Weekly Market Insights

April 10, 2023

A Confused Market

Financial Markets

We do hope our readers are enjoying the springtime holiday season. The United States equity markets closed the holiday-shortened week mixed. Although, had the market remained open through Friday, the results may have been different. Friday's jobs report was received as a positive by many investors.

The Dow closed up 0.63%, the S&P 500 closed down 0.10%, and the NASDAQ closed down 1.10%. The leading sectors in the S&P 500 were Utilities, Health Care, and Energy. The laggards were Industrials, Consumer Discretionary, and Materials.

Economics

The last jobs report leads us to suspect that the economy may be slowing. Ultimately, this should help to bring down inflation and ease some of the pressure on the Fed to continue on its tightening campaign. Of course, the jury is still out.

This coming week, there are several economic releases that should help add clarity to the question of where the economy stands. Wednesday, the Open Market Committee releases the minutes from March's monetary policy meeting, and the Bureau of Labor Statistics (BLS) releases the latest Consumer Price Index (CPI) reading. Thursday, the BLS releases the Producer Price Index. Friday, we will receive Retail Sales data from the Census Bureau, the Federal Reserve will publish its Industrial Production Index, and the University of Michigan will release its Consumer Sentiment Index. A big week indeed.

Conclusion

Although this past week ended on an up note with the jobs report, investors' most pressing questions are nowhere near answered. Investors and policymakers should be concentrating on a number of very important short- and long-term items. Clearly, the budget is near the top of the list, but global trade, supply chains, and regional trade groups are three additional topics that should not be overlooked.

March Economic Indicator Update

Recession fears spiked following the failures of Silicon Valley Bank, Signature Bank, and Silvergate Bank in mid-March. Subsequent concern that these events would lead to broader banking sector weakness, tighter credit conditions, and, ultimately, reduced consumption has only served to intensify the focus on economic growth. Just as these issues have emerged, we have also started to see growing signs of labor market weakness. While improved labor market balance has been and continues to be a necessity when it comes to addressing the elevated services inflation at hand, overcorrecting is a risk with a thin margin of error.

Inflation Indicators

The decline from peak CPI inflation of 9% in June 2022 to 6% in February occurred quickly, and current economic forecasts are calling for inflation to end 2023 in the 3-4% range. However, the next phase lower may prove to be more challenging, as the impact from improved labor market balance will take time to materialize in reduced consumption and services-related prices. Looking forward, actually getting to 2% inflation may not be as important as reducing inflation to a level where consumers and businesses feel less pressured and inflation expectations remain anchored.

- The Consumer Price Index increased 0.4% month-over-month, in line with consensus and below January's 0.5% pace, bringing the year-over-year rate down to 6.0%. Core CPI increased 0.5% in February and 5.5% from the prior year.
- Shelter continues to be the largest contributor, although we still expect a downshift in shelter inflation later this year as the CPI measure catches up to real-time data.

- The "Super Core" PCE (PCE services minus energy and housing) increased 0.2% in February and 4.6% year-over-year. Although down from its peak of 5.1% in late 2021, this core services measure has proven to be stickier than goods inflation gauges. Driven more so by labor market conditions and wage growth, we likely have to see further labor market loosening before the Super Core PCE declines significantly.[1]
- Inflation expectations continue to play an important role in the overall inflation picture. A recent NY Fed survey showed that three-year-ahead expectations remained constant from the prior reading of 2.7% and down from the peak of 4.2% in September 2021. Similarly, long-run inflation expectations from the Michigan Consumer Sentiment survey came in at 2.9% in March—within the narrow band of 2.9-3.1% that has held for 18 of the last 20 months. At this point, inflation expectations appear to be in check.

Labor Market Indicators

After months of just ancillary employment indicators showing signs of weakness, we are now seeing broader signs of labor market loosening. While the labor market is still very tight from a historical perspective, key indicators like job openings, layoff announcements, unemployment claims, and payrolls have started to ease. Under the surface, employment trends have varied significantly by industry for some time. Businesses hit the hardest by the pandemic, primarily in the leisure and hospitality, education, and health care sectors of the economy, have yet to fully recover and are continuing to hire rapidly. By comparison, some technology companies whose services were in high demand in the midst of the pandemic have found that they over-hired, and are now laying off a portion of the workers they added over the past few years. Ideally, as employment-impaired businesses become more fully-staffed, demand for labor and upward pressure on wages should diminish, helping to further alleviate inflationary pressures.

- JOLTS job openings declined to 9.9 million from 10.8 million the prior month. Openings are down from 12 million in March of 2022 but are still well above the 7 million openings in February 2020.
- Challenger layoff announcements rose 15.3% in March and are up over 300% year-over-year. The technology sector accounted for 38% of all cuts, followed by financial companies. Together, these two sectors have accounted for about half of all job cut plans year to date. The release noted that "companies are approaching 2023 with caution" and that they expect large-scale layoffs to continue.[2]
- Initial claims for unemployment insurance have been slowly rising since bottoming in September 2022. If the Challenger Report expectations come to fruition, we should expect unemployment insurance claims to keep trending higher.
- Non-farm payrolls increased by 236,000 in March, a deceleration from February's 326,000 rise and the average monthly gain of 334,000 over the prior 6 months. The largest gains were seen in leisure and hospitality, health care, and government jobs—all industries where employment is below or near pre-COVID levels. At this point, job gains in service businesses are still more than offsetting layoffs in the technology and finance industries.
- The Unemployment Rate decreased 0.1 percentage points to 3.5%, and the Labor Force Participation Rate ticked up 0.1 percentage points to 62.6%—still well below the pre-pandemic level of 63.3%.
- Average Hourly Earnings increased 0.3% month-over-month and 4.2% year-over-year. This marks a continuation of the downward trend that has been in place since hourly earnings peaked at 5.9% last March.

Consumer-Related Indicators

After a brief turn higher in February, consumption indicators reversed course and are once again showing signs of moderation. Thus far, demand has been supported by a strong labor market and by consumers tapping into savings and credit, but momentum appears to be waning.

[1]This alternative metric is seen as a better measure of core services inflation and includes spending on services like health care, education, hospitality, dining out, haircuts, and more.
[2]"Job Cuts Rise 15% in March 2023, up 319% from the Same Month Last Year, Highest Q1 since 2020." Challenger, Gray & Christmas, Inc. https://www.challengergray.com/blog/job-cuts-rise-15-in-march-2023-up-319-from-same-month-last-year-highest-q1-since-2020/.

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- Michigan Consumer Sentiment fell for the first time in four months, declining 8% from February. There was notable downward momentum in sentiment prior to the SVB failure, so it appears that banking issues had a limited impact overall.
- Conference Board Consumer Confidence increased slightly, driven by an increase in the Expectations sub-index, albeit from very low levels. Expectations have been below the level of 80, which is historically associated with recessions for 12 of the last 13 months.
- Personal Consumption Expenditures decelerated sharply from January's 2.0% gain, rising just 0.2%. On an inflation-adjusted basis, spending fell 0.1% from the prior month.
- Retail sales pulled back 0.4% month-over-month, worse than consensus estimates calling for a 0.1% decline.
- The New York Federal Reserve Quarterly Report on Household Debt and Credit showed that the share of current debt becoming delinquent increased again in the 4th quarter for nearly all debt types. This follows two years of historically low delinquencies.
- The report suggested that persistent inflation and rising rates may be testing borrowers' ability to repay debts (explained by increasing delinquencies).

Economic Growth Indicators

Like consumption-related data, several economic growth indicators turned higher in February, only to reverse and resume their path lower this past month. Taking into account expectations for a weaker labor market and a decline in consumption, we should anticipate further moderation in growth going forward.

- Industrial Production was flat month-over-month following January's 0.3% rise.
- Durable Goods Orders declined 1.0% month-over-month, following January's outsized 4.5% decline.
- The February ISM Manufacturing PMI declined to 46.3 from 47.7 in the prior month. This is the lowest level since May 2020 and marks the 5th consecutive reading in contraction territory. ISM estimates that this PMI level corresponds to -0.9% GDP growth on an annualized basis.
- The ISM Services PMI declined to 51.2 from 55.1, significantly below expectations for a reading of 54.5. The release noted a big pullback in the New Orders component.
- The Conference Board Leading Economic Index (LEI) declined 0.3% in February and fell 6.5% year-over-year. February marked the 11th consecutive month with a negative LEI reading.[3]

With many indicators weakening this past month, the future of the U.S. economy is in a state of limbo. The Federal Reserve has demonstrated their commitment to controlling inflation, even if it means forcing the economy into a recession. Many unknowns remain, but we continue to look for improved labor market balance, a moderation in consumer demand, and further disinflation, particularly in the service sector.

[3]The LEI is comprised of 10 indicators that cover a wide range of economic activity, including job growth, housing construction, and stock prices. The index is designed to give a broad-based look at the health of the economy and can be used to predict turning points in the business cycle.

Michael Olin Clark
Senior Advisor
moclark@1919ic.com

Ryan Schutte, CFA, CFP®
Senior Investment Associate
rschutte@1919ic.com

Abigail McKenna
Portfolio Administrator
amckenna@1919ic.com

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