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Economic Indicators | January 2023 | By Kim W. Suchy

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The Miracle on 34th Street had its joyous ending but the Santa Claus rally on Wall Street did not materialize as in years past. December is usually a strong month for stocks but Fed Chief Powell aka, Grinch, torpedoed the markets with another round of rate hikes and a hawkish tenor on Fed plans over the short and intermediate term.

After the last Fed meeting in December, Powell's presser was a downer as he refused to acknowledge that the battle against inflation is improving, even though core inflation, excluding food and energy, is steadily improving. As a result, the Fed appears to be at odds with market rates given that we have seen a dramatic decline in Treasury yields over the past month or so. The Fed has noted that inflation on some goods has eased but the new battle is against service sector inflation. However, if Treasury yields continue to drift lower, the Fed has no choice but to hit the "pause" button. Keeping their foot on the brakes only slows an economy in desperate need of acceleration.

The next Fed meeting is not until February 1st and the Fed will be absorbing many data points between now and then. Remember, bad news is good news and vice versa. Rising unemployment (reduces upward pressure on wages), slowing consumer spending (keeps a lid on prices), falling home sales and permit issuances suggest that higher mortgage rates will be slowing large capital expenditures in the future (TV's, couches and refrigerators). The weaker the reports, the more the Fed sees its policies having an impact. This economy needs the Fed to be really tuned in to how quickly the bad news becomes good news as the time lag between implementation and effect is really unknown.

Why is this understanding of the time lag so important? Congress managed to sneak through legislation just before they headed home for recess which was also on the front end of a snowstorm, which could have kept them in their offices, if they did not receive a "get out of town now" message from the President. In its haste, Congress sent a pork-laden $1.7T, 4,155-page "Omnibus" spending bill to Biden for his signature just 10 days before Republicans would gain control of the House. This makes Grinch's job even more difficult and now wishes he personally is added to the bad news category by being counted as a freshly minted unemployed. This spending must be financed and if rates keep rising, debt service costs will escalate further placing compounded strains on prices and, unfortunately taxes. Let's hope the Grinch can navigate his sled through some nasty turbulence.

POSITIVE DEVELOPMENTS

- While retail sales are soft, there is hope that the consumer discretionary sector could fare well in 2023. From the demand side of the equation, assuming the job market remains strong, spending may improve because gas prices have fallen in recent weeks. The price of a gallon of gas has fallen 34% from its June peak of $5.11 to $3.35. Note, we need diesel prices to fall further to help transport costs.

- The CPI rose 7.1% yoy in November, a slowdown from 7.7% last month. Overall inflation has been decelerating on a yoy basis since hitting a peak of approximately 9% in June. Removing food and fuel prices, which are volatile, CPI climbed by 6%. The slowdown in inflation was driven by food, energy and used vehicles. Food price inflation slowed, but grocery bills remain historically high...my favorite bread, Dave's Killer Organic Good Seed now costs me $7.19 per loaf! Rents are also surging.

- From the good news department, the money supply is contracting for the first time in 70 years. During the economic lows of the pandemic, cash was created and provided to companies and individuals for a multitude of reasons, but when we print more dollars, the result is inflation. When there are more dollars circulating in the economy, they are worth less. Thus, it requires more dollars to buy a unit of goods.

- The Dollar has weakened since October – this is good news as this makes foreign purchases of U.S. products less expensive. In an already soft economic environment with inflation, a strong Dollar acts as a "tax" on foreign consumption. In 2021, the Dollar declined and provided a tailwind to stocks because approximately 40% of SP500 corporate revenues are from international sales.

- The Commerce Department reported that personal spending increased 0.1% in November from the prior month. This compared with an upwardly revised 0.9% increase in October. Households boosted spending on services last month while cutting spending on goods, including autos. Further, the personal-consumption expenditures price index, the Fed's preferred gauge of inflation, rose 5.5% in November from a year earlier, a significant cooling from 6.1% in October.

NEUTRAL DEVELOPMENTS

- The failure of the crypto exchange FTX was a major financial crises that was triggered by the Fed's tightening policies. Leverage works great when rates are falling but blows things up when rising. FTX would have failed anyway as it was basically a Ponzi scheme. The Fed's May Financial Stability Report (FSR) mentioned cryptocurrencies just once as the 9th-greatest risk to US financial stability. The recent (11/2/22) FSR stated, "The turmoil in the digital assets ecosystem did not have notable effects on the traditional financial system because the digital assets ecosystem does not provide significant financial services and its interconnections with the broader financial system are limited." THANK GOODNESS!

NEGATIVE DEVELOPMENTS

- Housing starts continued to slow in November as elevated mortgage rates and ongoing supply-chain issues are weighing on builders. Unfortunately, housing isn't going to help bail us out of this economic slowdown as turnover will slow since those who locked-in fixed-rate mortgages before this year will hold their homes dear.
- Retail sales plummeted in November, falling by 0.6%. While this was a shock at face value, it comes on the heels of a very robust report in October. The retail weakness was widespread as only 4 of 13 retail categories grew in November, with the declines led by autos and building materials, dropping 2.3% and 2.5%, respectively. While sales are up 6.5% yoy as consumers spend more, they are not bringing home the same amount of goods. The 6.5% pace is not outpacing inflation, with the CPI up 7.1% over the same period.
- The Wall Street natives are getting restless and telling the Fed, "Give it a rest already!" We have had 7 big rate hikes in 2022 and investors want the Fed to give them a chance to work through the economy. Recent housing, manufacturing, retail sales and industrial production reports should be sending a loud and clear message that all this front-loading of rate hikes is already slowing growth.
- *Existing* home sales fell for the 10th consecutive month in November, posting the longest streak of declines since records began in 1999. Falling affordability has played a major role in the recent string of weak reports with rising mortgage rates the culprit now resting at 6.5% for a 30-year fixed rate.

THE MARKETS

The 4th quarter rally fizzled at year-end following two months of solid returns. As discussed earlier, the Fed really pressed markets lower with its hawkish tenor. Health care, utilities and industrials helped buoy some lackluster returns while consumer discretionary, tech and communications (this year's weakest sectors) lead the market lower in December.

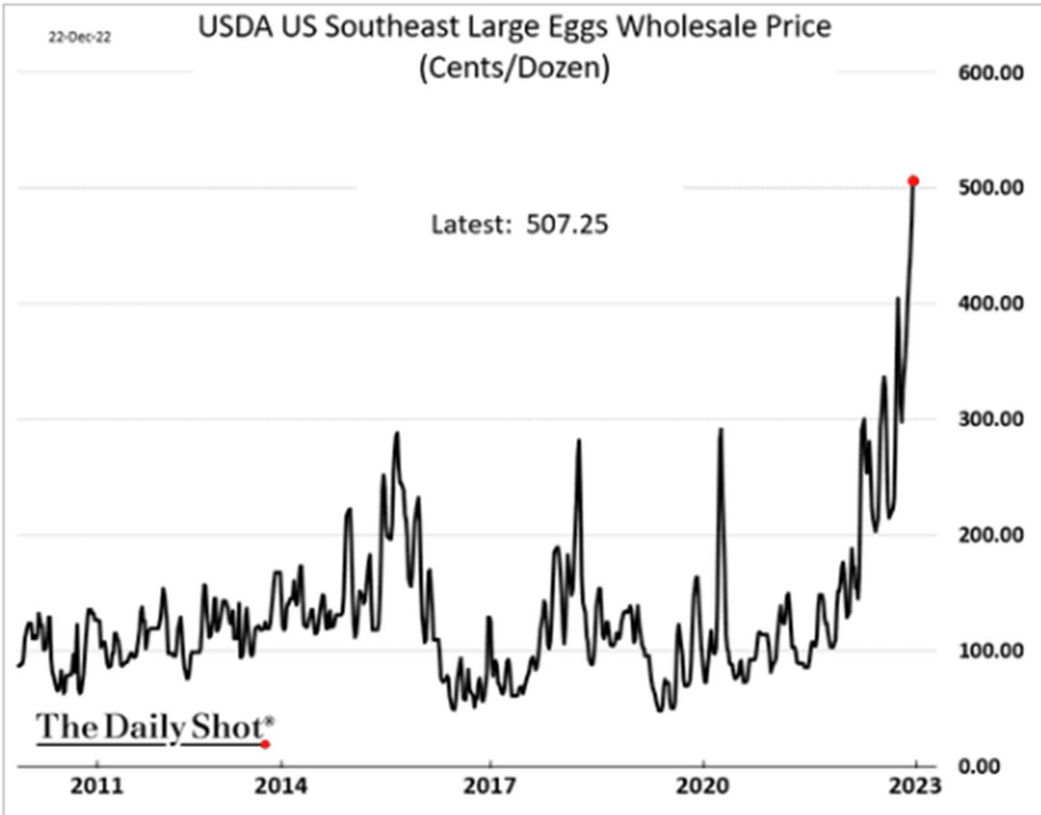
Bond yields escalated a bit in December. While the 2-10yr inversion came in modestly (perhaps suggesting that recessionary pressures are slipping) it remains at 51 basis points. We continue to believe that any economic slowing will be modest with a soft landing and not hard like prognosticators suggest.

On the International stock front, most European markets were lower as the EU raised rates and hinted that more robust hikes are in the cards. China and Hong Kong were higher in December on news that China would be open for business as quarantines were lifted.

The Dollar continues to retreat a bit as other countries begin their monetary tightening regimen and raise interest rates. This is good news for the U.S. multinationals that repatriate earnings into Dollars.

U.S Index	Last Month (% return)	YTD (%)
S&P 500	-6.2%	-19.8%
Dow Jones	-3.9%	-9.1%
NASDAQ Comp	-9.4%	-33.5%
Russell 2000	-6.5%	-21.6%

Source: https://tradingeconomics.com/stocks



Source: The Daily Shot

Graph of the Month: Egg Prices Hit Record High

Eggs have become a lot more expensive this year, and the main culprit isn't the obvious. Inflation has been a problem for most food items, including eggs; however, a bird flu outbreak has exacerbated eggs price stability. The bird flu has led to the deaths of about 58 million chickens and turkeys across nearly all 50 states this year, according to Agriculture Department data. More than 40 million egg-laying chickens have died, with the total supply falling more than 5% from the start of January to December.

Wholesale prices of Midwest large eggs hit a record $5.36 a dozen in December, according to the research firm Urner Barry, and prices have been rising for nine consecutive weeks. Strong demand has driven prices higher in the winter as people bake more and eat warm breakfasts in the cooler weather. Combined with lower supply due to the outbreak, prices for eggs have increased more than any other supermarket item this year.

There are signs that prices have peaked or are peaking, however. In their earnings release on December 29th, Cal-Maine Foods, who engages in the production, grading, packing, marketing, and distribution of fresh eggs, noted they expect prices to normalize as more supply comes available in the coming months. In addition, shortages are still a long way off according to the CEO of the American Egg Board. Egg supplies are more stable this year compared to the 2015 avian-flu outbreak.

Given eggs are staples in the refrigerator for many of you, next time you're at the grocery store, peek at those egg prices!

https://www.wsj.com/articles/egg-prices-surge-to-records-as-bird-flu-decimates-poultry-flocks-11671689775

NEWS YOU CAN USE

On December 17th, the Minnesota Vikings showcased a tremendous come from behind victory against the Indianapolis Colts, winning 39-36 in overtime, after trailing 33-0 at halftime. The 33-point comeback was the largest in a single game in NFL history. Entering the game, teams that trailed by 30 or more points at halftime were 0-132 in the Super Bowl Era (since 1966).

https://www.cbssports.com/nfl/news/vikings-vs-colts-score-takeaways-minnesota-completes-largest-comeback-in-nfl-history-clinches-nfc-north/live/

Two men were sentenced this month for being the masterminds behind a plot to kidnap the Governor of Michigan. In one of the most high-profile cases of domestic terrorism in recent years, Barry Croft, and Adam Fox, were sentenced to 19 years, and 16 years respectively in prison. Croft planned to kidnap Governor Gretchen Whitmer from her vacation home and escape by blowing up a bridge. The men were believed to be driven by Whitmer's tough COVID-19 restrictions during the pandemic.

https://www.npr.org/2022/12/28/1145812509/gov-whitmer-plot-sentence-croft

KFC for Christmas has a long history in Japan, evolving since launch in the 1970's. Catchy advertising, differentiation in dishes, and the Colonel dressed as Santa have all contributed to Japan's massive hunger for chicken on Christmas. Although only 1% of Japan's population is Christian, the holiday's commercial aspects have been embraced. The run-up to Christmas is KFC Japan's biggest sales week, with 2019 and 2020 Christmas sales reaching roughly $60M each year. Many Japanese place their KFC orders months in advance of Christmas week to avoid the lines that spill over into the streets.

https://www.foxnews.com/food-drink/kfc-christmas-fast-food-chain-holiday-hit-japan

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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