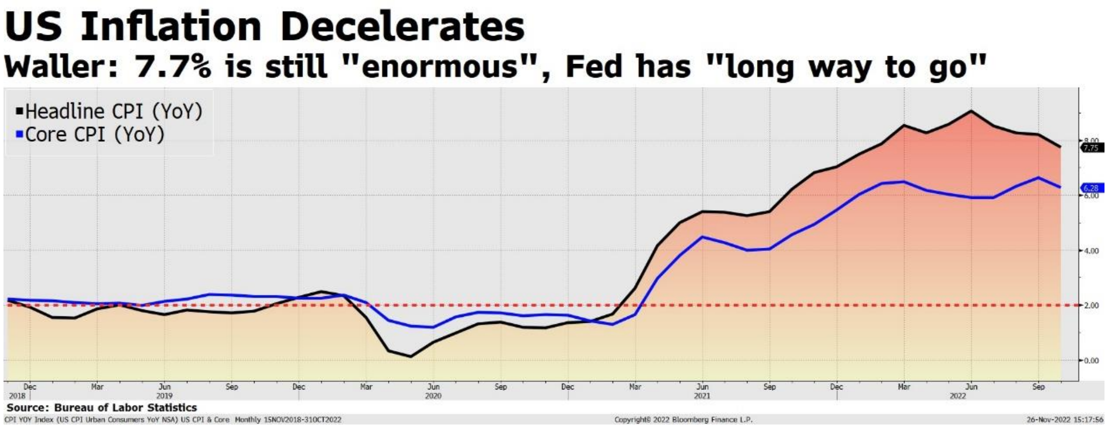
Courier Capital, LLC
Registered Investment Adviser
An affiliate of Five Star Bank

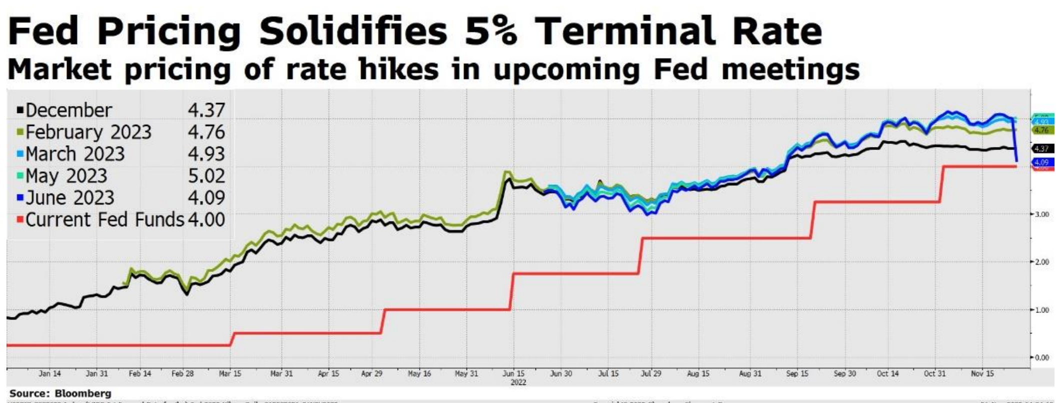
Economic and Market Update – SLOWING THE PACE (11/30/2022)

Latest Developments and Economics

The title of this month's review can apply either to the U.S. (and global) economy or the pace of interest rate increases that the Federal Reserve will pursue in coming months. Of course, the two are linked. If the economy does cool down and we see inflation trending down that would give the Federal Reserve some discretion to slow the pace of increases, which have totaled 375 basis points in 2022, including four consecutive raises of 75 basis points. There have been some concrete signs of the U.S. economy starting to cool. Housing has continued to slow and real estate agency Redfin listed rents falling in several U.S. cities (Milwaukee -17.6%; Minneapolis -7.8%; Baltimore -3.2%; Seattle -2.7% and Boston -2.5%).



The other encouraging sign was the latest CPI print which many interpreted as inflation moving past its peak. The headline read was 7.7% (0.20% less than expected and down from over 8.0% recently) and core (excluding food and energy) at 6.28%. Federal Reserve Governor Christopher Waller was quick to point out to an exuberant market that 7.7% was only one data point and is still much too high. This has caused some uncertainty as to where the Federal Reserve will finally stop (the destination) rather than the pace (the journey). The respective Fed presidents have been sending some mixed signals:



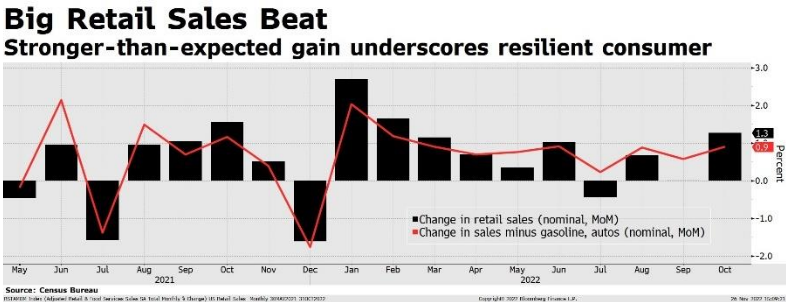
Cleveland Fed President Meister: "We're going to have more work to do, because we need to see inflation really on a sustainable downward path beck to 2%".

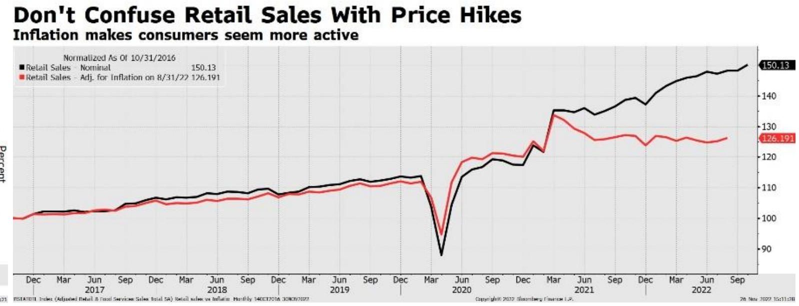
St. Louis Fed President James Bullard: a 5.00-5.25% target range was his minimum terminal rate, and he suggested that they may need to go as high as 7.0% in order to be "sufficiently restrictive".

Federal Reserve Vice Chair Lael Brainard: "I think it will probably be appropriate soon to move to a slower pace of rate increases."

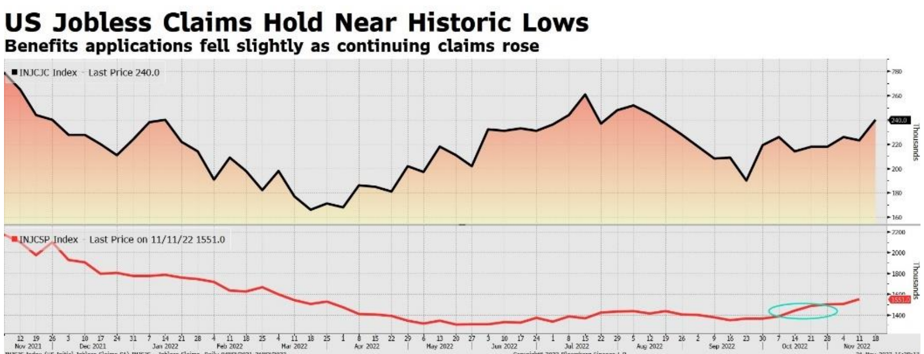
San Francisco President Mary Daly: "As we work to bring policy to a sufficiently restrictive stance -- the level required to bring inflation down and restore price stability -- we will need to be mindful, adjusting too little will leave inflation too high. Adjusting too much could lead to an unnecessarily painful downturn."

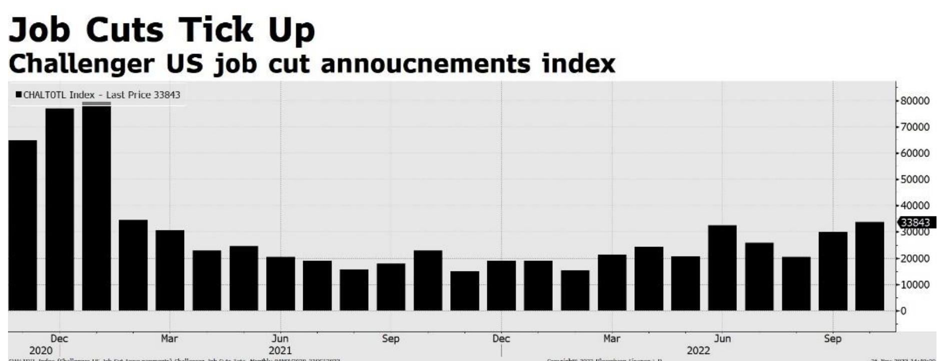
While the eventual terminal rate is in question (and dependent on future inflation data) the latest FOMC minutes show an appetite among a majority of the committee and chairman Powell that slowing the pace of increases would soon be appropriate, opening the door to 0.50% in December. They noted the slowing of economic growth and inflation, as we see in housing and wage data but, this takes time to flow through to economic data.

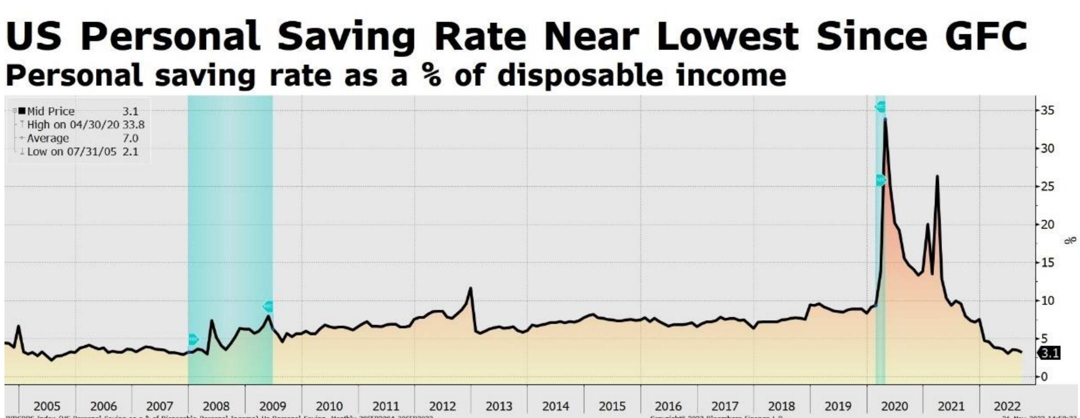


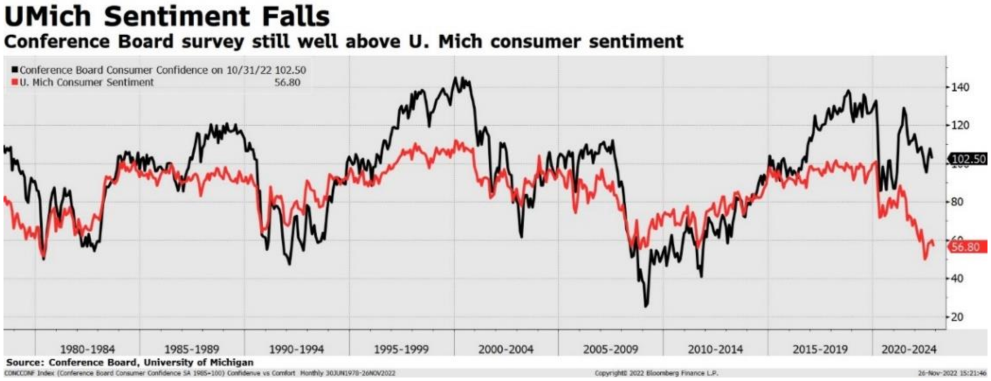


So, what is the Fed watching for that has significant impact on inflation? One item would be the behavior of the consumer. Recent data still shows that the consumer is spending, even though much of it has shifted from goods to services. The red line in the left chart shows that retail spending is up 0.9% after excluding food and energy (and 1.3% with them). However, the chart on the right shows that while they may be spending more, after inflation, their real spending (red line) is pretty much flat. So how is the consumer able to continue to be resilient – that is another item the Fed is watching closely. As long as jobs are plentiful and available consumers should be able to spend from income. There have been some announced layoffs lately. Meta (Facebook), Redfin, Twitter, Lyft, Citigroup, Barclay's Disney and Amazon are all companies that have announced job cuts or hiring freezes recently. While the jobless claims have ticked up as a result, the claims data are still near historic lows. In fact, the 'less hot' job market has slowed from about 444,000 jobs added per month in the first half of the year to an average of 289,000 over the last three months (October was 261,000). That pace still does not represent a substantial slowdown just yet. In addition, wage growth slowed from 4.5% in the first half of the year to 3.8% over the last three months. So, while the consumer isn't keeping up with inflation in wages, it has not stopped the spending. The source of the spending is just changing to be sourced from savings (which cannot last indefinitely). The savings rate at 3.1% of income is at its lowest point since about 2008.



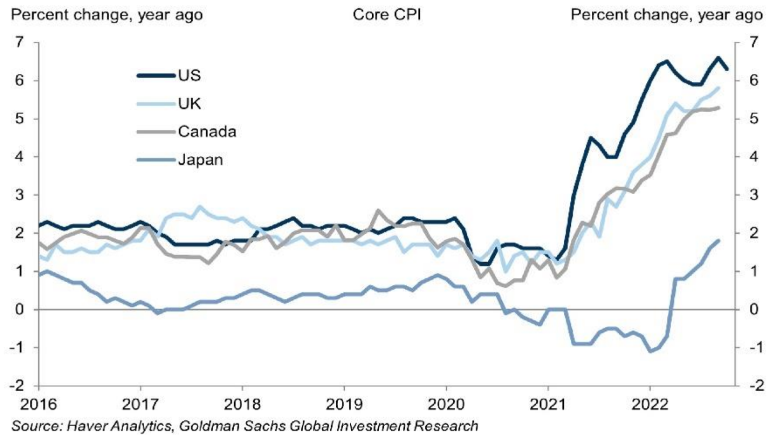


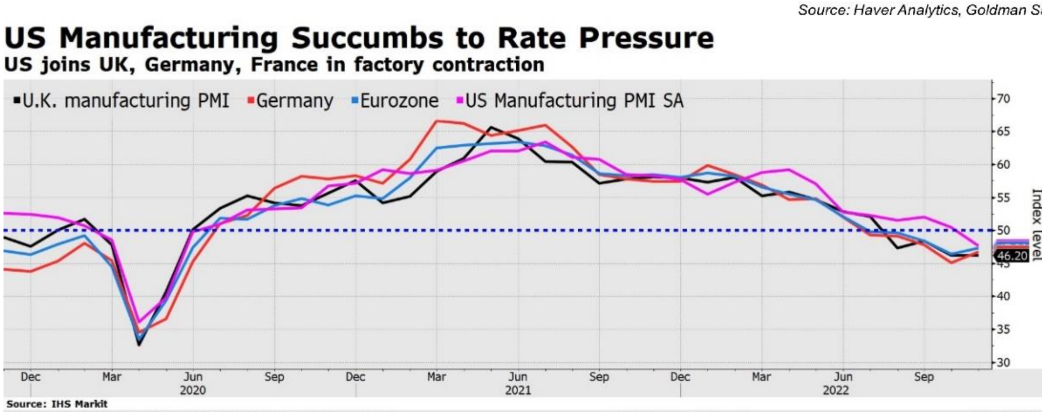




This situation has caused consumers to be in a rather foul mood. Consumer sentiment readings (red line) are at their lowest point in 40 years. This is a general summary of the feelings about future financial prospects, which does not bode well for near-term future consumer spending.

Inflation, rising interest rates and a slowing economic picture are not just the domain of the United States – this is a global state. Looking at other developed economies shows that inflation is at multi-decade highs across the world. While higher, the U.S. seems to be the one peaking first. All these central banks (except Japan) have been raising rates to fight inflation and slowing their economies. The ECB, FRB and Bank of England all raised rates by 75 basis points.

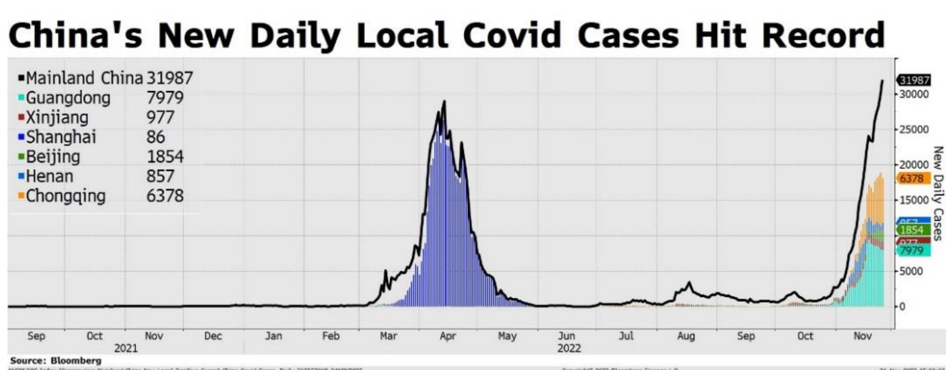




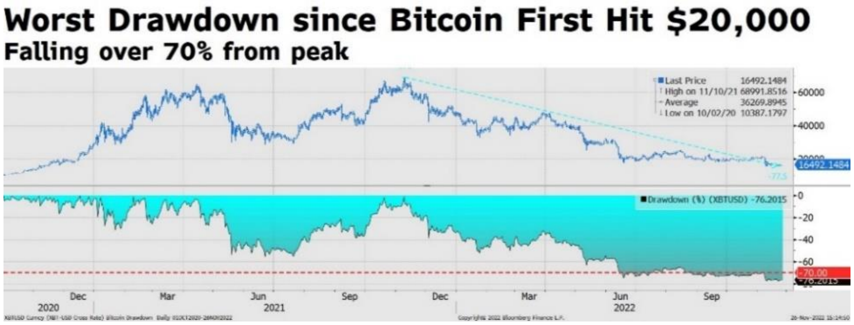
Slowing economies around the world are in sync in their general trend down as illustrated by Purchasing Manager Index readings (PMI) globally. This slowing around the world increases the chances of global recession rather than just in the United States.

In addition, we still need to be mindful of other shocks to the economy. The completion of mid-term elections removes one source of uncertainty. However, the threat of a national rail strike in the U.S. would have a significant impact on the U.S. economy with estimates of $2 billion per day in lost economic activity. As of today, it seems Congress stands ready to intervene to remove the possibility of a strike.

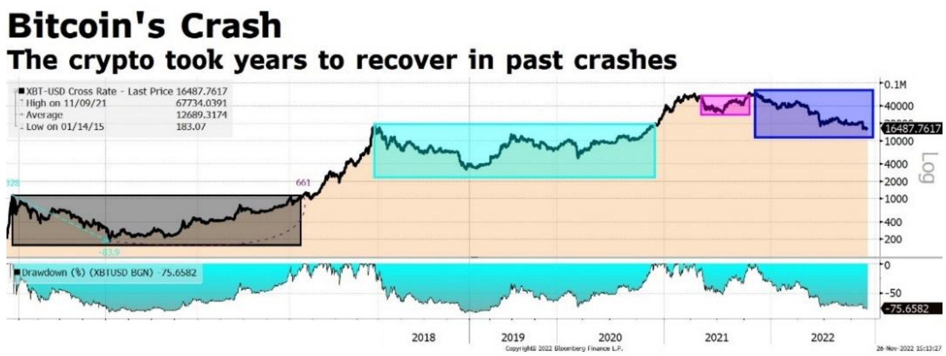
There is also the international impact on the U.S. economy. China had announced plans for easing their 'zero-Covid' restrictions that have locked whole cities down for extended periods of time. This was reversed as China has been experiencing its highest daily COVID cases of over 30,000 per day – higher than peak 2020. The policy and lockdowns have resulted in a precipitous drop in retail sales and real estate in China and prompted unprecedented social unrest across the country. This has the potential to continue to cause supply-chain disruptions. Apple already indicated an impact on iPhone sales.



One other item to note has been the significant developments in the crypto-currency markets. The failure of FTX, the third largest crypto exchange by volume, was an unexpected result for a foundation of crypto trading. The bankruptcy of FTX has caused significant reverberations throughout the industry and has contributed to crypto's significant decline. The Bahama's-based company built its business on trading options not allowed in the United States. In addition, the company had a "complete failure of corporate control" according to its new CEO John Jay Ray III. The failure of BlockFi to come to the rescue of FTX means that many people invested in Bitcoin and other cryptos most likely will lose their investment and the faith in the entire industry has been shaken. As a result, Bitcoin is selling at prices 70% below its peak.



If recent history is any guide, the recovery of Bitcoin's market price may take quite a while. Moreover, the historically significant correlation between the S&P 500 and Bitcoin has now diverged as Bitcoin has fallen so precipitously.

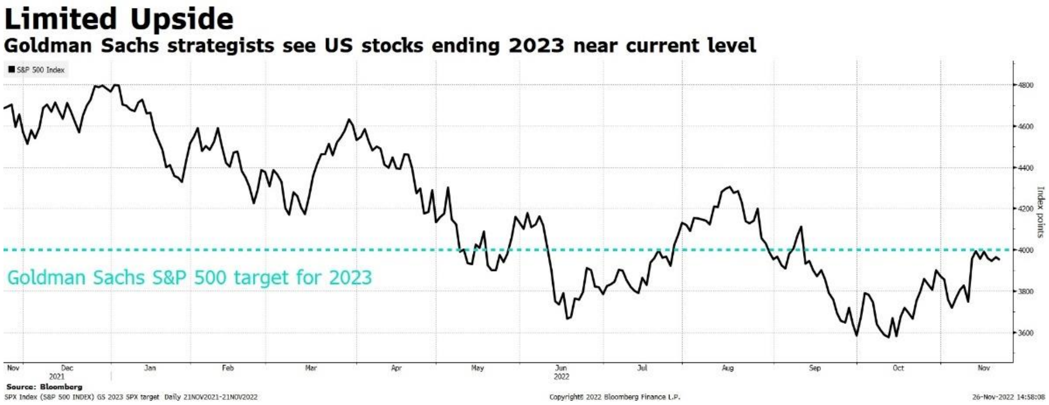


FTX was recently valued at $32 billion before its bankruptcy. The bankruptcy saw founder and CEO, Sam Bankman-Fried's personal fortune drop from $25 billion earlier this year to less than $1 billion altogether, most coming on a one-day drop of $15 billion. While the effects of this bankruptcy will continue to have significant impact on the crypto market, contagion to the general economy is considered very low. However, this event has caught the attention of the federal regulators as the Department of Justice and SEC have opened investigations and this bolsters the case for more federal regulation of the crypto markets to be taken up in Congress.

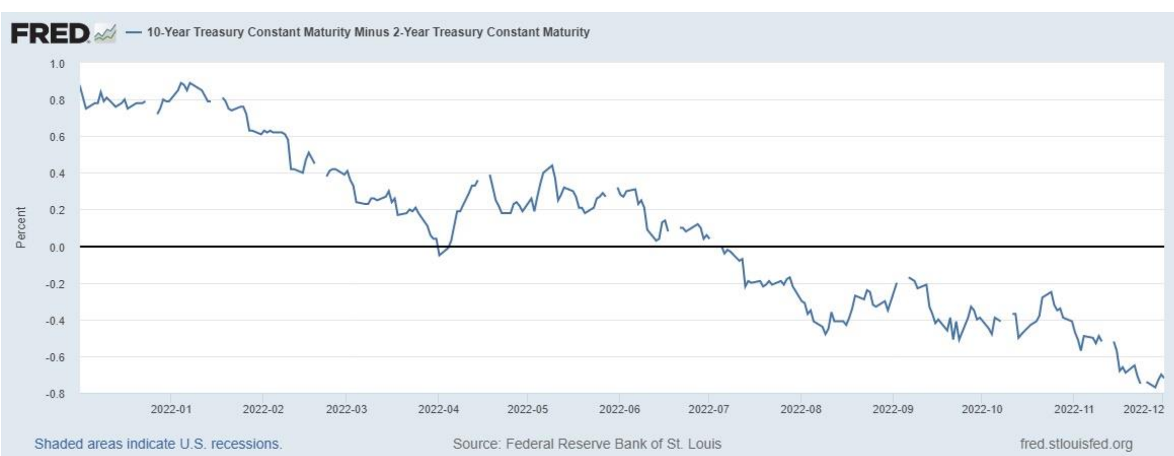
Financial Markets

The last day of November capped off a very good month for the S&P 500. The inflation news coupled with a softer tone from the Federal Reserve caused the index to rise 5.59% for the month. This also marks the second consecutive month of growth for the index. The bounce of the Fall lows means that the index is down 13.10% for 2022 – from over 20% down earlier this year. All of the S&P 500 sectors were higher for the month with Materials leading with a gain of 11.76% but it was Information Technology that had the greatest impact on the index given the weight of technology stocks in the index. The Technology sector was up 6.03% but it accounted for 28% of the entire index gain in November. High Beta stocks led the way in the month and the gains were across the board as well with Midcap and Small Cap stocks up approximately 6% and 4% respectively.

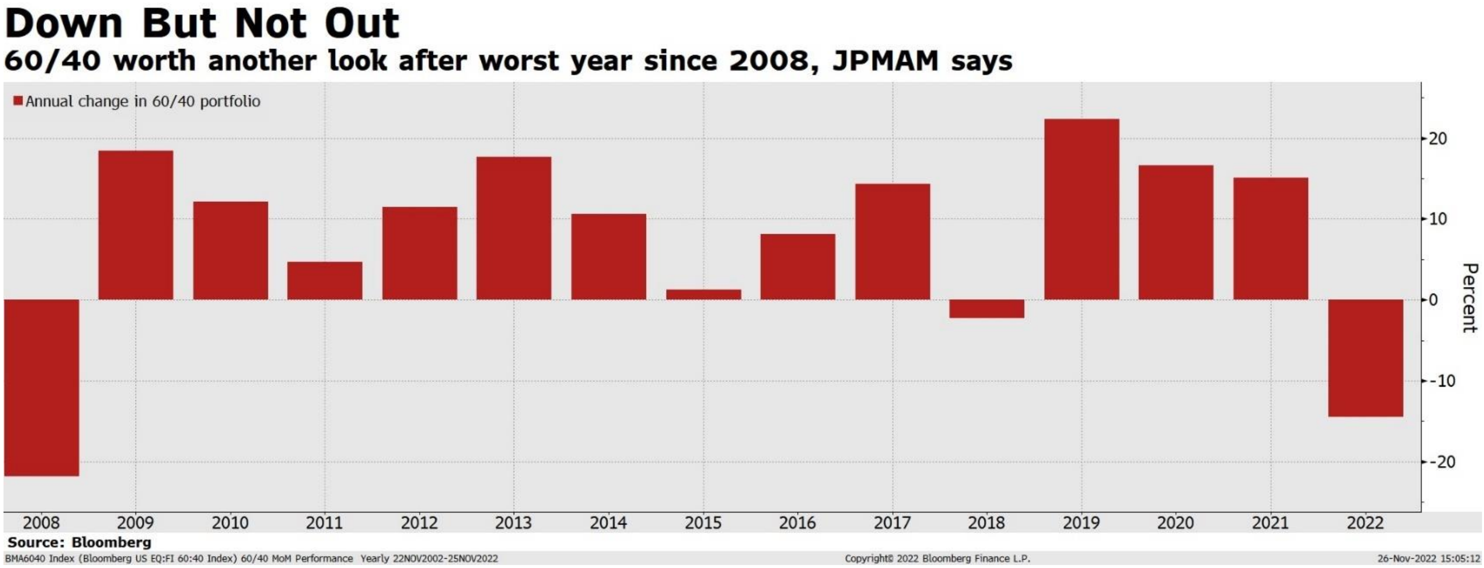
As we approach the end of 2022 the question turns to what will impact the future direction of equity markets. The recovery in November puts the S&P 500 right about the 4,000 level – near its 200-day moving day average and above its 50-day moving average. The catalyst from here would most likely need to be significant – clear signs of disinflation, a pause in the Federal Reserve interest rate hikes, an end to the war in Ukraine, which are all possible but there are still headwinds.



The professional strategists usually come out with their forecasts for the next year now and, historically, have had a poor track record at predicting market returns. This year may be even more difficult as there are so many variables and uncertainty in economic data and geopolitical developments. There have been forecasts that range from an increase in the S&P 500 for 2023 to a flat S&P (as Goldman Sachs predicts in the chart above). One thing that is consistent among the projections is that 2023 is expected to be choppy regardless of how in ends. This would be especially true if we do enter a recession sometime during the year. The economic growth question is among the largest uncertainties. Does the U.S. (and world) enter a recession and, if so, is it short and shallow or turn into something a little more pronounced with recovery during the year? The economic signals will be closely watched in coming months. We are past some of the more significant events of the Fall, like midterm elections, but attention will turn to corporate profits and guidance in January as the next big hurdle.



In fixed income markets yields declined after the lower inflation reading and the Federal Reserve guidance resulting in positive fixed income returns for November. The Bloomberg Aggregate Bond Index was up 2.80% for the month but is still down 12.70% for 2022. The yield curve continues to flash recessionary signals. It remains inverted at the 2-year and 10-year maturities and is getting deeper for longer. The graph represents the difference in yield between the two bond maturities and the line dipping below zero indicates that the rates on 2-year bonds are higher than 10-year bonds – an inversion. The longer and deeper this gets the stronger the signal of an economic slowdown forthcoming.



While this has been the worst outcome of a traditional moderate portfolio since 2008 investors are reminded to focus on the future rather than the past. J.P. Morgan has a silver lining view perspective of 2022. They are predicting a better result for the 60/40 portfolio, as long as your investment time horizon is longer-term. They base this on the fact that the declines this year provide investors the best entry point into financial markets since 2010. Their prediction is for an average annual return of over 7% for the 60/40 portfolio over the next 10-15 years.

Should you have any questions please contact us.

Image sources: Bloomberg and CNBC unless otherwise noted

Buffalo Office

1114 Delaware Ave.

Buffalo, New York 14209

PHONE: 716-883-9595

Jamestown Office

214 West Fifth Street

Jamestown, New York 14701

PHONE: 716-484-2402