Summary

Economic data for the week included consumer inflation decelerating at a faster degree than expected; however, the Federal Reserve and other global central banks maintained policies of raising interest rates at a fast clip. Retail sales and industrial production both declined, continuing a trend of weaker key economic data, while several regional manufacturing indexes were mixed.

Global equity markets fell back along with continued-hawkish central bank language. Domestic bonds, however, gained as long-term rates fell along with slower growth expectations. Commodities were mixed, with crude oil prices moving higher.

Economic Notes

(0) The **FOMC meeting** ended with a hike in fed funds of 0.50% to 4.25-4.50%, as noted earlier in the week. The quarterly dot plot of median fed funds expectations showed a tick up from 4.375% in 2022 to 5.125% in 2023 (a few dots were as high as 5.5%). However, the 2024 dots spread out to a wider range of outcomes, with most views coming in just above 4.0%. The 2025 expectation shows a still-wide range, centered around 3.0% or so. The long-run target is believed by members to still be about 2.5%, which consists of the 2.0% inflation and 0.5% short-term real rate. This is somewhat in keeping with market expectations of a terminal rate next year, and subsequent loosening of policy as the economy weakens. The timing of both remains the key question headed into 2023. As much as the Fed materials and Q&A are looked at, a criticism is that they tend to end up being all that accurate. Nevertheless, it gives us a snapshot in time of what the Fed members are thinking based on available data.

The post-meeting press conferences that Fed Chair Powell hosts can be interesting for the anecdotal comments and Q&A. Addressing inflation took high priority, as usual, again noting the difficulty of high prices on the American people—especially those least able to afford them. But, he shared that "We will stay the course until the job is done." And, "History cautions strongly against ending rate hikes prematurely." Notably, when asked about the possibility of the Fed discussing a raise of their long-term inflation target from 2% at some point, the idea was strongly dismissed. There is no magic behind the 2% number, only that it was the first specific target adopted by a central decades ago (by New Zealand), while the long-term historical inflation experience has generally run at a higher number.

(-) **Retail sales** for November fell back by -0.6%, reversing course from a gain the prior month, and below the median forecast of -0.2%, in addition to revisions downward for the prior month. The core/control measure (which excludes autos, gasoline, and building materials) fared slightly better, down -0.2%. By segment, food/beverage, health/personal care, and misc. retailers saw gains of 0.5-1.0% during the month, while furniture, building materials, and cars all fell back by -2% to -3%. On a year-over-year basis, total retail sales are up over 6%, but with inflation being where it is, after inflation 'real' sales are minimal, if not negative.

(-) **Industrial production** for November declined by -0.2%, below the forecast for no change. Business equipment and mining each fell back just under a percent, with motor vehicle assemblies down over -5% (although much of this was apparently planned in advance). Utilities production rose nearly 4%, albeit being largely influenced by weather most months. **Capacity utilization** fell back by -0.2% to 79.7%.

(-) The **Empire manufacturing index** fell back by -15.7 points, back again into contraction at a level of -11.2, below the -1.0 median forecast. New orders fell back further into contraction, while shipments declined but remained in expansion. Prices paid and received minimally changed, but remained at elevated levels. Contrary to the headline number, expectations for business conditions six months out roared back by 12 points into expansion.

(0/-) The **Philadelphia Fed manufacturing index**, on the other hand, rose 5.6 points to a still-contractionary -13.8 reading, but below the -10.0 level expected. Under the hood, employment, shipments, and new orders all fell back by around -10 or more points, into or further into contraction. Prices paid and received each fell back, but stayed in expansion. Here, too, expectations for business conditions six months out rose by 11 points into positive territory. Anecdotal commentary noted that around half of respondents felt that low labor supply and supply chain issues were holding down capacity utilization, although these were both improvements from a quarter ago.

(0/+) The **consumer price index** for November rose 0.1% on a seasonally-adjusted basis (although the index actually fell -0.1% as measured on an unadjusted basis). Core prices, removing food and energy, rose by 0.2%, well off of recent monthly reports. Within the November data, shelter continued to be a strong contributor, up 0.6% on the month, as a tempering of home prices and rents have not begun to be reflected due to timing differences. Other contributors on the upside include food (0.5%) and apparel. These were outweighed by items falling in price, such as energy commodities (-2.0%), used cars (-2.9%), airfares (-3.0%), and medical care services (-0.7%).

Year-over-year, headline CPI decelerated to 7.1%, while core fell to 6.0%. Over the past year, energy and food prices have risen at rates of 13% and 11%, respectively, both of which have filtered into costs of other items, including transportation. Trailing inflation has remained high for a variety of important items in the basket, including shelter, new cars, insurance, airline fares, and other consumer categories. However, they've been starting to move in a favorable direction from highs in the spring. In fact, based on calculated paths for minimal new inflation, headline CPI may move into the upper 3's to low 4's on a trailing 12-month basis by early 2023, with rapidly rising prices from early 2022 rolling off. This type of snapback is probably not what consumers are expecting, but could start to normalize conditions faster than expected. Of course, this bout of recent inflation has already lasted longer than many predicted it would.

Debate about future inflation is ongoing. On one side, economists continue to see high monetary balances (like M2) that have stopped expanding, but have not completely flushed through the system. Consumers had been hoarding a decent amount of savings, some of which was due to government transfer payments, but these balances are now falling and consumer credit levels are again rising. Of course, that can become problematic in the event of a recession. A strong labor market and tightness in finding suitable workers could keep wages somewhat elevated compared to pre-pandemic. A reversal in the multi-decade trend of globalization toward more domestic-oriented manufacturing and supply chain awareness, or even just a less severe 're-regionalization', could push prices higher as the era of ultra-cheap manufacturing fades. On the other hand, strong structural influences, such as rising automation/digitalization, still-low levels of worker union membership, and aging demographics point to potential for a continued pre-pandemic trend of lower inflation. Context is important also. The average annual inflation level from the start of CPI in 1913 through last month is over 3%, and average levels of the last 50 years approach 4%, so inflation rates of 2% or below have been a historical anomaly.

(+) **Import prices** for November fell by -0.6%, just beyond the -0.5% expected. Petroleum product prices fell back by over -3%, lowering the ex-petroleum import price number to -0.3% for the month. Prices also declined for industrial supplies and consumer goods, while food/beverage prices rose 2%.

(+) **Initial jobless claims** for the Dec. 10 ending week fell by -20k to 211k, well below the 232k consensus estimate. **Continuing claims** for the Dec. 3 week rose by 1k to 1.671 mil., just below the 1.674 mil. median expectation. Initial claims fell back primarily in NY, GA, and TX, with no meaningful increases for any state. Seasonal effects can hamper efforts at interpreting claims data around year-end, but there has been no real deterioration.

Market Notes

Period ending 12/16/2022	1 Week (%)	YTD (%)
DJIA	-1.65	-7.50
S&P 500	-2.05	-17.88
NASDAQ	-2.70	-31.02
Russell 2000	-1.81	-20.40
MSCI-EAFE	-2.13	-14.81
MSCI-EM	-2.10	-20.14
Bloomberg U.S. Aggregate	0.80	-11.13

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
12/9/2022	4.31	4.33	3.75	3.57	3.56
12/16/2022	4.31	4.17	3.61	3.48	3.53

U.S. stocks fell back last week as a hawkish Federal Reserve kept rhetoric high for continued rising rates, dampening investor sentiment. Equities had seen an early 2% bump on Tues. as CPI came in at a more tempered pace than expected, showing more signs of a downward trend. CPI (and the Fed) are two of the most critical headline items for investor sentiment as we look into 2023. Additionally, Friday represented a 'quad witching' day, on which $4 tril. worth of options contracts expired—such days have been prone to higher than average volatility as investors reposition.

By sector, only energy saw gains approaching 2%, in keeping with higher oil prices, while all other categories lost ground to various degrees. In, 'growth', consumer discretionary fell back by nearly -4%, lagging all other sectors. Real estate also declined by -2%.

Foreign stocks declined in line with U.S. equities, with emerging markets faring slightly better than developed. The ECB and Bank of England each raised rates at the same 0.50% pace as the Fed, although with similarly hawkish language. Otherwise, manufacturing sentiment generally continued to run at contractionary levels.

U.S. bonds gained last week as interest rates ticked lower on the longer end of the yield curve, with treasuries outperforming corporates. Despite the FOMC moving the fed funds rate higher again, committee expectations for growth fell back, which depressed long-term expectations, further inverting the curve. Foreign bonds were mixed, with developed markets and emerging local bonds down sharply.

Commodities were mixed to higher on the week, with declines in metals offset by gains in energy. The price of crude oil rose almost 5% to around $74.50/barrel, as hopes for a China reopening have led to cautiously optimistic sentiment for improved global economic growth (the main driver for energy demand).

Have a good week and Happy Holidays.

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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.