OBSERVATIONS

- The 6-month US Treasury bill reached 5%— a first since 2007—as markets brace for additional rate hikes following last week's inflation data (see One More Thought).[1]
- US based funds focused on China have seen 5 consecutive weeks of net inflows, with 10 of the last 12 weeks posting net inflows as investors bet on China's reopening. The MSCI China Index has risen +33% over that 12 week stretch, though remains -46% lower from June 2021.[2]
- The NFIB Small Business Optimism Index increased 0.5 points in January to 90.3 but remains below the 49-year average of 98. Overall, small business concerns with inflation eased slightly, but the number of all business owners saying that filling job openings remains difficult increased to nearly 1 in 2 respondents.[3]
- Retail sales were up 3% in January over December, well above expectations, but retail sales numbers for November and December were revised down. Retail sales grew in almost every category in January including at restaurants, car dealerships, department stores, and home goods/appliance stores.[1]
- Meanwhile, the manufacturing sector looked less robust as industrial production was unchanged in January from December and capacity utilization inched lower. On a year-over-year basis January-2023 was +0.8% higher than January-2022 suggesting growth in the sector has all but stalled.[1]
- Homebuilder confidence rose in February to 42—any number below 50 indicates that more builders view the market as poor rather than good—from January's 35 index reading.[4] Overall fewer homebuilders are reporting price cuts for new homes and the amount of the discounts averaged 6% in February compared to averaging 8% in December-2022. Housing starts and new permits, however, continued to decline in January, with starts falling -4.5% to 1.309 million (annualized rate) from December's 1.371 figure which had already been revised lower.[1]
- Producer prices continued to ease in January but the decline in input prices was less than what the market had expected. The PPI index fell to 6.0% Year-over-Year (YoY) in January from December's 6.5% YoY reading. Core-PPI fell to 4.5% YoY from December's 4.7% YoY figure.[1]

EXPECTATIONS

- Q4-2022 earnings season is winding down with over 82% of S&P 500 firms having reported. Overall, this was a weaker earnings quarter as the number of companies beating consensus EPS estimates was only 68%—below the 5-year (77%) and 10-year (73%) averages. However, some of the recent rally in US equities—the S&P 500 closing last Friday +6.3% YTD—suggests that while this quarter was weaker than earlier 2022 quarterly earnings, it was better than a worst-case scenario in which more companies missed on earnings and guidance for next year was completely slashed.[5]

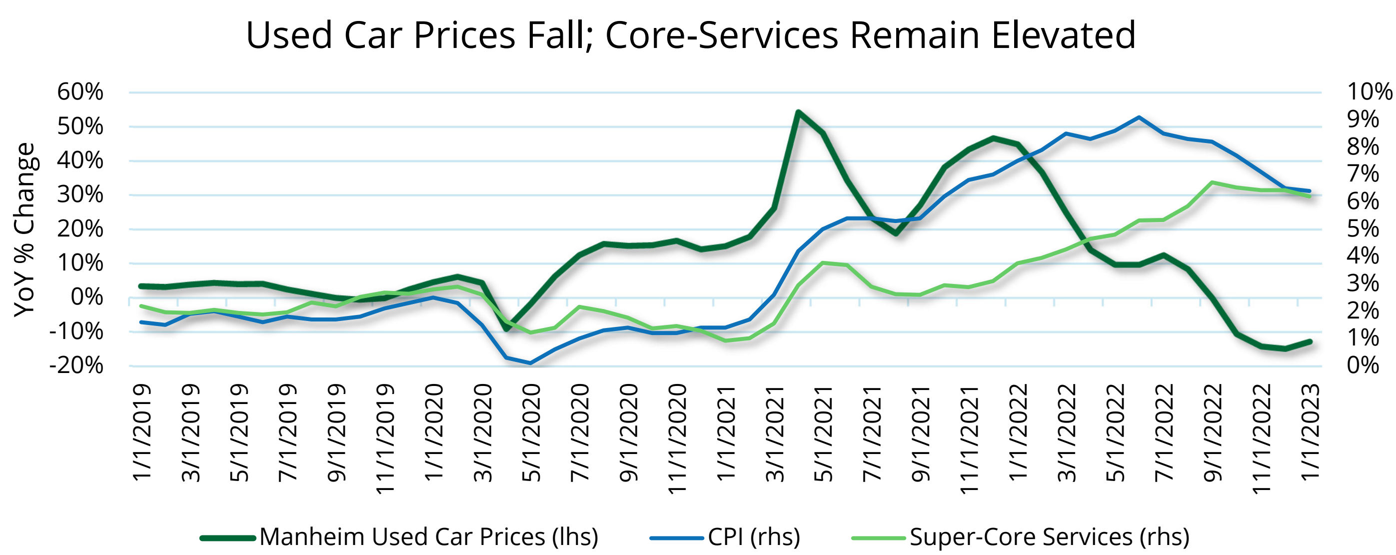
ONE MORE THOUGHT: *CPI, Used Cars, and Super Core Inflation*[1]

Fed Chairmen Jay Powell mentioned the word "disinflation" fifteen times at his press conference earlier this month. In short, he was drawing attention to the fact that in many parts of the economy, prices had begun to fall. He noted that supply chains for many manufactured goods had normalized and that heightened demand for goods over

[1] *Bloomberg LP*
[2] *Bloomberg, https://www.wsj.com/articles/investors-pour-into-chinese-stock-funds-in-reopening-bet-96c8bc85?mod=markets_lead_pos3, MSCI China returns 11/9/2022 to 2/14/2023*
[3] *https://www.nfib.com/surveys/small-business-economic-trends*
[4] *https://www.nahb.org/news-and-economics/press-releases/2023/02/cautious-optimism-for-builders-in-february*
[5] *https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_021723.pdf*

services seen during the pandemic had fallen and therefore it was no surprise to see prices for these goods moving lower. A good example of this is used car prices, which spiked in late 2020 when supply-chain disruptions reduced the supply of new cars, only to move sharply lower in late 2022 as more new cars came to market and demand eased. Another category, housing, the Fed expects prices to continue to rise in the near-term before moving lower later this year. This is because the components of CPI related to housing reflect trends in rental markets and housing prices with a lag. Thus, price increases witnessed by new renters or home buyers in mid-2022 are still making their way into the official CPI numbers. However, these measures have materially declined in recent months and therefore the Fed can be reasonably sure that official CPI measures for housing will begin to ease over the coming months. However, in other areas, particularly in the services sector there has been little signs of price easing. The latest January CPI report released last week continued to show that progress was being made combatting inflation except in super-core services (ex-housing/rents) where prices have shown little signs of easing, which the Fed worries may continue so long as the labor market remains tight and wage gains remain strong. All this suggests that the Fed is likely to raise rates at its next meeting—the markets largely expect this, and it is rapidly increasing expectations for the number of additional hikes anticipated this year—but also will adjust upwards how high it needs to hike rates this year to put all categories of prices, including core-services, on downward trajectory.

CHART OF THE WEEK



Source: Clearstead, Bloomberg 2/15/2023

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