losses in China and Brazil. The ECB raised interest rates by 0.75% to 1.50%, as expected. However, comments were along the lines of a pause in the rate hike pace, as current levels are closing in the 'neutral' target level. That could mean a 0.50% hike in December, along with a likely roadmap for the unwinding for their bond portfolio in Q1-2023. Europe differs from the U.S. in that the economy is slowing at a faster rate, with a weak outlook due to uncertainty over the winter energy situation. Surprising markets, Canada decided to only hike by 0.50% as opposed to the expected 0.75%, raising hopes that the U.S. and other developed nations will follow that example.

The Chinese Communist Party conferenced ended with concerns over the upcoming few years, resulting in Hong Kong and Chinese shares down sharply. The composition of the new leadership group, while it didn't contain any surprises, caused markets to assume a higher likelihood of more extreme policies. These include more future lockdowns and regulatory crackdowns, as well as lessened experience and interaction with the West. There have also been protests in China in response to a third 5-year term for Xi Jinping, which showed some signs of public discontent. In other news troubling to global markets, rising Covid cases have resulted in additional lockdowns (again).

The strength of the U.S. dollar has remained a headwind for foreign markets, as it raises the prices of imported goods, as well as affects funding markets, particularly in EM. However, while EM has been held back by the dollar's strength, the rise in local currency debt markets in the last decade or two has buffered the impact compared to troubles in past decades, for example. Interestingly, year-to-date, the U.K. has been the best-performing primary global equity market, even in U.S.-dollar terms (a headwind), which may surprise some people.

U.S. bonds gained ground last week, as interest rates pulled back in keeping with weaker economic prospects. As in recent weeks, slowing economic data raised hopes the Fed may pause sooner than later; in fact, some Fed officials alluded to a potential pause in comments, as did the ECB. Bond prices were up across the board, led by corporates with tighter credit spreads (especially high yield). Foreign bonds also fared positively, with help from the U.S. dollar falling back by over a percent.

Commodities were mixed last week, with gains in energy offset by declines in agriculture. The price of crude oil rose by 3% to just below $88/barrel, as did domestic natural gas prices. Ironically, natural gas prices in Europe have been falling, as inventories have been filled faster than many have expected prior to winter, which is a positive from an economic growth perspective. On the other hand, Russia has pulled back on an agreement allowing export grains from Ukraine, laying out an uncertain future for certain products.

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, KraneShares, 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.