The Weekly Market Update – 10/17/22: September CPI Data = More Rate Hikes

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	3,583.07	-1.55%	-0.07%	-24.82%	-16.82%	4,796.56	33.9%
Dow Jones Industrial Average	29,634.83	1.15%	3.17%	-18.45%	-12.44%	36,799.65	24.2%
NASDAQ Composite	10,321.39	-3.11%	-2.40%	-34.03%	-28.56%	16,057.44	55.6%
Russell 2000	1,682.40	-1.16%	1.06%	-25.07%	-23.68%	2,442.74	45.2%
MSCI EAFE (USD)	1,670.64	-1.35%	0.55%	-28.49%	-26.77%	2,398.71	43.6%
MSCI Emerging Markets (USD)	863.33	-3.83%	-1.42%	-29.93%	-31.10%	1,444.93	67.4%
Bloomberg Commodity Index	113.67	-2.96%	1.95%	14.62%	12.81%	237.95	109.3%
Barclays U.S. Aggregate Bond	86.29	-1.23%	-1.62%	-17.61%	-18.21%	112.07	29.9%

Source: FactSet

September's Consumer Price Index (CPI) was hotter than expected, adding to investor concerns that measures to slow inflation will create deeper economic challenges. According to the Bureau of Labor Statistics (BLS), the September CPI (a widely followed measure of consumer inflation) report reflected headline inflation of 8.2% year-over-year (Y/Y, vs. September 2021) and up 0.4% from the prior month, August (M/M). Both readings were higher than expected, despite lower M/M gasoline prices down 4.9% from August. Multiple categories added to CPI gains, including food, home utilities, shelter, medical care, insurance, and airline fares. While the headline number of 8.2% has declined for three consecutive months from the 9.1% Y/Y peak in June 2022, a sustained larger decline has been elusive. Core CPI, which excludes food and energy, increased 6.6% Y/Y and 0.6% M/M. The core CPI numbers were also higher than expected, and deeper analysis revealed unfavorable trends from previous months. This included the highest monthly Y/Y increase in 2022, and up from June's 5.9% price gain. The 0.6% M/M increase matched the highest increase in the past four months. Driving the accelerating core CPI data were shelter (rent and owners' equivalent rent) up 0.7% M/M and 6.6% Y/Y, and medical care services, up 1.0% M/M and 6.5% Y/Y. As recently as April 2022, the Y/Y price increases for shelter and medical care were 5.1% and 3.5%, respectively. This bears watching, as price changes in those categories are considered "sticky," meaning that changes move slowly, so the recent trend of higher Y/Y prices creates headwinds for lower core CPI readings in the months ahead. There was some good news in the September CPI report, as several goods-related categories showed lower prices M/M. This included apparel, footwear, window coverings, furniture, appliances, and used cars. In addition, despite the overall rise in food prices, notable M/M price declines included ground beef, pork chops, eggs, and milk. In our view, while headline inflation levels appear to have peaked in June, and should continue to fall, the pace of improvement is slow, and still-high core CPI data is likely to lead to ongoing interest rate increases from the Federal Reserve Bank (Fed).

The fed funds futures market is positioned for two additional 0.75% interest rate hikes before year-end. The primary tool used by the Fed to fight inflation is to increase its fed funds overnight bank lending interest rate target. Following rate increases at five consecutive Fed Open Market Committee (FOMC), the low end of the target range has moved to 3.00% currently from 0.0% at the end of 2021. The target was raised 0.75% at the three most recent meetings, and two more meetings are scheduled in 2022 (ending 11/2/22 and 12/14/22, respectively). According to the CME Group's CME FedWatch Tool, which analyzes the futures market to assess investor expectations, as of 10/17/22 the market reflects a 95% chance of a 0.75% rate hike on 11/2/22, and a 67% chance of 0.75% on 12/14/22 as well. This would put the 2022 year-end fed funds rate at 4.50%, a level in our view that is likely to slow the economy's growth potential.

Third quarter (3Q22) earnings season begins to heat up this week with 64 S&P 500 index constituents scheduled to report financial results. After some lowering of consensus expectations in recent weeks, 3Q22 S&P 500 earnings are estimated (per FactSet as of 9/30/22) to increase 2.6%. This would be the lowest quarterly Y/Y growth rate in eight quarters (since 3Q20), but continued earnings growth indicates that companies are navigating through challenges caused by inflation, ongoing supply chain disruptions (especially in China), and war in Ukraine. Of importance to investors will be corporate outlooks for 4Q22 and 2023.

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