Weekly Market Perspectives

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Economic Weakness and Inflation Loom Large as the Holiday Season Approaches

Thanksgiving dinner costing consumers roughly 20% more than last year

U.S. stocks finished last week modestly lower, with the S&P 500 Index and NASDAQ Composite both giving back some of their big gains in the prior week and after posting their best weekly performance since June. The S&P 500 closed the week lower by 0.7%, with the NASDAQ losing 1.6% and the Dow Jones Industrials Average finishing the week flat.

Value was also flat on the week, outperforming Growth (down 1.3%) and helping the more defensive category regain some of the 440 basis points in underperformance to Growth witnessed in the prior week. Consumer Staples (+1.7%), Healthcare (+1.0%), and Utilities (+0.8%) mitigated the S&P 500's losses, while Consumer Discretionary (down 3.2%) and Energy (down 2.4%) added to the pressure.

West Texas Intermediate (WTI) crude sank 10.1% last week to $80.20 per barrel, posting its worst weekly performance since June. Gold dropped to $1,750.50 per ounce, falling 0.8% last week.

U.S. Treasury prices were mixed across the curve, with the 2-year/10-year spread inverting to cycle lows, finishing the week at -70 basis points. This means that investors lending money to the U.S. government for ten years will receive 70 basis points less yield than if they were to lend the government money for three months. This is highly abnormal and reflective of the Federal Reserve's aggressive actions to keep increasing interest rates to bring down inflation.

Odds of Further Economic Weakness Appear to be Increasing

Notably, the highly watched 3-month/10-year Treasury spread finished the week inverted for the first time since the start of the pandemic, closing Friday at -43 basis points. In our view, this is a harbinger of more bad news to come, as the 3-month/10-year Treasury spread is one of the most accurate recession indicators in the market. According to *Bespoke Investment Group*, if the U.S. economy doesn't see at least a shallow recession within the next four quarters, it will mark the first time since the 1960s the signal failed to predict a recession. However, we would caution investors against making any sudden portfolio changes on that point alone. Both the stock and bond markets have been pricing in an economic downturn all year and possibly even a shallow recession. Historically, asset prices move ahead of the economy and, in our view, are likely to bottom and start moving higher before a possible recession is evident.

Nevertheless, the 3-month/10-year inversion should not be ignored. The signal validates the unusual circumstances the U.S. economy currently finds itself in, indicates that odds of further economic weakness are increasing, and argues for a cautious and balanced portfolio approach heading into the new year. ***Bottom line*: If investors were on the fence about believing the market's recent rally was *the* rally that was going to turn the bear market around, the 3-month/10-year inversion likely cleared many off the fence.**

That brings the following question to mind: *Is the inflation rally running out of steam?* Cooler inflation in the U.S., hope that China will more fully relax its zero-COVID policies next year, and the end of the U.S. mid-term elections have put some wind behind the sails of equity markets this month. But the S&P 500's 200-day moving average could again act as strong resistance to further stock gains (it has all year), while the current rally is on par with what investors saw in July and August and before stocks headed lower. In addition, *FactSet* noted several reports and prime brokerage desks pointing to an outsized "short-squeeze" as adding momentum to the recent rally. Importantly, this trading activity tends to be fickle and changes direction rapidly, indicating, like during past rallies this year, investors could fall back to their larger growth concerns, which may again weigh on stock prices at some point.

But it's not all about technicals and traders. According to *BofA's Flow Show* report last week, driven by *EPFR Global* data, $22.9 billion flowed into stock funds the week ending November 16th. That's the most in 35 weeks, with U.S. equity funds attracting $23.9 billion during the week and Tech funds seeing a boost in flows. According to *EPFR Global*, year-to-date U.S. equity fund flows are running at just under $200 billion, following the outsized $400 billion smashed into U.S. equity funds in 2021. Pundits continue to point to the lack of meaningful capitulation in the market, given the steady pace lower across stocks this year. During periods of market strength, this point is often recirculated and tends to refocus investors' attention back to concepts around "bear market bounces" and that The Fear of Missing Out (FOMO) trade has not entirely left the building.

Bottom line: Further weakness on the economic front, particularly if it runs through most of next year and is accompanied by higher interest rates that linger at higher levels for longer, could act to displace more investor confidence at some point. This may result in reversing some of the strong stock fund inflows over the last two years or so, pressuring equity prices and producing a more obvious capitulation moment. Longer-term, we would consider such an event an opportunity to put cash to work in stocks. Viewing the pressure as a time to shift toward a more contrarian mindset and buying opportunistically while others sell into the events of the day.

October Retail Sales Shows Shifts in Consumer Behavior; Builder Sentiment Declines for the 11th Straight Month

On the week, October retail sales came in stronger than expected across the board, with the headline reading rising +1.3% month-over-month, compared to the +1.0% expected. Ex-autos and gas, the figures were even stronger, with sales in nine of thirteen categories higher on the month. Notably, overall retail sales figures have returned to baseline patterns seen prior to the pandemic, though *how* consumers spend (i.e., services versus goods or online versus in-store) remains an ongoing shift. A batch of retail earnings last week also showed shifting trends among consumers, with higher-end consumers starting to adjust spending due to high inflation (e.g., Target's Q3'22 earnings miss and lower guidance). However, Walmart, Home Depot, and Lowe's reports generally exceeded expectations, pointing to higher-end consumers looking for value and continuing to spend on home improvement. In addition, producer price inflation moderated more than expected in October, while industrial production pulled back. Finally, builder sentiment declined for the 11th straight month, and housing starts/permits in October beat estimates but slowed from September levels.

Thanksgiving Dinner Will Cost Roughly 20% More than Last Year; Investors Soon Will Shift their Attention to the Holiday Shopping Season

As families prepare for Thanksgiving festivities on Thursday and investors enjoy a shortened holiday week, inflation will likely be a front-and-center topic at the "adult" table this year. According to the *American Farm Bureau Foundation*, Thanksgiving dinner will cost roughly +20.0% more than last year. In addition, thanks to an outbreak of avian influenza and record-high feed prices, a 16-pound turkey will cost roughly +21.0% more than last Thanksgiving. Along with a more expensive turkey, stuffing, eggs, and pumpkin pie mix will also cost more. But those hosting this year's feast will find that the price of cranberries is down from last year. Also, some grocers have held essential Thanksgiving food items at last year's prices, while others have even rolled back prices to 2019. Indeed, a small break to give thanks for amid a year where almost everything now costs more than it did last year.

Unlike last year, when the Omicron coronavirus strain was discovered, this Thanksgiving week should be relatively quiet. U.S. markets will be closed on Thursday for the Thanksgiving holiday, with Friday likely a light volume day as the market closes early at 1 pm EST. While stocks and bonds have been pushed around by Federal Reserve and inflation machinations over the last few weeks, a clear direction in Fed policy remains in flux — other than rates are moving higher. This week, neither the incoming economic data nor Fed speeches will likely add more clarity. Home data, durable orders, FOMC meeting minutes, and preliminary looks at November manufacturing/services data will provide the week's major economic releases on Wednesday.

Later in the week, investors' attention will shift to the start of the holiday shopping season, which will provide more color on the state of the U.S. consumer. According to the *National Retail Federation*, retail sales for the November-December shopping months should grow between +6.0% and +8.0% this year versus last year. Factor in inflation running at +7.7% in October, and that's not a lot of holiday shopping growth. In *Deloitte's* 37th annual holiday shopping survey, respondents said they planned to spend $1,455 per household during the holidays, down from $1,463 a year ago. Black Friday, Cyber Monday, and all the days between now and the New Year will likely be closely watched for how consumers approach giving in a period of high inflation and rising interest rates.

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The NASDAQ composite index measures all NASDAQ domestic and international based common type stocks listed on the Nasdaq Stock Market.

The **Dow Jones Industrial Average (DJIA)** is an index containing stocks of 30 Large-Cap corporations in the United States. The index is owned and maintained by Dow Jones & Company.

West Texas Intermediate (WTI) is a grade of crude oil commonly used as a benchmark for oil prices. WTI is a light grade with low density and sulfur content.

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