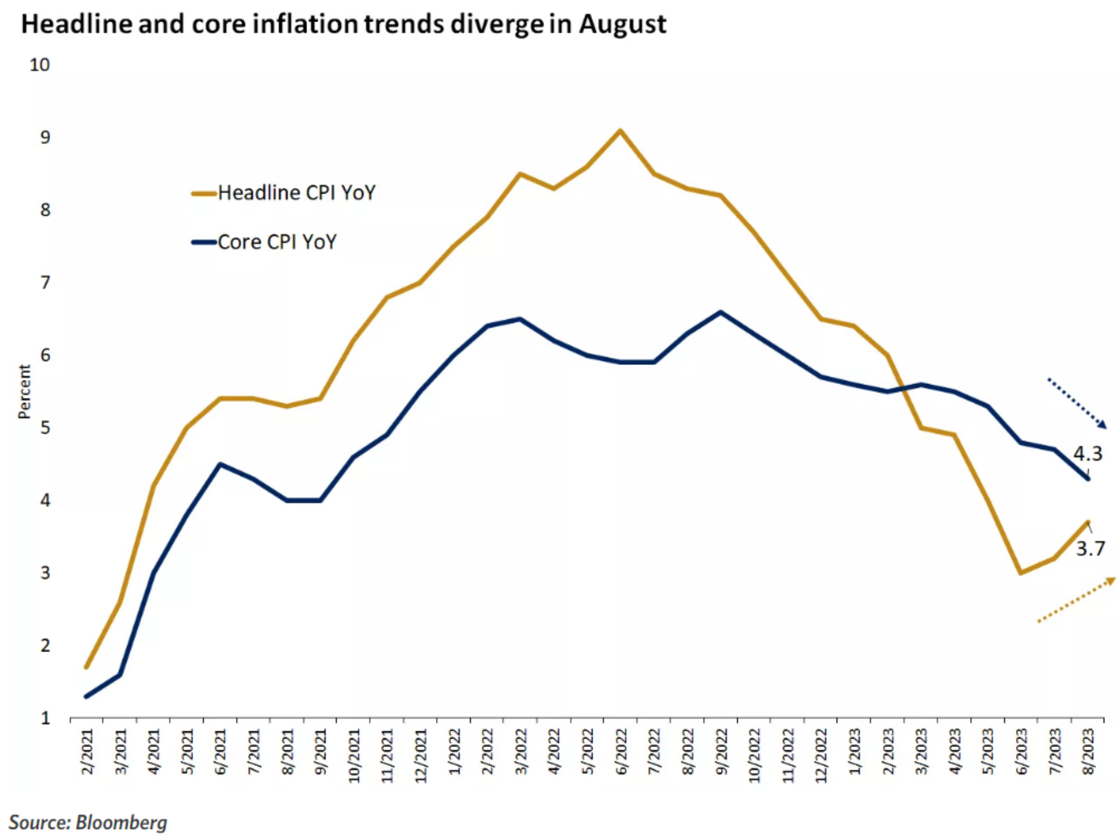
Monday September 18, 2023

SUMMARY-

I. *Markets mixed as Fed decision approaches.*
II. *New inflation data shows impact of rising energy prices.*
III. *Oil prices to see demand pressures from both sides.*
IV. *Early signs of easing labor markets may lead to Fed pause.*

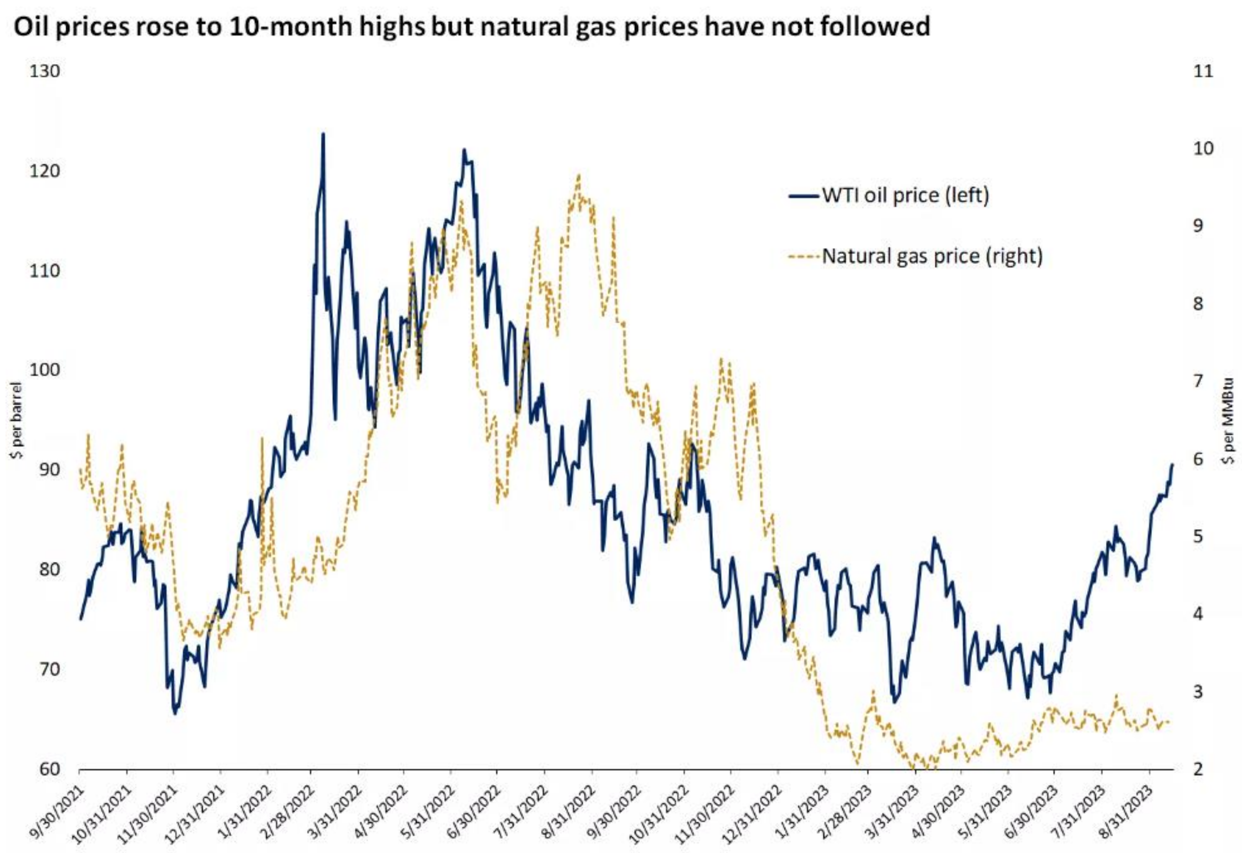
Good afternoon:

Equity markets were flat-to-mixed last week as market strategists and traders digested new inflation data in anticipation of this week's Fed decision. According to Chairman Powell at the Jackson Hole Economic Symposium last month, the Fed "is navigating by the stars under cloudy skies." In the wake of this admission that the outlook is not terribly clear, investors turned their attention to the August CPI report last week, hoping for a better view of what is coming. While the report revealed an acceleration in price growth, it was largely in line with expectations. Headline CPI month/month climbed 0.6% and core CPI rose 0.3%, as some prior disinflationary forces reversed course. This report left many now wondering how long these factors will provide new inflationary pressures.



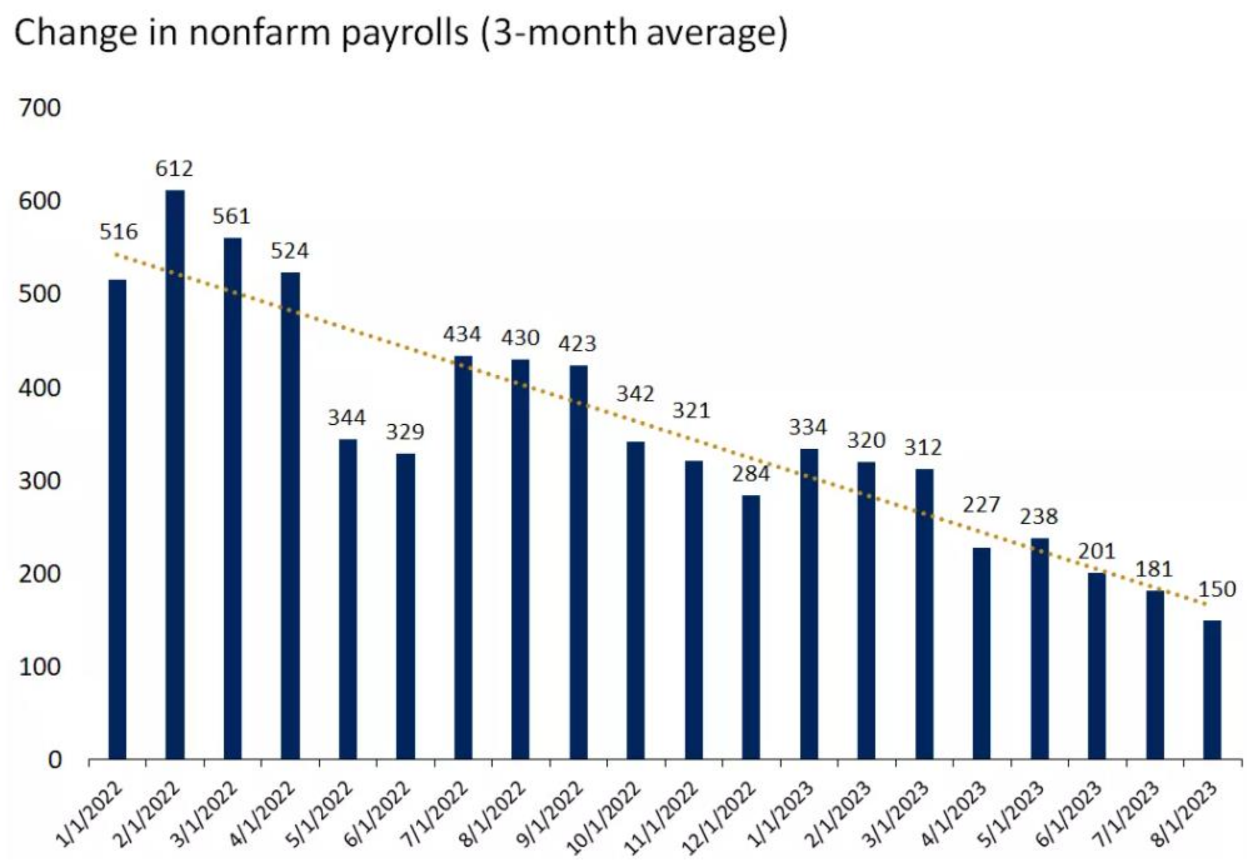
The primary cause to the recent spike in headline inflation is this year's rise in energy prices. After averaging $75 for most of the year, West Texas Intermediate Crude (WTI) hit a 9-month high last week of over $90/barrel. However, prices are still below last year's peak of $123/barrel following the invasion of Ukraine. Although some have cited the waning travel season domestically, sluggish growth in China, along with a slowdown in Europe as possible demand easing factors, offsetting issues could keep demand, and in turn prices strong in the coming months. Top oil exporter Saudi Arabia and Russia both recently announced they will maintain lowered production levels at least through the end of the year.

Additionally, the current administration has only just begun to refill the nation's strategic oil reserves that it withdrew in an effort to tame gasoline prices. Starting in March 2022, President Biden emptied a total of 180 million barrels, bringing the stockpile to its lowest level in nearly 40 years. The replenishing of these reserves is likely to keep pressure on prices with such an additional large buyer in the oil market. As cold weather approaches, it is fortunate that natural gas prices have yet to follow crude prices higher, although that is normally the case as this chart illustrates.



Source: Bloomberg

Beyond current inflation data, the Fed is also watching all-important labor markets closely as they announce their decision this week on interest rates. Since job security and wage gains are what drive the confidence to spend, the Fed uses these job statistics as an early indicator of economic trajectory. Although employment conditions remain strong, some indicators are showing a gradual softening which could prompt the Fed to remain on hold. Our economy is still producing new jobs each month but at clearly declining rates after more than a year of aggressive rate hikes.



Source: Bloomberg

Based on all the current information, we believe the Fed will likely *not* hike this week while continuing to say they are closely monitoring the data and will be quick to hike if necessary in the future. Increased market volatility is always possibility in the wake of any Fed action or statement although major large cap averages are all modestly higher this morning to start the week. The important thing is that the Fed appears to be at or near the end of its long tightening cycle, and the economic soft-landing scenario that hardly anyone thought plausible at the start of the year now seems more and more likely.

Have a great week!

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