

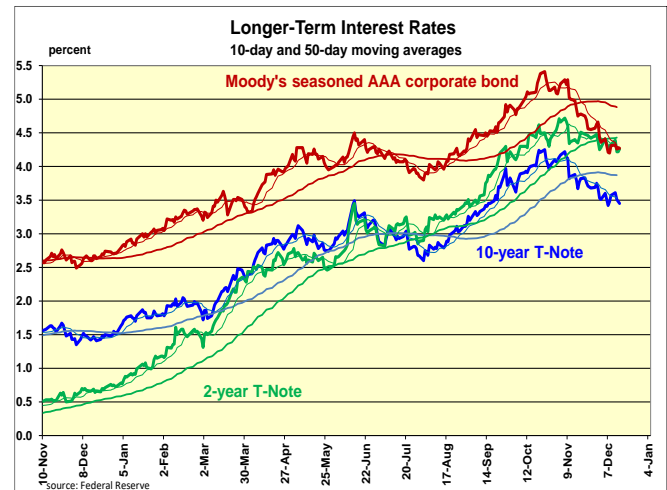
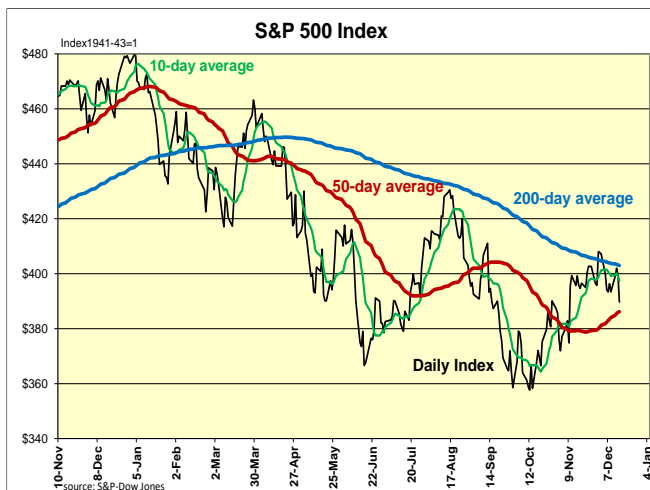


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December 16, 2022

8:30 AM ET

		<u>Fundamental</u>	<u>Actual</u>	<u>Outlook</u>
Fixed-income:	10-yr Treasury rate	5.5	3.4	heading higher
Equities:	S&P 500	3,200	3897	under pressure



## Market Outlook

After reaching major technical resistance at 4100, stocks have turned sharply lower. The S&P500 is down 5% from its recent high and 19% from its all-time high. Potential support now is at 3860.

Unlike previous setbacks, which were often accompanied by higher interest rates, the latest downward move in stocks has been with a combination of higher short-term rates and lower longer-term rates.

Recent financial markets reacted to both the Fed's latest comments and yesterday's economic news. Chairman Powell said the Fed raised its expectation for the peak in interest rates necessary to restore inflation to 2%.

Markets had previously anticipated a lower top in interest rates or even a pause with lower interest rates later in 2023. Markets now assume the Fed's intended policy is more likely, and the risks of a downturn in the economy are greater.

Yesterday's economic news reinforced concern of an economic downturn. November retail sales and the Fed's manufacturing index both were down at 7% annual rates. USEIA reported that fuel consumption in the last four weeks is down 7% from a year ago—another indication demand is falling.

The decline in activity we have been expecting during the first half of 2023 might be arriving sooner. However, other data still are pointing to moderate fourth quarter growth.

Stocks remain overvalued and the Fed continues draining money from the economy. With an economic downturn soon to become apparent, further downward pressure on stocks is likely.

## A Look Back

November retail sales data were reported down 0.6%. This puts November sales up only at only a 3.4% annual rate from the third quarter average. With November core inflation up at a 4.3% pace, real retail sales in the fourth are down close to 1%.

## Forces Impacting the Near-term Outlook for Stock Prices

Economic Fundamentals: **negative**  
Monetary Policy: **restrictive**

Stock Valuation: **over-valued 22%**  
Recommended Stock Exposure: **20%**

Retail sales data are highly erratic and subject to substantial revisions. However, the Fed's November measure of manufacturing output was also down by about the same amount.

The good news this past week was for November's CPI—up 1% with core inflation up 2½%, annualized. Compared to the third quarter, November inflation was up at 4.3% annualized, while the year-over-year increases were 6% to 7%.

Despite two months of lower inflation, the Fed cautioned against becoming too complacent. They also raised their estimates for inflation in 2023 as well as their expectation for the fed funds rate. They also lowered their growth estimates. The Fed currently expects the fed funds rate to peak at between 5.1% and 5.4% this coming year.

The Fed's latest estimates now are consistent with our forecast of persistent inflation and the need for more interest rates hikes. From our perspective Powell said all the right things.

Other economic numbers remain mixed. The Fed of Atlanta model uses current economic data to estimate real growth. The data show fourth quarter real growth at a 2.8% annual rate.

Weekly unemployment reports were little changed. The labor market is a lagging indicator and will be the last market to point to a downturn in the economy.

### The Week Ahead

Later this morning S&P will report its advance estimate of business activity in early December. In contrast to other data, S&P's estimates show the economy declining in the three months ending in November. It will be interesting to see if there is any change in their December survey.

On Monday, Homebuilders report on early December housing activity. We expect they will report a low reading close to November's 33.

The most important upcoming is Thursday's report on November consumer spending, wages, and inflation. We expect current dollar spending and income growths to remain in the vicinity of 5%, with consumer inflation in the 4% vicinity.

### The Lighter Side of Political Economy

**Elon Mush Buys Santa's Workshop, Releases Emails Showing How Naughty and Nice Lists Were Created—Babylon Bee**



**We wish you a Merry Christmas, Happy Hanukkah and all-around good time with family and friends. There will be no scheduled report this coming week. Relax and enjoy the holidays.**

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