Weekly Investment Insights

June 13, 2022

Key Takeaways:

- Wholesale inventories are improving.
- Inflation surges to highest level since December 1981.
- Consumer sentiment reaches lowest level in history.
- Global equities fall; Asia posts modest gain.
- Global yields jump on inflation concerns.
- Crude oil shrugs off OPEC+ increased production.

Weekly Economic Recap –

Consumer Sentiment Plummets as Inflation Surges

Consumer credit increased in April, but at a more subdued pace than March. However, revolving credit (e.g., credit cards) is growing at the fastest annual pace since 1997.

Wholesale sales grew at the slowest monthly pace in four months and the growth in inventories slowed. As a result, the inventory to sales ratio rose to a four-month high.

The ECB announced Thursday their plans to raise interest rates by 25 bps at its July meeting, and future hikes to come thereafter (and aggressive if needed). The announcement was paired with a downgrade of growth forecasts and upwardly revised inflation projections.

Inflation as tracked by the headline Consumer Price Index jumped at the fastest annual pace since December 1981. Shelter costs jumped 0.6% for the month, the largest one-month gain since March 2004, while the YoY gain of 5.5% is the largest since February 1991. Core CPI (which excludes volatile food/energy prices) grew 6% year over year which was the second month the year over year gain slowed.

The University of Michigan Consumer Sentiment Index plummeted to its lowest reading on record as the 1YR forward outlook on business conditions led the weakness. Nearly 40% of respondents cited inflation as their primary concern to personal finances, which has only been higher one other time in history (during the Great Recession).

Weekly Market Recap –

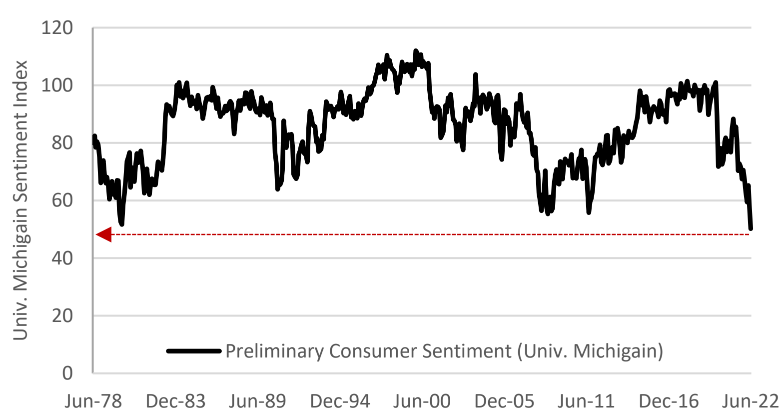
All Major Asset Classes Fall; Inflation and Central Bank Fears

Equities: The MSCI AC World Index fell for the second consecutive week as the ECB confirmed their plans to raise interest rates and U.S. inflation reached its highest level since December 1981. Developed markets significantly lagged their emerging market counterparts as macro data, specifically inflation and growth concerns fueled the sell off. All the major U.S. Indices declined but it was led large cap growth and technology.

Fixed Income: The Bloomberg Barclays Aggregate Index fell for the second consecutive week as inflation data may push the Fed to raise short term rates more aggressively. The difference between the 10YR Treasury yield and the 2YR Treasury yield narrowed to the lowest since April. High yield was the worst performing fixed income sector.

Commodities/FX: The Bloomberg Commodity Index posted a modest gain for the week led by gains in crude oil despite a large OPEC+ expected increease in production. Copper prices fell sharply on growth concerns after aggressive central bank rhetoric and fears of additional COVID restrictions in China.

Consumer Sentiment Plummets



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Past performance is not indicative of future returns

Key Takeaways:

- Flow of funds report goes unnoticed with sweltering inflation data.
- Health of corporations, consumers and the government questioned after disappointing 1Q22.
- Household net worth falls but underlying balance sheet strong.
- Corporations net worth rises.
- The second half of the year will likely be choppy.

A Closer Look into the Health of the Consumer and Corporations

While most investors were focusing on the disappointing news on inflation last week, there was another important data release that may have gone unnoticed. On a quarterly basis, the Federal Reserve releases a report called the Financial Accounts of the U.S. (AKA, the flow of funds report). This report analyzes the health of the U.S. through looking at household wealth, the health of U.S. corporations and the U.S. Government. This is a detailed report that looks at where funds are flowing, how liabilities are growing or contracting, net worth and balance sheets across these three sectors of the economy. Since the pandemic, we have seen household net worth climb to a record high (~$150 trillion, more than 600% of GDP). Corporations have paid down expensive debt and replaced it with lower rated options. In addition, we have watched the share of total debt in the U.S. be increasingly made up of Government debt. We wanted to revisit this frequently neglected report to see what the destruction from the dismal first quarter has done to the health of these areas. Below are some key takeaways from the two primary sectors (i.e., nonfinancial corporate businesses, households, and nonprofit corporations).

Household net worth falls for the first time since 1Q20:

- Household net worth which considers a household's assets (e.g., real estate, savings, investments) to its liabilities (e.g., mortgages, loans, credit cards) fell for the first time since 1Q20. Most of the weakness was due to a drop in the value of the corporate equities and corporate bonds that households own. Both fell the most since 1Q20.
- However, a household's wealth in real estate remains strong. The value in real estate rose to the highest level on record. More importantly, and to help calm fears of another housing bubble, is that owners' equity in real estate rose to a record high.
- Another sign of strength on the consumer is that deposits (includes savings and checking accounts) rose to a new record high ($18.5 trillion) in 1Q22. When you consider the amount of savings households have in relation to total liabilities, they have ~99% in savings compared to their liabilities ($18.6 trillion).

Corporate net worth rises despite tumultuous start to the year.

- Corporate net worth rose in 1Q22 to $30.1 trillion but it was the slowest quarterly gain since the pandemic (1Q20). Within the asset component, nonfinancial assets rose (i.e., real estate, equipment, intellectual property, and inventories).
- Corporations did increase traditional debt (e.g., corporate bonds, commercial paper) but they saw strong demand for traditional loans (e.g., mortgages, autos).
- Despite the strong net worth, corporate balance sheets saw two metrics change that are worth monitoring. Their debt/equity rose to a 12-month high and debt to net worth rose to a two-quarter high.

The Bottom Line:

While this report is backward looking, it is full of useful information on the health of America. Households and corporations are strong, for now. However, there are cracks emerging and if inflation does not moderate, these balance sheets will likely weaken. Specifically, the household sector whose spending can be correlated with their net wealth effect (includes house and investment prices).

Global Equities Deteriorate on Inflation and Central Bank Fears

U.S. Equities	Current	1WK	1MO	3MO	1YR	YTD
Dow Jones Industrial Average	31,393	-4.6%	-2.1%	-4.9%	-7.2%	-12.8%
S&P 500	3,901	-5.0%	-2.3%	-8.1%	-6.7%	-17.6%
Russell 1000 Growth	2,248	-5.7%	-3.5%	-12.4%	-13.6%	-26.6%
Russell 1000 Value	1,489	-4.4%	-0.7%	-4.6%	-4.1%	-9.2%
Russell Midcap	2,727	-5.1%	-0.1%	-7.4%	-12.2%	-17.3%
Russell 2000	1,800	-4.4%	2.3%	-10.2%	-21.3%	-19.4%
Nasdaq	11,340	-5.6%	-3.3%	-13.4%	-18.5%	-27.3%

International Equities	Current	1WK	1MO	3MO	1YR	YTD
MSCI AC World (USD)	620	-4.4%	-0.4%	-7.0%	-12.2%	-17.1%
MSCI EAFE (USD)	1,934	-4.6%	1.2%	-4.6%	-16.0%	-15.8%
MSCI Europe ex UK (USD)	2,053	-6.0%	0.6%	-4.7%	-20.1%	-20.7%
MSCI Japan (USD)	3,210	-2.2%	1.5%	-7.0%	-16.8%	-15.8%
MSCI UK (USD)	1,086	-4.0%	1.9%	-1.2%	-3.5%	-5.7%
MSCI EM (USD)	1,055	-0.5%	5.1%	-3.6%	-21.7%	-13.6%
MSCI Asia ex Japan (USD)	681	0.6%	6.4%	-2.6%	-21.9%	-13.1%

Fixed Income	Current Yield	1WK	1MO	3MO	1YR	YTD
U.S. Aggregate	3.8%	-1.5%	-0.9%	-6.2%	-10.6%	-10.7%
U.S. Govt/Credit	3.7%	-1.4%	-0.8%	-6.3%	-11.0%	-11.3%
U.S. 10 Year Treasury	3.2%	-1.8%	-1.2%	-9.2%	-12.5%	-13.0%
U.S. TIPS (1-10YR)	3.5%	-0.7%	0.9%	-3.8%	-0.4%	-3.4%
U.S. High Yield	7.8%	-2.3%	-0.5%	-5.5%	-8.5%	-10.5%
EM Bonds (USD)	6.7%	-1.7%	-0.3%	-5.3%	-15.9%	-14.9%
Municipal Bonds	3.0%	-1.0%	1.7%	-4.2%	-8.1%	-8.2%

Commodites	Current	1WK	1MO	3MO	1YR	YTD
Bloomberg Commodity Index	290	1.23%	8.8%	8.5%	42.9%	36.9%
Crude Oil (USD/bbl)	$118.9	1.5%	21.0%	13.8%	71.7%	56.7%
Gold ($/oz)	$1,871.6	-0.4%	1.2%	-7.8%	-2.4%	0.2%
Copper	$429.5	-5.1%	0.6%	-8.9%	-7.3%	-5.7%
Wheat	$1,084.8	-2.2%	-8.5%	3.5%	55.8%	41.0%
U.S. Dollar	104	2.5%	0.4%	5.9%	15.9%	9.7%
VIX Index	27.8	11.9%	-15.9%	-8.2%	72.4%	61.1%

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