Investment Solutions

HIGHTOWER MARKET NOTE

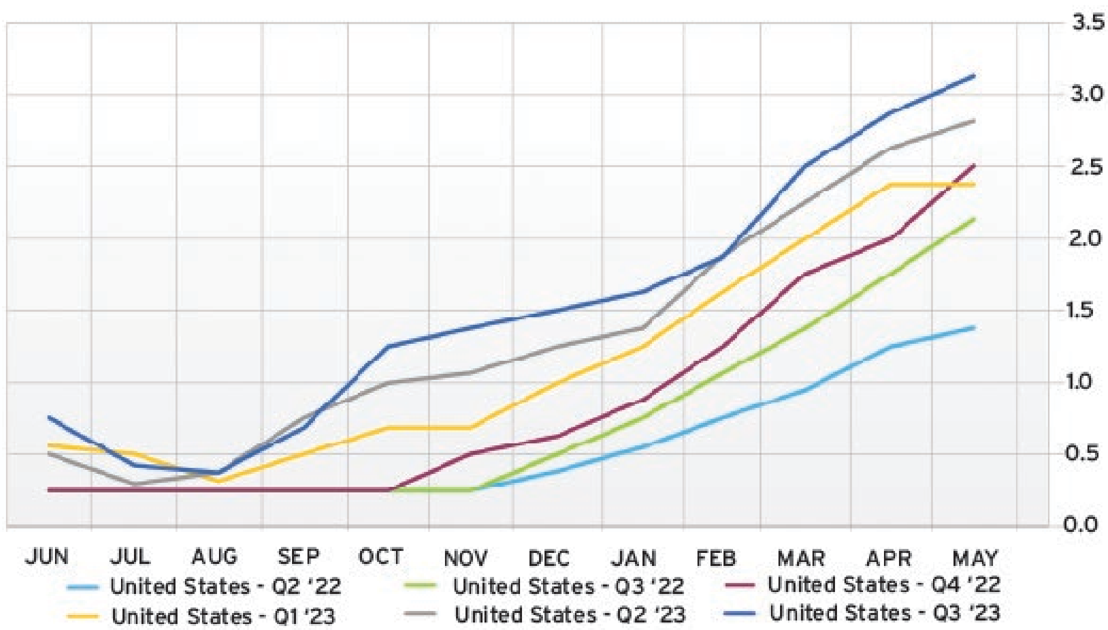
with Stephanie Link

Mixed Economic Signals, but the Fed Still Needs to Act

Week of June 6, 2022

1. **Our Base Case: Three More 50 bps Hikes.** Fed Vice Chair Lael Brainard indicated a likelihood for two more 50 bps rate hikes and then analyzing the data. The Fed is "laser-focused" on inflation and not making any comments on the likelihood of recession. This indicates aggressive tightening ahead. Considering the Fed's aggressive mandate and the expectation that inflation will remain elevated, three more sets of 50 bps rate hikes is our base case. Brainard also said that it is "very hard to see the case for a pause [in rate hikes]."

Chart 1: Policy Rate Consensus Trends[1]



[1] Source: FactSet (chart)

We expect the choppiness in markets to continue as uncertainty prevails – between the Fed, inflation and the geopolitical arena. The VIX, despite having declined over the past month, remains above its 200-day moving average – an indication of elevated volatility in markets.

2. **Econ Data Showing Mixed Signals: Strong Jobs Demand, Strong Inflation.** May ISM figures reported the 24th consecutive month of expansion. Expansion was driven by new orders, backlog and deliveries growth, and higher prices. A continued consumer-demand shift from goods to services was apparent in ADP employment figures and the nonfarm payrolls (NFP) report. Many service industries expanded hiring in May, while goods employment, although slowing, remains elevated from its pre-pandemic levels. We're rooting for services to do well as services is two-thirds of U.S. consumption.

   In the NFP report, the U.S. economy added 390,000 jobs in May, which was stronger than expectations. Job growth was highlighted within education and health services, leisure and hospitality, professional and business services, and transportation and warehousing. Within the goods sector, construction jobs were up strongly. Wages rose 5.2% y/y, which remains well above the long-term average and continues to add to elevated inflation. Earlier in the week, the Unit Labor Cost report also showed higher than average wages of 12.6% y/y. The Federal Reserve pays particular attention to this report, and it is higher than what they'd like to see.

   In addition to the strong NFP report, the Challenger Gray & Christmas jobs cuts report highlighted that layoffs were down 16% y/y in May, underscoring widespread job demand – though the tech sector diverged from the broader group and increased job cuts.

Chart 2: Hiring Continues Along with Higher Unit Labor Costs[2]

[2] Source: FactSet (chart)

3. **<u>Ominous Predictions from CEOs.</u>** Elon Musk (Tesla CEO) and Jamie Dimon (JP Morgan CEO) both made high-profile negative comments last week regarding the economic backdrop. Musk has a "super bad feeling" about the economy and announced labor cuts, while Dimon warned of an economic "hurricane […] coming our way."[3] Offsetting these comments was Brian Moynihan (Bank of America CEO) who downplayed the "hurricane" comments saying, "we're in North Carolina, you've got hurricanes that come every year."

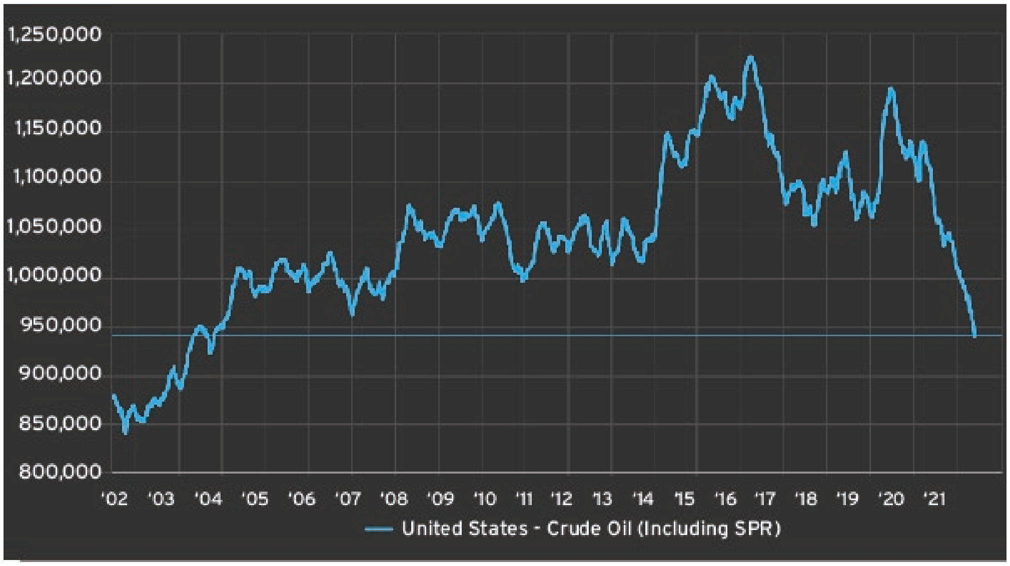
   We are not predicting an economy-wide recession, but there are certainly pockets that are slowing. The tech sector is experiencing layoffs and hiring freezes, and we'll continue to monitor the impact that sustained inflation is having. We also are laser focused on the consumer after several high-profile retail companies missed numbers and guided lower. The offset here is that the services companies (travel, restaurant, hospitality), led by the airlines, have raised earnings estimates.

4. **<u>OPEC+ Raises Production Quota, but Actions Speak Louder than Words.</u>** Last week's meeting between members of OPEC+ resulted in an agreement to raise monthly quotas by 648,000 barrels per day (bpd) through August. Despite this promise, OPEC+ is underdelivering on its current monthly quota of 542,000 bpd due to limited capacity. The agreement also includes Russia, which has seen production decapitated because of the sanctions. Russia's oil production is expected to fall about 8% this year.[4] Saudi Arabia, one of the only countries with spare capacity, is hesitant to invest in additional production for the same reasons as many oil and gas corporations – preference for shareholder returns and an improving balance sheet.

   Oil supply remains tight, and last week both crude and gasoline stockpiles fell. Domestic crude oil inventory is at its lowest level since 2004, while the price of WTI crude oil is up nearly 60% year-to-date.

Chart 3: Crude Oil Inventories Steeply Down[5]

[3] Source: CNBC
[4] Source: Wall Street Journal
[5] Source: FactSet (chart)



5. **Fixed Income Inflows.** Municipals made headlines last week, as Lipper reported the first inflows since February 9th, and economists do expect this to become a trend. Municipal yields ended the shortened week 7-9 bps higher on the short end while the long end saw less movement, rising only 4-6 bps. Treasuries sold off throughout the week, as the 2-yr finished 10 bps higher and the 10-yr 9 bps higher, albeit still below the 3% mark. Corporate spreads remained relatively unchanged, seeing a 2-bps widening in High Yield and an unchanged Investment Grade spread.

6. **The Week Ahead.**
   Econ – Friday: CPI (May).

Stephanie Link: CNBC TV Schedule

DATE	SHOW	TIME
Monday, June 6	Power Lunch	1:00 PM ET
Tuesday, June 7	Half Time	12:00 PM ET
Wednesday, June 8	Squawk Box	6:00 AM ET (time to be determined)
Thursday, June 9	Closing Bell: Overtime	4:00 PM ET

Return for Selected Indices[6]

[6] Source: Bloomberg

		% CHANGE		
Index Name	End of Week	Week	Month	YTD
S&P 500 INDEX	4,109	-1.15%	-4.25%	-13.23%
NASDAQ COMPOSITE	12,013	-0.95%	-7.21%	-22.94%
DOW JONES INDUS. AVG	32,900	-0.83%	-3.06%	-8.62%
RUSSELL 1000 INDEX	2,259	-1.14%	-4.46%	-14.10%
RUSSELL 2000 INDEX	1,883	-0.23%	-3.29%	-15.72%
FTSE 100 INDEX	7,533	-0.57%	0.95%	3.88%
HANG SENG INDEX	21,082	2.07%	1.75%	-8.92%
NIKKEI 225	27,762	3.66%	3.52%	-2.63%

				% CHANGE		
Index Name	YTW	Spread	Duration	Week	Month	YTD
U.S. TREASURY	2.91%		6.55	-0.97%	-0.25%	-8.71%
U.S. AGGREGATE	3.47%	+56 bps	6.71	-0.88%	0.17%	-9.28%
U.S. CORPORATE INV. GRADE	4.31%	+140 bps	7.96	-0.85%	0.33%	-12.30%
U.S. CORPORATE HIGH YIELD	7.21%	+430 bps	4.76	-0.35%	0.02%	-8.37%
U.S. MUNICIPAL BOND INDEX	2.89%		5.39	0.32%	2.00%	-7.30%

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