Weekly Market Insights

June 7, 2023

It Passed!

Financial Markets

Investors were highly relieved when the debt ceiling agreement finally passed Congress. While most experienced analysts expected an eventual resolution, cutting it so close to the “X date” was harrowing nonetheless.

The financial markets began to rally as the passage of the bill became more assured. The Dow finished the week up 2.02%, the S&P 500 up 1.83%, and the NASDAQ up 2.04%. Although we are pleased with the outcome, the Economic Indicators section highlights some of the remaining hurdles left to navigate. Politicians who wanted to make a splash got their opportunity and can now take a break knowing that their constituents, for the most part, are happy. The next big financial battle will come when the budget proposal comes. This is a far more important and necessary issue than the debt ceiling, and it is the correct forum to debate the legitimate needs of the country. Alas, the nation will not escape the hyperbole from the far left and far right of the parties, but all should be heard.

There are a number of important and interesting factors coming up that must be dealt with. The Ukraine war remains an ongoing issue, but that is really out of the realm of politics. The fear of inflation and excessively high interest rates appears to be on the back burner, at least for the moment. We have written a lot about global trade and it remains a very important factor for global economic wellbeing. Generally, there seems to be an ongoing transition from open trade to countries forming trade alliances. Where China is heading is hard to say, as analysts have to rely on data with questionable accuracy. Another very interesting and difficult issue relates to emerging countries seemingly abandoning the Washington Consensus and moving back to the 1950’s Industrial Policy. Both the World Bank and the International Monetary Fund (IMF) have written extensively about this. We will explain what the Washington Consensus is and why it is so important next week.

Conclusion

Investors ended the week in a happy mood, although we reiterate that it was very unlikely that the week could have ended in a catastrophe. The debt ceiling battle ended as it should have—without surprises. Some very reasonable demands from both sides were met and nothing draconian was added. As we begin to hear budgetary proposals, some will be very extreme. Readers shouldn’t pay too much attention to the loudest and most extreme, as they almost certainly will not stand the test of time.

May Economic Indicator Update

As has been the case for several months, May's economic indicators were mixed, signaling neither decisive strengths nor weaknesses in the overall economy. The latest Federal Reserve Beige Book[1] encapsulates this sentiment, reporting that overall economic activity was little changed in April and early May among the twelve districts. Generally, indicators continue to point to a strong labor market, weakening economic growth, slowing consumption, and disinflation. While strong employment has been supportive of the case for avoiding a recession, the question remains whether continually tight labor market conditions will lead to higher inflation and a more aggressive monetary policy response from the Fed.

[1]The Federal Reserve Beige Book is a report published by the Federal Reserve eight times per year. It provides qualitative information and anecdotal reports on the current economic conditions across the twelve Federal Reserve Districts in the United States.

Weekly Market Insights (cont'd)

Inflation Indicators

Inflation indicators continue to decline from last year's historic highs, but there are signs that disinflation may be slowing. Headline inflation gauges have benefited from the normalization of goods spending, but services inflation remains elevated. While housing prices have provided upward pressure on the Consumer Price Index (CPI) and Personal Consumption Expenditure (PCE) Deflator Index measures, shelter's impact on the overall indices looks to be easing. The expectation is that we will see more significant declines in this component in the months ahead, hopefully fueling the next leg lower in the overall CPI and PCE indices.

- The Personal Consumption Expenditures (PCE) Deflator Index increased 0.4% month-over-month, higher than the 0.3% consensus estimate and up 0.3 percentage points from the prior month.
- The Core PCE also increased 0.4% month-over-month but only marked a 0.1 percentage point acceleration from the prior month.
- The year-over-year rates were 4.4% and 4.7% for the headline and core measures, respectively.
- Shelter was the main contributor to price growth for both the core and headline measures but showed signs of deceleration.
- Average Hourly Earnings rose 0.3% month-over-month, in line with consensus and lower than the prior month's 0.5% increase. The year-over-year decelerated to 4.3%, a downtick from the April's 4.4% rise.
- The Fed Beige Book noted price growth slowed across many districts.

Labor Market Indicators

After demonstrating signs of normalizing in recent months, May's labor market indicators showed surprising strength. While sustained employment strength will support continued consumption, it may also act to counter disinflation, particularly in services prices.

- Nonfarm payrolls increased 339,000 in May, well ahead of market expectations for a 195,000 rise and April's reading of 294,000.
- Prior months saw notable upward revisions, with April's reading increasing by 41,000 and May's increasing by 52,000.
- The unemployment rate increased by 0.3 percentage points to 3.7%.
- The Labor Force Participation rate held steady at 62.6% for the second month in a row.
- JOLTS job openings rose to 10.1 million in April, up from an upwardly revised reading of 9.7 million in March. The latest increase reverses three months of declines.
- While still below the record 12 million openings seen in March of 2022, current openings are well above the 6.1 unemployed reported in May.
- Challenger Gray Layoffs continue to rise, with U.S – based employers announcing 80,089 job cuts in May, a 20% increase from the prior month. Year to date, companies have announced 417,500 cuts, a 315% increase from the same period last year and the most since 2020.
- Increased layoffs have yet to translate to significantly higher unemployment insurance claims, slowed payroll gains, or a higher unemployment rate.

Consumer-Related Indicators

Consumption indicators rebounded after several months of subdued readings. One month alone does not mark a change in the overall trend, but a reacceleration would provide some assurance of avoiding a recession in the near term. Relative to actual consumption data, consumer sentiment and confidence measures provided a conflicting message. With the debt ceiling issue now behind us, it is possible that we will see a relief rally in consumer sentiment and confidence measures next month.

Weekly Market Insights (cont'd)

- Retail Sales increased 0.4% in April, marking the first increase in three months. March's print was revised higher to -0.7%, an improvement from the initial 1.0% decline.
- Personal Consumption Expenditures increased 0.8% month-over-month, higher than the 0.3% consensus estimate and 0.3 percentage points higher than the prior month. The inflation adjusted measure also rebounded, increasing 0.5%.
- The Michigan Consumer Sentiment Index declined 7% in May, erasing about half of the sentiment gains achieved after the index hit an all-time low last June. The year-ahead economic outlook fell 17% from last month and long-run expectations fell 13%. Pessimism over both the short and long-term may signal consumer concern that a potential recession will have long-term negative impacts.
- The Conference Board Consumer Confidence Index declined slightly in May, with more significant declines in the Present Situation component leading the overall index lower. While steady from the prior month, the Expectations component has been below a level of 80 every month since February 2022. This level is typically associated with a recession within the next year.

Economic Growth Indicators

While economic growth has shown signs of moderating, May's indicators were comparably positive. Survey data from purchasing manager indices has been in contractionary territory for some time, but indicators of actual activity like Industrial Production, Durable Goods Orders, and GDP have not yet turned decisively lower.

- 1st quarter GDP was revised higher by 0.2 percentage points to 1.3%, led by an increase in consumption.
- Industrial Production improved 0.5% month-over-month, higher than the prior month's flat reading. Despite the higher than expected monthly growth, the year-over-year rate was tepid at 0.2%.
- Durable Goods Orders increased 1.1%, significantly ahead of estimates calling for a 1.0% contraction. This reading is even more impressive considering the prior month's outsized 3.2% advance.
- The ISM Manufacturing Index came in at 46.9[2], slightly lower than market expectations and April's 47.1 reading. There was a big drop into contractionary territory in the Prices Paid component, with respondents indicating they were more concerned about filling their order books than selling prices.
- The Atlanta Fed's GDPNow real-time estimate of 2nd quarter GDP growth is pointing to 2.0% annualized growth.

Since peaking last June, the U.S. economy has experienced sustained disinflation despite a strong labor market and elevated wage growth. Continued wage growth will be supportive for consumer spending, and it is unusual to see a recession without a decline in consumption. While supportive of a soft landing scenario, the question remains whether enduring consumption strength will dent the disinflation narrative and prompt more aggressive interest rate hikes in the future.

[2]PMI level's below 50 signal contraction.

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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