## *Summary*

Economic data for the week included an upward revision to Q3 U.S. GDP, higher personal income/spending, as well as a positive surprise from the November employment situation report. These were offset by a decline of ISM manufacturing into contraction, lower home prices, and weaker consumer sentiment.

Global stock markets fared positively last week, with foreign outperforming domestic. Bond prices also rose as yields across all maturities fell back; foreign bonds were also aided by a weaker dollar. Commodities gained, due to a rise in prices for industrial metals and crude oil.

## *Economic Notes*

(+) The second release of **U.S. GDP** for Q3 was revised up by 0.3% from 2.6% to 2.9%, a tenth higher than expectations. The difference was due to a 0.3% revision upward for personal consumption, 1.4% in business fixed investment, as well as higher growth from government consumption and net exports. Construction, however, continued to show sharp declines. The GDP price deflator for Q3 was revised up from 4.1% to 4.3% on an annualized basis, showing continued inflation pressures. Core PCE inflation was revised up slightly to 4.6% on an annualized quarterly basis and 4.9% year-over-year. Per its composition, PCE has been running well below CPI, but remains over two times the Fed's long-term target of 2%.

The Atlanta Fed's GDPNow estimate for Q4 shows expected positive growth of 2.8%; this had been steadily creeping upward over the past month at a pace over 4% before a drop last week. The Blue Chip consensus estimates for the quarter still range widely from approximately -1% contraction to +2% growth, with a median of just under 0.5%. Clearly, the economist community is not bullish on the economy, with predictions of upcoming recession far more common than not.

(0) **Personal income** rose 0.7% in October, exceeding the median forecast of 0.4%. This reflected a 0.5% wage gain and 1.6% rise in transfer payments, due to one-time tax credits issued by states. **Personal spending** rose a similar 0.8%, on par with expectations. Over the past year, income and spending are up 5% and 8%, respectively, although inflation has eaten away significantly at those nominal reported numbers. The personal savings rate fell back to 2.3%, which was one of the lowest readings recorded (since 1959). The **PCE price index** rose 0.3% on a headline level in Oct., and 0.2% for core, removing food and energy. These were each about a tenth below expectations. Over the trailing 12 months, core and headline were up 5.0% and 6.0%, respectively. One note is that the more intense stashing of savings by consumers during the pandemic seems to be abating.

(-) The **ISM Manufacturing Index** for November fell by -1.2 points to a 49.0 level, a bit below the 49.7 expected. As a diffusion index, readings under 50 signify contraction, which has been a long-awaited point for this closely-watched index. Under the hood for the month, production fell by a point, but remained expansionary; new orders and employment both declined further into contraction. The supplier deliveries measure ticked up by a half-point, but remained in contraction as well. Notably, prices paid fell by almost -4 points to 43, which was the lowest level since the spring of 2020, and reiterating waning inflationary pressures on side of goods. Anecdotal comments were focused on customer new orders falling (notably in Europe), and lower need for labor, while supply chain hurdles appear to be less of an issue compared to the rough patches of the last two years. This overall result is in keeping with increasing recessionary readings from other indicators; notably lows in the ISM have also tracked S&P bear market lows (with a few months' room for error on either side).

(-) **Construction spending** in October fell by -0.3%, just a tick lower than the -0.2% expected, including downward revisions for two prior months. While public nonresidential spending rose by a half-percent for the month, weakness in other segments, including private spending offset to the downside. Construction cost inflation was up 2% in Oct. alone—which pushed 'real' spending even lower than the headline drop.

(-) The **S&P/Case-Shiller home price index** fell by -1.2% in September, in keeping with expectations. All 20 cities experienced declines, led by the West Coast—San Francisco, Las Vegas, and Phoenix were all down over -2% on the month. Nationally, the trailing 12-month rate of increase decelerated further, by -2.7%, to 10.4%.

(0) The **FHFA house price index**, on the other hand, ticked up by 0.1% in September, in contrast to the -1.2% decline expected. The East South Central region (AL/KY/MS/TN) saw a gain of 1%, while the New England and Mountain regions fell back by -1%. The trailing 12-month rate of increase decelerated by -1.0% to 11.0%. There are some timing differences in the two house price indices, with home prices measured when transactions are closed, as opposed to when contracts are signed (typically a month or more prior). Therefore, a natural lag in price appraisal impact exists. The consensus expectation for coming months is negative, as more recent sales activity obviously incorporates the sharp rise in mortgage rates.

(-) The Conference Board **index of consumer confidence** for November fell by -2.0 to 100.2, just above the 100.0 expected. Expectations for the future fell slightly more than assessments of present conditions. The labor differential, measuring the ease in finding employment, ticked up by a point, due to jobs still being 'plentiful'.

(-) The **ADP private employment report** for November showed a gain of 127k, about half the pace of the prior month, as well as short of the 200k expected. The service sector contributed solidly, up 213k (224k gain in leisure/hospitality); this was offset by a decline of -86k in goods production (-100k in manufacturing). While only one report, this shows some slowing in the hiring segment which has been seen by some anecdotal reports, notably in technology and related industries.

(0) **Initial jobless claims** for the Nov. 26 ending week fell by -16k to 225k, below the 235k expected. **Continuing claims** for the Nov. 19 week rose by 57k to 1.608 mil., well above the 1.570 mil. expected. Initial claims were mixed by state, with larger declines in GA, CA, and IL. The continuing claims picture is complicated, with some research showing that over half of increases over the past several months are due to residual seasonality adjustments, as opposed to outright labor market deterioration. Much of this was due to extreme and rapidly-changing readings during the pandemic, which skewed complicated seasonality calculations. The end of the year, and large-but-inconsistent jumps in associated seasonal holiday hiring, also can cause seasonal adjustments to veer off-track at times.

(+) The November employment situation report came in better than expected, contrary to prior hints that we would see some softening, based on other labor data. **Nonfarm payrolls** rose by 263k, well above the 200k expected. Leading sectors included leisure/hospitality (88k), health care (45k), government (42k), social assistance (23k), construction (20k), and manufacturing (14k). On the other side, retail (-30k) and transportation/warehousing (-15k) jobs declined, in keeping with recent trends. Leisure/hospitality employment continues to run -6% below pre-pandemic levels, so there remains room for improvement.

The **unemployment rate** was unchanged at 3.7%, with little change in the workforce participation rate. The U-6 underemployment rate fell a tenth to 6.7%. The household survey showed a -138k decline, although this was skewed by a drop in the self-employed but a rise in multiple-job holders. **Average weekly earnings** rose by 0.6% on the month, bringing trailing 12-month increase to 5.1%. **Average weekly hours** fell back by -0.1 to 34.4, pulled down by the manufacturing segment.

(0) The Fed's **Beige Book**, which provides anecdotal accounts of regional economic conditions over late Oct. and Nov., showed that economic activity was generally 'flat or up slightly' from the prior report, but down from the 'modest' average pace of the prior book. However, results were mixed with roughly half of the Fed's 12 districts noting gains, and the other half indicating no change or declines. Details by sector were mixed as well, with inflation and higher interest rates certainly weighing on activity, but not to equal degrees. For instance, lower-income consumers have been substituting for lower-priced items, while higher-end travel, restaurants, and auto sales were seeing higher activity—the latter helped by normalized inventories. Interestingly, manufacturing activity was still higher as well. Real estate activity deteriorated, as expected with higher interest rates, in both sales and leasing activity. Bank lending has also fallen, with lower demand and tighter credit standards. Labor markets were still noted as 'tight', although demand has weakened, yet there has been a noted layoff reluctance by employers. Importantly, inflation pressures showed some easing, as both supply chains improved and demand has fallen, notably as consumers have sought out discounted goods. There remained concern from respondents about a weaker outlook for the economy, which is an example of how recessions can eventually become self-fulfilling, if consumers and businesses begin to tighten their belts.

## *Market Notes*

| Period ending 12/2/2022 | 1 Week (%) | YTD (%) |
|---|---|---|
| DJIA | 0.41 | -3.30 |
| S&P 500 | 1.19 | -13.26 |
| NASDAQ | 2.12 | -26.17 |
| Russell 2000 | 1.33 | -14.62 |
| MSCI-EAFE | 1.05 | -12.78 |
| MSCI-EM | 3.51 | -18.82 |
| Bloomberg U.S. Aggregate | 1.54 | -11.44 |

| U.S. Treasury Yields | 3 Mo. | 2 Yr. | 5 Yr. | 10 Yr. | 30 Yr. |
|---|---|---|---|---|---|
| 12/31/2021 | 0.06 | 0.73 | 1.26 | 1.52 | 1.90 |
| 11/25/2022 | 4.41 | 4.42 | 3.85 | 3.68 | 3.74 |
| 12/2/2022 | 4.34 | 4.28 | 3.67 | 3.51 | 3.56 |

U.S. stocks gained ground on net last week, with 'growth' sectors communications and consumer discretionary leading the way with sizable gains of 2-3% each, while energy lagged, down -2%.

Indexes began the week on a sour note, with rising Covid cases and protests in China that raised uncertainty and weighed on investor sentiment generally; however, soothing comments from government officials alluded to an upcoming evolution in lockdown policy. By mid-week, strong Congressional support for the Railway Labor Act looked to head off a potential strike by railroad workers—a bill that would require companies and unions to accept labor agreements even if rejected by members, as well as other measures to avoid disruptions for that economically-critical sector. (The last government action to settle railroad labor issues was in 1992, so there has been a precedent.)

Stocks were helped mid-week as well with indications from Fed Chair Jerome Powell that the December rate hike will most likely be at a 'moderate pace' of 0.50%, reassuring investors, despite an otherwise hawkish tone that still alluded to a terminal rate near 5%. Additionally, the S&P 500 value rising above its 200-day moving average level has tended to draw attention from a technical standpoint as a 'bullish' signal, although these can be imprecise around turning points. By Friday, a strong employment situation report brought back the 'good news is bad news theme', as the hoped-for weakening needed for the Fed to reassess rate policy didn't occur.

From a valuation perspective, according to FactSet, the S&P (at 4,050 or so) is trading at roughly a 17.6x forward P/E, based on 2023 earnings. This reflects 70% of firms reporting positive surprises for Q3, at a blended growth rate of 2.5%—the headline figure remains heavily skewed by energy earnings growth of over 130%, while half of index sectors show declines. The pattern is expected to steadily erode away in Q4, with a total market earnings decline of -2% to -3% expected. For 2023, earnings growth expectations have fallen from around 8% to 5-6%.

Foreign stocks in developed Europe and the U.K. slightly outperformed those in the U.S., due to beneficial currency movements. Japanese stocks were flat, while emerging markets were led by Chinese stocks up 5-10% on the week. The latter was due to hopes for easing of lockdown policies noted earlier, with government hints of easing and a relaxation of quarantine requirements. In recent weeks, protests against the zero-Covid policy had been escalating—large demonstrations of any kind have remained relatively rare, making these events quite unusual. The underlying problem remains a growing discontent from a restless younger population versus the government recognition that vaccination rates for older citizens remain well below those of other countries, which has kept mortality risk/benefit at still-unacceptable levels. While it's assumed a loosening of extreme policies may occur in the spring, there is no fast solution for the vaccination problem, especially with far poorer domestic vaccine efficacy compared to therapies developed in the U.S. and Europe.

U.S. bonds gained as interest rates fell back across the entirely of the treasury yield curve, along with comments from Chair Powell perceived as dovish; investment-grade corporates slightly outgained treasuries. Foreign bonds followed the same direction, but to an even greater degree due to the U.S. dollar falling back by over a percent on the week, leading to a positive currency push. The U.S. treasury yield curve remains sharply inverted (-0.83% for the 10y-3m and -0.77% for 10y-2y)—still the most so since 1980-81, a period where the 10y-2y reached several troughs of -1.5% to -2.0%. Despite its simplicity, and calls that 'this time is different', this has remained one of the more effective indicators of recession risk.

Commodities were mixed, but were helped a bit by the weaker dollar. Industrial metals gained sharply, in nickel, copper, and aluminum markets, followed by a more tempered rise in precious metals. Industrial metals gains were correlated to higher hopes for a China reopening, which is expected to unleash more predictable manufacturing activity. The price of crude oil gained nearly 5% to just under $80/barrel, with some uncertainty over the upcoming weekend's OPEC+ meeting (where production quotas were left unchanged on Sunday), and the wildcard of a price cap on Russian oil set to be imposed. Oil prices have fallen back significantly from highs around $93 just a few weeks ago, with continued concerns over global recession and weakened demand outweighing prior fears over lack of supply (from uncertain workarounds to Russian sources). Natural gas prices, driven largely this time of year by expected weather, fell back by nearly -15%, as U.S. forecasts turned warmer for the end of the year.

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, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal. 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.