OBSERVATIONS

- The manufacturing part of the economy continues to expand but at a slower pace than was expected. The ISM Manufacturing index registered 55.4, less than the forecasted 57.6 and the lowest since September 2020. The sub-indexes of prices paid, new orders, and employment were all softer than forecasts.[1]
- In China, the impact of Covid lockdowns in several major cities have pushed PMIs to the lowest levels since early 2020 at the onset of the pandemic. China's manufacturing PMI fell to 46.0 and its services PMI fell to 36.2 in April—any reading below 50 suggests a contraction in activity.[2]
- The combination of high home prices and now much higher mortgage rates has strained home affordability. Nearly 95% of US housing market is less affordable than its long-term level, pre-COVID that figure stood at just 6%. A further rise of +5% in home prices, would push affordability to be the worst on record.[3]
- The economy added +428k jobs in April, better than expectations of 380k, while the unemployment rate remained at 3.6%. Job gains were widespread.[4]
- The number of people quitting their job reached a new record high of 4.5 million people in March according to last week's Job Opening and Labor Turnover Survey (JOLTS) release. Meanwhile, the job market remains tight as the survey highlighted that there are 1.9 job openings for every unemployed person.[5]
- India raised its policy benchmark lending rate, joining now 50 other monetary policy institutions who have similarly lifted their respective interest rates this year. Meanwhile, the Bank of England raised rates by 0.25% and warned of increased risks of recession while also seeing inflation in the double digits.[1]
- The 10-Yr U.S. Treasury yield broke through 3.0% last week for the first time since November 2018 as the Fed lifts rates (more in One More Thought).[1]

EXPECTATIONS

- 87% of the S&P 500 firms have reported Q1 earnings and 79% have beat expectations, however of the firms that have issued future guidance, 69% of them have issued a negative outlook on future earnings.[6]
- According to Shankman Capital, there were no high yield bond defaults and three small leveraged loan defaults in April. As a result, the JPMorgan U.S. high yield default rate dropped 2bps to 0.21%, the lowest rate on record, while the leveraged loan default rates rose 6bps to 0.46%.[7]

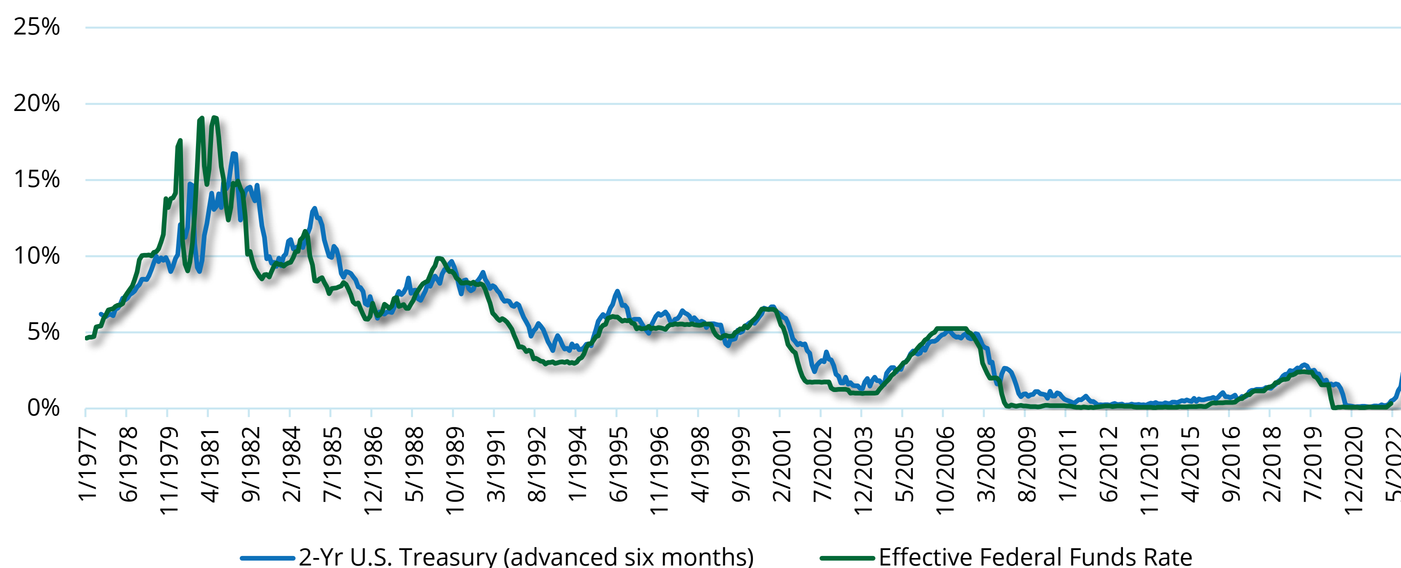
ONE MORE THOUGHT[8]: *Federal Reserve…. no surprises but equally confusing*

The Fed hiked its main policy interest rate (the Federal Funds Rate) by +0.50% as widely expected. The Fed also laid out its plan to reduce the balance sheet beginning in June (we'll have more on this in coming weeks). The rate hike was the largest single-meeting increase since May of 2000 during the dot-com bubble when the fed raised the fed funds rate from 6.0% to 6.5% (*at that time inflation, CPI, was running around 3.2%*). While signaling more hikes to be ahead, one notable point during the post meeting press conference was Chair Powell's response to a question regarding a rate hike of greater than 0.50%, to which he responded, "a 75-basis point increase is not something that the committee is actively considering." That response clearly pushes back against comments made by a few Fed

[1] *Bloomberg LP*
[2] *https://www.markiteconomics.com/Public/Release/PressReleases*
[3] *https://www.cnbc.com/2022/05/02/mortgage-rates-surge-as-home-affordability-nears-record-worst.html*
[4] *Bureau of Labor Statistics, Employment Situation Summary 6-May-2022*
[5] *https://www.bls.gov/news.release/jolts.nr0.htm*
[6] *FactSet Earnings Insight 6-May-2022*
[7] *ShenkmanCapital.com; JPMorgan*
[8] *https://www.federalreserve.gov/newsevents/pressreleases/monetary20220504a.htm, Bloomberg LP*

members as well as the market's expectations for an eventual 0.75% increase. The crosstalk, if not contradictory nature of messages from around the Fed, while perhaps calming (in that 75bps is off the table) is certainly also confusing. That said, while the path may be less certain, bond markets have helped establish a 'North Star' for where the Fed eventually pushes interest rates. More specifically, the 2-Yr U.S. Treasury helps to convey the market's estimation for where it believes the Federal Funds Rate is likely to be in six to nine months from now. The current level of the 2-Yr yield is consistent with an expectation of a Fed Funds rate of about 2.75% to 3.00% by year end (Chart of the Week). So, while the debate had been around the expected level of rates, we shift towards what we believe to be the next potential driver of volatility in financial markets —and that would be towards potential surprises impacting the expected level of rates. The drivers of those surprises are relatively narrow in scope but likely center around: the continued evolution of inflation (currently a negative), signals of slowing in the economy (currently a neutral to positive), developments in Russia-Ukraine (currently a negative). Significant changes could provoke the Fed to pause or slow or speed up its policy changes, which is likely to be transmitted into financial markets as additional volatility. Again, investors need to be prepared for continued volatility as the years of zero interest rate policy comes to an end.

CHART OF THE WEEK



Source: Clearstead, Bloomberg LP, as of 29-April-2022, h/t John Hussman (https://www.hussmanfunds.com/comment/mc220429/), 2-Yr U.S. Treasury Yield advanced six months

Aneet Deshpande, CFA
Chief Strategist
Clearstead

Dan Meges
Managing Director of Equity
Clearstead

Information provided in this article is general in nature, is provided for informational purposes only, and should not be construed as investment advice. These materials do not constitute an offer or recommendation to buy or sell securities. The views expressed by the author are based upon the data available at the time the article was written. Any such views are subject to change at any time based on market or other conditions. Clearstead disclaims any liability for any direct or incidental loss incurred by applying any of the information in this article. All investment decisions must be evaluated as to whether it is consistent with your investment objectives, risk tolerance, and financial situation. You should consult with an investment professional before making any investment decision. Performance data shown represents past performance. Past performance is not an indicator of future results. Current performance data may be lower or higher than the performance data presented.