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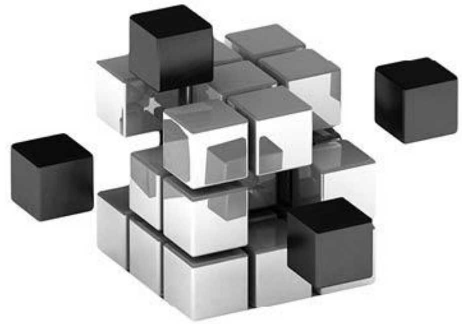
MARKET
SIGHTLINES



Shaping Our 2023 Outlook:
Getting Ready for the December Fed Meeting

By Michael O'Keeffe, *Chief Investment Officer*

Last week we shared some insights from the work we are doing as we shape our 2023 Outlook. Two important, interrelated anchors we discussed are inflation and the Federal Reserve's (Fed's) monetary policy. In this week's Sight|Lines, we go a little deeper still on these topics as we prepare for next week's final Fed meeting of the year.

THE TAKEAWAY: WHILE THE DATA IS MIXED, THE FED MAY SLOW HIKES

We learned about the November producer price index (PPI) and core PPI this morning. Next week we'll learn about the November consumer price index (CPI) and the results of the final Fed meeting of 2022. All of this will be important as we try to discern the path of Fed policy in 2023. In summary:

- The monthly PPI and core PPI for November were modestly higher than expected.
- Services purchasing managers' indices (PMIs) were truly mixed for November. The S&P Global Services PMI fell to 46.2, and was contractionary, while the ISM Services Index rose to 56.5, expansionary.
- We're seeing some pricing-related data that is promising, with gas prices lower, new leases falling, and supply chain pressures improving.
- At its meeting next week, the Fed is likely to consider moderating its rate hikes and refocus on the question: How long must it hold a restrictive policy level to restore price stability and bring down inflation?
- Fed futures are signaling the fed funds rate will peak at 5% (upper range) in June of 2023, and the central bank will begin easing in the fourth quarter of that year.
- Progress with geopolitical issues lessens the risk that a geopolitical issue or event will risk our ability to find balance on a host of domestic issues.

IN-DEPTH: YES, WHILE THE DATA IS MIXED AND THE FED MAY SLOW HIKES, THE CENTRAL BANK REFOCUSES ON HOW LONG TO STAY RESTRICTIVE

The monthly PPI and core PPI for November were just above expectations. On Tuesday, we'll learn the November results of the CPI, another important inflation reading. Also, the Fed meets next week and will issue on Wednesday a revised policy statement and Summary of Economic Projections (SEP) afterward. Fed watchers and market analysts alike will parse this information and Chairman Jerome Powell's post-meeting comments carefully to try to discern the path of Fed policy in 2023. Going deeper:

- The monthly PPI and core PPI for November were each up 0.3% vs. the median economist estimate of 0.2% and 0.1%, respectively.

    - PPI is an input for CPI, so this reading may influence future CPI levels.
    - These results compare to October when PPI and core PPI each rose 0.2% for the month.
- Services PMIs were truly mixed for November. The S&P Global Services PMI fell to 46.2, below 50, and was contractionary, while the ISM Services Index was above 50 and rose to 56.5, expansionary.
    - The S&P Global Services reading reflects a sharp drop in new orders and restrained client demand, while the ISM Services improvement results from stronger business activity and employment. Both note an improvement in bottlenecks and moderating prices.
    - So why are these two indices reflecting contrasting states of the services economy? In our view, one reason is that ISM Services focuses on large multinational corporations that might be biased by conditions in another country while S&P Global Services is focused on companies operating in the U.S.
- We're seeing some pricing-related data that is promising, with gas prices lower, new leases falling, and supply chain pressures improving.
    - Average gas prices peaked at $5.02 per gallon in June (6/13/22) but have fallen to $3.32 recently.
    - The Global Supply Chain Pressure Index sits at 1.2, well below its high of 4.1 in December 2021.
    - The Zillow Rent Index shows new leases have decelerated on a yearly basis from a peak of 17.1% in February to 9.8% in October.
- At its meeting next week, we believe the Fed will consider moderating its rate hikes and is refocusing on the question: How long must it hold a restrictive policy level to restore price stability and bring down inflation? Some recent comments from Fed Chair Jerome Powell:
    - *The truth is that the path ahead for inflation remains highly uncertain.*
    - *The time for moderating the pace of rate increases may come as soon as the December meeting.*
    - *It is likely that restoring price stability will require holding policy at a restrictive level for some time.*
- Fed futures are signaling the fed funds rate will peak at 5% (upper range) in in June of 2023, and the central bank will begin easing in the fourth quarter of that year.

CONCLUSION

As we discussed last week, in December we're preparing our outlook for 2023. Two important, interrelated anchors in focus are inflation and the Fed's monetary policy. We learned this week that two important inflation measures, the November PPI and core PPI, were modestly higher than expected. And next week will be important as we'll learn about CPI and the latest Fed thinking. These results will help us shape our 2023 outlook for inflation, Fed policy, and the markets.

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Asset allocation and diversification do not ensure a profit and may not protect against loss. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility. Small company stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies. Property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance of real estate companies. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. The Standard & Poor's 500 index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ. The DJIA was invented by Charles Dow back in 1896. The MSCI EAFE index (Europe, Australasia, and the Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. VIX is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options. The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The Core Consumer Price Index (Core CPI) is an aggregate of CPI excluding food and energy. The Producer Price Index (PPI) measures the average change over time in selling prices received by domestic producers of goods and services. PPIs measure price change from the perspective of the seller. The Core Producer Price Index (Core PPI) is an aggregate of PPI excluding food, energy, and trade. ISM Services and S&P Global Services PMIs are diffusion indices measuring the strength of the economy where above 50 shows expansion and below 50 shows contraction. Global Supply Chain pressure Index tracks the state of global supply chains using data from the transportation and manufacturing sectors. Zillow Rent Index is a measure of market rate rents across the US.

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