Ropes Wealth Acknowledges This Terrible, Horrible, No Good, Very Bad Week

In the children's book, Alexander and the Terrible, Horrible, No Good, Very Bad Day, the protagonist goes to sleep with gum in his mouth and wakes up with gum in his hair. He doesn't get a seat by the window during carpool, doesn't get dessert with his lunch, is rebuffed by his friends on the playground, has to get a cavity fixed at the dentist, and is served lima beans for dinner. Alexander considers moving to Australia due to his bad day. He ultimately finds that everyone has bad days, and every bad day comes to an end, eventually.

We need to channel Alexander at this moment, because the economic news this week wasn't good and moving to Australia won't necessarily make it better (though their inflation rate is only 6.1%!).

The U.S. Consumer Price Index (CPI) was up 0.1% in August, following a flat (0.0%) reading in July. Year-over-year, consumer prices rose a stubbornly high 8.3%. While this was down from the 8.5% pace reported in July, the inflation rate is still near a four-decade high. Food prices rose 0.8%, while energy prices dropped -5.0% in August, following a -4.6% decline in July. Excluding food and energy costs, the core CPI rose 0.6%, double the 0.3% rise expected. Year-over-year, the core CPI increased 6.3%, up from the 5.9% gain the month prior.

In the details, housing prices increased 0.8%, thanks to a 0.7% rise in the owners' equivalent rent (OER), medical care prices increased 0.7%, other goods and services costs also gained 0.7%, and recreation prices rose 0.2% in August. Apparel prices rose 0.2%, and education and communication prices gained 0.1%. On the other hand, transportation prices fell -2.3%, due to a -0.1% decline in used cars and truck prices. New vehicle prices, however, rose 0.8%. Additionally, commodities fell -0.8%, and airline fares dropped -4.6% in August, the third consecutive month of decline.

Clearly prices remain stubbornly elevated with categories such as housing and medical care continuing a fierce upward ascent compared to energy prices and air fares. The persistence and pervasiveness of inflation continues to confound our world economy even as interest rates trend at levels we have not seen in years and supply chain bottlenecks continue their remarkable progress from the pandemic days. From a policy standpoint, this report falls well short of a meaningful decline in prices, keeping pressure on the Fed to continue along a longer-term pathway to higher rates despite mounting evidence of weakness in the domestic economy.

Markets reacted badly to the news, hoping for an excuse for the Fed to slow the pace of rate hikes; in fact, this report served to do the opposite, sparking speculation the Fed may raise rates by 100-basis points at next week's meeting instead of just 75 basis points. We see the Fed sticking to the 75-basis point plan but concede our mounting fear that traditional policy tools are just not effective in fighting supply-side price pressures. As a result, we worry the Fed may unnecessarily tighten the U.S. economy into recession and prolong the downturn by being dogmatically focused on a narrow set of backward-looking inflation data.

To that point, though August retail sales were stronger than expected, up 0.3% for the month and 9.1% year-over-year, the devil was in the details as the sales report showed we are spending more but taking home less. Consumers are markedly shifting the goods and services in their basket on a month-to-month basis, something consumers do when they are increasingly concerned about their financial footing. Furthermore, spending continues to be dominated by two key categories – autos and energy – indicating expenditures elsewhere are even more moderate than the headline read suggests.

These key economic reports were coupled with the news this week that the 30-year fixed mortgage rate topped 6.0% for the first time since 2008. As a result, mortgage applications have slumped, boding poorly for home sales. For context, the low mortgage rate during the pandemic was 2.85% and the average homeowner mortgage rate is 3.31%.

Meanwhile, industrial production unexpectedly declined, New York manufacturing activity improved but remained contractionary, and Philadelphia manufacturing unexpectedly fell into contraction territory.

Thankfully, after a tense round of negotiations that came down to the wire, railway workers and companies came to an agreement over wage increases to avert a strike that was set to go into effect and could have disrupted shipments across the country. Given roughly 40% of long-haul trade is transported by rail, idle trains could have cost the U.S. economy billions per day. At least one thing went right this week.

Remember Alexander's story that every bad day eventually comes to an end, and this too shall pass. Stock markets have slid lower all week but remain in a range that suggests we have found the lows of this downturn, even if we can't find our way convincingly above them. We remain focused on the quality of your underlying holdings and are using this moment to push up the quality and endurance of your individual positions. As we described last week, we see great opportunity in high quality bonds and are also striving to make the best of a bad market by being proactive in tax management techniques that will set portfolios up nicely for the future. We are grateful for your confidence and wish you a wonderful, delightful, happy, and very good weekend in spite of this week's market action.

Thank you 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**.

Ropes Wealth Advisors LLC
800 Boylston Street Boston, MA 02199-3600