OBSERVATIONS

- Last Tuesday the S&P 500 experienced its worst day of the year (-4.3%) and worst since June 2020 on the heels of a surprising inflation reading (more in One More Thought). The S&P finished the week -4.8% on the week, the benchmark's worst week since mid-June.[1]
- Producer prices (PPI) meanwhile, decelerated for the second consecutive month on a month-over-month basis, declining -0.1% from July. On a year-over-year basis (YoY), PPI declined -1.1 percentage-points to 8.7% while core PPI (excluding food, energy, and trade) cooled to 5.6% YoY—the lowest since June 2021.[1]
- Significant municipal bond fund outflows continue with muni bond funds on track for their largest yearly redemptions since at least 1992 after net withdrawals of $84 billion so far, this year-to-date. This comes with munis (Bloomberg Muni Index) suffering their worst annual declines since 1981 (-10% as of September 15).[1]
- The U.S. Strategic Petroleum Reserves (SPR) — the country's emergency crude oil stock—fell to 434.1 barrels, the lowest since October 1984. The current SPR release program announced by Biden on March 31, 2022, is set to end in October.[2]
- Retail sales increased +0.3% in August from July, but much of this increase was related to the volatile automotive sector. Sales excluding autos fell by -0.3% in August from July, but much of this decline was driven by declines in gasoline prices during August.[3]
- Industrial production decreased by -0.2% in August from July—largely due to weather events that curtailed energy production at some utilities in August—and capacity utilization declined by -0.2%. However, manufacturing output edged up 0.1% in August from July, while mining activity was flat.[4]

EXPECTATIONS

- Major US railway firms and the union representing railway conductors and engineers reached a tentative agreement last Thursday after a marathon bargaining session ahead of last Friday's deadline. The tentative deal includes 24% pay raise over five years and changes to personnel scheduling policies.[5] The deal averts a nationwide rail strike that would have further snarled supply chains and likely would have led to additional shortages of goods for manufacturers and consumers.
- Ukraine's counteroffensive made significant progress last week taking back wide swathes of the Kharkiv Oblast—about 2,300 square miles, which is a bit more than the state of Delaware—in the country's east and dealing Russia its first major defeat on the battlefield since its failed attempt to capture Kiev early in the war. Ukrainian forces are also pressuring Russian soldiers in and around the southern city of Kherson.[6]

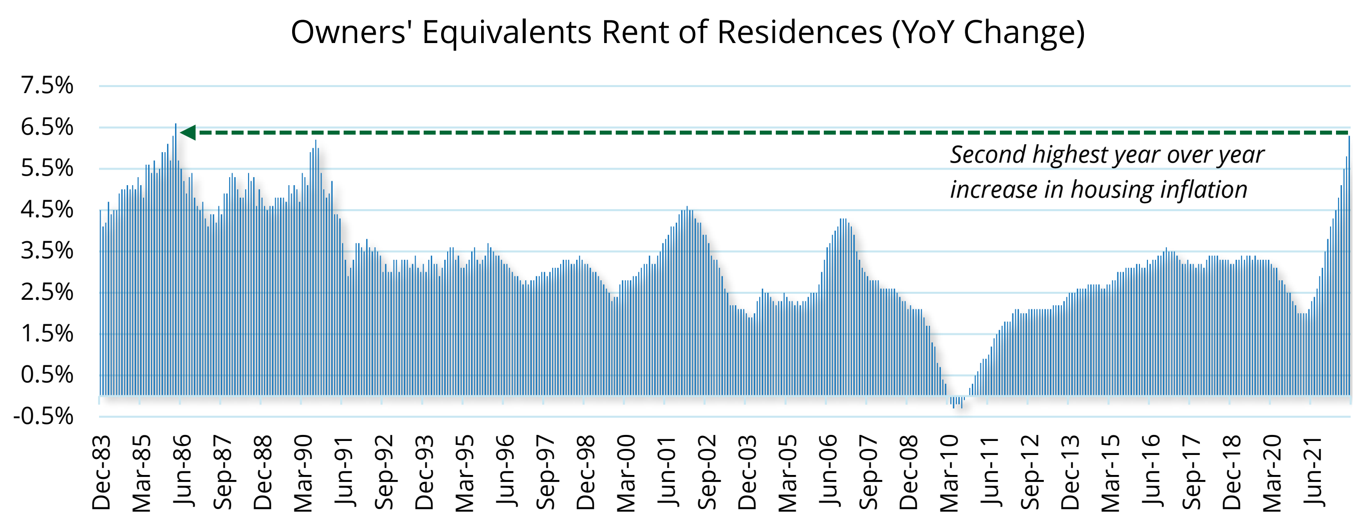
ONE MORE THOUGHT: *Housing leads to a hot inflation print and the S&P 500's worst day of the year* [7]

Backwards looking CPI inflation figures came in higher than expected with headline CPI up +8.3% (vs. median estimate of +8.1%) while core readings are up +6.3% (vs. median estimate of +6.1%), both on a year-over-year (YoY) basis. Sequentially, the YoY headline inflation figure, which captures food and energy, declined from +8.5% in July to

[1] *Bloomberg LP*
[2] *Bloomberg LP, Reuters, Department of Energy – Strategic Petroleum Reserves*
[3] *https://www.census.gov/retail/marts/www/marts_current.pdf*
[4] *https://www.federalreserve.gov/releases/g17/current/default.htm*
[5] *https://www.wsj.com/articles/u-s-railroad-strike-averted-as-white-house-unions-reach-tentative-deal-11663234424?mod=hp_lead_pos1*
[6] *https://understandingwar.org/backgrounder/russian-offensive-campaign-assessment-september-14*
[7] *https://www.bls.gov/news.release/cpi.t01.htm, Bloomberg LP*

this month's +8.3% as commodities declined -10.1% during August. Clearly what caught the market off guard last week was the magnitude of the surprise in the core inflation (excluding food and energy) reading. Core CPI rose from July's +5.9% reading to August's +6.3% reading and while strategists and economists were anticipating a higher figure than July (median estimate of +6.1%) a +0.2% surprise, was unnervingly higher than expected. For at least as far back as we can gather the data, ca. 2003, the YoY CPI figure has been relatively easy to forecast given the makeup of the index and the data sets involved. Over this period, the median value of the differences between actual CPI as compared to the estimates for CPI, was zero —so this recent surprise is of significance, and significant surprises move markets (the S&P 500 experienced its worst day of 2022, losing -4.3%, last Tuesday, following the report). The drivers of this recent reading were similarly broadly spread as prior months though we would note that inflation in housing (as measure by the quirky OER – Owners' Equivalent Rent) rose by +6.3% YoY, the second highest reading since 1983 (Chart of the Week). OER accounts for nearly 25% of CPI and tends to operate with a lag effect into CPI measures, as house prices rise the impact into core inflation tends to be somewhere on the order of 12-18 months. Meaning the strength of housing from the aftermath of the pandemic is now filtering into reported inflation. What does this mean? The data simply affirms the Fed's current aggressive stance and expect the Fed to keep pressing the brake pedal with a focus on tightening financial conditions by lifting the Federal Fund's target rate. The markets, in our view, will remain stubbornly volatile as a result.

CHART OF THE WEEK



Source: Bloomberg LP, Clearstead, as of September 13, 2022, CPI Owners' Equivalent Rent YoY

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