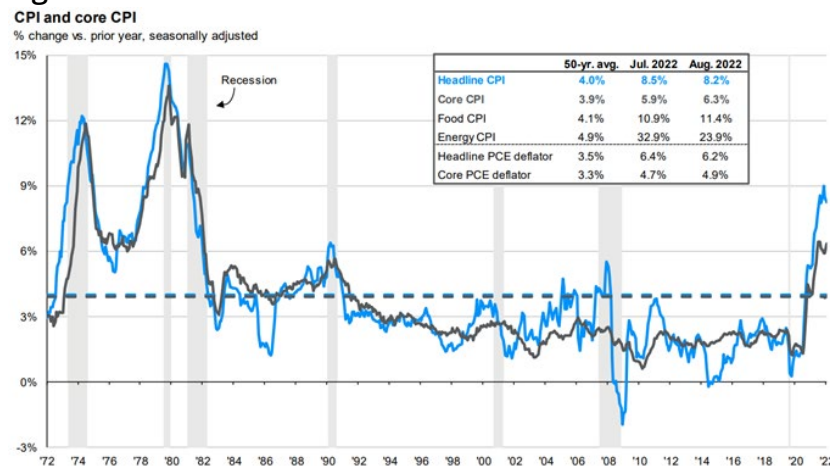


By Richard Frankel

## Summary:

- Inflation is extremely high, and the Fed is trying to combat it by raising interest rates.
- Consumer sentiment is at a more than 40-year low.
- Housing affordability is at an extreme low.
- The ratio of job openings to jobseekers is high, and the unemployment rate has returned to pre-pandemic levels.
- Wage growth is not keeping up with inflation.
- We are likely heading toward, or already in the beginnings of, a recession.

**Figure 1. Inflation**

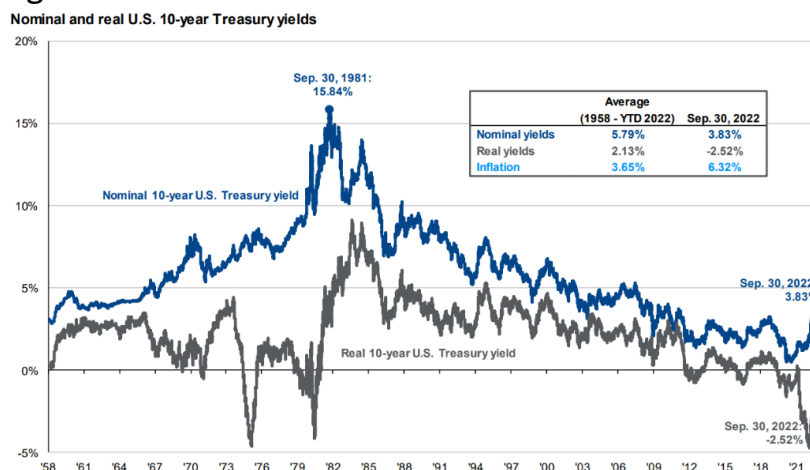


Source: BLS, FactSet, J.P. Morgan Asset Management.  
CPI used is CPI-U and values shown are % change vs. one year ago. Core CPI is defined as CPI excluding food and energy prices. The Personal Consumption Expenditure (PCE) deflator employs an evolving chain-weighted basket of consumer expenditures instead of the fixed-weight basket used in CPI calculations.  
Guide to the Markets - U.S. Data as of September 30, 2022.

As seen in Figure 1, as of August 2022, headline CPI and core CPI are sitting at levels not seen since the recession of 1981. The headline CPI is at 8.2%, which is more than double the 50-year average of 4%. The Core CPI is at 6.3%, which is 2.4 percentage points above the 50-year average. Food inflation is 11.4%, nearly triple the 50-year average of 4.1% and energy price inflation is a whopping 23.9% -- down from September 2022, but still more than quadruple the 50-year average of 4.9%. These numbers reflect the extreme levels of consumer inflation right now. For the consumer price index to be so high, and to have goods cost so much, shows an erosion of purchasing power that is unprecedented in the last 40 years.



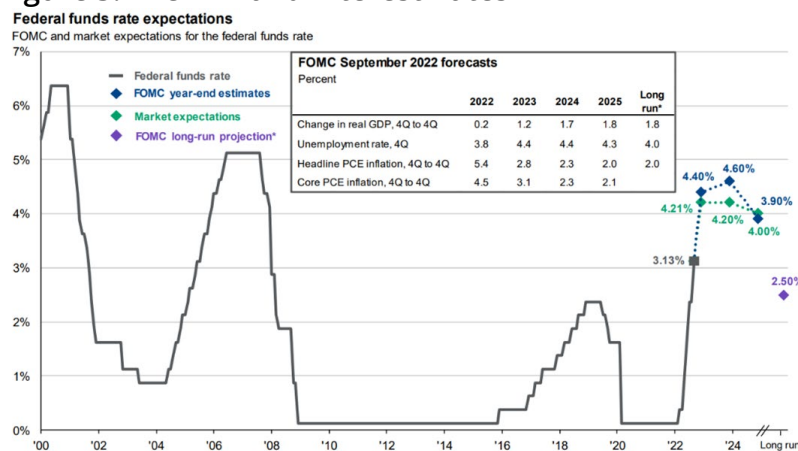
**Figure 2. Interest Rates and Inflation**



Source: BLS, FactSet, Federal Reserve, J.P. Morgan Asset Management.  
 Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month. For the current month, we use the prior month's core CPI figures until the latest data is available.  
 Guide to the Markets – U.S. Data are as of September 30, 2022.

As seen in Figure 2, nominal and real US 10-year treasury yields have risen sharply over the past year. As of the end of September 2022, nominal yields were sitting at 3.83%, while real yields remain significantly negative at -2.52%. At the same time, inflation is 6.32%; although nominal interest rates have increased, the negative real yield suggests that further interest rate increases are imminent. The Fed raised rates on November 2<sup>nd</sup> by 75 more basis points, demonstrating their commitment to combating high inflation with higher interest rates (<https://www.cnn.com/2022/11/02/fed-raises-borrowing-costs-with-another-jumbo-interest-rate-hike.html>). We will likely continue to see the Fed Funds rate rise through 2023, when JP Morgan expects they will peak at around 4.6%, as seen in Figure 3.

**Figure 3. The FED and Interest Rates**

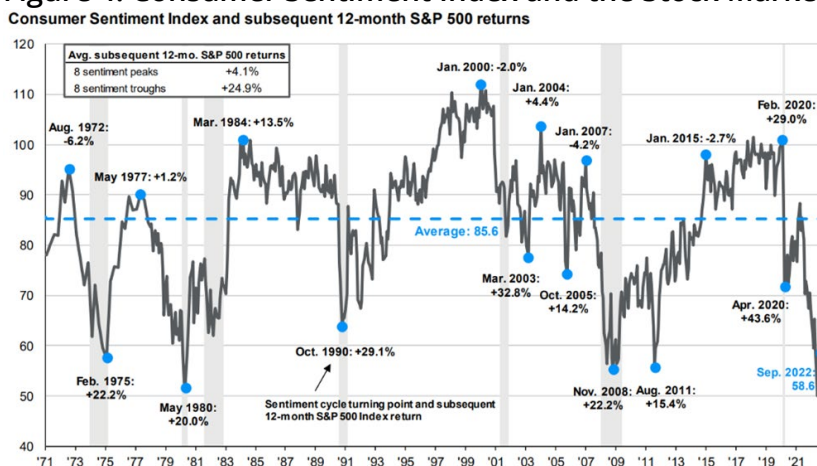


Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.  
 Market expectations are based off of the respective Federal Funds Futures contracts for December expiry. \*Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.  
 Guide to the Markets – U.S. Data are as of September 30, 2022.

As seen in Figure 3, JP Morgan's federal fund rate expectations show a continued steep rise in rates in the near term. As previously stated, the Fed recently raised interest rates 75 basis points, and this behavior is unlikely to stop against the backdrop of the incredibly high inflation being experienced. We are likely to see interest rate peak in 2023, and it is unlikely that we will see rates fall until inflation moderates in late 2024, when hopefully the economy will be in better shape.



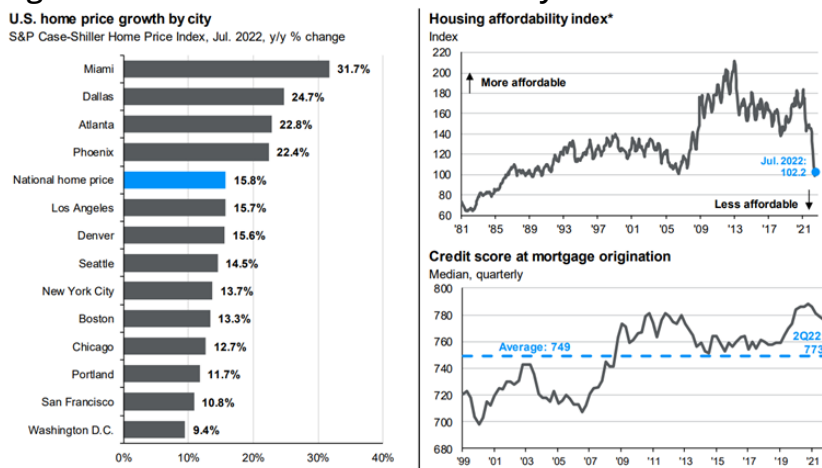
**Figure 4. Consumer Sentiment Index and the Stock Market**



Source: FactSet, Standard & Poor's, University of Michigan, J.P. Morgan Asset Management. Peak is defined as the highest index value before a series of lower lows, while a trough is defined as the lowest index value before a series of higher highs. Subsequent 12-month S&P 500 returns are price returns only, which excludes dividends. Past performance is not a reliable indicator of current and future results. Guide to the Markets - U.S. Data are as of September 30, 2022.

As seen in Figure 4, while consumer sentiment did rise since August, it is still at a low not seen since the financial crisis of 2008 and has not seen levels like these since May 1980. This level of consumer confidence augurs poorly for near term economic activity. However, as shown in the chart it appears that consumer sentiment bottomed out in August and has since bounced back from its August low. In the past, consumer sentiment troughs have heralded significant increases in the S&P 500 in subsequent 12 months.

**Figure 5. Home Prices and Affordability**

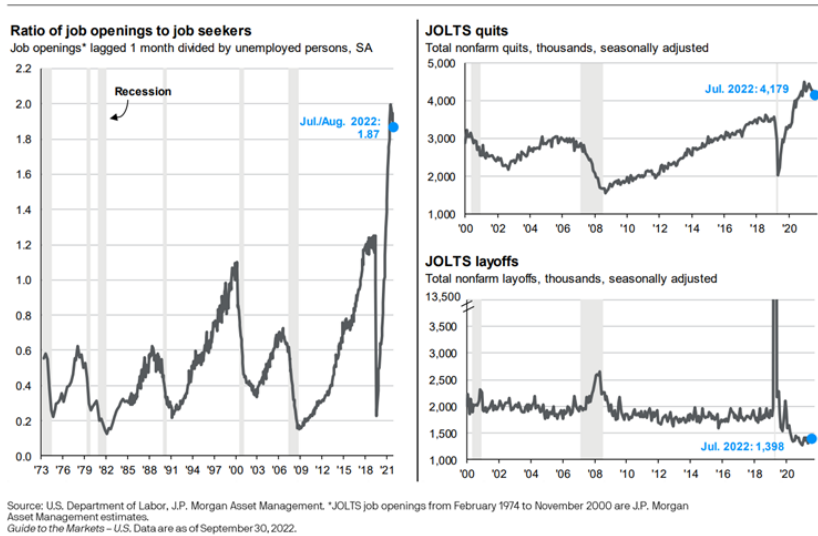


Source: J.P. Morgan Asset Management; (Left) FactSet, Robert Shiller, Standard & Poor's; (Top right) U.S. National Association of Realtors; (Bottom right) New York Fed Consumer Credit Panel/Equifax. \*Based on the National Association of Realtors methodology, an index value above 100 signifies that a family earning the median income has more than enough income to qualify for a mortgage loan on a median-priced home. The calculation assumes a down payment of 20% of the home price and it assumes a qualifying ratio of 25%. Guide to the Markets - U.S. Data are as of September 30, 2022.

As seen in Figure 5, the average national home price has gone up by 15.8% over the past year, making homes as unaffordable now as they were during the financial crisis of 2008. In addition to reflecting the pandemic-induced surge in housing prices, the sharp decline in affordability reflects the more than doubling in mortgage rates over the past year. All of this suggests home prices are likely to fall in the coming months.

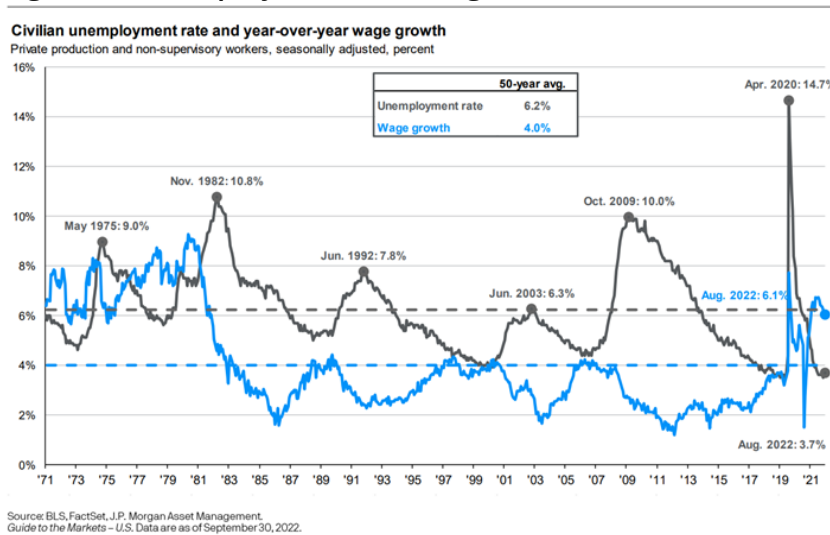


Figure 6. Labor Demand



As seen in Figure 6, the current ratio of job openings to job seekers is 1.87, a high not seen in the past 50 years. People quitting their jobs are at a high not seen in the past 20 years. Layoffs are at a low not seen in the past 20 years. The disparity between job seekers and job openings suggests that the demand for workers will continue to outpace supply. Clearly, open jobs are not paying high enough wages to attract workers – which does not bode well for inflation.

Figure 7. Unemployment and Wages



As seen in Figure 7, the unemployment rate has returned to pre-pandemic levels at 3.7%. At the same time, though wage growth has risen over the past year, it recently dropped to 6.1%, which is far lower than the level of inflation at 8.2% headline CPI. This disparity between headline CPI and worker's wage growth makes it more difficult for workers to spend money on anything but living expenses, especially considering the high cost of housing previously discussed in figure 5. With goods more expensive, inflation rising, and housing unaffordable, all into the foreseeable future, workers' wages must increase.



## Things to watch out for:

- Rising inflation and the Fed's attempt to combat it through high interest rates.
- Possible increases in the S&P 500 in the next 12 months as heralded by the bottoming of the consumer sentiment index.
- Record low housing affordability.
- Rising wages alongside a lower ratio of workers to job openings.
- Continued possibility of a recession if we are not already in the midst of one.



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