MORNING BRIEFING
December 12, 2022

The Call Of The Wild

Check out the accompanying chart collection.

Executive Summary: . A few choice negative words about consumer spending prospects from a few high-profile bank CEOs tripped up the S&P 500 last week. But on Monday, a strong NM-PMI release did the same, setting investors fretting about the very opposite: that consumer spending might be too strong. Meanwhile, the bankers are crying all the way to the bank: The S&P 500 Financials sectors' forward revenue and forward earnings have never been higher. If investors need reassurance that the economy isn't headed south, the Atlanta Fed's GDPNow model certainly provides it. … Also: PPI inflation is falling relatively quickly. … And: Wage growth seems to have peaked.

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Strategy: The Howling. Last week wasn't a good one for Santa. The S&P 500 failed to hold on to its 200-day moving average (*Fig. 1*). The index is now down 18.0% from its January 3 record high through Friday's close. It is still up 10.0% from its October 12 closing low. However, the bears are growling that the bear market isn't over, with many of them expecting new lows early next year. Their call of the wild was confirmed by the howling of a pack of bankers who warned that consumer spending is slowing, suggesting that a consumer-led recession may be nearing.

Leading the pack of pessimists (again) was JPMorgan Chase Chief Executive Jamie Dimon. On Tuesday, he told CNBC that consumers and companies are in good shape but noted that may not last much longer as the economy slows down and inflation erodes consumer spending power. "Those things might very well derail the economy and cause this mild-to-hard recession that people are worried about," he said. Consumers have $1.5 trillion in excess savings from pandemic stimulus programs, but it may run out some time in mid-2023, he told CNBC. Dimon also said the Federal Reserve may pause for three to six months after raising benchmark interest rates to 5%, but that may "not be sufficient" to curb high inflation.

Also on Tuesday, at a Goldman Sachs financial conference, Bank of America CEO Brian Moynihan told investors that the bank's research shows "negative growth" in the first part of 2023, but the contraction will be "mild." Goldman Sachs CEO David Solomon said at the same conference, "Economic growth is slowing. When I talk to our clients, they sound extremely cautious."

We’ve said it before: If a recession is coming in 2023, it will be the most widely anticipated recessions of all times. It would be the first time that we’ve collectively talked ourselves into a recession, and the bankers are among the most vocal pessimists, leading the way with their unsettling howling.

So what are the bankers doing to prepare for their widely expected hard landing? Not much, so far, other than lending more money to their customers. Commercial bank loans and leases are up $1,134 billion ytd to a record $11.9 trillion during the November 30 week (*Fig. 2*). Commercial bank allowances for loan and lease losses showed little change ytd, down $0.3 billion to $166.7 billion (*Fig. 3*). That’s well below low the pandemic peak of $220.5 billion during the September 2 week of 2020.

Now consider the following related developments in the S&P 500 Financials sector:

(1) *Security issuance*. Depressing the big bankers is that their equity issuance business has imploded back to pre-pandemic levels (*Fig. 4* and *Fig. 5*). On a 12-month-sum basis, total equity issuance plunged from a peak of $474.8 billion through April 2021 to $110.5 billion through October of this year. Both initial public offerings and seasoned equity offerings have plummeted since the 2021 boom.

Down but still holding up relatively well is corporate bond issuance. The 12-month sum peaked at $2.5 trillion during March 2021 (*Fig. 6*). It was down to $1.6 trillion during October.

(2) *Forward revenues & earnings*. The bankers are crying all the way to the bank. The forward revenues of the S&P 500 Financials sector rose to a record high during the December 1 week (*Fig. 7*). During the Great Financial Crisis (GFC), forward revenues peaked during the November 1 week of 2007 and plunged 48% through early 2012. The sector’s forward earnings has been in record-high territory in recent weeks (*Fig. 8*). During the GFC, it went into a freefall, dropping 78% from the 2007 peak through the 2009 trough.

(3) *Market cap & earnings shares*. If a recession is coming, it’s hard to see it reflected in the performance of the S&P 500 Financials sector. In the past, tightening monetary policy often triggered a financial crisis, which morphed into an economy-wide credit crunch and recession. This time is different so far. That’s been our pitch for a while. Bloomberg’s Rich Miller came to the same conclusion in a December 8 *story* titled “The Federal Reserve Is Deflating Financial Bubbles, Without a Crash.”

The story observed: “Financial reforms instituted after the financial crisis helped ensure that the latest housing cycle didn’t feature the kinds of loosening in credit standards seen in the early 2000s. The so-called Dodd-Frank measures have left banks much better capitalized, and much less leveraged than they were back then.”

We observe that the S&P 500 Financials sector accounts for 11.6% of the market capitalization of the S&P 500 (*Fig. 9*). That’s reasonable considering that the sector’s earnings share of the S&P 500 is higher at 16.1%.

(4) *A risk-off week*. On Monday of last week, investors were unnerved by November’s stronger-than-expected NM-PMI. They concluded that the economy may be too strong,

requiring the Fed to raise interest rates still higher and increasing the risk of a recession. Of course, a strong NM-PMI implies that consumers are continuing to spend on services. Nevertheless, Tuesdays' nattering nabobs of negativity convinced investors that consumer spending is suddenly weakening, raising the risks of a recession.

By the way, on Thursday of last week, I spoke at a conference at The Breakers Palm Beach. The airports were mobbed. The planes were full. The hotel was packed. So were its restaurants and recreational facilities.

In any event, last week was another risk-off week in the stock market, with the S&P 500 down 3.4%. Defensive stocks outperformed cyclical ones, as evidenced by the performance derby of the S&P 500 and its 11 sectors: Utilities (-0.3), Health Care (-1.3), Real Estate (-1.9), Industrials (-3.2), Materials (-3.3), Information Technology (-3.3), S&P 500 (-3.4), Financials (-3.9), Consumer Discretionary (-4.5), Communication Services (-5.4), and Energy (-8.4). (See *Table 1*.)

(5) *No recession in GDPNow*. Friday's update of the Atlanta Fed's *GDPNow* tracking model showed that real GDP is up 3.2% (saar) during Q4, following Q3's 2.9% increase. Consumer spending is up 3.7%. Capital equipment is up 10.7%. The weak sectors are nonresidential structures (-3.9%) and residential investment (-19.8%). There's no economy-wide recession reflected in the tracking model. There is a rolling recession that is rolling through single-family housing activity and nonresidential construction, however.

Inflation I: Moderating PPI? On Friday, we learned that November's headline PPI inflation rate rose 0.3% m/m, higher than the 0.2% expected, and October's increase was revised up from 0.2% to 0.3%. The good news is that the y/y comparisons showed that the PPI final demand inflation rate peaked at 11.7% during March and fell to 7.4% during November, the lowest since May 2021 (*Fig. 10*). Of course, that's still too high, but it is falling at a relatively fast pace. Here is more good news, especially in the latest three-month annualized data:

(1) *PPI final demand*. While the PPI final demand rose 7.4% y/y during November, the three-month annualized rate was only 3.5% (*Fig. 11*). Here are the same happy comparisons for PPI final demand goods (9.6%, 4.1%) and PPI final demand services (5.9%, 2.9%).

(2) *PPI services*. Moderating significantly are trade services (10.9%, 1.2%) and transportation & warehousing services (12.7%, -3.3%) (*Fig. 12*). The former measures markups. A bit more troublesome are services less transportation & warehousing services (2.7%, 4.6%).

(3) *PPI personal consumption*. The PPI release includes series related to personal consumption (*Fig. 13*). They too continue to moderate significantly, as comparing the y/y and three-month annualized rates highlights: total personal consumption (6.7%, 3.8%), personal consumption of goods (11.3%, 7.6%), and personal consumption of services (5.2%, 2.5%).

(4) *CPI vs PPI personal consumption*. The January 2014 issue of *Monthly Labor Review* *discusses* the differences between the PPI personal consumption and CPI measures of consumer prices:

“The scope of the PPI for personal consumption includes all marketable output sold by domestic producers to the personal consumption sector of the economy. The majority of the marketable output sold by domestic producers comes from the private sector; however, government produces some marketable output that is within the PPI’s scope. In contrast to the PPI’s scope, that of the CPI includes goods and services provided by business or government when explicit user charges are assessed and the goods or services are paid for by consumers.

“The most heavily weighted item in the All Items CPI, owners’ equivalent rent, accounts for approximately 24 percent of the overall index. Owners’ equivalent rent is the implicit rent that owner occupants would have to pay if they were renting their homes and is included in the CPI in order to capture the cost of shelter for owner-occupied housing units. The PPI for personal consumption does not include owners’ equivalent rent within its scope, because owners’ equivalent rent is not a domestically produced, marketable output.”

Inflation II: Peaking Wage Inflation? Investors were unsettled on Thursday by November’s wage growth tracker (WGT) released by the Federal Reserve Bank of Atlanta. There was no evidence that WGT is moderating, though it does seem to have peaked. The non-smoothed WGT peaked at a record-high 7.4% during June (*Fig. 14*). It has been hovering around 6.3%-6.5% for the past five months through November. There are more signs of moderation in average hourly earnings for production and nonsupervisory workers; its reading was 5.8% y/y during November.

November’s WGT showed that job switchers saw their pay rise 8.1%, while job stayers had a 5.5% increase (*Fig. 15*). This significant differential certainly explains the remarkable turnover in the labor markets, with record and near-record highs in quits, job openings, and hirings over the past year. That’s weighed on productivity, which has also boosted labor costs, fueling the wage-price spiral.

Nevertheless, the spiral may be starting to decelerate. The Bureau of Labor Statistics reported last Wednesday that unit labor costs in the nonfarm business sector increased 2.4% (saar) during Q3, reflecting a 3.2% (!) increase in hourly compensation and a 0.8% increase in productivity. Unit labor costs increased 5.3% y/y during Q3, which suggests that inflationary pressures on the CPI peaked during Q2 (*Fig. 16*).

Calendars

US: Mon: Federal Monthly Budget -$248.5b; Consumer Inflation Expectations. **Tues:** Headline & Core CPI 0.3%m/m/7.3%y/y & 0.3%m/m/6.1%y/y; API Crude Oil Inventories. (DailyFX estimates)

Global: Mon: UK GDP -0.4%m/m/1.4%y/y; UK NIESR GDP Tracker; UK Headline & Manufacturing Industrial Production 0.0%m/m/-2.8%y/y/0/0%m/m/-5.4%y/y; UK Goods Trade Balance -£16.56b; Japan Machine Tool Orders; Australia Westpac Consumer Confidence; Macklem. **Tues:** Eurozone Economic Sentiment Index -26.4; Germany CPI; Italy Industrial Production -0.5%; UK Employment Change & Unemployment Rate –

17k/3.7%; UK Average Earnings Including Bonus 6.2% 3mo/yr; Japan Machinery Orders 2.6% y/y; Japan Tankan Survey; Japan Industrial Production -2.6%; China New Yuan Loans; UK Financial Stability Report; EU Energy Ministers Meeting; Lowe. (DailyFX estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index fell 3.5% w/w, nearly dropping back into a bear market again at 19.2% below its record high on December 27, 2021. The US MSCI ranked 42nd of the 48 global stock markets that we follow in a week when just 13 of the 48 countries rose in US dollar terms. The AC World ex-US index fell 0.3% w/w, but ended the week still in a bear market at 20.3% below its June 15, 2021 record high. BIC was the best regional performer, with a gain of 2.9%, followed by EM Asia (1.4%) and EAFE (-0.2). EMEA (-4.0) was the worst performing region last week, followed by EM Latin America (-3.6), EM Eastern Europe (-1.0), and EMU (-0.4). Egypt was the best-performing country last week, with a gain of 9.9%, followed by China (6.8), Hong Kong (6.7), and Sri Lanka (5.2). Among the 30 countries that underperformed the AC World ex-US MSCI last week, Argentina's 8.5% decline was the biggest, followed by those of Indonesia (-5.4), Hungary (-5.2), Mexico (-3.9), and Brazil (-3.9). The US MSCI's ytd ranking fell five places w/w to 32/49. After leading since July, the US MSCI's ytd decline of 18.8% is now more than the AC World ex-US's 16.7% drop. EM Latin America is up 0.7% ytd; it and EAFE (-15.3) are the only regions that have outperformed the AC World ex-US on a ytd basis. The regional laggards: EM Eastern Europe (-83.7), EMEA (-38.0), BIC (-21.6), EM Asia (-20.5), and EMU (-18.1). The best country performers so far in 2022: Turkey (67.2), Jordan (20.9), Chile (19.1), and Peru (12.2). Apart from Russia—in which investors have lost 100.0% of their investment this year, as its MSCI index stopped pricing—here are the worst-performing countries ytd: Sri Lanka (-62.6), Pakistan (-42.7), Hungary (-36.7), and Poland (-33.0).

S&P 1500/500/400/600 Performance (*link*): All three of these indexes moved lower w/w, but avoided falling back into a bear market. LargeCap fell 3.4% w/w, less than the declines for MidCap (-4.1%) and SmallCap (-4.7). LargeCap finished the week at 18.0% below its record high on January 3; MidCap is 15.2% below its record high on November 16, 2021; and SmallCap is 19.1% below its November 8, 2021 record high. Just one of the 33 sectors moved higher for the week, down from 24 rising a week earlier. SmallCap Utilities was the best performer, with a gain of 0.8%, followed by MidCap Utilities (-0.1), LargeCap Utilities (-0.3), LargeCap Health Care (-1.3), and LargeCap Consumer Staples (-1.8). SmallCap Energy (-13.4) was the biggest decliner for the week, followed by MidCap Energy (-11.2), LargeCap Energy (-8.4), SmallCap Communication Services (-6.2), and SmallCap Materials (-5.8). In terms of 2022's ytd performance, LargeCap's 17.5% decline continues to trail those of MidCap (-13.1) and SmallCap (-15.3). Four of the 33 sectors are positive so far in 2022, down from seven a week earlier. Energy continues to dominate the top performers: LargeCap Energy (48.9), SmallCap Energy (33.2), MidCap Energy (28.7), MidCap Consumer Staples (1.1), and LargeCap Utilities (-1.6). The biggest ytd laggards: LargeCap Communication Services (-38.6), SmallCap Communication Services (-33.6), LargeCap Consumer Discretionary (-33.0), SmallCap Real Estate (-29.7), and MidCap Real Estate (-27.1).

S&P 500 Sectors and Industries Performance (*link*): All 11 S&P 500 sectors fell last week, and seven outperformed the composite index's 3.4% decline. That compares to a 1.1% gain for the S&P 500 a week earlier, when nine sectors rose and four outperformed the index. Utilities was the best performer, albeit with a decline of 0.3%, followed by Health Care (-1.3%), Consumer Staples (-1.8), Real Estate (-1.9), Industrials (-3.2), Materials (-3.3), and Tech (-3.3). Energy was the worst performer with a decline of 8.4%, followed by Communication Services (-5.4), Consumer Discretionary (-4.5), and Financials (-3.9). The S&P 500 is down 17.5% so far in 2022, with seven sectors ahead of the index and just one in positive territory. The best performers in 2022 to date: Energy (48.9), Utilities (-1.6), Consumer Staples (-1.9), Health Care (-2.4), Industrials (-6.6), Materials (-10.9), and Financials (-12.0). The ytd laggards: Communication Services (-38.6), Consumer Discretionary (-33.0), Real Estate (-26.2), and Tech (-25.3).

S&P 500 Technical Indicators (*link*): The S&P 500 fell 3.4% last week and weakened relative to its 50-day moving average (50-dma) and its 200-day moving average (200-dma). The index was above its 50-dma for a fifth straight week, but moved back below its 200-dma after moving above a week earlier for the first time in 34 weeks. It had been above its 200-dma for 81 straight weeks through early February. The S&P 500's 50-dma moved higher for a third straight week as the index dropped to a four-week low of 2.2% above its rising 50-dma from a 15-week high of 6.6% above a week earlier. That compares to a recent 15-week low of 10.6% below at the end of September, a 23-month high of 8.7% above the index's rising 50-dma the week in early August, and a 27-month low of 11.1% below its falling 50-dma in mid-June. The index had been mostly trading above its 50-dma from late April 2020 to early April 2022; in June 2020, it was 11.7% above, which was the highest since its record high of 14.0% in May 2009. That compares to 27.7% below on March 23, 2020—its lowest reading since it was 29.7% below on Black Monday, October 19, 1987. The price index closed Friday at 2.3% below its falling 200-dma, down from a 35-week high of 0.9% above its falling 200-dma a week earlier. That's well above its 26-month low of 17.1% below its falling 200-dma in mid-June and down sharply from 10.8% above its rising 200-dma in November 2021. That also compares to 17.0% above in December 2020, which was the highest since November 2009 and up from the 26.6% below registered during the Great Virus Crisis on March 23, 2020—the lowest reading since March 2009. At its worst levels of the Great Financial Crisis, the S&P 500 index was 25.5% below its 50-dma on October 10, 2008 and 39.6% below its 200-dma on November 11, 2008. The 200-dma fell for a 31st straight week, but its pace of decline has slowed recently from its fastest rate since July 2009.

S&P 500 Sectors Technical Indicators (*link*): Eight of the 11 S&P 500 sectors are trading above their 50-dmas, down from all 11 sectors above a week earlier as Communication Services, Consumer Discretionary, and Energy moved back below in the latest week. Ten sectors now have a rising 50-dma, up from nine a week earlier as Utilities turned back up w/w. That leaves Consumer Discretionary as the only sector with a falling 50-dma. Looking at the more stable longer-term 200-dmas, these six sectors continue to trade above that measure: Consumer Staples, Energy, Financials, Health Care, Industrials, and Materials. For perspective, at the depths of the Great Virus Crisis in April 2020, Health Care was the only sector trading above its 200-dma. Energy and Health Care are the only two sectors with a rising 200-dma, down from five sectors a week earlier. The 200-dma turned down w/w for the Consumer Staples, Industrials, and Utilities sectors.

US Economic Indicators

Producer Price Index (*link*): November's final demand PPI was larger than expected, while October's 0.2% increase was revised up to 0.3%, though the underlying trend in inflation continues to moderate. November's PPI rose 0.3%, matching gains posted in both October and September, with the yearly rate easing for the seventh month since reaching a record-high 11.7% in March, slowing to an 18-month low of 7.4% last month. Meanwhile, core prices—which excluded food, energy, and trade services—advanced 0.3%, fluctuating between 0.2% and 0.3% the past six months, with the yearly rate easing from a record-high 7.1% in March to a 19-month low of 4.9% in November. *Final demand goods* increased for the third month, though November saw an uptick of only 0.1%—slowing from October's 0.6%—as a big jump in vegetable prices was tempered by a drop in gasoline prices. The yearly rate eased to a 20-month low of 9.7%, down from June's record high of 17.6%. In the meantime, *final demand services* increased 0.4%, following gains of only 0.1% and 0.2% the prior two months, with the yearly rate slowing to a 17-month low of 5.9% after peaking at a record high of 9.4% in March. The PPI for *personal consumption* rose 0.3%, with an average monthly gain of 0.1% over the past five months, down from 0.9% during the first half of the year. The yearly rate has eased steadily from March's 10.4% record high, falling to 6.7% by November—the lowest since March 2021. The yearly rate for *personal consumption excluding food & energy* eased to a 13-month low of 5.5%, down from March's record high of 8.1% in March. Looking at *pipeline prices*, pressures remain elevated, though have slowed from recent highs. The yearly rate for intermediate goods prices eased to a 20-month low of 7.6% from a cyclical high of 26.5% last November, while the crude goods rate also slowed dramatically to 3.0% y/y from its recent peak of 50.7% in June; it was at 59.0% last April—which was only a tick below its record-high 59.1% in August 1973.

Consumer Sentiment Index (*link*): Consumer sentiment beat forecasts this month, while inflationary pressures eased, according to mid-month readings. The headline consumer sentiment climbed 2.3 points to 59.1 (vs 56.5 expected) in mid-December, reversing roughly three-quarters of November's 3.1-point fall—from a six-month high of 59.9 to 56.8—though remained low from a historical perspective. Joanne Hsu, director of the survey, noted "gains in the sentiment index were seen across multiple demographic groups, with particularly large increases for higher-income families and those with larger stock holdings, supported by recent rises in financial markets." The *expectations component* rebounded 2.8 points in mid-December to 58.4 after falling the prior two months by 2.4 points (to 55.6 from 58.0), while the *present situation component* recovered 1.4 points to 60.2 from November's 6.8-point plunge (58.8 from 65.6). The *one-year expected inflation rate* eased to a 15-month low of 4.6% in mid-December, down from its recent high of 5.4% in March and April but still well above the 2.5% reading in December 2020. The *five-year expected inflation rate*, at 3.0%, has remained within the narrow (though elevated) 2.9%-3.1% range for 16 of the last 17 months.

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