CLAYTON WEALTH PARTNERS

DECEMBER 2022

MARKET PERSPECTIVE

Not Done Yet

By James M. Walden, CFA

DASHBOARD

- Business Cycle
- Trend
- Valuation

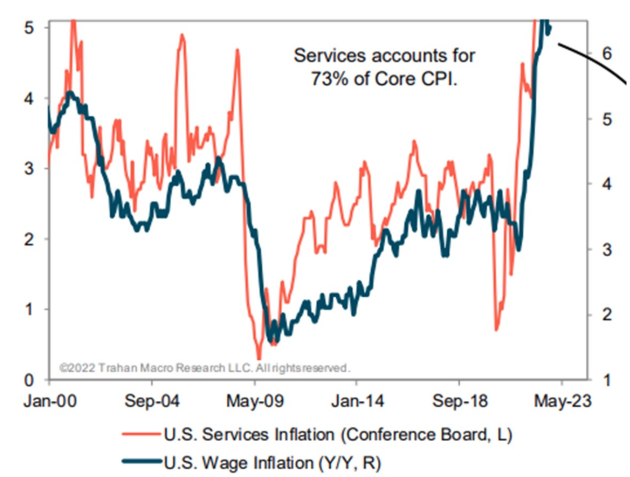
Labor Department data shows continuing moderation in inflation—good news, to be sure. But the Fed isn't ready to join the celebration.

Despite annual inflation improving to 7.1% in November from 7.7% in October, the central bank indicated it is likely to continue raising interest rates into 2023, albeit in smaller increments, after hiking rates by 0.50 percentage points at its December meeting. And the Fed now projects it will raise rates to a peak of more than 5%, up from September's forecast of a 4.6% peak, before starting to cut in 2024.

At the core of the Fed's resolve to keep raising rates is the central bank's "dual mandate": maximum (sustainable) employment and price stability (i.e., low and stable inflation). At times, these goals work against each other, but the Fed seeks to strike a balance. Right now, the former is around a 50-year low (as measured by the unemployment rate), while the latter is only now improving from 40-year highs. Currently, these two remain far from balanced.

So far, all the decline in core CPI has come from lower goods inflation, due in large part to improvements in supply chains. But services inflation accounts for around three-quarters of total core CPI. And services inflation is highly correlated with wage inflation, as shown in Exhibit 1:

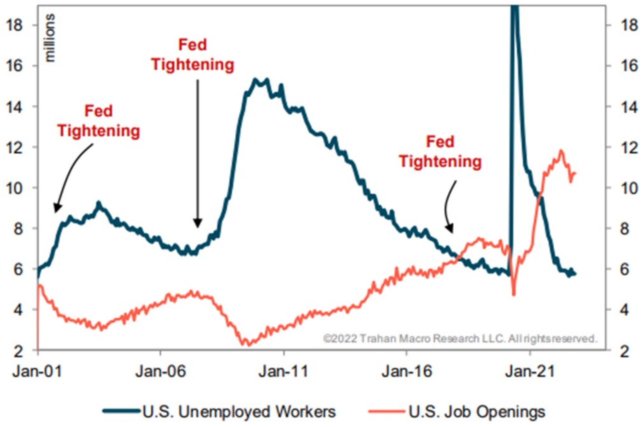
Exhibit 1: Correlation Between Services Inflation and Wage Inflation



Source: Trahan Macro Research (TMR), Clayton Wealth Partners (CWP).

Wage inflation is likely to remain elevated given how tight labor markets are (see Exhibit 2). And elevated wage inflation is likely to keep services inflation, and ultimately overall core inflation, elevated.

Exhibit 2: Labor Markets Supply vs. Demand



Source: TMR, CWP.

With the Fed continuing to tighten, a meaningful headwind to equity markets remains in place. For perspective, the S&P 500 bottomed only once (1987) while the Fed was still hiking in the nine previous Fed-tightening cycles dating back to 1974.

For now, we remain cautious.

Bullish

- Significant pent-up consumer demand
- Strong jobs environment
- Relatively healthy consumer finances
- Reasonable equity valuations
- The most attractive yields for fixed income in years

Bearish

- Slowing global economic growth
- High global inflation
- Tightening by the Fed and other global central banks
- Russia-Ukraine war and other geopolitical concerns
- Equities in a downtrend

JAMES WALDEN, CFA
Partner and Chief Investment Officer

As Partner & Chief Investment Officer, James Walden strives to maximize our clients' long-term, risk-adjusted portfolio returns. This includes determining strategic and tactical asset allocations, as well as specific investment analysis and prudent rebalancing. Jim is also a partner & management team member. His expertise includes advanced investment research and valuation, and he is passionate about his role in helping clients reach and exceed their financial goals.

CLAYTON WEALTH PARTNERS

716 S. Kansas Ave.
Topeka, KS 66603

832 Pennsylvania St., Suite 1005
Lawrence, KS 66044

785-232-3266 | claytonwealthpartners.com