Summary

Economic data for the week included consumer price inflation that continued to decelerate to close out 2022, but still remains high. Other positive news included jobless claims falling back and an improvement in consumer sentiment.

Equities fared well globally last week to continue a winning streak in the new year, thanks to lower inflation and optimism over the current earnings season. Bond prices rose along with falling interest rates. Commodities also gained, helped by a weaker U.S. dollar and stronger crude oil prices.

Economic Notes

(0/+) The **Consumer Price Index** for December fell -0.1% on a headline level, the first decline in over two years, but rose 0.3% for core, after removing the impact of food and energy prices. For the single month, gasoline prices fell back by over -9% (no doubt already noticed by many consumers), while food prices ticked up 0.3%. Within the core data, airfares and used car prices each falling -3% helped pull down the index, while shelter costs rose another 0.8%, reflecting the lagging impact of higher rents and home prices, which had been rising until recently, but take several months to be reflected in inflation measures.

Year-over-year, both CPI measures decelerated—headline by -0.6% to 6.5%, and core by -0.3% to 5.7%. This was obviously welcome news, albeit not unexpected. Inflation measures continue to drift lower from peaks in 2022, with a focus now on the speed of the decline and how quickly the Federal Reserve deems the deceleration as sufficient to pull back on rate hikes. Overall, inflation remains far higher than economists and policymakers are comfortable with, which explains the Fed's continued hawkish language, whether it be in formal releases or on the speaking circuit. However, when looking at future potential paths for inflation, the good news that even if headline CPI rises at a 0.2% monthly rate for coming months, the trailing 12-month figure will be back under 4% by March. The slower reading likely keeps the probability high for only a 0.25% Fed rate hike at the end of this month.

There have already been a few calls for the Fed (and other central banks) to reconsider their 2% inflation target as no longer 'realistic'. Having a numeric target can be helpful when communicating with policy precision, but less helpful when conditions aren't cooperating. Central banks plugged along for decades without an overt target level. There isn't any magic around 2%, only that it was the first quantitative inflation target for inflation formally published by a central bank—by New Zealand in 1990, less as a long-term economic-driven rule than it was a way to signal that nation's specific commitment in bringing inflation down from a 10% level in the immediate years prior. (Interestingly, since inflation was beaten in NZ, their 2% target was relaxed to a range of 1-3%.) Why not zero as a target? It's assumed that a small amount of inflation is a positive and unavoidable byproduct of a growing economy, in addition to fears that inflation moving too low into deflation is a condition assumed to be more difficult to reverse. So, that fear of deflation now takes precedence over fear of inflation, which is seen as easier to combat with the blunt tool of raising interest rates high enough (as Fed Chair Volcker proved in the early 1980s). For reference, starting with the first official U.S. CPI measure in 1913 through last month, the average annual headline rate was 3.1%, with a few wide variations over the decades. So, some calls for a loosening of inflation policy from 2% to 3%-ish aren't baseless from a historical perspective. However, any prospective evolution in the Fed's inflation target would require careful calibration and extensive use of 'forward guidance' communications, which highlights the modern challenges in placing and/or moving away from more precise quantitative targets once set.

(0) **Import prices** rose 0.4% in December, well above the -0.9% expected decline. When removing petroleum from the index, prices rose 0.8%, as petroleum/related-product prices fell by -3%. Aside from a 60% rise in the price of imported natural gas, industrial supplies rose a percent while food rose nearly a half-percent. Other items saw little change during the month.

(+) The preliminary **Univ. of Michigan index of consumer sentiment** for January rose by 4.9 points to 64.6, above the 60.7 level expected—and the highest reading since April of last year. Assessments of current conditions improved by over 9 points, while expectations for the future also rose by a few points. Inflation expectations for the next year fell by -0.4% to 4.0%, continuing a string of improved reports; expectations for the next 5-10 years rose a tenth to 3.0% (although gains aren't unusual in Jan. based on seasonal tendencies). Anecdotal commentary noted that sentiment improved due to easing inflation and stronger personal finances, although uncertainty over inflation remains high.

(0) **Initial jobless claims** for the Jan. 7 ending week fell by -1k to 205k, below the 215k expected via median forecast, with gains of 10k in CA offset by declines in a variety of states. Continuing claims for the Dec. 31 week fell by -63k to 1.634 mil., below the 1.710 mil. median forecast. Seasonality effects appear to still be at play, but overall claims remain at low levels. At the same time, while looking for some pattern in the data, levels are up 23% from the 166k trough in March 2022 and have been as high as 50% from trough levels. Historically, claims being up 25% from lows has been one sign of a recession-like labor market change, although the drift higher this cycle has been subtle.

Market Notes

Period ending 1/13/2023	**1 Week %**	**YTD %**
DJIA	2.01	3.54
S&P 500	2.71	4.22
NASDAQ	4.83	5.88
Russell 2000	5.27	7.17
MSCI-EAFE	4.25	7.04
MSCI-EM	4.18	7.71
Bloomberg U.S. Aggregate	0.88	2.74

U.S. Treasury Yields	**3 Mo.**	**2 Yr.**	**5 Yr.**	**10 Yr.**	**30 Yr.**
12/31/2022	4.42	4.41	3.99	3.88	3.97
1/6/2023	4.67	4.24	3.69	3.55	3.67
1/13/2023	4.67	4.22	3.60	3.49	3.61

U.S. stocks were led higher by an improved CPI inflation reading, as well as optimism over Q4 earnings. Gains were led by traditional 'growth' sectors last week, at a pace of 4-5% in consumer discretionary, technology, and communications. Lagging were defensive sectors such as consumer staples, which was the only loser for the week. Real estate also gained over 4% last week, as interest rates fell back.

The U.S. Treasury Department warned that the national debt limit will be officially reached this coming week, although accounting and payment reshuffling (included under what are known as 'extraordinary measures') will be implemented to kick the can until summer, when such measures are no longer feasible. Naturally, Treasury Secretary Yellen is imploring Congress to act now, well in advance of another last-minute crisis, but these events have remained a persistent source of political consternation. Based on recent episodes, political negotiations needed to raise the limit could be contentious, with some wanting the debt limit abolished altogether (noting that it applies to due payments already committed through prior passed legislation), while others are in favor of a prioritization scheme to formally pay bondholders first, while pushing transfer payments, such as welfare and food stamps, to the back of the line. Of course, the ultimate problem to avoid is

the default of U.S. treasury debt, which, depending on how a default is defined, could be disastrous to financial markets. (Treasuries are considered to be the ultimate 'risk-free' asset, implying a default is unthinkable, and tends to not be a priced-in factor for valuations.) Unfortunately, the 2011 political episode that came very close to the deadline resulted in a downgrade of U.S. debt by Standard & Poor's from AAA to AA+, based not on a problem with 'ability to pay' but less confidence in 'willingness to pay'. Unfortunately, a permanent solution has yet to emerge, and some degree of financial market volatility has been a common result in the interim.

The Q4 earnings season has begun for U.S. equities, with decent results from the big banks that usually report first, although a more pessimistic tone about the economy and preparations for potential credit losses in the event of recession turned sentiment lower. FactSet estimates a potential net decline of -3.9% for Q4 in total, in contrast to an expected gain just a few weeks back. However, initial estimates at quarter-end have tended to run low, compared to realized earnings after all have reported. With expected declines for Q1 and Q2 as well, earnings remain a key wildcard in 2023, as to whether equities have priced in an earnings recession in addition to, or instead of, an economic recession. On the optimistic side, estimates for Q3 and Q4 2023 show high-single digit recovery at this point, placing the full year in a net positive light.

Foreign stocks performed in line with U.S. equities, with Europe and Japan outperforming, although all segments ended positively. Economic data included indications of a milder slowdown than first expected, including positive GDP growth in the U.K., and stable employment, which elevated spirits. In EM, demonstrations in Brazil played a far less important negative role than the positive impact of stronger budgetary discipline.

Bonds fared positively as interest rates fell back along the yield curve, along with lower inflation; corporates outperformed treasuries slightly as spreads narrowed. A fall of -2% in the value of the dollar pushed foreign bonds higher, in both developed and emerging markets.

Commodities rose on the week, led by gains in energy and industrial metals, with lesser gains for precious metals and agriculture. Crude oil rose over 8% on the week to just under $80/barrel, due to rising orders from China in keeping with reopening plans. This offset a similar magnitude decline natural gas, as warmer winter weather continued to weigh on perceived demand. In fact, spot prices are down -50% over the past month, following strong price spikes during the past year at various times—both in keeping with gas being one of the most volatile commodity contracts.

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, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, Univ. of Michigan, 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.

The information above has been obtained from sources considered reliable, but no representation is made as to its completeness, accuracy or timeliness. All information and opinions expressed are subject to change without notice. Information provided in this report is not intended to be, and should not be construed as, investment, legal or tax advice;

and does not constitute an offer, or a solicitation of any offer, to buy or sell any security, investment or other product. FocusPoint Solutions, Inc. is a registered investment advisor.

Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.