Cornerstone

ASSET MANAGEMENT GROUP, LLC

Economic Indicators | March 2023 | By Kim W. Suchy

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January certainly gave us the sense that perhaps this recession talk was starting to wane as the markets across all capitalizations rallied. Why? We witnessed a reasonable disconnect between investors and the Fed. The markets rallied as investors sensed that the Fed was taking its foot off the brakes with one maybe two more 25bp rate increases, a pause, then contemplate a rate cut later in 2023.

This sentiment was founded in several weak economic reports; i.e. housing sales and starts, industrial production, retail sales, Purchasing Manager Indexes and consumer sentiment which suggested further rate hikes could lead to recession. Further, the fact that consumer prices had fallen steadily over the last several months seemed that inflation was under control and the lag effect of a rate hike on sending inflation to the Fed's 2% target was still uncertain. All was good, then came February.

Over the last few weeks, many investors have adopted the premise that rate cuts are not likely for a considerable amount of time. Recent consumer and producer price reports suggest that inflation remains a bit hot. So hot, that some market pundits have hinted that one or two 50bp rate increases could be in the cards. While Fed Chair Powell's comments have been more dovish of late than they were in 2022, he continues to bang the drum that more rate hikes are needed to bring inflation down. We have certainly seen the "goods" component of inflation reined in but the "services" component won't budge. The Fed knows the service side is often stickier and more stubborn than goods inflation, thus the elevated concern.

Inflation aside, investors were rattled at another very strong jobs report for January coupled with better economic data; i.e. retail sales and consumer sentiment suggest the Fed feels that the economy's consumer is in respectable shape and can endure a higher rate environment for several more months in order to get inflation well on its way towards target levels. It's notable that sound economic news and a strong employment market caused Treasury rates to move higher as the bond market felt this tandem of good news was inflationary. As such, when rates rise valuations in the stock market retreat as future earnings are discounted at a higher rate. This is the very reason why stocks slid from January's levels. As we have said before; good news is bad news and bad news is good news…

Here is your look at developments in the global marketplace.

POSITIVE DEVELOPMENTS

- The annual rate of inflation, as measured by the CPI, declined in January for a 7th consecutive month, reaching an annual rate of 6.4%. In June, the figure was 9.1%, a 40-year high. The rate measures the cost of goods and services compared with the previous year.
- The University of Michigan's consumer sentiment index, showed that Americans may be starting to feel better about the economy. This index, which is based on answers to various financial-related questions, rose in February for the 3rd consecutive month, increasing by 2.3 index points. However, the sentiment is still 14 index points lower than it was two years ago.
- Janet Yellen, Treasury Secretary, recently stated that a soft landing is possible because the job market is so strong and because there is no significant debt overhand like there was before the Global Financial Crisis. Economist Ed Yardeni has shared a similar sentiment for some time.
- The 2/27/23 WSJ reports that new supply means apartment rents are falling in big cities. New rental rates have been falling for 6 mos. or so. Rents are still rising in the CPI because people who signed leases a year or two ago are still paying increases when they renew, but those are not as big as they were a few months ago. Shelter inflation is expected to peak soon which is a large piece of CPI (44%).
- Evercore Research notes that consumer discretionary and consumer staple companies face hurdles from higher interest rates because they have a large proportion of short-term debt that will soon need refinancing. However, those sectors are supported by the spending of households which maintain healthy balance sheets. These households have remained relatively sheltered from rising interest rates. Deleveraging since the global financial crisis has lowered households' interest rate sensitivities.

NEUTRAL DEVELOPMENTS

- Existing home sales started off 2023 by falling for the 12th consecutive month, now resting at the lowest level in more than a decade. Falling affordability has played a major role in the record streak of declining reports. The surge in mortgage rates, with interest rates on 30-yr fixed rate loans currently hovering near 6.8%. While improved sales facilitate GDP growth as home buyers typically upgrade with new appliances and furnishings which we are not seeing, the good news is that people are sticking with their cheaper mortgages and less likely to default.
- The 2nd estimate of Q4 2022 real GDP expanded by 2.7% (q/q, annualized) – a slight downward revision from the 2.9% reported in the Bureau of Economic Analysis's estimate. The U.S. economy ended last year on a slightly softer footing, with the bulk of the downward revisions concentrated in consumer spending. While GDP still appeared to expand at an above trend pace, nearly three-quarters of the gains were concentrated in net exports and inventory investment, which continue to experience distortions as supply chains normalize.
- The Fed minutes are a near mirror image of the message delivered by Jay Powell at the Feb. 1 press conference, though the tone is perhaps a bit tougher. Powell started strong, stressing still-too-high inflation and the need for more hikes, but his tone softened as he went on, until he eventually conceded the possibility the markets might be right and the Fed may have just one more rate hike before cutting in the 2H of 2023. He did not think that would be the case, he said, but it could be true *if* inflation fell much faster than the Fed or he expected. *This may be a pipe dream…stay tuned*
- Personal income rose 0.6% and personal consumption rose 1.8% in January. Personal income is up 6.4% in the past year, while spending has increased 7.9%. Disposable personal income (income after

taxes) increased 2.0% in January and is up 8.4% from a year ago. While this looks good at face value, with incomes up 6.4% in the past year and spending up 7.9%, the Fed may be concerned that the current level of interest rates is NOT slowing demand, hence prices, to attain their target levels

NEGATIVE DEVELOPMENTS

- The PCE Price Index increased 0.6% month-over-month following an upwardly revised 0.2% increase (from 0.1%) in December. The core-PCE Price Index, which excludes food and energy *and is the Fed's preferred inflation gauge,* also rose 0.6% month-over-month. This left the PCE Price Index up 5.4% yoy, versus 5.3% in December, and the core-PCE Price Index up 4.7% yoy, versus 4.6% in December.
- FactSet Document Search (which allows users to search for key words or phrases across multiple document types) was used to answer this question. Through Document Search, FactSet searched for the term "inflation" in the conference call transcripts of all the SP500 companies that conducted earnings conference calls from December 15 through February 23. Of these companies, 325 have cited the term "inflation" during their earnings calls for Q4. This number is above the 5-year average of 201 and above the 10-year average of 157.

THE MARKETS

February had a tough time trying to replicate January's quick start. Good news in the economic arena led to concerns that the Fed had more wood to chop before stopping rate hikes. Consumer discretionary, tech and industrials had a positive month while energy, real estate and communications had weak performance.

Yields on short-term Treasuries have been rising quickly this year, reflecting expectations of rate hikes by the Fed, while longer maturity yields have moved up at a slower pace on concerns that Fed policy may hurt the economy. As a result, the shape of the Treasury yield curve remains inverted. The 2yr.-10yr. inversion was at -69bps at the close of January and is now -86bps…more recessionary fear is driving inversion.

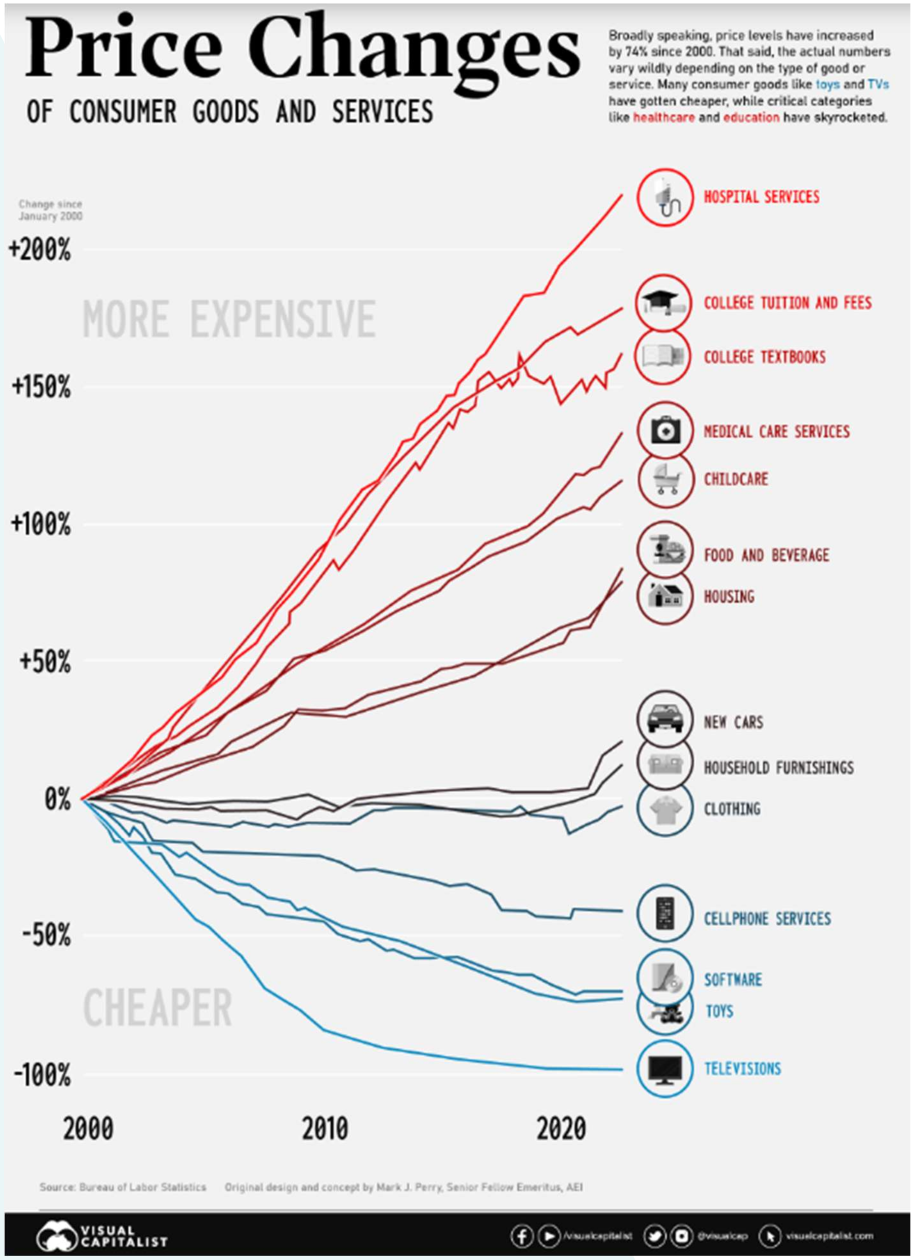
On the International stock front, most European markets were higher last month. Shanghai and Japan were also higher while the Hang Seng drifted broadly lower.

The Dollar's rally gathered momentum in recent weeks as upbeat economic data led to growing expectations that the Fed will have to raise interest rates more than initially expected. The dollar index, which measures the currency against a basket of peers, was set for a February gain of 2.5%, its first monthly increase since September.

U.S Index	Last Month (% return)	YTD (%)
S&P 500	-3.9	-1.5
Dow Jones	-2.5	3.4
NASDAQ Comp	-1.4	9.5
Russell 2000	-0.5	8.0

Source: https://tradingeconomics.com/stocks

Graph of the Month: Price Changes of Consumer Goods and Services



This graph illustrates the price change for various consumer categories since January 2000. As you can see, since the start of the 21st century, there has been divergences of price movements across these various categories. Many consumer goods that were easily outsourced saw prices decline, while other defensive categories saw massive increases.

America has a long history with medical inflation. This is attributed to rising labor costs, an aging population, better technology, and high drug prices. Rising medical costs can have serious consequences on US consumers. According to Forbes, 50% of Americans now carry medical debt, and over half of those Americans owe at least $1000.

Education has had chronic inflation issues ever since the mid 1980's. Since 2000, tuition prices have increased by 178% and college textbooks have jumped 162%. The elevated costs of education have contributed to the $1.75 trillion in total student loan debt. According to the Federal Reserve, 55% of students from public four-year institutions had student loans, with $28,950 owed per borrower on average.

Although essentials like healthcare and education have skyrocketed, other consumer goods have decreased dramatically. Remember the days when flat screen TV's were big ticket items? In 2000, a flat screen TV would cost around 17% of the median income at the time. Today, a new TV will cost less than 1% of the US median income. Toys have also seen a significant drop in price as the value proposition has changed as children have new digital options to entertain themselves with. In addition, cellular services and software have gotten much cheaper over the past two decades.

https://www.visualcapitalist.com/inflation-chart-tracks-price-changes-us-goods-services/

https://www.forbes.com/sites/debgordon/2021/10/13/50-of-americans-now-carry-medical-debt-a-new-chronic-condition-for-millions/

https://www.forbes.com/advisor/student-loans/average-student-loan-statistics/

NEWS YOU CAN USE

Microsoft's ChatGPT-powered Bing has been grabbing headlines ever since they debuted the AI chatbot this month. You can ask the bot anything and it will provide amazing results. It can dispense essays, songs, and website code with varying degrees of success. The basic version of ChatGPT is completely free to use. However, it's not free for OpenAI to continue running it, of course. It is estimated that OpenAI spends around $3 million per month to run it (or $100,000 a day).

https://www.digitaltrends.com/computing/how-to-use-openai-chatgpt-text-generation-chatbot/

The Kansas City Chiefs were victorious over the Philadelphia Eagles in a very tight match in Super Bowl LVII. There was a lot on the line for advertisers. This year a 30-second commercial advertisement went for $7 million, which after production costs for a spot, advertisers could spend up to $10 to $15 million in total. Many hope that a great ad can help catapult a brand's image and boost sales and hope to capitalize on the game's viewership. Super Bowl LVII drew 113 million viewers across all platforms, which is a slight 1% higher than last year.

https://www.cbsnews.com/news/super-bowl-2023-commercials-best-and-worst/

According to Crowdstrike's annual global threat report, it has observed China-linked cyberespionage groups targeting 39 industries on nearly every continent. Nearly 25% of China's hacking was aimed at North America, while most attempts targeted its neighbors. This report comes after the US shot down a Chinese Spy Balloon on February 4th, which traveled across the entire country. The report suggests hacking is where the Chinese make their money, and it remains their chief espionage activity.

https://www.nbcnews.com/news/forget-chinese-spy-balloon-china-linked-hackers-collect-far-informatio-rcna72583

As always, if I can be of additional guidance, please feel free to call me at 312.485.6847.

Best regards,

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