TALKING POINTS

FRIDAY, NOVEMBER 11, 2022

THE WEEK

- Better than expected October inflation numbers gave the stock and bond markets something to rally on.
  - By the numbers:
    - Headline CPI: +7.7% year-over-year, +.4% month-over-month.
    - Core CPI: +6.3% y-o-y, +.3% m-o-m.
  - Select category inflation:
    - Fuel oil: +68%; Gas Utilities: +20%; Transportation: +15%; Electricity: +14%; Groceries: +12%; Restaurants: +8.5%; Shelter: +7%
- Market reaction was jubilant, but have the facts here changed?
  - Inflation of course remains elevated and, though goods inflation is declining (it's still above 5%), services inflation continues to rise (see chart below).
    - Services inflation is stickier than goods inflation and it is less responsive to the Fed's rate hikes. It is also closely tied to labor markets and wages...both of which show persistent strength.
  - Two Fed Presidents who are also on the Fed Funds rate hiking committee spoke yesterday (George and Mester). Both mentioned the importance of maintaining "tightening" financial conditions: this means higher interest rates and lower stock prices. Today's market action, which has seen the ten year yield fall 32 basis points in a single day and the S&P 500 gain 5.5%, flies in the face of the Fed's desired outcome.
    - Cleveland Fed President Loretta Mester, yesterday (after release of CPI numbers): "Given the current level of inflation, its broad-based nature, and its persistence, ***I believe monetary policy will need to become more restrictive and remain restrictive for a while.***"
- Recall what Chairman Jerome Powell said at Jackson Hole: "A single month's improvement falls far short of what the Committee will need to see before we are confident that inflation is moving down."
- The stock market rewarded the year's losers yesterday (growth stocks, post-IPOs, most-shorted names).
- The internals are improving: over 80% of S&P 500 stocks are trading above their 50-day moving average and about 50% are above their 200-day moving average.
  - We are closely watching these to determine whether this latest rally proves durable.
  - Tellingly, the number of stocks hitting new lows outpaced the number of stocks hitting new highs again yesterday for the 59th straight trade day.

KEY TAKEAWAYS

⇒ The trend is your friend but a single bear market gangbusters day does not yet make a trend.
⇒ Inflation is going the right direction but remains high and stubborn (see median CPI chart).
⇒ The Fed is standing firm; the rising interest rate headwinds aren't shifting.
⇒ The software is monitoring prices closely to discover and allocate toward durable trends.

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MARKET CHARTS

EXHIBIT 1 - SERVICES INFLATION RISING

- Note that as goods inflation decelerates, services inflation (stickier, less responsive to interest rate hikes) continues to rise.

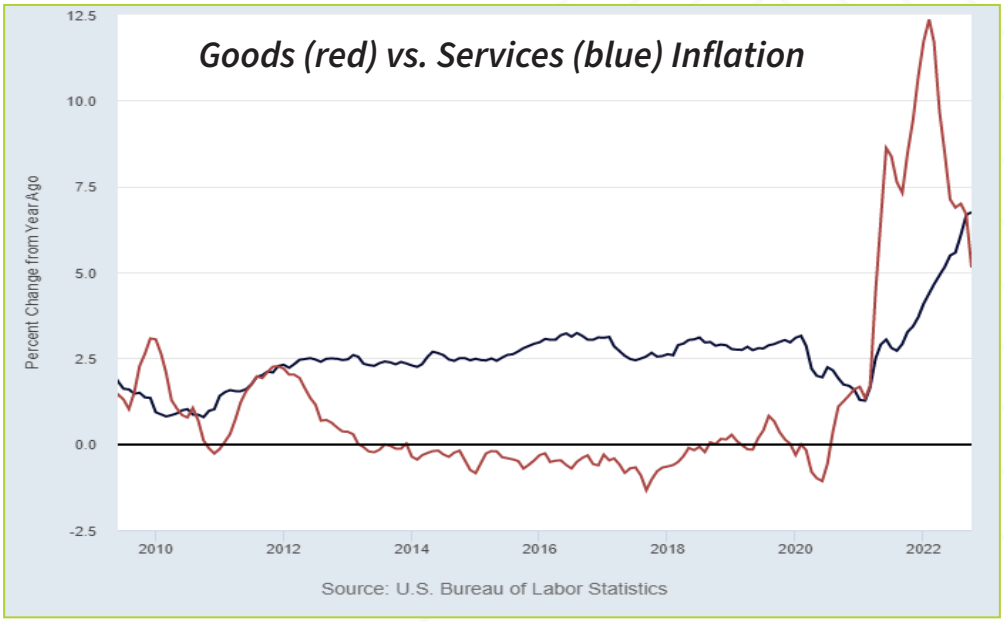
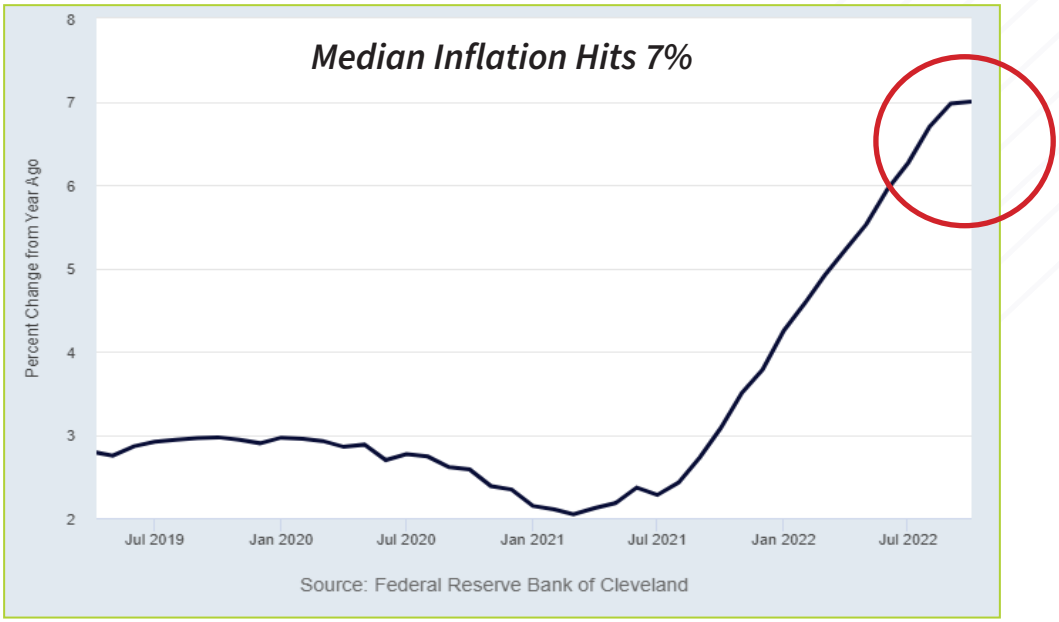


EXHIBIT 2 - MEDIAN INFLATION STILL RISES, PACE SLOWING

- The Cleveland Fed's Median Inflation reading shows the price change that's right in the middle of all other price changes. This number continues to set records (before this year the highest median inflation got was 4.8 in 1990 when Core CPI was 5.5). Underlying inflation remains strong.



MARKET CHARTS

EXHIBIT 3 - BREADTH IMPROVING

- Here we see the percentage of stocks in the total stock market that are trading above their 200-day moving average. Currently at 42%, it's higher than the summer rally but still below the late-March rally.

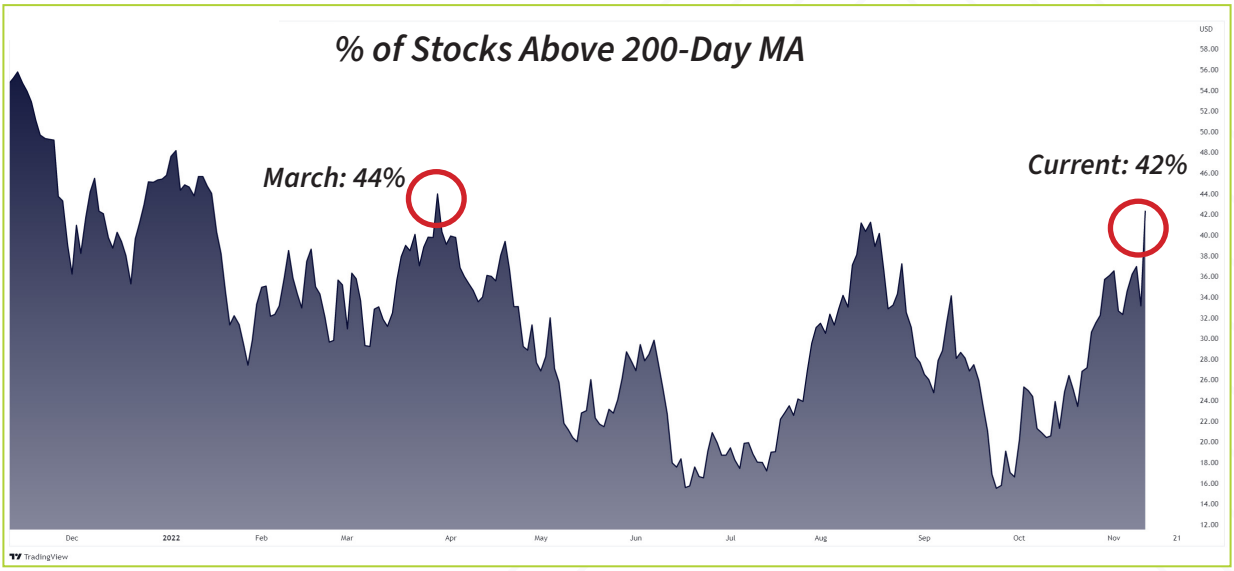


EXHIBIT 3 - DECLINERS STILL OUTPACE ADVANCERS

- However, the number of stocks hitting new lows has outpaced the number of stocks hitting new highs for 59-straight trade days. Underlying weakness remains.



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