alloya
Corporate Federal Credit Union

Economic Update



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Commentary

After reaching an all-time high earlier this month (based on the S&P 500), the equity markets have taken a hit. AI-related stocks have taken the brunt of the downturn, with the Nasdaq index falling by 2.6% on October 22 alone. Investors are beginning to question the expected returns from the enormous capital outlay by AI-related companies. All told, the broad-based S&P 500 is only down 2% from its peak and is essentially unchanged for the month of October. All eyes now turn to the Fed meeting next week after the first rate hike in three years at their last meeting.

Prior to the recent downturn, the main economic thesis was about the resiliency of the economy. Over the past few years, the economy has surged ahead despite several negative shocks. The economy has dealt with higher interest rates, higher tariffs and an energy price shock. Any one of those events has caused an economic downturn in the past, yet this economic growth cycle has survived all three. Much of the resiliency has come from the optimism surrounding AI investment.

As we've mentioned before, the AI capital spending boom is one of the largest in the history of the United States. The large spending outlay increases economic growth today and the belief that productivity and earnings growth will expand at an accelerated rate in the future has helped fuel stock market gains and in turn, household wealth. That belief is now being more heavily questioned, and if it were to falter, there is an increased risk of an economic downturn.

We expect these concerns to influence the Fed's decision next week. Absent them, the case for another rate hike would be strong: Headline inflation has risen to 3.7%, and core inflation remains well above the Fed's target. Although employment data weakened slightly last month, the labor market remains in a low-hire, low-fire pattern and does little to change the inflation outlook. Given all these factors and the proximity of the November elections, we expect the Fed to hold rates steady.

We look for the economy to continue to expand for the next several quarters. We believe that the AI investment story will continue to help spur growth and keep valuations elevated. That will help to maintain strong consumer spending.

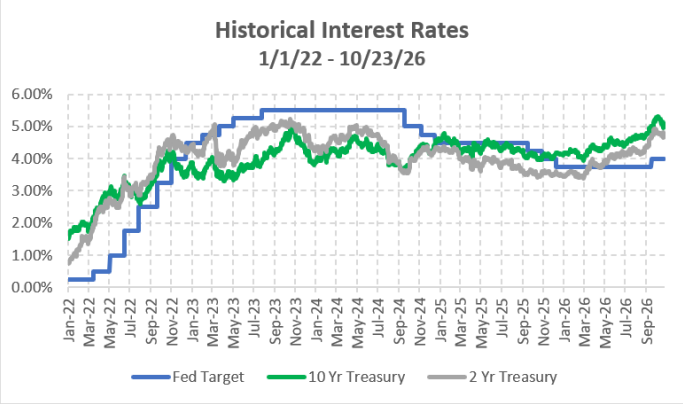
Fixed Income Outlook

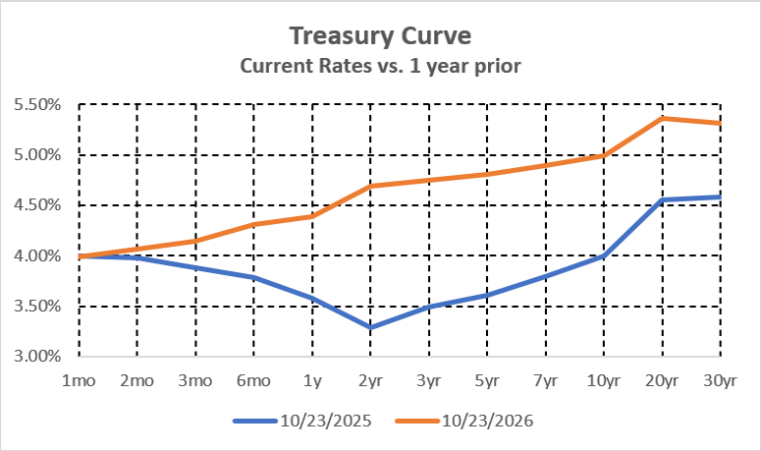
The Treasury curve has shifted downwards thus far in October. Yields are lower by 20 to 30 basis points across the curve. Most of that is due to the questioning of investment in AI's ability to continue to drive growth. The market is pricing in only 10% chance of a Fed hike next week.

THIS MONTH

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

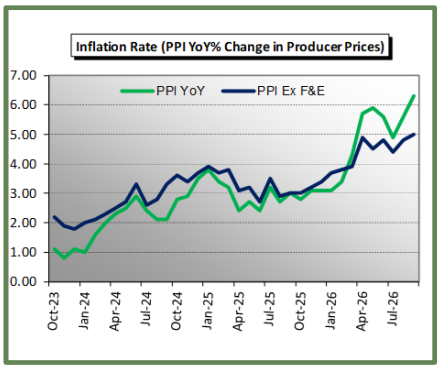
While we don't believe they will hike, we think that the probability is closer to one in three. Like the market, we do see another Fed hike later this year.





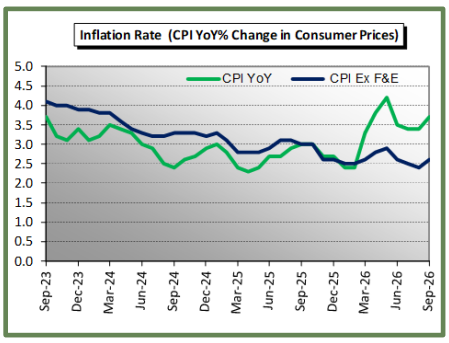
Inflation Readings

(Data source: Bloomberg)



Producer Price Inflation Surges

Producer price inflation in September increased at the fastest pace in more than four years. The year-over-year pace was 6.3% versus 5.6% last month and an expected rate of 5.4%. Energy prices were the key driver of the increase.

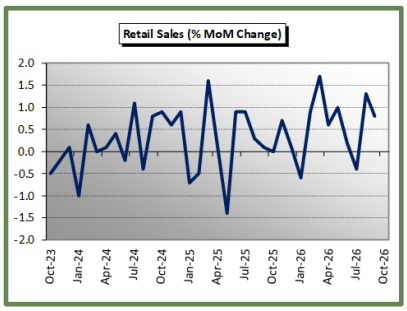


Consumer Inflation Increases

Consumer inflation in September increased to 3.7% on a year-over-year basis versus 3.4% the month prior. It was the fastest pace of inflation in five months. Both the headline and core inflation levels were above expectations.

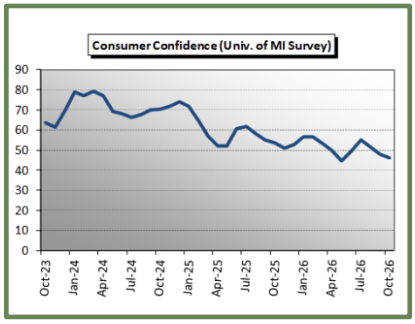
Consumer Readings

(Data source: Bloomberg)



Consumer Spending Remains Strong

Consumer spending in September came in higher than expected. Spending increased by .8% on a month-over-month basis versus an expected gain of .3%. Much of the variance was due to higher gas prices, but eight of the 13 retail categories did experience gains.

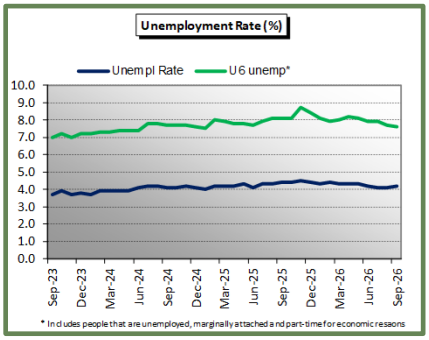


Consumer Confidence Continues to Fall

Consumer confidence declined to a five-month low based on the preliminary sentiment index for October. Confidence was below expectations, and the current conditions metric fell to the lowest level on record.

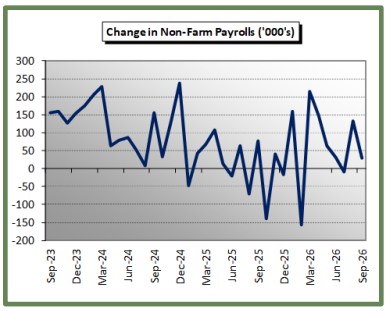
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Rises

The unemployment rate in September rose to 4.2% from 4.1% the prior month. The market was expecting the rate to remain unchanged. The underlying details of the report were relatively strong with a significant rise in the labor force and an increase in the labor force participation rate. On the downside, wage growth was weaker than expected.



Payroll Growth Disappoints

Payroll growth in September came in below expectations. The number of jobs increased by 29,000 versus an expected gain of 90,000. In addition, the previous two months were revised lower by 60,000. The current three-month average payroll fell back down to 50,000. The labor market remains in a low hire/low fire mode.