Summary

Economic data for the week included producer and consumer prices staying elevated, although still decelerating on a year-over-year basis. Industrial production was little changed, while several regional manufacturing indexes showed divergent results. Housing data was also mixed.

Equities ended in varied directions last week, with flattish U.S. returns, while Europe gained, and Asia fell back. Bonds also lost ground with interest rates moving higher along with persistent inflation concerns. Commodities fell across the board, along weaker energy prices and a stronger dollar.

Economic Notes

(+) **Retail sales** for January reversed course by rising 3.0%, exceeding the median forecast of 2.0%. Removing autos and gasoline only removed a half-percent from the growth result, while core/control sales rose 1.7%, as building materials sales saw minimal gains. In fact, all 13 categories measured showed growth for both January and were up over 6% in total on a year-over-year basis. In other areas, food/drinking places saw a 7% gain, followed by strong sales results in furniture/appliances, and general merchandise. This report is quoted in nominal terms, but the strong showing appeared to show decent after-tax 'real' growth as well. The January effect with seasonal measurement factors and continued pandemic distortions likely played a role in the release, as perhaps did higher Social Security income after CPI adjustments for the new year.

(-/0) **Industrial production** in January was unchanged, falling short of the median forecast calling for a 0.5% rise. **Capacity utilization** ticked down by a tenth of a percent to 78.3%. Under the hood, utilities production fell by a dramatic -10% (the worst month for that component since before World War II), pulling down the entire index, due to a cold December evolving into an unusually warm January in many locations. Regardless, that represents an important input into GDP. Otherwise, manufacturing production rose 1% (with positive results in autos and business equipment), while mining gained 2%.

(+/0) The **Empire manufacturing index** rose by 27.1 points to a still-contractionary -5.8 in February, beating expectations for a lesser gain to -18.0. New orders rose sharply, but remained in contraction, as did shipments, which eased slightly back into expansion. However, employment fell by nearly -10 points into contraction. Prices paid and received both gained, further into expansion, while delivery times slowed for more respondents. Importantly, assessments of six months-ahead business conditions rose further into expansion as well.

(-) On the other hand, the **Philadelphia Fed manufacturing index** fell by -15.4 points further into contraction at -24.3, contrary to expectations of an improvement to -7.5. This was the lowest reading since spring 2020 at the early stages of the pandemic. Deteriorating data included new orders falling further into contraction, while employment and shipments also fell back but remained positive. Expectations for the next six months also fell back by a few points, but remained positive as well. The anecdotal question of the month concerned inflation, specifically product prices, which were seen as likely to decelerate to around 4.0% over the next year, a few percent below the response from a few months ago—showing that lower inflation assumptions have begun to filter in to business expectations, albeit still slowly.

(-) The **Producer Price Index** for January rose 0.7%, beyond the expected 0.4% and almost twice the median forecast. On a core level, removing food and energy prices, prices rose 0.5%, with the impact being a 5% rise in energy prices, as food prices fell by -1%. However, prices were higher generally in a variety of areas. This brought the year-over-year PPI to 6.0% and 5.4% for headline and core, respectively. Looking at further detail, goods prices remain up 7.5%, with services up 5.0%. There could be some seasonal adjustment issues with PPI over the last two months also, but producer prices have generally remained as sticky as other measures. Data like this is what has kept the Federal Reserve hawkish longer than many would have hoped.

(0/-) The **Consumer Price Index** for January reaccelerated by 0.5% on a headline level and 0.4% for core, removing food and energy prices. These were both generally in line with expectations. The headline figure was driven by a 2% rise in energy for the month, with food up 0.5%. (Within the latter, and troubling for many, egg prices rose over 8% in January alone, and 70% year-over-year, due to an avian flu outbreak affecting chickens.) Within core segments, little had changed in the pace of prior price movements, with used cars down another -2% (prices have fallen -1% to -2% per month for the past 6 months), along with declines in airfares and medical care services. However, shelter costs rose 0.7% to lead other sectors, along with gains in apparel and transportation services. Shelter costs, which include the impact of both rents and implied home prices, have a lagged effect in the index, so recent downward moves in both (seen in Zillow and other data providers) could take time to find their way into CPI. These aren't perfect measurements of inflation, but remain about the most accurate relative to anything else.

Within the BLS data, the methodology has changed a bit, with consumer expenditures now based on the trailing one calendar year, as opposed to every two years, and included some revisions higher for December CPI that were included in the January figures. This should result in more accurate and timely information, considering the rapid pace of inflation changes during the pandemic. Anytime seasonal adjustments are made, consistency from the prior stream of data is disrupted a bit, with better normalization expected over multi-month periods going forward. These stats also include the impact of typical new year price adjustments for various products in January, such as prescription drugs. More subtle in the recent inflation episode is the sneaky impact of effects like 'shrinkflation' in food packaging, where the item price is left little changed, but the package itself has downsized—this makes inflation a little bit less obvious, but the per unit impact still makes its way through.

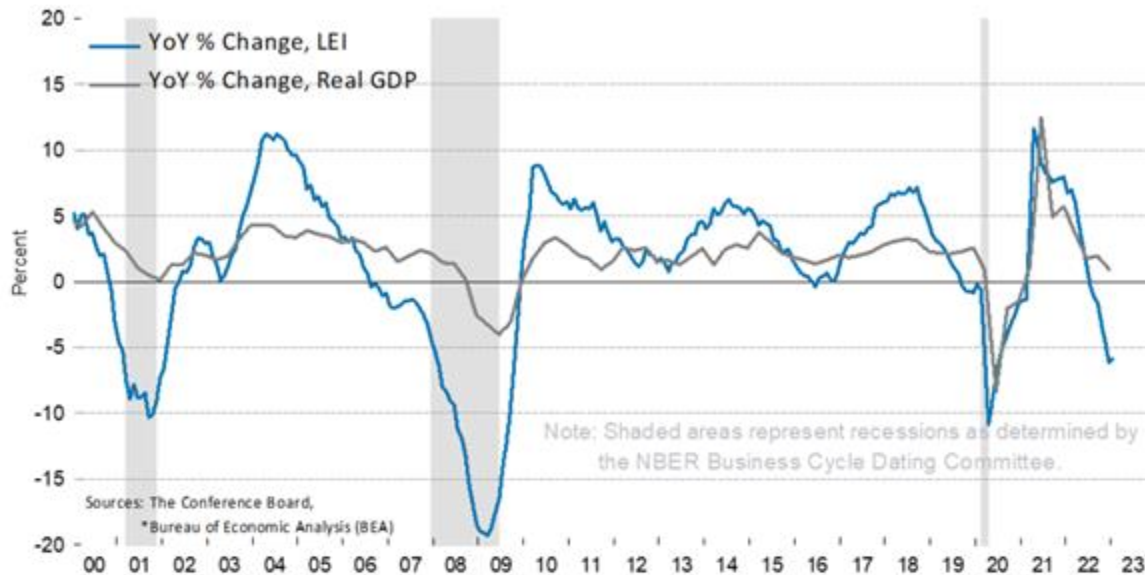
Year-over-year, CPI rose 6.4% and 5.6% for headline and core, respectively. This was essentially unchanged on a headline basis from December, while core decelerated by about a tenth of a percent. While petroleum prices were mixed over the past year, based on the distillate product, food prices were up over 10%, which had a strong negative impact on consumer budgets, particularly on the lower-income side. Shelter costs remain 8% higher. On a broader index level, the good news is that the increasingly-watched trailing 3-month inflation number is showing stronger signs of falling off more quickly, coming in at an annualized 1.6% for headline and 3.6% for core.

(0) **Import prices** for January fell by -0.2%, just beyond the expected -0.1%. Removing petroleum, which fell by -5%, prices rose 0.2%, compared to an expected drop of -0.3%. A key component of the report was a -11% decline in natural gas prices, reversing a sharp gain the month prior. Otherwise, autos and food/beverages prices rose upwards of a percent, while air passenger fares fell over -12%. While inflation remains high by a variety of measures, month-to-month adjustments to both directions have also been volatile.

(-) **Housing starts** in January fell by -4.5% to a seasonally-adjusted annualized rate of 1.309 mil. units, below expectations calling for a -1.9% drop to 1.356 mil. Both single-family and multi-family declined to similar degrees. Starts are still down over -21% over the past year as a whole, with single-family starts down -27%, tempered by a lesser drop in multi-family. Regionally in January, the Northeast experienced a -42% drop, followed by -25% in the Midwest, as would be expected in winter, while the South and West saw minor gains. **Building permits** rose 0.1% in the month, to a 1.339 mil. seasonally-adjusted annual rate, also below expectations of a 1.0% rise, and remain down -27% over the past year. These results disappointed due to winter weather not being as severe as normal, although higher financing rates continue to weigh on housing sentiment.

(+) The **NAHB housing market** index rose 7 points to 42, exceeding expectations of a minor gain to 37 and continuing a trend of reversing a full year of declines. However, the sub-50 figure remains a negative for sentiment overall. Future sales rose by the largest amount, by 11 points, while current sales and prospective buyer traffic also gained. All four national regions saw gains, led by the Northeast and West.

(-) The Conference Board Index of **Leading Economic Indicators** for January experienced a drop of -0.3%, still negative, but at a lesser pace than the -0.8% drop the prior month. For the trailing six months, the index is down -3.6%, compared to -2.4% for the prior six-month period that ended in July 2022. This moderation in the decline pace was noted by the Conference Board, although the majority of indicators remained negative, particularly in consumer expectations, ISM new orders, and building permits. These all point to recession in the months to come, due to 'high inflation, rising interest rates, and contracting consumer spending.' Again, while these are already-reported individual data points, but the combination in their metrics represents the historically-useful signal.



(0) **Initial jobless claims** for the Feb. 11 ending week fell by -1k to 194k, but still fell below the 200k consensus forecast. Continuing claims for the Feb. 4 week rose 16k to 1.696 mil., just a tick above the 1.695 mil. expected. Initial claims were mixed, with no major outliers as the largest differences in both directions were in the largest states, as would be expected. Seasonal adjustments appear to continue to play a role in the labor index levels for the time being.

Market Notes

Period ending 2/17/2023	**1 Week %**	**YTD %**
DJIA	0.02	2.35
S&P 500	-0.20	6.50
NASDAQ	0.63	12.76
Russell 2000	1.47	10.65
MSCI-EAFE	0.12	7.47
MSCI-EM	-1.38	4.58
Bloomberg U.S. Aggregate	-0.47	1.07

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
2/10/2023	4.79	4.50	3.93	3.74	3.83
2/17/2023	4.84	4.60	4.03	3.82	3.88

U.S. stocks fell back slightly last week as both producer and consumer inflation failed to cool as fast as was hoped, coupled with strong retail sales figures. This, of course, was taken to imply a Fed that stays hawkish for

longer, with perhaps even another quarter-point hike mid-year now baked into some estimates. In recent weeks, a 5.00% possible terminal rate has now morphed closer to 5.25-5.50%, although the sharp increases seem to still be in the rear-view mirror. By sector, a mix of growth (consumer discretionary and communications) and defensives (staples and utilities) earned positive returns, while energy fell by over -6% on the losing side.

Foreign stocks gained in Europe and the U.K., while Japan and emerging markets fell back on the week. Similar to the U.S. in some respects, sentiment in Europe has continued to strengthen, along with stronger-than-expected corporate earnings results, while inflation in the U.K. slowed. However, the ECB remains steadfastly hawkish, with continued expected rate hikes in coming meetings, as with the U.S. Fed. Speaking of central banks, a change in the Bank of Japan leadership has raised questions about the potential for breaking out of the yield curve control policy, and letting long-term rates rise higher to a more natural level. Chinese equities fell back upon sentiment challenged by less favorable rhetoric concerning U.S.-China relations, related to the recent balloon incidents, although details still remain unclear.

Bonds fell back last week as well, with firmer inflation numbers pushing interest rates higher as a variety of economists decided to raise estimates for the Fed terminal rate by another quarter-percent roughly. In fact, the 1-year T-bill yield breached 5% for the first time in 15 years, as investor expectations for a higher Fed funds rate seeped into markets, but the curve remained solidly inverted. Treasuries outperformed corporates, although high yield and floating rate bank loans outperformed. Foreign bonds were held back by both higher rates and a stronger U.S. dollar.

Commodities declined across the board last week, not helped by strength in the dollar, despite continued expectations for rising demand through the year. Energy led the way downward as crude oil prices fell -4% last week to under $77/barrel, and natural gas declined another -9%, with warmer winter temperatures weighing on heating demand and higher inventories for petroleum generally.

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, 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.

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