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Economic Update

NOVEMBER 2023

Commentary

This month, the markets have celebrated the potential end of the Federal Reserve's hiking campaign. Moderating employment and inflation data have furthered hopes that the next Fed move will be to lower rates rather than bringing them higher. Both equity and bond markets have rallied significantly with the change in mindset. Equities have increased by almost 8% in November, which is just a whisker below the highs for the year and within 5% of the all-time high reached in early 2022. The 10-year Treasury note price has gained 4% on the month and is lower by approximately 50 basis points.

The latest employment report showed a slowdown in the pace of hiring and an increase in the unemployment rate. The unemployment rate has now increased by 0.5% from 3.4% to 3.9% over the past six months. The pace and magnitude of that increase has sounded alarm bells that the economy is near a recession. The Sahm rule, a popular and historically accurate recession indicator, is getting close to its trigger level. The rule states that if the three-month average unemployment rate is at least 0.5% above its low in the prior 12 months, the economy is in a recession. The rule would have been an early predictor for every recession since 1970.

Even though the absolute level of the unemployment rate remains low, increasing levels of unemployment can lead to a negative feedback loop. As workers lose paychecks, spending slows, which leads to less revenue for businesses and even fewer workers needed. The increase in the unemployment rate in this cycle has been an oddity. The number of employed people has actually increased since the unemployment rate hit its low in April. The unemployment rate has moved upwards because more people have returned to the workforce. This may mean that the Sahm rule will have less predictive power than it has in the past.

Inflation was cooler than expected. Prices were unchanged on a month-over-month basis — the lowest change since July 2022. The year-over-year change dropped from 3.7% in the previous month to 3.2%. Walmart CEO's warning of declining prices caused some to argue that overall deflation is what the economy should be worried about in the near future. This concern is overblown since Walmart is mainly impacted by one side of the inflation equation — goods inflation. It has not been uncommon for goods prices to deflate over the past few decades. In fact, goods inflation averaged 0% for the 20 years prior to COVID-19 and there were many months when goods prices declined. As opposed to goods inflation, services inflation remains positive and very unlikely to deflate any time soon.

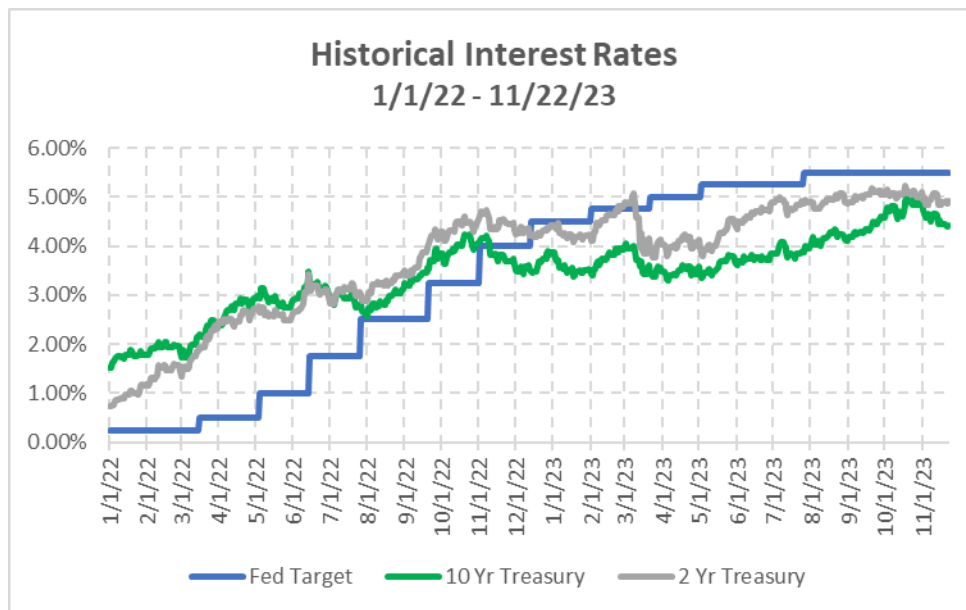
The economy has remained resilient in the face of several risks. Several leading indicators point to a recession in the near term. We believe that the weight of the significant rate increases and numerous risk factors will push the economy into a mild recession next year. A key factor is that there will be less fiscal support in 2024 compared to 2023.

THIS MONTH

- COMMENTARY
- FIXED INCOME OUTLOOK
- LABOR READINGS
- INFLATION READINGS
- CONSUMER READINGS

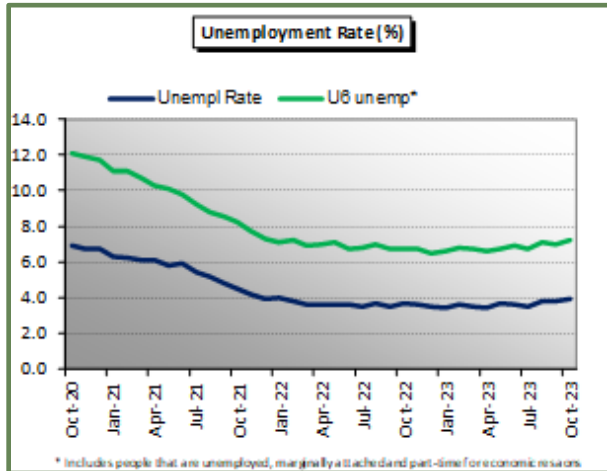
Fixed Income Outlook

Treasury yields have fallen significantly in the month of November, with the longer end of the curve declining by almost 50 basis points. The initial impetus was due to a relatively dovish Fed at the November 1 Federal Open Market Committee (FOMC) meeting. Yields were pushed even lower after weaker-than-expected labor data and softer inflation data. The market is pricing only an 8% chance of another rate hike and almost 100 basis points of rate cuts by the end of next year. This seems a little aggressive to us.



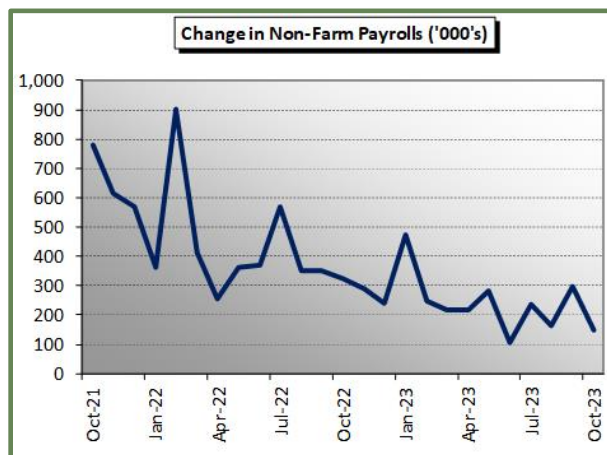
Labor Readings

(Data source: Bloomberg)



The Unemployment Rate Continues to Climb

The unemployment rate in October rose to 3.9% from 3.8% in the previous month. The market was expecting the rate to remain unchanged. The increase in the unemployment rate over the last several months is now near a level that indicates that a recession is very likely within the next few months. The underlying details of the report were weak, with a decrease in the labor force and employment.

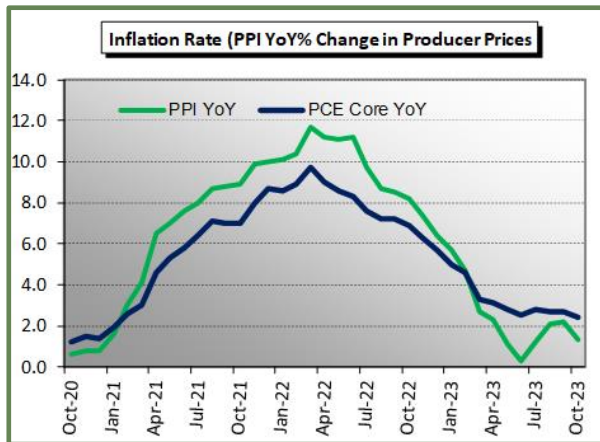


Payroll Growth Slows

Payroll growth in October was lower than expected. Jobs gained by 150,000 compared to an estimated 180,000 gain. In addition, the previous two months' job gains were revised downwards by 101,000.

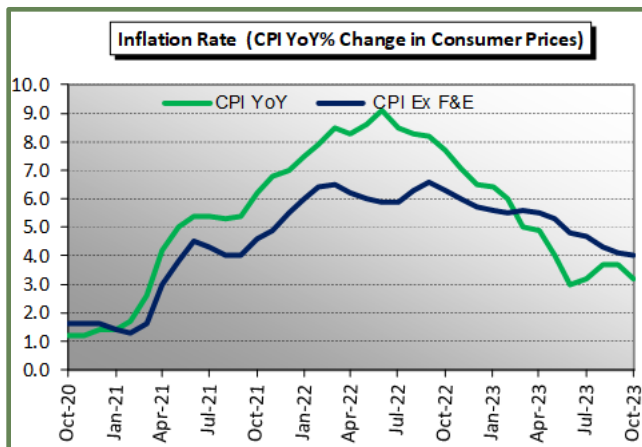
Inflation Readings

(Data source: Bloomberg)



Producer Prices Decline

Producer prices were lower than expected and decreased on a month-over-month basis by the most since April 2020. The main reason for the decline was due to lower energy prices.

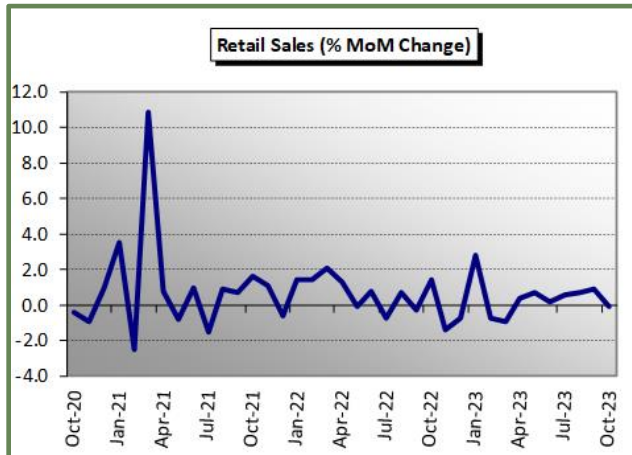


Consumer Inflation Falls

The overall inflation rate increased by 3.2% on a year-over-year basis in October, which was down significantly from 3.7% the previous month. The market was expecting a decline to 3.2%. On a month-over-month basis, prices were unchanged and are at the lowest monthly reading since May 2020. Core inflation data also came in below expectations for the month.

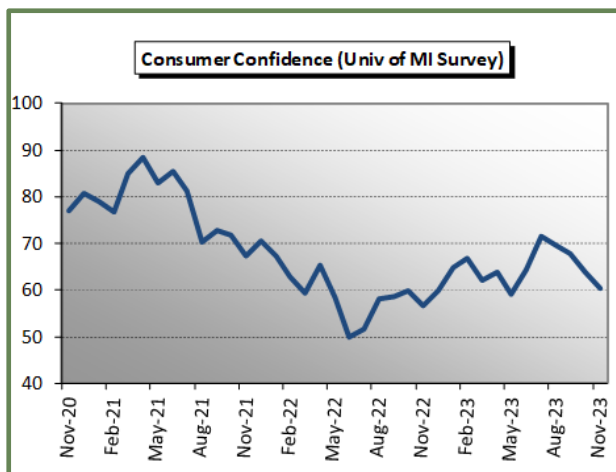
Consumer Readings

(Data source: Bloomberg)



Retail Sales Decline Less than Expected

Retail sales in October declined 0.1% on a month-over-month basis. This was better than the expected 0.3% decline after very strong sales in September. Control group sales, which are used to calculate gross domestic product (GDP), rose by 0.2%. This represents a decent start for fourth quarter GDP after strong consumer spending in the third quarter.



Consumer Confidence Declines

Consumer confidence in November was weaker than expected and fell to the lowest level since May. Expectations for higher inflation were the main culprit as longer-term inflation expectations reached their highest level since 2011, despite gasoline prices falling significantly during the month.