Ropes Wealth Culls Through Inflation, Retail Sales, and Investor Inertia

This week the all-important CPI report was released. Consumer prices rose 0.5% in January, as expected, which was the largest gain in three months. Year-over-year, consumer prices rose 6.4%, while excluding food and energy costs, core prices were up 5.6%. The details of the report showed inflation is everywhere: housing prices increased 0.8%, apparel prices were up the same, goods and services costs rose 0.6%, recreation prices advanced 0.5%, and education and communication prices notched a 0.4% gain. Only medical care and airline fares dropped in January, the fourth consecutive month of decline.

While the CPI – headline and core – showed modest improvement from last month, the rate of improvement has slowed and is falling short of expectations. And the longer this battle ensues with inflation, the higher rates will need to go in order to slay the inflation dragon. And yet, despite Fed officials' insistence that additional rate hikes are likely, attitudes of investors remain almost nonchalant about the risks.

Consumers are nonchalant too. We learned this week that retail sales jumped 3.0% in January for the largest monthly gain since March 2021. Year-over-year, retail sales rose 6.4% in January, following a 5.9% rise in November. Besides surging car sales, food and beverage sales climbed 7.2%, furniture sales gained 4.4%, general merchandise sales jumped 3.2%, and clothing sales rose 2.5% at the start of the year. Likewise, health and personal care, sporting goods and building materials sales all jumped up.

With these kinds of hot numbers on inflation and retail sales, not to mention last week's surging jobs report (adding 517k jobs), the Fed will be emboldened to move forward with a higher rate scenario. Keep in mind, the Fed is intentionally trying to destroy demand and boost the unemployment rate. Neither goal has yet to be achieved despite 425 basis points of tightening in the past eleven months.

Inertia is a powerful force, which may explain why investors are taking these numbers in stride. That and, of course, the powerful market decline in 2022. Central bankers keep saying they're not done raising rates. Fed Chairman Jay Powell just said, "We're not yet at a sufficiently restrictive policy stance, which is why we say that we expect ongoing hikes will be appropriate." And the Fed minutes show unanimity against cutting rates this year. The World Bank is forecasting for 2023 the weakest global growth rate in 30 years, other than the Great Recession of '08/09 and the 2020 covid-lockdown.

Companies are feeling the pinch. And while rightsizing has begun in the form of hiring-freezes and layoffs, profit margins should be impacted by slower sales volumes and higher input costs. Each of Wal-Mart, Target, and Amazon have increased hourly wage rates for front-line workers. Many tech companies have been announcing substantial layoffs to both right-size for the current environment and contain costs generally after years of heavy spending.

For the Nasdaq and S&P 500, the current price-to-earnings multiples of forward-12-month estimated earnings is about 25% and 13% above their respective 20-year averages, despite multiple factors such as higher interest rates (which lowers values), the prospects of a recession, and earnings estimates that are already down 10% from last year's peak for the Nasdaq, and just over 5% for the S&P 500. In other words, this market ain't especially cheap.

And yet, markets rarely fall for two consecutive years. The stock market is a discounting mechanism for the future. Therefore, the market will probably not wait until the recession risk is over to begin a new bull market. We have a

balancing act to manage this year: we must be simultaneously wary and cautious of all the risks while at the same time seek investment opportunities and align positioning for the resurrection of higher returns. There is no inertia or nonchalance in the way we perceive market risk today, but likewise we caution against being paralyzed in the face of it. As always, we see great benefit to prioritizing liquidity needs, and then staying balanced but engaged with markets at these repriced levels in the wake of 2022. To quote investment sage Warren Buffett, “We don’t have to be smarter than the rest. We have to be more disciplined than the rest.”

Thank you as always for your interest in our investment commentary. If you would like to speak personally with a member of our team at any time, please click **here**.

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