OBSERVATIONS: Mixed Economic Data

- Existing home sales continued to slide in January, falling to 4.0 million sales (annualized rate), which is down -0.7% from December-2022, but -36.9% lower than a year earlier before the Fed began hiking interest rates.[1]
- The weakness in the housing market was also reflected in home-improvement giant Home Depot, which Q4-2022 earnings disappointed amid flat sales and rising costs due to higher employee wages.[1]
- Venture Capital funds raised $20.6 billion in the fourth quarter of 2022, down -65% from the same quarter of 2021 and the lowest Q4 total since Q4 2013.[2]
- Some cracks in subprime auto debt: Over 9% of subprime auto loans (particularly concentrated in borrowers with FICO scores less than 660) are now 30 or more days delinquent. This marks as the highest share since 2010 and comes despite the record low employment.[3]
- The US composite PMI—which captures both services and manufacturing—increased in February to 50.2 (any number over 50 signals economic expansion) from January's 46.8 reading, which suggests that economic activity is gradually improving after a slow start to the year as both services and manufacturing scores improved in February—although some of rebound this year could be attributable to the mild winter experienced thus far in much of the country.[4]
- The University of Michigan Consumer Sentiment Index rose for a third straight month in February to 67, mostly supported by improvement in consumer's outlook of the economy for the year ahead. Still, sentiment is well below the long-term average (since 1978) of 85 and ranks in the bottom decile of all observations, meaning nearly 90% of all monthly historical consumer sentiment data is higher than today's reading of 67.[1]

EXPECTATIONS

- The minutes of the late-January Federal Reserve meeting suggests another 25 basis-point hike is likely to occur at the mid-March Fed meeting. The meeting notes indicated that most Fed officials preferred a 25-basis point hike rather than a more aggressive 50-basis point hike, but several Fed officials noted that financial conditions had eased in January and that this could necessitate additional rate hikes that had not been previously expected. The market generally received the message that the Fed would likely raise its "dot plot" projection—the Fed's estimate of how high rates would go this year—at the mid-March meeting and earlier this month began pricing in additional rate hikes for May and June of this year.[1]
- In addition to the relatively hawkish Fed meeting minutes, the Fed's preferred inflation gauge—the core PCE index—increased in January from December. December's core PCE was revised up to 4.6% year-over-year (YoY) and January's core PCE registered 4.7% YoY, which will only heighten market worries over additional rate hikes.[1]

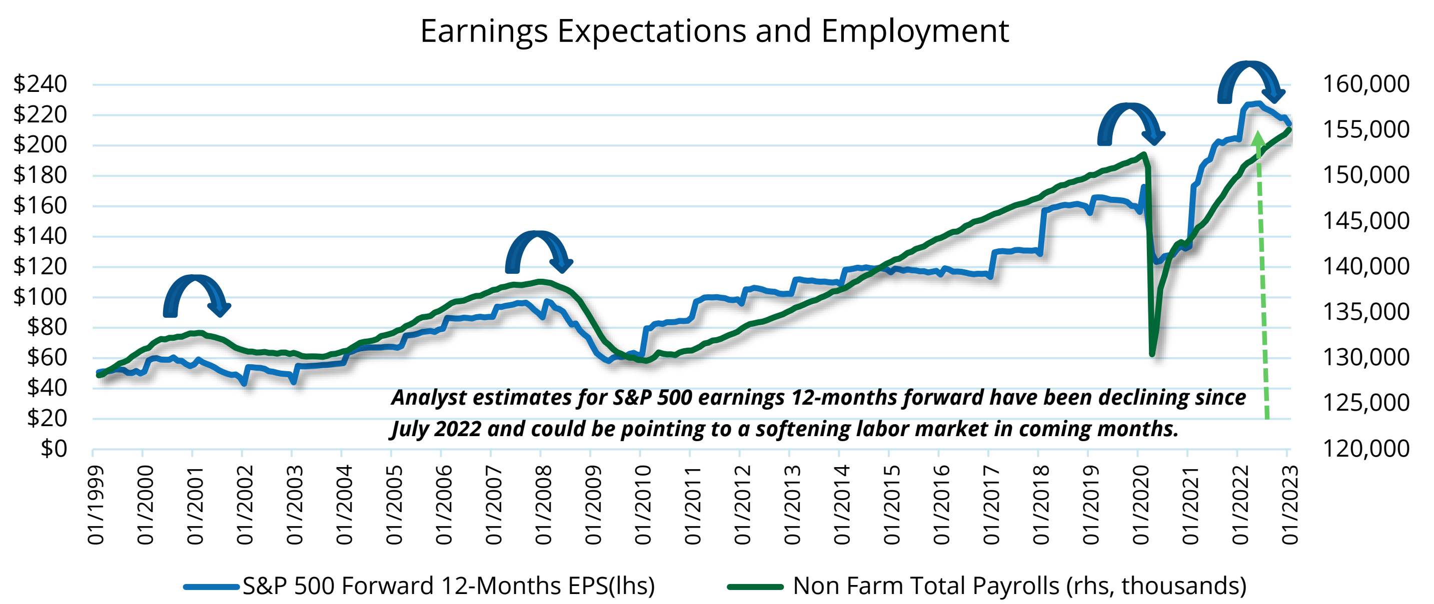
ONE MORE THOUGHT: *From hard landing to soft landing to no landing*

Market narratives of a 'no landing' economic scenario—one in which there is no recession in 2023—are picking up by economists and strategists alike as markets rallied in January, though still remains within the range that we have broadly discussed in prior thoughts and in our 2023 outlook. Meanwhile, the strength of the labor market points to

[1] *Bloomberg LP*
[2] *https://www.wsj.com/articles/venture-fundraising-hits-nine-year-low-c2b4774?mod=markets_lead_pos2*
[3] https://www.wsj.com/articles/more-auto-payments-are-late-exposing-cracks-in-consumer-credit-3cbc2382?mod=economy_lead_pos4
[4] https://www.pmi.spglobal.com/Public/Home/PressRelease/1a48b2fdf6114741aade2fd71f25f4a6

an underlying economy that continues to chug along, despite the significant interest rate hiking back drop. A couple of points here; first, jobs are lagging indicators and the rollover in earnings expectations may suggest that recent employment trends start becoming challenged in the months ahead (Chart of the Week). Second, the long and variable lags of monetary policy would suggest that the economy has yet to fully reflect the rise in rates – notably those in excess of what many would consider the long-term neutral policy rate. Specifically, the rate hiking cycle has seen the Fed's main policy rate go from zero to 4.5%, and the rate hikes from zero to 2.5% to 3.0% can really be thought of as simply getting back to neutral. That "getting back to neutral" process has helped to pull speculation out of financial markets more than it has served to slow the economy or tighten financial conditions. It is conceivable that the additional rate hikes from that neutral point to todays fed funds rate are yet to be fully digested by the economy—therefore the full brunt of more restrictive monetary policy is yet to come. Regardless of the 'no landing' narratives, we are of the belief that this cycle, like others in past, will end with an eventual recession. Taken a step further we would posit that a no landing scenario in 2023 may mean a hard landing in 2024 or 2025. As of now, we have witnessed favorable technical support for markets though recent inflation data has added to monetary policy angst, likely bringing with it continued volatility in the weeks ahead.

CHART OF THE WEEK



Source: Clearstead, Bloomberg LP, Monthly data as of 1/31/2023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