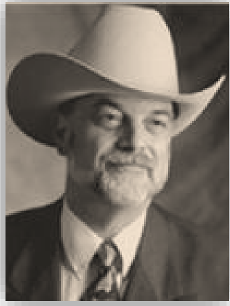

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TPWC Market and Economic Update

The Markets

Our dear old S&P 500 Stock Index (SPX) took a breather this week after its rather spectacular two-week runup as the year began. After breaking through the 4000 level on Tuesday morning and topping out around 4010 early Wednesday, it sagged back down below 3900 on Thursday on news that some bank earnings were lower than expected and December retail sales were reported down. From there forward it climbed steadily as solid economic news filtered in to close out the third week of 2023 at 3972.61, down 0.66% for the week but still up 3.47% so far this year. Of course, that rise still leaves the SPX down over 17% from its high last year and off 9.67% from a year ago. For perspective, the Index is up about 11% from its recent low in mid-October, up about 76% from March of 2020, and up about 21% from where it was three years ago. Our other followed index, the CRSP Mid-Cap Value Index, fell 1.4% for the week to close at 2427.77, but is up 3.77% so far this year. It is still 6.53% lower than its record high set back in January 2022 and is down 2.45% from one year ago.

The benchmark yield on the 10-year U.S. Treasury note rose early in the week, sagged mid-week, but finished about where it was last week, yielding 3.48%. The Treasury yield curve remains decidedly inverted with the 6-month T-Bill still carrying an annualized rate of 4.80%. Oddly, the 10-year note has the lowest yield of all the reported maturities. That "kink" in the yield curve has led some to suspect that the Federal Reserve may be intentionally depressing the 10-year yield as part of its actions to slow economic activity. West Texas Intermediate crude oil prices soared and slumped in time with the market and interest rates and ended the week at $81.40, up 1.74% but still $40 lower than it was in June of last year and $45 higher than it was in May of 2020.

The Economy

The market sag mid-week appeared to be largely a result of the Commerce Department report that Retail Sales, a measure of purchases at stores, restaurants, and online, fell a seasonally adjusted 1.1% from November to December. Adding to the gloom was a revision in the November numbers to show a 1% decline from October. The key to understanding those numbers though is not to be seen in looking at one or even two months. Total retail sales were up 9.2% for the year 2022 and up 6.2% from December of 2021. What looked to the market and casual observers like a potential decline in consumer purchases that might signal a coming recession was in fact merely a reversion to the mean. Neither retail purchasers nor the retail infrastructure could support a 9.2% increase in sales for more than a short period of time. That 9.2% increase in retail sales in 2022 reveals one of the prime underlying causes of the inflation rate we have seen over the same period. 2022 will largely be noted in economic history as the year consumers in the United States rebounded from the depressed economic activity they displayed during the pandemic.

In our opinion, the decline in retail sales we saw in November was first simply a return to historically normal behavior, and second, a result of the inflation scare that emerged in late summer and early fall. When purchasers perceive that prices are going to rise significantly, they tend to make purchases earlier, using savings or if necessary, credit. As soon as they perceive that prices are stabilizing, they tend to slow purchases and take some time to digest what they have already bought. The opposite of that is when purchasers sense deflation coming. Then, they defer making purchases, anticipating they will be able to get the same goods or services at a lower price in the future. That, incidentally, is why deflation is extremely dangerous. If people defer purchases because they perceive there is a risk that they will not have

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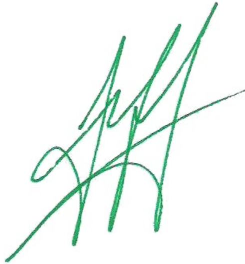
adequate income in the future, that causes businesses to lose money, and lay workers off. That, in turn, reduces consumer demand, causing further deflation. Down that road lies severe recessions and even depressions.

On the goods side of the economy, industrial production fell 0.7% from November to December, after falling 0.6% in November. Again, it appears that the decline may be just a return to normal from our previously unsustainable high levels. Meanwhile the Producer Price Index, the measure of wholesale prices, declined 0.5% in December, providing further evidence that inflation on the goods side of our economy is halted and appears to be reversing. Meanwhile, the ISM Services Purchasing Managers Index came in at 49.6, indicating that the services side of our economy has leveled off after a blistering rise over the last year.

So far, the data continue to indicate that the U.S. economy has left inflation behind and is stabilizing at a reasonable and potentially sustainable growth rate. Moody's Analytics reduced its estimate of the annualized GDP growth rate for the fourth quarter to 3.6% from an earlier 4.3%, but that is still an excellent rate of expansion. 2023 looks to be developing into a potentially bumpy slower growth year, but we still see no sign of a potential severe recession on the horizon other than in the yield curve.

Until next week we, and the always faithful TPWC Team, pledge to continue to do our best to provide the best possible fiduciary advice, service, and portfolio management to you and to do our very best to avoid conflicts as we work solely in your best interests.



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