OBSERVATIONS

- Stairs up, elevator down: After a decade of compounded annual gains of +8.5% per year from 2010-2020, China's high yield bond index, dominated by real estate firms, has declined nearly -55.0% since mid-May 2021 as the country grapples with its troubled property sector.[1]
- US homebuilder sentiment fell to 38, half the level from six months ago and the lowest level since 2012 with the rise in interest rates cited as a significant headwind—the average rate on a 30-Yr fixed mortgage was 7.1% as of last week.[2]
- Mortgage demand fell for the fourth straight month to a 25-year low and the number of borrowers that would benefit from refinancing fell to a record low. Meanwhile, as affordability has declined borrowers are turning to adjustable-rate products (ARMs) with ARM products now representing nearly 13% of all mortgage applications, the highest share since March 2008.[3]
- Industrial production rose by +0.4% on a month-over-month (MoM) basis in September, better than consensus expectations for a +0.1% rise. Gains were broad based, with manufacturing recording a MoM rise of +0.4%, besting expectations for a +0.2% rise. Meanwhile, US factory utilization rose to 80.3% last month, matching its highest level since March 2008. [1]
- Since 1931, the S&P 500 has seen about 55% of trading days in a calendar year be positive. This year, the S&P 500 has seen just 43.5% of trading days in positive territory year-to-date, the lowest since 1974 and the eighth time since 1931 where that figure was below 45% for a calendar year. For those prior instances, the average return for the index in the year following was +12.5%.[4]

EXPECTATIONS

- Currency volatility, primarily in the form of US dollar strength, cost North American companies over $34 billion in Q2 of this year — the largest impact since 2013. The continued strength of the dollar is likely to have a similar, if not more pronounced, impact to Q3 earnings.[5]
- UK Prime Minister (PM) Liz Truss resigned after 44 days in office and a failed unfunded budget plan that was widely panned as likely to make UK inflation worse for an economy which just registered an inflation rate of 10.0%. A new PM—the country's fifth in six years— is expected to be chosen by this week's end.[1]
- Ukraine is poised to take additional territory in southern Ukraine as it pushes towards the city of Kherson; Russia for its part has mined a major dam that if destroyed would flood the area but would help its troops retreat.[6]

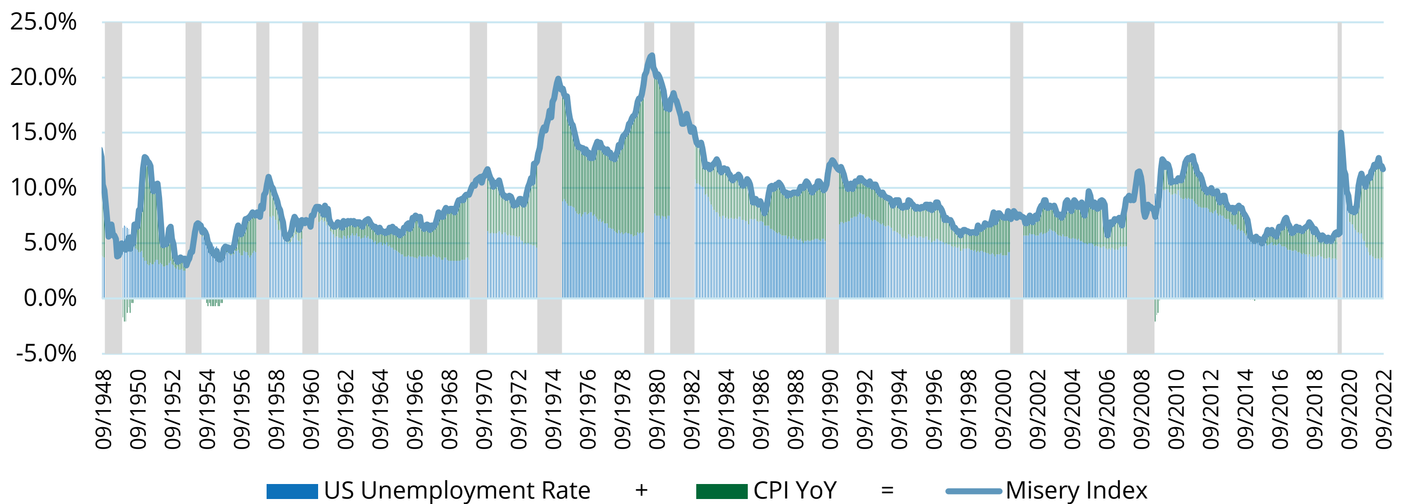
ONE MORE THOUGHT: *Revisiting the 'Misery Index'*[7]

The Misery Index (Chart of the Week) was first created by economist Arthur Okun to illustrate the economic zeitgeist of the average citizen. The index is elegant in its simplicity and is the sum of unemployment and headline inflation and is relevant to the Fed's dual mandate of promoting maximum employment while ensuring price stability. In the post WWII era, the misery index has averaged 9.3%, with an average unemployment rate of 5.8% and an average

[1] *Bloomberg LP*
[2] *CNBC, NAHB/Wells Fargo Housing Market Index*
[3] *https://www.cnbc.com/2022/10/19/mortgage-demand-drops-to-a-25-year-low-as-interest-rates-climb.html*
[4] *Clearstead, LPL Research, Return data based on YTD through 10/18/2022, Bloomberg LP*
[5] *Bloomberg LP, Kyriba Corp*
[6] *https://www.understandingwar.org/backgrounder/russian-offensive-campaign-assessment-october-20*
[7] *Clearstead, Bloomberg LP, data as of 9/30/2022, Misery Index = CPI YoY + Unemployment Rate*

inflation rate of 3.5% over this time. Parsing a bit further we find that during non-recessionary periods, the Misery Index has averaged 9.0%, with an average unemployment rate of 5.7% and an average inflation rate of 3.3% over this time. Of more relevance to today, recessionary periods have seen the index at 11.1%—unemployment averaging 6.2% and inflation averaging 4.9%. Today, the index stands at 11.7%, with unemployment of 3.5% and inflation at 8.2%, and while it fits the narrative of the historical precedent of past recessionary Misery Index readings, differences remain. The labor market strength of today is a significant differentiator to prior periods given that unemployment is near levels not seen since the 1950s. As the Fed battles the price stability (inflation) part of their dual mandate, it is supported by a robust labor market that will allow it to be aggressive in its policy making. As a result, until there is clear and ample evidence of inflation rolling over—which is not likely to be seen until next year sometime given the long and variable lags of monetary policy—the Fed will continue to hike rates. The silver lining of sorts is that the aggressive rate hiking is giving the central bank traditional monetary policy 'breathing room' to ease financial conditions to spur economic activity down the road, one would hope that this means no more quantitative easing. The path to normalization has been, and will continue to be, tough but is likely to set the stage for more attractive long-term, durable, investment returns.

CHART OF THE WEEK



Source: Clearstead, Bloomberg LP, data as of 9/30/2022, Misery Index = CPI YoY + Unemployment Rate, Shaded areas indicate recessions

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