

OBSERVATIONS

- Total mortgage application volume fell to 22-year lows last week. Refinancing volumes are -75% lower than a year ago, while applications for new home purchases are -21% lower as compared to a year ago.¹
- German bond yields rose to their highest since 2014, with the 10-year German bond yield topping 1.45% last week, as the European Central Bank formally announced it will end its quantitative easing measures and begin to raise rates for the first time since 2011 at its next meeting in July.²
- The Japanese Yen hit a 20-year low reaching more than 134 Yen to the U.S. dollar and falling over -16.5% since the beginning of the year, pushed down by expectations that the Bank of Japan will defy global monetary tightening trends and keep monetary policy very accommodative throughout 2022.³
- Meanwhile, U.S. consumer pessimism worsened in June with the Michigan consumer sentiment index hitting 50.2, the lowest reading on record dating back to survey's origin in 1978.⁴
- Oil prices moved up last week with West Texas Intermediate Crude selling for more than \$120 per barrel and gas prices at the pump hitting an average of \$5.00 per gallon nationally.⁵
- Meanwhile Chinese inflation remained flat in May at +2.1% YoY as China grapples with weak demand stemming from its zero-Covid policy. Chinese authorities re-imposed a partial lockdown in Shanghai over the weekend impacting over 25 million residents just eight days after the ending of lockdown measures in the city to conduct mass Covid testing amid yet another outbreak of Omicron.⁶

EXPECTATIONS

- Headline U.S. inflation increased to +8.6% year-over-year (YoY)—consensus expectations were that it would remain steady from last month's level of +8.3% — as housing, gas, and food prices moved higher. Core inflation fell to +6.0% YoY down from April's +6.2% YoY reading. *As of this inflation report, core CPI hit a high of +6.5% on a YoY basis earlier this year in March 2022.* In contrast, headline CPI continues higher given the influence of food and energy — which will continue to cause discomfort to headline inflation readings. Also of note are the regional disparities in headline inflation, where for example Texas (+9.9% headline CPI), Louisiana, Oklahoma, and Arkansas are witnessing near double digit readings.⁷
- One key technical level breached with one likely tested this week; the 10-Yr U.S. Treasury yield breached the psychologically important 3.0% yield level last week and is likely to rise further depending on additional hawkishness out of this week's Federal Reserve meeting where a 50bps rate hike is expected. Meanwhile, the S&P 500 is likely to retest this year's (May 20) low of nearly 3,800 for the index — pushing the S&P 500 into bear market territory — as negative sentiment continues to weigh on financial markets.⁵

ONE MORE THOUGHT: *As of now U.S. small cap stocks reflect value-growth rotation not a looming recession*⁸

U.S. small cap stocks, as measured by the Russell 2000 Index hit an all-time high on November 8, 2021. Since that day through its recent lows on May 11, 2022, the Russell 2000 Index fell -29.7%. However, during this same period

¹ <https://www.cnbc.com/2022/06/08/mortgage-demand-falls-to-the-lowest-level-in-22-years.html>

² <https://www.ft.com/content/1a699b10-7ed4-40b4-b0f3-1eb716e1f8d2>

³ <https://www.ft.com/content/8bf5579f-f2bc-400e-bd31-efc57a2ed5cf>

⁴ <http://www.sca.isr.umich.edu/>

⁵ Bloomberg LP as of 6/10/2022

⁶ <https://www.wsj.com/articles/shanghai-orders-over-half-its-residents-to-undergo-covid-testing-as-resurgence-fears-rise-11654781093>

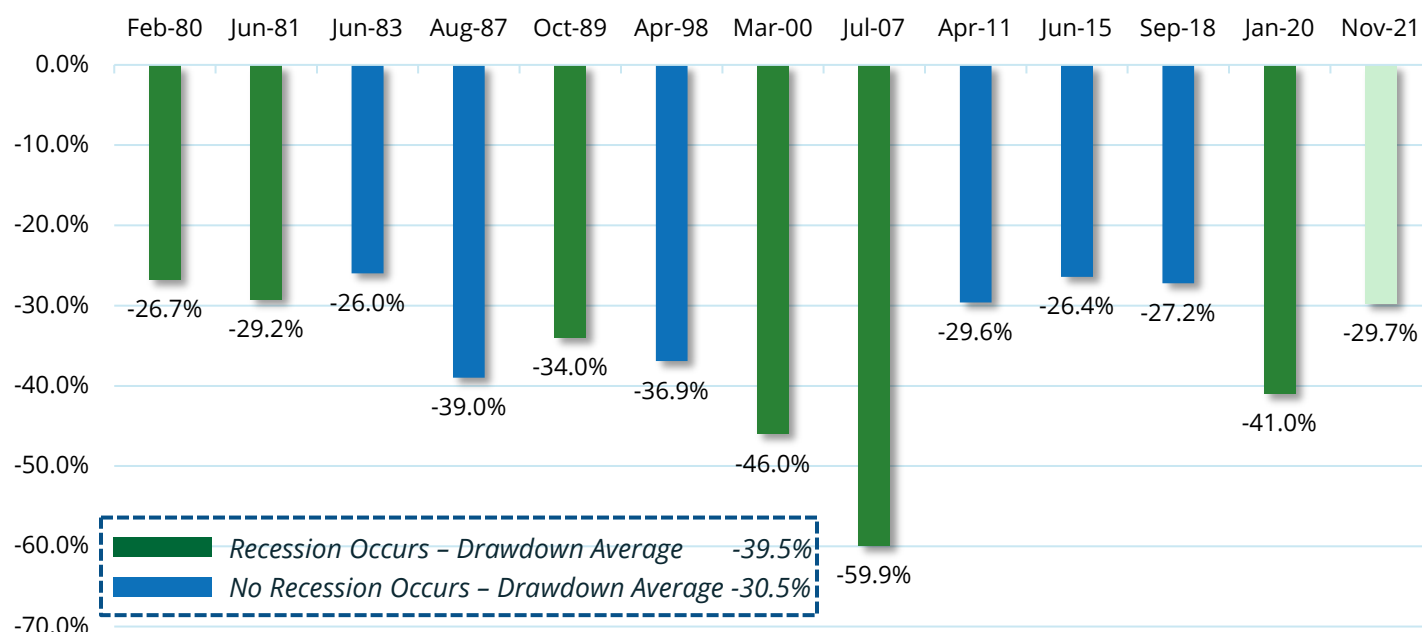
⁷ <https://www.bls.gov/news.release/cpi.nr0.htm>, Bloomberg LP

⁸ Bloomberg LP 6/8/2022

the growth and value sub-indices (Russell 2000 Value and Russell 2000 Growth) exhibited very different declines. The Russell 2000 value fell by -19.7% whereas the Russell 2000 Growth Index fell by -38.3%. Also, looking back at all the major declines in U.S. small cap stocks since 1980, a pattern emerges that U.S. small cap declines occurring before or coincident with a U.S. recession average close to -40.0% (See Chart of the Week below). However, small cap bear markets that do not precede or coincide with a recession are typically milder and average declines of only about -30.0% — very similar to the small cap decline from Nov-2021 to May-2022. Since mid-May, U.S. small caps have rallied by +5.1% with both value and growth stocks participating nearly equally (Russell 2000 Growth +5.5% and Russell 2000 Value +4.7% through 10-June). This suggests, similar to our findings regarding U.S. large cap stocks (see [Research Insights June-2022](#)) that the decline was more related to the Fed's aggressive pivot to raise interest rates than the market anticipating a recession in 2022. Of course, this narrative is highly fluid and subject to economic data in the months to come as the economy continues to adjust to higher inflation and interest rates.

CHART OF THE WEEK

US Small Caps - Not Yet Priced for Recession



Source: Clearstead, Bloomberg LP, Longview Economics, as of June 8, 2022

Aneet Deshpande, CFA
Chief Strategist
Clearstead

Dan Meges
Managing Director of Equity
Clearstead

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