Summary

Economic data included the positive news of consumer and producer price inflation coming in softer than expected, while industrial production and housing starts also saw strong gains for the month. Also, retail sales increased, albeit to a lesser degree than hoped.

Equities gained around the world, as markets celebrated tempered inflation results, causing a drop in long-term yields. Bonds fared well for the same reason of lower rates. Commodities gained, with hopes for stronger demand and some supply concerns.

Economic Notes

(0) **Retail sales** rose 0.4% in December, below the expected gain of 0.6%. Taking out autos kept the same result, while core sales, which removes the most volatile components (autos, building materials, and gasoline), bumped this up to a 0.7% gain. This was nearly two times expectations, although inflation accounted for much of the nominal rise. For December, three-quarters of industry categories saw gains, with the strongest being in autos, gasoline, food/beverage, and misc. stores (gifts, florists, pet supply, etc.—many benefiting from the holidays), while building materials and personal care led on the negative side. Overall retail sales were up 4% for the past year, which represents a small gain on a 'real' after-inflation basis. Aside from being driven by the volatile categories, core sales fared decently, corresponding to a decent holiday spending season in line with good economic growth overall, even if the consumer spending splurge has been fading.

(+) **Industrial production** rose 0.9% in December, far exceeding the 0.3% median forecast. Manufacturing production saw a 0.6% gain, with a strong rise in auto assemblies as well as aircraft/parts, following the resolution of the Boeing strike from the prior month. High-tech equipment production also saw gains, as it for 2024 as a whole, being one of the few manufacturing bright spots as of late, with auto production down on the year. Utilities production rose 2%, due to the usual impact of cold winter weather raising heating needs, as did mining production also up 2%. **Capacity utilization** rose by 0.6% to 77.6%.

(-) The **Empire manufacturing index** for January fell by -14.7 points to a contractionary -12.6, below the positive 3.0 expected. New orders and shipments both fell over -10 points, back into contraction as well, while employment gained sharply. Prices paid also rose back into solid expansion. Expected business conditions six months out rose by nearly 10 points to 37.

(+) The **Philadelphia Fed manufacturing index**, on the other hand, rose by a dramatic 55.2 points to a solidly expansionary 44.3, above the -5.0 level expected. In fact, this was the second-largest monthly increase in the history of the series, reaching the highest level in nearly four years. All segments saw gains, including employment, shipments, and new orders. Prices paid also rose, to continued expansionary levels. Expected business conditions six months out rose by over 12 points to a 46 level, pointing to optimism about the future. The NY and Philly regional measures have experienced far more

volatility than normal in recent years, offering conflicting signals, which reduces their usefulness to some degree over the short term.

(0/+) The **Consumer Price Index** picked up a tenth from the prior month to 0.4% in December on a headline level (zero on a non-seasonally-adjusted basis). Core CPI, removing food and energy, came in a tenth lower than the prior month at 0.2% (also no monthly change when unadjusted). Energy commodity prices rose by over 4% in December, accounting for the reacceleration. However, this was offset by flattish price gains elsewhere, which financial markets appeared to react the most strongly to. Gains were seen in used cars/trucks (1.2%) and new cars (0.5%), auto insurance (0.4%), and airline fares (3.9%, although the seasonally-unadjusted pace was -2.5% lower). Shelter came in at 0.3% again overall, with rent and owners' equivalent rent each up a tenth from the prior month's pace. Deflationary areas included lodging (down -1%), motor vehicle fees, and personal care products.

Year-over-year, headline CPI accelerated a tenth of a percent to 2.9%, while core CPI decelerated a tenth to 3.2%. During the year, food prices rose 2.5% (egg prices rose 37%, not a small part of the food basket), while energy declined -0.5%, accounting for much of the differential between the headline and core. In the interesting exercise of looking at alternative CPI combinations for 2024, 'All items less shelter' rose only 1.9%, with 'All items less food, shelter, and energy' up 2.1%. There seems to be progress on the consumer inflation front, but it is slow and almost imperceptible on a month-to-month basis. The most difficulty remains in shelter, but also price adjustments upward in areas like auto repair and auto insurance, among a few others, like certain groceries, which consumers tend to be reminded of at least weekly. These were assumed to play a large role in making the incumbent Democratic election chances especially dim last year, as it equated to voter views of economic and labor weakness (despite those elements not necessarily being the case).

(0/+) The **Producer Price Index** for December rose by 0.2% on a headline level, two-tenths below expectations, and was unchanged for core after removing food and energy. Goods prices rose 0.6% for the month, along with energy prices up over 3%, while services prices were unchanged. Final demand PPI rose 3.3% for the year on a headline basis, and 3.5% for core, ex-food and energy. By segment, final demand goods rose 1.8% for the year (held back by energy down -2%), while services rose 4.0%. For the year, passenger transportation costs were sharply higher (around 5%, tied to airfares), while other items were widely mixed in terms of impact. As with CPI, a handful of categories related to services/wages and housing appeared to remain the pain points for prices, while other goods have settled into a more normal range. Nevertheless, overall PPI continues to run at a higher-than-desired pace.

(+) **Housing starts** rose 15.8% to a seasonally-adjusted pace of 1.499 mil. units in December, exceeding the 3.0% increase expected and reversing the prior month's decline, which was revised down a bit. By group, multi-family starts rose over 60%, while single-family rose 3%. By region, the Northeast and Midwest saw the strongest increases in 20-40% area, followed by the South with strength as well, while starts in the West fell slightly. **Building permits**, on the other hand, fell by -0.7% for the month to a seasonally-adjusted 1.483 mil. units. These were led downward by a -5% drop in multi-family, offsetting a 2% gain in single-family. Year-over-year, housing starts on the multi-family side fell over -8%, while those

for single-family went down nearly -3%, resulting in a -4% net drop. It appears that housing completions have been a more recent priority than starts, in a continued stretch when more new housing inventory is badly needed.

(+) The National Association of Home Builders (**NAHB**)/Wells Fargo Housing Market Index (HMI), a gauge of homebuilder sentiment, rose a point to 47 in January. Being below the 50 neutral level, this still implies builders rate current conditions more negatively than positively (the Northeast was the sole exception, at a level of 60). By segment, current sales rose a few points to 51, as did prospective buyer traffic to a still-low 33, while future expectations for the next six months fell several points but remained at a positive 60. Interestingly, a trend of price cuts for homes continues, at around 30%, which has been stable since last summer, and includes high use of sales incentives. It appears that might not be due to a lack of demand, but more so due to continued high mortgage rates. Per the NAHB, it was noted that the ~6% rates from the fall rising to near ~7% today continues to weigh on consumers and builders, as do high land costs. Though, there is hope for regulatory improvement in 2025, with a mixed outlook overall for the industry, which tends to be very sensitive to economic conditions (and interest rates).

(0) **Initial jobless claims** for the Jan. 11 ending week rose by 14k to 217k, just above the median forecast of 210k. Continuing claims for the Jan. 4 week fell by -18k to 1.859 mil., below the 1.870 mil. expected by consensus. Claims rose slightly in a variety of states, including MI, OH, IL, CA, and TX, implying weather effects to some degree but more so from seasonal adjustments related to the holidays.

Occasionally, questions come up about the economic impact of **natural disasters**, such as last week's destructive fires in the Los Angeles area. This will likely end up being one of the most destructive events in California history, particularly in dollar terms due to high real estate values in the neighborhoods affected. It's been estimated that the event could pare a few tenths of a percent off the first quarter's GDP growth numbers, as well as lower levels of nonfarm payrolls and raise jobless claims a bit, as would be expected given the reduction in activity in the area, including evacuations. However, the effects are more isolated in the scheme of the entire U.S. Wider regional weather effects often have a greater impact than isolated ones, even if the affected periods are shorter in duration. If there is any bright side (from an economic standpoint), it's that eventual rebuilding activity translates into 'growth,' which can be additive to GDP in future quarters. Though, the timing and magnitude can vary based on the severity of the disaster, demographic impact (if residents move), as well as availability of workers/materials/etc.

Market Notes

Period ending 1/17/2025	1 Week %	YTD %
DJIA	3.69	2.26
S&P 500	2.93	2.01
NASDAQ	2.45	1.67
Russell 2000	3.97	2.08
MSCI-EAFE	1.95	1.21
MSCI-EM	1.26	-0.39
Bloomberg U.S. Aggregate	0.99	-0.02

U.S. Treasury Yields	3 Mo.	2 Yr.	5 Yr.	10 Yr.	30 Yr.
12/31/2024	4.37	4.25	4.38	4.58	4.78
1/10/2025	4.36	4.40	4.59	4.77	4.96
1/17/2025	4.34	4.27	4.42	4.61	4.84

U.S. stocks reversed back upward last week, as markets celebrated the Wed. CPI report, which was still sticky, but a bit cooler than expected, which drove down long-term yields. Sentiment also appeared to be helped by the Israel-Gaza ceasefire agreement, which lowers the temperature in the Middle East.

Value strongly outperformed growth, with every S&P 500 sector ending positively, and small caps outpacing large caps. Leading were cyclicals energy, materials, and financials, each up over 6% for the week. For the latter, as earnings season started, strong reports in financials drove prices higher for JPMorgan, Goldman Sachs, Citigroup, and Wells Fargo, among others. Defensive consumer staples and health care brought up the rear with minimal gains. Real estate also gained nearly 5% as interest rates came back down sharply. Financials started off earnings season, with big banks performing strongly, with stronger net interest margins (from higher interest rates) as well as hopes for an easier regulatory environment in the coming administration.

Earnings season for Q4-2024 has begun, with FactSet estimating a 12.5% growth rate for the quarter (including 10% of S&P 500 firms having reported, the rest being expectations), down a bit from a few weeks ago, but a significant improvement from Q3. Leadership is expected in financials (improvement on net interest margins, related to interest rates), in addition to ongoing strength for communications services, technology, and consumer discretionary. Energy is expected to bring in the rear, with an anticipated -25% earnings decline, related to oil price volatility over that period.

Foreign stocks saw similar gains to those in the U.S., with Europe outgaining the U.K., Japan, and emerging markets. The U.K. saw inflation slow to 2.5%, which was welcome, but it was offset by flattish economic growth there, and the second straight year of negative GDP growth in Germany—the combination of which provides a better backdrop in the region for central bank rate cuts. On the other hand, hawkish language from bankers in Japan pointed to a stronger likelihood of rate hikes in coming

meetings. Within EM, Chinese stocks rose nearly 6% to lead the way, as 4th quarter GDP and industrial production came in better than expected. As sentiment for Chinese equities has been quite poor, any signs of catalysts showing 'better' than 'bad' have been cause for some degree of jubilation.

Bonds gained about a percent, both for investment-grade and high yield, as interest rates fell back by 0.10-0.15% along the longer end of the yield curve, in keeping with contained CPI inflation results. Floating rate bank loans earned positive but muted returns, as expected. A slight decline in the value of the U.S. dollar halted the weakness in foreign bonds, which also saw similar strong gains for the week. In an example of how conditions and sentiment have shifted, 30-year Chinese bond yields fell below 30-year Japanese yields, a condition considered unthinkable just a few years ago.

Commodities rose across the board, led by industrial metals, although precious metals, energy, and agriculture also gained about a percent each. Crude oil rose nearly 2% last week to $78/barrel, with offsetting influences of the Gaza ceasefire agreement calming risk premiums and more sanctions on Russia threatening global supplies.

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, Univ. of Michigan, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. 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.