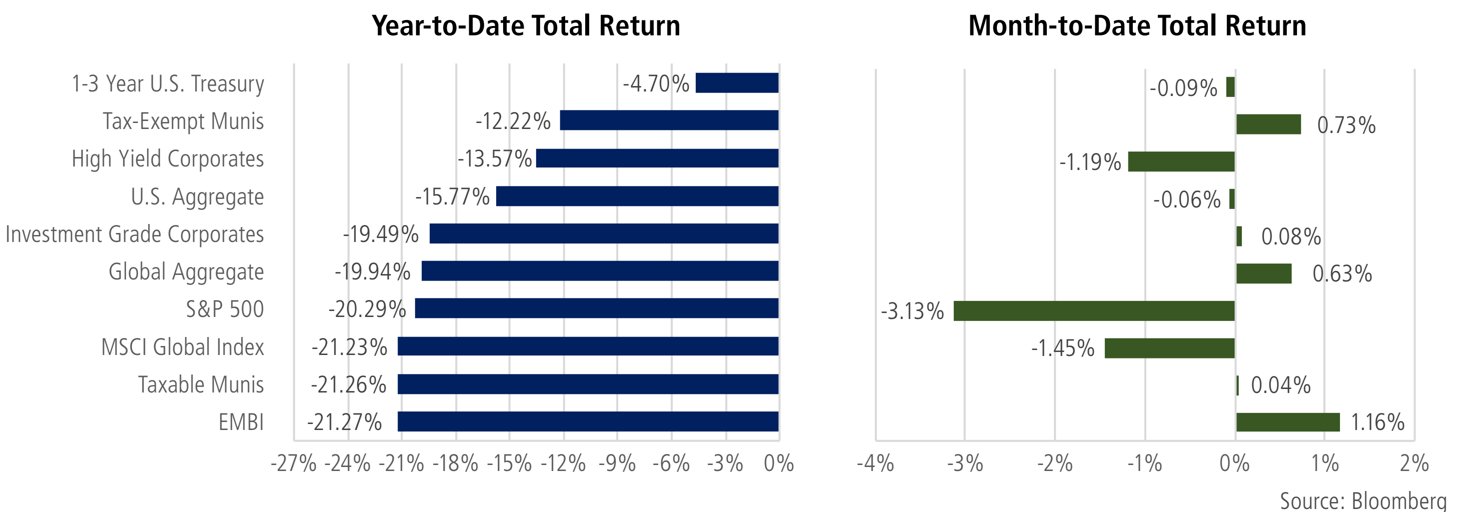
Week Ending: **November 10, 2022**

Cold Water

Economic Overview:

The October Consumer Price Index (CPI) jolted markets this week. Core CPI increased "just" 0.3% month-to-month versus an expected 0.5% rise. Is inflation finally slowing? We must dispense a few droplets of cold water on the notion. On two other occasions in 2022—in March and July—core CPI slowed to 0.3%, only to rebound in subsequent months. Will this time be different? Fortunately, the underlying drivers of CPI have evolved since the spring and summer. In the last three months, core goods rose 0.4% annualized. But we need to see outright goods price deflation, not just disinflation. Goods prices (roughly one-quarter of core CPI) exerted a persistent downward drag on average inflation over the last decade. What about services prices, the other three-quarters of core CPI? Core services prices advanced at an annual rate of 7.8% in the three months to October. The trend is, well, still moving in the wrong direction! To return to 2% (the Fed's goal), we need much more progress on goods and services. Overall, it's probably too soon for the bond market to assume success.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

High Yield: The face value of high yield debt outstanding has shrunk this year, from $1.54 trillion to $1.38 trillion, as rating agencies have upgraded issuers from high yield to investment grade at a steady clip. The reduced size of the investment universe has served as a technical tailwind as high yield bonds become increasingly scarce.

Corporates: Just like the good ol' days, it was a feast in the primary market for investment-grade corporates as copious amounts of supply were met with insatiable demand. In three days, 28 issuers hit the market for over $45 billion in supply, headlined by Oracle and General Electric's healthcare unit for $7 billion and $8.25 billion respectively. To highlight the demand, dealers were able to tighten deals by as much as 55 basis points from the initial price talk.

Securitized Products: Over 95% of homeowners have no incentive to refinance at current mortgage rates and no desire to lose low fixed rate golden handcuffs to move homes. Thus residential mortgage-backed new issuance is expected to be the lowest in years. As the year closes into relatively high market volatility, deals are increasingly being pushed into next year as well.

Municipals: $66 billion of bonded projects were on the ballot this week, a sharp rise from $27 billion last year. $37 billion has already been approved by voters, likely translating to a healthy increase in issuance that is likely to start coming to market in the second half of next year.

Equities: The equity market is set to end the week higher after softer-than-expected inflation data led to a sharp equity rally. Nearly all sectors posted positive returns, with real estate, materials, and technology leading markets higher, while energy, consumer staples, and utilities were the market laggards.

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