Ropes Wealth Recaps This Week's Data and Urges Moderation

Markets delivered a standing ovation to the long-awaited news that inflation pressures are finally abating, with the S&P 500 surging 5.5% in one day in a welcome relief rally. We still have a long way to go to claw back from this year's hole of steep losses, but we will take it! The dramatic rally caught short sellers wrong-footed, making gains even more outsized, and was reassuring even as cryptocurrency markets stumbled in the turmoil surrounding the demise of the crypto exchange FTX.

Why the euphoria? Headline U.S. inflation came in at 7.7%, the lowest since January, before Russia's war in Ukraine pushed up commodity prices. More important for the Fed, the core measure that excludes food and energy slowed more than anticipated. In the details, shelter costs contributed more than 50% to headline Consumer Price Index (CPI), with gasoline and food also providing a boost to the overall price level. Consumers paid more for motor vehicle insurance, recreation, and new automobiles, but did pay less for used cars and trucks, medical care, apparel, and airline fares. Although shelter costs dominated the increase in prices, with annual costs related to rent and owner's equivalent rent (OER) soaring to new record highs, such price pressures should be short lived. Private sector measures of rent growth suggest that CPI shelter costs may be close to peaking and that should provide further relief.

This softer CPI report indicates that inflation is at least no longer worsening and as a result, markets jumped to the conclusion that the Fed will be able to comfortably downshift to only a 50-basis point rate hike at their upcoming December meeting, and perhaps pause or pivot from there. Following the report, the 2-year Treasury dropped in yield by 26 basis points to 4.33% and the U.S. dollar had its worst one-day decline in thirteen years.

We are grateful for the surge in stock prices and hope to see continued momentum in the weeks ahead. That said, we urge caution in presuming the Fed will make a fast pivot off their hard stance against allowing price pressures to get out of control. More likely, the Fed will continue to push forward until the Fed Funds target rate is at or close to 5%, and we stand at a range of 3.75%-4% today. While that may seem harsh, we are still facing the highest inflation levels since 1982. Importantly, we likewise remind clients that for markets it is not the absolute levels of inflation or interest rates that are often most critical, but the directionality and pace that matter most. Today we received confirmation that the directionality and pace for inflation has shifted more positively at long last.

In other news this week, election outcomes confirmed gridlock is the order of the day in Washington, or at least it looks like it will be that way once the votes are counted. While markets normally savor gridlock, it would be an understatement to say that a polarized government will make passing government spending bills and increasing the debt ceiling even more challenging than previously expected. This could lead to politically induced market volatility in 2023. If Republicans ultimately win the House, they will do so with a narrow majority and, given factions within the GOP that often buck the party's leadership, the House could be almost unmanageable, and the odds of government shutdowns will increase. If the U.S. enters a recession in 2023, a divided Congress could struggle to pass a fiscal stimulus bill which will leave the Federal Reserve as the main institution responsible for setting economic policy in the country.

We are therefore not out of the woods yet. That said, we continue to advocate for careful review of your investment plan, and a focus on allocation, quality, and liquidity. We are focused on shoring up your balance of stocks and bonds, harvesting tax losses as appropriate, and replenishing liquidity for what will hopefully be a better year ahead.

To our soldiers out there, to the veterans of all branches: thank you for your sacrifice, your bravery, and the example you set for us all. Happy Veterans Day!

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