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ASSET MANAGEMENT GROUP, LLC

Economic Indicators | May 2022 | By Kim W. Suchy

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The investment arena has definitely been risk-off since our last writing to you in late March. While several headwinds can be cited as catalysts, the primary catalyst has been Fedspeak. Like synchronized swimmers, Fed officials have been airing their hawkish laundry and "talking" rates higher perhaps to give the markets plenty of time to establish equilibrium before rates are actually adjusted in May. The 10-year Treasury bond yield rose sharply from 2.32% on March 31 to 2.8% last week in the midst of all the Fedspeak which unsettled the stock market. Inflation appears here to stay as the Fed Chair Powell label for inflation, "transitory", has disappeared.

The combination of entrenched inflation, a hawkish Fed, and significant economic headwinds appear to be increasing the chance of a recession late this year or early next year. While the Fed believes it can execute a soft landing, Fed tightening is always a tricky process because the neutral rate (rate at which the Fed stops hiking) is unknown and is affected both by economic conditions, like the unemployment rate and inflation, and by exogenous factors like mortgage refinancing and fiscal policy which are not in their models. Fiscal policy will be a wild card and difficult to "manage around" as this is a midterm election year and those politicians on the fence usually want to bring projects to their constituents.

From the early 1980s until 2020, deflationary forces were keeping a lid on inflation. Technological disruption, demographics (an aging population consumes less), and debt (low interest rates) all kept prices in check. Over the past year, however, the deflationary pressures have waned as deglobalization, decarbonization, demographics, and rising interest rates (debt) all have higher price tags and are working their way into what consumers and producers have to pay.

Late last week, we received the first look (of three) at Q1 Gross Domestic Product (GDP) which is the broadest measure of economic output, it showed a quarter-over-quarter (q/q) annualized rate of *contraction* of 1.4%, after the 6.9% *increase* in Q4. While personal consumption rose 2.7% in the quarter, large declines in inventory investment, a mushrooming trade deficit (promulgated by deglobalization and decarbonization) and large declines in government spending (stimulus reductions) have been major contributors to the softening in GDP. It is doubtful that the Fed will adjust its predisposed move of a 50 basis point hike based on this latest news. The Fed has a sizeable inflation issue to tackle and is likely to start next week with a big splash.

Here is your look at developments in the global marketplace.

POSITIVE DEVELOPMENTS

- The Beige Book is a Fed publication about current economic conditions across the 12 Fed Districts and is released 8 times per year. In the latest report, it described a pickup in economic activity in the past 6 weeks, with growth accelerating a bit from "modest to moderate" to "moderate," and consumer spending accelerating. Companies reported hiring despite the labor shortage. They also reported solid wage growth, though some Districts reported early signs that the strong pace of wage growth had begun to slow. Inflationary pressures remained strong since the last report, with firms continuing to pass swiftly rising input costs through to customers. *So far, consumers remain active fighting off the cost push inflation.*

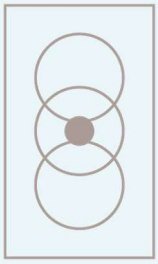
- Albertsons grocery has begun to use Afresh's operating system to help its workers manage the fresh produce area. The goal is to reduce food waste. Roughly 52% of the fruits and vegetables grown end up wasted—along with resources it took to grow them. The Afresh operating system uses a probabilistic model of future demand, shipment times, and other factors to make optimal purchasing decisions that reduce waste. It also connects the company and all of its suppliers and stakeholders across the perishable goods category. "A 25% reduction to food waste would conserve 83B gallons of water per year, recover 90M meals per year, and eliminate 10M+ tons of greenhouse gas emissions per year," wrote Afresh's co-founder and chief technologist Volodymyr Kuleshov.

- The US Leading Economic Indicators (LEI) rose again in March despite headwinds from the war in Ukraine, according to The Conference Board. The Board stated, "This broad-based improvement signals economic growth is likely to continue through 2022 despite volatile stock prices and weakening business and consumer expectations." Leading indicators increased 0.3% in March, following an upwardly revised 0.6% advance in February (double the initial 0.3% increase) and a 0.4% decline in January—which was only its second decline since April 2020 and the first since February 2021.

    - The University of Michigan's preliminary consumer sentiment index recently surged to 65.7 in April, bouncing off an 11-yr low of 59.4 in March. The "expectations" component surged to 64.1 in April (up from 54.3 in March), while the "current conditions" component rose to 68.1 (from 67.2)…*All good!*

- The Labor Department announced last week that weekly jobless claims declined to 184K compared to 186K the previous week, and continuing unemployment claims declined to 1.417M in the latest week vs. 1.475M in the previous week. This is the 9th week in a row that weekly jobless claims have been below 200K so unemployment claims remain very positive for continued low unemployment in the upcoming months.

- The Census Bureau reported that building permits LEI ticked higher in March. It is likely to move higher given the strong demand for housing, even though affordability is down as a result of surging home prices (Case Schiller reports that home prices are up 20.2% yoy) and rising mortgage rates. Rising rents will also provide incentives to build more multifamily housing units.



NEUTRAL DEVELOPMENTS

- The Fed has two primary functions: 1) fighting inflation to engineer a slowdown of the economy, and 2) reducing overheating risks in the labor market. The Fed currently believes that economic activity is resilient enough to bear a significant tightening, and financial conditions still have room to tighten. The Fed's strategy is to revert rapidly to a neutral stance on rates and to remain *slightly* restrictive to anchor inflation expectations. As I have stated before, the Fed has telegraphed several rate hikes in 2022 and they could accelerate the pace in rate adjustments, hiking by 50 bps in May and June.

NEGATIVE DEVELOPMENTS

- March saw the producer price index (PPI) for final demand shoot up by a record-high 1.4%, following an upwardly revised 0.9% jump in February, averaging monthly gains of 1.2% during Q1 according to the Bureau of Labor Statistics. Core prices, which excludes food, energy, and trade services, surged 0.9% last mo., averaging monthly gains of 0.6% the first 3 mos. of 2022. The yearly rate for the headline measure accelerated at a record 11.2% yoy.
    - Russia is the largest exporter of wheat and Ukraine is the 5th largest. The ongoing war will continue to affect the supply of wheat and other grains through the rest of this year and possibly into next, prompting grain prices increases which means these price increases are likely to make their way to the consumer and be reflected in future CPI numbers. Note, wheat futures prices recently hit a record high and remain elevated while soybean futures prices are near the highest levels seen in 10 years. Corn futures prices recently returned to near records. The World Bank estimates that for each percentage-pt. increase in food prices, 10M people are thrown into extreme poverty worldwide. Further, they estimate that the proportion of household income spent on food in Asia and Africa will rise over the next year from 20% to 30%.
- Consumer prices soared in March, posting the largest mo. increase in more than 15 years. As expected, the 1.2% increase was mostly driven by a spike in energy prices related to the Russia-Ukraine War. Energy prices increased 11.0% in March (driven by an 18% rise in gasoline prices).
- The housing market is feeling the impact of rising mortgage rates and inflation taking a hit on purchasing power. The National Association of existing home sales contracted for the 2nd mo. by 2.7% in March and 11.1% over the past year…the lowest since mid-2020. Sales fell in 3 of the 4 U.S. regions in March, with sales in the West holding steady, while all 4 remained below year-ago levels.
- China's economic growth has stalled and much of Europe is in a recession, many economists now believe that inflation may have "peaked" in March. Currently, nearly 30M people are in C19 lockdown in Shanghai and now Beijing is locking down. Note, Shanghai is 3 times larger than NYC and people have been forced to stay in their apartments and undergo virus testing. If people test positive, they are forced into quarantine centers. Shanghai accounts for a significant % of China's GDP and operates its biggest port. U.S. companies doing business there, i.e. Apple and Tesla, have been negotiating to restart their production, which stalled due to these lockdowns.

THE MARKETS

At the time of this writing, nearly 25% of the companies in the SP500 have reported earnings for Q1 2022. Of these companies, Fact Set says that 79% have reported actual EPS above estimates, which is above the five-year average of 77%. In aggregate, companies are reporting earnings that are 8.1% above estimates, which is below the five-year average of 8.9%. In terms of revenues, 69% of S&P 500 companies have reported actual revenues above estimates, which is equal to the five-year average of 69%. In aggregate, companies are reporting revenues that are 1.3% above estimates, which is below the five-year average of 1.7%. While these earnings and revenue results are respectable, the broader equity markets remain volatile day to day depending on who is reporting and the magnitude of the "beat" or "miss".

All domestic stock indexes ended the month in the red. A wide range of headwinds remain in place for the markets, chief among them being an expected aggressive Fed tightening, lockdowns in China, persisting inflation pressures, rising interest rates, and the recent jump in the U.S. dollar.

U.S Index	Last Month (% return)	YTD (%)
S&P 500	-10.2	-13.3
Dow Jones	-6.5	-9.3
NASDAQ Comp	-14.8	-21.2
Russell 2000	-10.9	-17.0

Consumer staples, energy and real estate were the strongest performing sectors last month while communication services, consumer discretionary and tech were the weakest.

On the international front, most markets, with the exception of the U.K., ended the month in negative territory. Inflationary concerns, lockdowns in China and energy supply issues (particularly in Europe) have weighed heavily on stock performance.

International Index	Last Month (% return)	YTD (%)
Euro Stoxx 50	-5.0	-11.5
Hang Seng	-3.8	-9.9
Germany	-4.9	-11.3
Nikkei	-3.9	-11.5
FTSE – U.K.	0.1	2.2
China Shanghai	-4.9	-16.3
Crude Oil	0.2	38.2

https://tradingeconomics.com/stocks

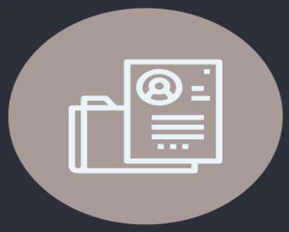
Recently, bond yields have tempered the rise witnessed earlier this month; this may not continue should inflationary pressures mount and or the Fed takes aggressive action with its upcoming rate hikes. With rates rising here in the U.S. they attract foreign capital as foreign investors find U.S. rates more attractive than their sovereign debt. This causes the Dollar to rise and currently the U.S. dollar has reached highs not seen since 2002. The Dollar has benefited from weakness in all major currencies as Europe, China, and Japan saw their currencies fall on increasing economic woes.

CHART OF THE MONTH – CBOE PUT/CALL RATIO

The Put/Call Ratio is an indicator that shows option put volume relative to call volume. Put options are used to hedge against market weakness or bet on a decline. Call options are used to hedge against market strength or bet on an advance. The Put/Call Ratio is above 1 when put volume exceeds call volume and below 1 when call volume exceeds put volume. Typically, this indicator is used to gauge market sentiment. Sentiment is deemed excessively bearish when the Put/Call Ratio is trading at relatively high levels and excessively bullish when at relatively low levels. Chartists can apply moving averages and other indicators to smooth the data and derive signals.

A Put/Call Ratio at its upper extremities would show excessive bearishness because put volume would be significantly higher than call volume. Excessive bearishness would argue for optimism and the possibility of a bullish reversal. On April 22, the CBOE Put/Call Ratio exceeded 1.3, spiking to 2020 sell off levels. It remains above 1, indicating put volume is exceeding call volume and sentiment is bearish.

Source: https://stockcharts.com/h-sc/ui
https://www.investopedia.com/ask/answers/06/putcallratio.asp



PLANNING CALLOUT – Growth vs Value

The difference between growth and value stocks funnels down to the way in which they are perceived by the market. Growth stocks are typically companies whose earnings are expected to continue growing at an above-average rate relative to the market and carry high multiples such as price to earnings and price-to-book ratios.

Value stocks are those that tend to trade at a lower price relative to their fundamentals. They typically have low P/E and price-to-book ratios, and oftentimes pay a dividend. Investors who purchase value stocks hope to find bargain prices and hope the stock catches up to its fundamentals.

Growth and value are different styles of investing, and these styles tend to run in cycles. It is important to allocate to both in a diversified asset allocation and remain tactical during various market cycles.

For more on growth vs value please visit: https://www.csamg.com/Growth-Stocks-vs--Value-Stocks.c1022.htm

NEWS YOU CAN USE

Scottie Scheffler, No. 1 golfer in the world, capped off an amazing two months of golf by winning the Master's this month. The Master's title was his fourth win in his last six tournaments and earned him $2.7 million. That brings his total to $8.8 million over his last six starts.

https://www.pgatour.com/daily-wrapup/2022/04/10/scottie-scheffler-wins-masters-tournament-augusta-national-golf-club-first-major.html

Delta Airlines tested Elon Musk's SpaceX Starlink Satellites for in-flight wi-fi this month, which is just scratching the surface of Starlink's capabilities. SpaceX has launched nearly 2,000 satellites since 2019, which is expected to grow to 30,000-40,000 to provide internet for earthbound subscribers. Starlink's initial goal was to capture 40 million internet subscribers by 2025. Analysts project Starlink could be worth $100B, if or when, it goes public.

https://www.barrons.com/articles/elon-musk-spacex-starlink-51650672885?mod=past_editions

On April 14th, Egypt authorities seized a massive cargo ship which blocked the Suez Canal for almost a week last month. An Egyptian court ordered the vessel's Japanese owner, to pay $1 Billion in compensation as a result of losses inflicted when the Ever Given ship prevented marine traffic from transiting through the vital global trade waterway.

https://www.foxbusiness.com/markets/egypt-seizes-ever-given-ship-in-suez-canal-demands-compensation

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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