Economic and Investment Outlook - October 2022

United States

- Nonfarm payrolls rose a solid 263,000 m/m in September. The unemployment rate declined to 3.5% from 3.7% the previous month, tying the lowest level since 1969, as the labor force participation rate fell back to 62.3%. Wage gains seem to be peaking and were stable with average hourly earnings up 0.3% m/m and 5.0% y/y. U.S. payrolls totaled 152.5 million in February 2020 versus 153 million today, an increase of 0.34% or 524,000 jobs.

- In the only sign of labor market weakness, job openings declined to 10.1 million in August, and down 1.8 million from the record high in March of this year. There are still 5.75 million unemployed workers.

- The U.S CPI rose 0.4% m/m in September and 8.2% y/y. The core CPI surged 0.6% m/m and 6.6% y/y. Housing and food are up 6.7% and 11.2% y/y, respectively. The CPI for electricity climbed 15.5% y/y, while energy was up 19.8% over the same time period.

- The headline Personal Consumption Expenditures Price Index (PCE) rose 0.3% m/m in August but dropped to 6.2% y/y versus 6.4% in July. Core PCE rose 0.6% m/m, the 3rd fastest monthly gain of the pandemic cycle. Core PCE remained unchanged at 4.9% on a y/y basis.

- The September Manufacturing-PMI registered 50.9%, 1.9 percentage points lower than the 52.8% recorded in August, and the 28th consecutive month of economic expansion. However, this is the lowest reading since the pandemic recovery began. In May 2020, the Manufacturing-PMI was 43.5%. Within the Index, new orders and employment are contracting.

- The September Services-PMI was 56.7%, showing that services are holding up better than manufacturing. In both indices, prices-paid has moderated while supply-chain problems seem to have significantly abated.

Global

- Eurozone's headline CPI climbed to a record 10% y/y in September, compared to 9.1% in August. The core CPI inched up to 4.6% y/y versus 4.2% the previous month.

- Germany's Producer Price Index increased 7.9% m/m and an astonishing 45.8% y/y. The pain of higher prices already looks to be slowing economic activity significantly. Germany is important as it represents 30% of the Eurozone's GDP.

- European policymakers are fiscally stimulating to offset slowing economic activity (and the painful energy crisis), as their central banks are tightening aggressively to tame inflation, an unsustainable and contradictory policy mix. Thus far in 2022, the Eurozone and the United Kingdom have spent $312 billion and $197 billion, respectively, on fiscal stimulus.

- The Bank of England decided to ease monetary policy with one hand by buying Gilts (the British equivalent of a U.S. Treasury), while tightening with the other hand by raising rates. This, too, is not sustainable, just like having your feet on the brake and gas at the same time.

- The 10-year Gilt recently jumped to a high of 4.48% from a low this year of 0.97%. Remember, the Bank of England is forecasting a U.K. recession, as they continue tightening monetary policy to combat 10% inflation.

- The World Bank lowered its forecast for China's economic growth in 2022 to 2.8% from 4.3%, just 3 months ago.

- China's Communist Party Congress starts October 16th. President Xi Jinping will want a smooth-running economy as he bids for an unprecedented 3rd five-year term in power. To address their property weakness, it appears more stimulus is coming in the form of lower rates, easing lending standards, and encouraging developers to complete housing units.

F.N.B. Wealth Management

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Fixed Income

- September's employment data points to a continued tight labor market and dashes hope for a Fed pivot away from raising rates anytime soon.

- The Federal Open Market Committee (FOMC) summary of economic projections called for a median fed funds rate of 4.4% at the end of 2022 and 4.6% at the end of 2023. This implies that the FOMC expects to raise the fed funds rate to a terminal range of 4.50% to 4.75% next year.

- The Fed remains on track for a cumulative 1.50 percentage points rate increase this year with 75 basis points (bps) coming at the November 1-2 FOMC meeting, and an additional increase of 75 bps in December due to strong employment and stubbornly high inflation.

- The real fed funds rate is still in deep negative territory, with a current fed funds rate of 3.00-3.25% and the U.S. Consumer Price Index at 8.2% y/y in September.

- The Fed started raising interest rates in March 2022. It takes well over a year for a change in the Fed funds rate to show up in economic data. By this measure, we would begin to see meaningfully weaker economic data in March 2023, merely 5 months away.

Tactical Fixed Income Allocation

- Neutral duration to the fixed income strategy's respective benchmark as financial markets price in the slower economic growth resulting from the sharp and quick pace of rate hikes.

- Overweight to short-term investment grade corporates - capture additional income with a minimum of incremental risk.

Equity

- According to Strategas, of the 187 quarters since 1976 (46 years), there has never been a period that has seen negative quarterly returns for both stocks and bonds three quarters in a row. It just happened. Negative returns for both stocks and bonds are frequently associated with recessions.

- Volatility – During the first nine months of 2022, 88% of trading days had an intraday range greater than 1%, the highest level since 2009 when 95% of the trading ranges were greater than 1%. Expect higher levels of market volatility in the months ahead.

- Equity analysts are in the process of reducing their S&P 500 earnings estimates for both 2022 and, more importantly 2023, to reflect the recessionary impact on corporate earnings. Investors are attempting to determine what P/E ratio they should apply to these lower earnings, a difficult task not knowing how long and deep the recession may be.

Tactical Equity Allocation

- Overweight to U.S. Large Cap stocks with an emphasis on quality.

- Remain underweight to International Developed with no exposure to Emerging Markets (EM). Although valuations remain attractive relative to U.S. equities, International Developed and EM may be pressured by the change in globalization, global growth slowing, and the U.S. dollar at a 20-year high relative to a basket of international currencies.

- Exposure to gold in an environment of high inflation, negative real interest rates, and geopolitical tensions.

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