EMPOWER INVESTMENTS™

Empower Investments Capital Markets Perspective

Week in Review: October 17th – 21st

INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD
Dow Industrials	Lg. Cap Eq.	31,082.56	4.89%	-14.46%
S&P 500®	Lg. Cap Eq.	3,752.75	4.74%	-21.26%
NASDAQ Comp.	US Equity	10,859.72	5.22%	-30.59%
S&P Midcap 400©	Mid-Cap Equity	2,312.21	2.98%	-18.64%
Russell 2000®	Sm. Cap Eq.	1,742.24	3.56%	-22.41%
Stoxx 50	Europe Eq.	3,476.63	2.81%	-19.12%

INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD
FTSE 100	UK Equity	6,969.73	1.62%	-5.62%
Nikkei 225	Japan Equity	26,890.58	-0.74%	-6.60%
EEM:US	Emkt. Equity	$35.27	3.10%	-27.80%
EFA:US	Non-US Equity	$57.99	3.54%	-26.30%
UST 10y (yield)	US Treasury	4.22%	0.20%	2.71%
Bloomberg U.S. AGG	Fixed Inc.	1,960.94	-1.07%	-16.74%

Past performance is not a guarantee of future results. Investing involves risk, including possible loss of principal.

Backseat driver.

When our kids were very small, we had a little toy dashboard that attached to their car seat. It was brilliant: it allowed them to imitate their mom's driving (save for a few occasional hand gestures, thankfully…) as she sped around town from one appointment to another. I suppose the genius of it was that it gave them **a very real sense of control when in fact they had almost none**.

I wonder if that's how Jerome Powell feels about the jobs market.

One of the Federal Reserve's stated objectives with all the rate-ratcheting it's done this year **is to "restore balance" to the labor market**[1], which is enormously important if the Fed hopes to prevent one of the most damaging kinds of inflation of all: a **wage/price spiral that can easily become self-reinforcing**. But so far the only real progress the Fed seems to have made on that front is a sizable decline in the number of job openings evident in the August JOLTS report released a few weeks ago[2]. That's great, but meanwhile initial jobless claims have failed to increase meaningfully,[3] payroll growth has remained strong and unemployment actually *fell* in September[4].

And then last week, the latest sign that the jobs market is still too hot came from the **first two regional Fed manufacturing surveys**: both Empire State and the Philly Fed surveys indicated that in a very general sense **things are slowing pretty substantially** (thanks, certainly, to the Fed's efforts,) **but hiring is not**. This line from last Monday's Empire State release captures the Fed's jobs market conundrum perfectly: "the indexes for future shipments and new orders remained depressed, though employment is expected to increase[5]." Translation: yeah**, sure, the economy is slowing fast, but businesses are still snapping up qualified employees whenever and wherever they can** find them.

It's hard to blame employers for that given how tight the labor market has been – it was difficult to hire before COVID and is arguably even tougher now. It also probably shouldn't come as a surprise that **all these Fed-sponsored rate**

[1] https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20220921.pdf
[2] https://www.bls.gov/news.release/jolts.a.htm
[3] https://www.dol.gov/ui/data.pdf
[4] https://www.bls.gov/news.release/empsit.nr0.htm
[5] https://www.newyorkfed.org/medialibrary/media/survey/empire/empire2022/esms_2022_10.pdf?la=en

increases haven't yet been able to so much as even *dent* the still red-hot job market. After all, Fed policy famously works with a lag as far as pretty much everything besides aggregate demand is concerned, and labor markets are no exception. That couldn't have possibly escaped your notice if you listened to the last post-Federal Open Market Committee (FOMC) press conference in September, and is made even more obvious by the fact that **unemployment rates have actually tended to *decline* during recent Fed rate-tightening cycles** more often than they fall[6].

Okay, I realize that's a LOT of commentary on the jobs market during a week that didn't even include any big, splashy data releases related only to the labor market. But **I think the Fed's jobs conundrum is an important part of the story behind last week's market moves precisely because it *wasn't* front-and-center** of the narrative. Here's why: probably the best explanation for last week's upbeat tone in stocks is that various members of **the Fed's decision-making conclave were suddenly sounding a little less aggressive** when it comes to interest rates. None other than James Bullard, noted (notorious?) hawk, sounded almost sympathetic when he suggested that the Fed might at some point have to quit "front-loading" interest rate increases and consider holding steady at some point in 2023[7].

That's the friendliest Bullard has sounded in a long time and **probably helped investors get comfortable enough to send US stocks to their best weekly performance since June** by hinting, at least to some, that a Fed "pivot" might be occurring. But what's interesting is that the sentiment Bullard (and others) conveyed is really pretty consistent with the market's prior expectations about rates as well as the Fed's own widely published "dot plot," which shows where the Fed's own rate-setters think rates will be in the future. So **it's something of a head-scratcher to me that investors might somehow suddenly have seen this as a "pivot" in Fed policy**. Sure, it might suggest that November's now widely expected 0.75% increase might be the Fed's last super-sized hike, but that **wasn't too far from what people already believed anyway**.

But one thing a supposed sudden turn in Fed rate sentiment *does* seem inconsistent with – at least to me – **is the big, red bull's-eye that Powell seems to have painted on the jobs market**. As last week's Empire State and Philly Fed reports seemed to suggest, Powell's aim where jobs are concerned isn't a whole lot better than his predecessors, and if the Fed truly is targeting labor market stability as one of the preconditions to back off a little bit, then **we could be waiting a little while**. After all, "data dependence" is a comforting phrase to hear from the Fed when you think the data is rowing in the same direction as you, but its easy to forget that it works both ways. I guess I'm just worried that last week's strong rally in riskier segments of the market might prove to have been a little premature, that's all.

And now, for something completely different.

My fellow nerds might recognize the above as one of the many quotable catchphrases from British comedy troupe *Monte Python*. I stress the "British" part because one of the other most notable developments as far as markets are concerned came from the *Pythons'* own homeland: **British Prime Minister Liz Truss** officially became the shortest-serving Prime Minister of the UK when she **resigned last week**. As we've discussed in earlier versions of this *Perspective*, Ms. Trust brought the UK economy dangerously close to exactly the kind of crisis – a liquidity crisis – that markets are most vulnerable to when things are as fragile as they seem right now. By resigning, she has closed the door to a batch of fiscal policies that by common interpretation threatened to further stoke the flames of already too-hot UK inflation and might well have given markets globally an excuse to burp. **Count this one under "crises averted."**

On the other hand, a mini-crisis that wasn't averted – at least not if you invest in China – was **Chinese President Xi Jinping's consolidation of powe**r. Over the weekend, China wrapped up its once-every-five-years National Party Congress, during which Xi was chosen to lead his country for a rare third term. That wasn't a surprise at all. But what *did* catch markets a little off-guard was the appointment of two Xi loyalists with significant state security chops to the all-powerful Politburo. That signaled to China experts **that Xi's priority over the next few years will be internal stability and security** as well as securing greater geopolitical clout[8]. **Notably absent** from the top of that list of priorities is **China's previous manic focus on economic growth**.

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[6] Bureau of Labor Statistics, Federal Reserve, Bloomberg and Empower investments calculations
[7] Bloomberg, 10/19/22
[8] https://www.scmp.com/news/china/politics/article/3197094/security-mission-focus-xi-jinpings-key-communist-party-appointments

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Ordinarily, I probably wouldn't devote two full paragraphs of space to geopolitical events. I firmly believe that while **geopolitics** are fascinating to talk about, they **are almost always mere noise** as far as markets are concerned. That's still true. But both Truss' resignation and China's party congress **have captured the market's attention in a way that frankly feels a little weird** (China in particular: as I write this, Chinese and Hong Kong markets are cratering.) That might be partly due to the fact that the world's #2 economy seems to be swearing off economic growth like a meth addict in rehab, but it **might also be related to that above-mentioned market fragility**: investors seem on edge waiting for something to give, and a geopolitical surprise is as good a candidate as any (and oh yeah, Ukraine…'nuf said.)

Lastly, because this update is supposed to focus mostly on economic stuff, a quick word about the other economic news from last week: **housing**. As mentioned (*ad nauseum*,) the state of the US housing market is depressed. As also frequently mentioned, that fact has really lost its ability to surprise anyone and is therefore hardly worth a mention unless and until things start to improve. But as last week's NAHB data showed, we're probably still a long way from that[9]. The National Association of Home Builder's **builder sentiment survey fell very close to its COVID low**, suggesting that stubbornly high prices and still-rising mortgage rates are still keeping demand depressed. Because it's becoming almost canon to point out that **the economy rarely starts to recover before housing** hits bottom, last week's depressed NAHB is worth a mention here.

What to Watch This Week: October 24th -30th

Notable economic events (October 24th – 28th)

Monday*:* Flash PMIs, CFNAI; earnings: n=100-plus

Tuesday: Consumer confidence, home prices (x2), Richmond Fed; earnings: MSFT, GOOG, GM, UPS, PHM, V

Wednesday: New home sales; earnings: F, BA, NSC, CP, HOG, BG

Thursday: Employment cost index, durable goods orders, 3Q GDP; earnings: AAPL, AMZN, MA, CAT (n=372)

Friday: Personal income/outlays, UofM consumer sentiment; earnings: XOM, CVX

Source for index data: Bloomberg.com; Empower Investments calculations.

Earnings season picks up momentum this week, with roughly 850 individual companies expected to release results (including 650 or more on Wednesday and Thursday alone.) That's far too many to mention, so here are a few highlights that might be relevant to the overall macroeconomic picture: first, **high-growth firms** like Microsoft and Google (both expected Tuesday,) will report followed by Apple and Amazon on Thursday. Expect these firms to get a lot of attention given their sheer size, as well as indicators of consumer demand in general.

Ditto for **automakers** (GM on Tuesday, Ford on Wednesday,) as well as **another handful of airlines** and iconic US brand Harley-Davidson – all of which will provide context around consumer behavior as economic uncertainty goes further and further into the mainstream. For those who see **logistics and transport** as a good window into the macro, we get two more railroad operators on Wednesday (Norfolk Southern and Canadian Pacific,) as well as parcel service UPS. On the heavier/dirtier side of the economy, look toward **Caterpillar** (Thursday) and **oil super-majors** Exxon-Mobile and Chevron (both on Friday.)

So far, third-quarter earnings have been surprisingly strong, with only slightly fewer companies failing to meet estimates than in past quarters, even as earnings growth slows more generally[10]. Last week's continuation of the financial firm hit parade is a good example: most reporting firms met or exceeded their targets, but **guidance about future quarters was mixed** (and, in a feature unique to banks and financials, a troubling tendency of loan loss provisions to creep surprisingly higher is one reason to suspect that the economy in general might be weakening fast.)

[9] https://www.nahb.org/news-and-economics/housing-economics/indices/housing-market-index

[10] Sources: Zacks.com, company reports, Bloomberg

So **the bulk of earnings reports this week will probably contain some relevance to the US consumer**. The need to understand how consumers are positioning themselves for any expected downturn will be important to understanding exactly how likely it will be for that downturn to actually arrive. Thankfully, we'll also have a healthy dose of economic data to cross-foot that against – including **two consumer confidence surveys** (Conference Board on Tuesday and the

University of Michigan on Friday.) Also on Friday will be the income-and-outlays report, which details how much (and where) consumers are earning and spending their cash as well as estimates.

And finally, maybe the biggest indicator of consumer activity of all – not to mention economic activity more generally – the Bureau of Economic Analysis' **preliminary read on third quarter GDP will arrive on Thursday**. While GDP releases are not ordinarily worth much attention in my view, this time is different: after declining during both the first- and second quarter of 2022, **economists are expecting third quarter GDP to turn positive again**. If it does, expect some to begin to question whether the downturn is over. If it doesn't, it will become harder for organizations like the NBER to delay officially calling this an honest-to-goodness recession.

Also, embedded in every Gross Domestic Product release is **all sorts of inflation-relevant data** like so-called Personal Consumption Expenditures deflators. That, plus Thursday's Employment Cost Index release from the Bureau of Labor Statistics, will provide more insight into whether the wage-price spiral mentioned above might be developing.

Finally, there are several ways to guess about how quickly economic activity is declining that aren't released alongside GDP data. Monday's flash **purchasing managers' indices** are particularly relevant given how well they correlate to economic activity more generally, while the **continuation of regional Fed manufacturing reports** (Richmond on Tuesday, Kansas City on Friday) will likely show that recent trends are intact (some good, some bad.) Namely, these data have recently shown that while growth and new order activity might be tipping over, the silver linings are reduced pricing pressures and easing supply chain stress. Look for those trend to continue as this week's data rolls in.

Investing involves risk, including possible loss of principal. *Past performance is not a guarantee of future results.*

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