# Weekly Market Insights

**June 6, 2022**

# A Trendless Market

## *Financial Markets*

U.S. financial markets started this past week with hopes that we may be at a turning point, but ended the holiday-shortened period with losses. Both equity and fixed income fell. The S&P 500 fell 1.20%, the Dow fell 0.94%, and the NASDAQ fell 0.98%. Investors were concerned about the strength of the economy and the level of aggressiveness of Federal Reserve tightening. Readers will get a much clearer picture of the outlook for the economy when they read Ryan Schutte's (1919 Investment Associate) section reviewing this past month's economic indicators.

## *Economics*

Last week, we spent a lot of time writing about our concerns with China. We believe an important follow-up would be to address our thoughts on the future of globalism and international trade. Others have written about how current issues with China and the fallout from the Russian invasion of Ukraine would put an end to globalism and result in less international trade. We believe this is unlikely. Globalism has been moving forward for a millennium, but it has evolved along the way. No one knows what the next iteration will look like, but we can make educated guesses. Here is one possible scenario. The Americas and Western Europe will be much closer in trade and policy. Since it will be many years before the global dependence on fossil fuels comes to an end, Russia, Saudi Arabia, and the United States will be an unfriendly and fractious mini trading bloc.

China will continue to try to create an Asian trading bloc. This effort will continue to run into obstacles for a number of reasons. First and foremost, China will demand to be the leader rather than a member. Despite claims from its leaders, China has never been particularly popular throughout Asia, and its self-vaunted economy is having trouble. Much of Asia is in the Western sphere ideologically or leans that way.

These spheres of influence will trade among themselves but not necessarily freely. Will all this come to fruition? No one knows, but it is an interesting starting point. Next week, we will argue why free trade and globalization is so beneficial.

### May Economic Indicators

The Beige Book is a report published by the Federal Reserve before each of the eight open market committee meetings that provides insights on changes occurring throughout the national economy. Since information is collected separately among the twelve Fed banks, it highlights regional differences in economic trends. Major takeaways from the most recent release are slowing but still positive economic growth, tight labor markets with some regions showing signs of easing, and elevated inflation with signs of moderation in three of the twelve districts. Although the information disclosed in the report stems from qualitative rather than quantitative data, many of the major indicators we monitor and report on each month support the Beige Book conclusions.

Inflation measures showed early indications of moderating with the Consumer Price Index (CPI) rising 0.3% month-over-month and 8.3% year-over-year, a step down from March's 1.2% and 8.5% pace. Although still elevated relative to the Fed's 2% target, it is encouraging to see initial signs of reprieve after eight straight months of increasing year-over-year inflation rates. Supply chain disruptions have been an often-cited contributor to the current inflationary environment, and it is no secret that improvements here would help relieve some of the pressure on prices. The ISM Manufacturing Index[1] can provide helpful insights on this front, and, while the index reported slowing price increases, growing inventories, and improvements in firms addressing labor shortages, supply chain constraints remained a frequently mentioned concern for many panelists. The situation seems to be bifurcated across different industries with some panelists "seeing a light at the end of the tunnel" when it comes to restoring supply and others reporting that "shortages (among other issues) are still disrupting the supply chain."[2] With Chinese lockdowns ending and companies continuing to adapt their supply chains, we will watch for disruptions to abate. The continued shift in demand from goods to services should also help to lessen supply pressures and act to slow inflation in bigger ticket items like cars, appliances, and housing. Furthermore, Fed tightening and the resultant increase in borrowing rates will help to temper demand, but existing shortages may keep prices higher at least temporarily while supply catches up. Wage pressures are another important piece of the inflation picture, and, as long as labor supply fails to meet demand, businesses will be forced to offer higher pay to fill open positions. The annual pace of hourly earnings growth slowed to 5.2% in the most recent report, and, according to an NFIB survey, small businesses' plans for compensation increases are slowing. Despite signs of improvement, wage growth is well-above trend, and we remain far from labor market equilibrium. Looking forward, improving the disconnect between labor supply and demand will be a crucial factor in easing inflation pressures.

The U.S. labor market is very tight, but there have been subtle signs of softening in recent weeks. The unemployment rate held steady at 3.6% while nonfarm payrolls increased by 390,000—above consensus but below March's 436,000 gain and 2021's average pace of 552,000. The largest additions were seen in the leisure and hospitality sector, reflecting the shift in consumer demand from goods to services. Still, total leisure and hospitality employment is over 1.3 million below that of February 2020, and significant labor supply shortages remain. The private ADP employment report[3] also indicated a decline in the pace of job growth with 128,000 additions in May. While this is the smallest monthly gain since the pandemic recovery started, it's worth noting that companies struggling to hire from a limited pool of workers was cited as the primary reason for the subdued gain rather than companies choosing to hire fewer workers. Furthermore, more timely weekly unemployment claims remain historically low, signaling that firms may be unwilling to depart with employees despite outlooks for slower growth. Although job openings declined 455,000 to 11.4 million from the prior month, they remain elevated relative to the roughly 6 million unemployed. If labor supply fails to increase sufficiently to meet demand, then reduced labor demand and a reduction in job openings may be needed to narrow the supply-demand gap. Although it may seem paradoxical, slower job growth and reduced openings could be a positive for the economy if it provides relief to inflationary wage pressures. At this point, controlling inflation should take precedence over labor market strength.

Consumption metrics remained strong while consumer sentiment turned lower after showing signs of improvement in the prior month. Both Personal Consumption Expenditures and Retail Sales increased 0.9% over the course of the month, which is even more impressive following strong March reports. In a reversal from the prior month's gains, the Michigan Consumer Sentiment and Conference Board Consumer Confidence indices both resumed their trends lower. The surveys cited consumers' negative views on buying conditions for higher-cost items cars, homes, and major appliances, likely reflecting the impact of higher

[1] The ISM Manufacturing Index is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at more than 300 manufacturing firms.
[2] ISM Institute for Supply Management. *May 2022 Manufacturing ISM® Report on Business. https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/pmi/may/.*
[3] The ADP National Employment Report tracks the level of nonfarm private employment in the U.S. The report is prepared by Advanced Data Processing—one of the largest payroll processing firms in the U.S.

borrowing costs. Participants in the Conference Board survey also cited a perceived softening in the labor market. While strong consumption and spending metrics signal consumer resilience, continued pessimism and reduced confidence may present headwinds if inflation pressures persist and rates continue to increase.

With the latest Atlanta Fed GDPNow estimate coming in at 1.3%, U.S. economic growth looks poised for a subdued bounce back after the first quarter's surprise negative reading. Resilient consumption backed by a strong labor market will provide a cushion as the Fed acts to temper inflation pressures. However, achieving labor market balance will be paramount in controlling inflation going forward, and, if labor force participation does not improve, there is room for a reduction in job openings without a significant increase in layoffs.

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