

Wall Street Slips on Inflation and Rate Debate

October 17, 2016 U.S. stocks gained fractionally on Friday, but not enough to finish positive last week as investors remain cautious about interest rates and hopeful on corporate earnings. Earlier in the week, Wall Street saw the 10-year Treasury spread over 10-year TIPS, a proxy measure of consumer prices, expand to 1.69%, the most since May. Meanwhile, Wednesday's release of the minutes from the Fed's September FOMC meeting revealed that policymakers remain committed toward raising rates this year. However, on Friday, Fed Chair Janet Yellen said that there are "plausible ways" that running the economy hot for a while could repair some prior recession damage. Third quarter earnings season got off to a rocky start, however several major large-cap banks posted results topping forecasts.

In economic data, retail sales climbed 0.6% in September, the most in three months. The Fed's Labor Market Conditions Index, derived from 19 labor indicators, retreated further into negative territory last month with a loss of 2.2 index points, following a revised August decline of 1.3 index points from -0.7 previously reported. Import prices rose 0.1% last month after falling 0.2% in August. Favorably, import prices are now down 1.1% YoY, the smallest 12-month decline since August 2014. Export prices climbed by 0.3% after a 0.8% August drop and are down 1.5% YoY, the smallest decline since October 2014.

For the week, the S&P 500 fell 0.95%, capping its first pair of weekly declines since August, while the Dow Industrials lost 102-points (-0.56%), and the NASDAQ Composite declined 1.48%. Seven of the 11 major sector groups ended with weekly declines, led by Healthcare (-3.22%), Materials (-1.19%), and Consumer Discretionary (-1.14%). Utilities (+1.34%) and Real Estate (+1.22%) outperformed the most among gainers. The US Dollar Index strengthened 1.43% over the week, ending at a seven-month high of 98.019. Oil retreated on Friday as the dollar advanced, but gained 1.08% over the week. Treasury securities declined last week, with the yield on 10-year Treasury notes gaining eight basis points to end at 1.799%.

What We're Reading

September FOMC Minutes Implications ↗

Government Borrows \$0.15 for Every \$1 Spent ↗

M&A Outlook for 2017 ↗

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Week's Economic Calendar

Monday, October 17: Empire State Mfg Survey, Industrial Production;

Tuesday, October 18: Consumer Price Index, Housing Market Index;

Wednesday, October 19: MBA Mortgage Applications, Housing Starts, Atlanta Fed Business Inflation, Beige Book;

Thursday, October 20: Jobless Claims, Philly Fed Business Outlook Survey, Existing Home Sales, Leading Indicators;

Friday, October 21: No major releases.

Market Watch

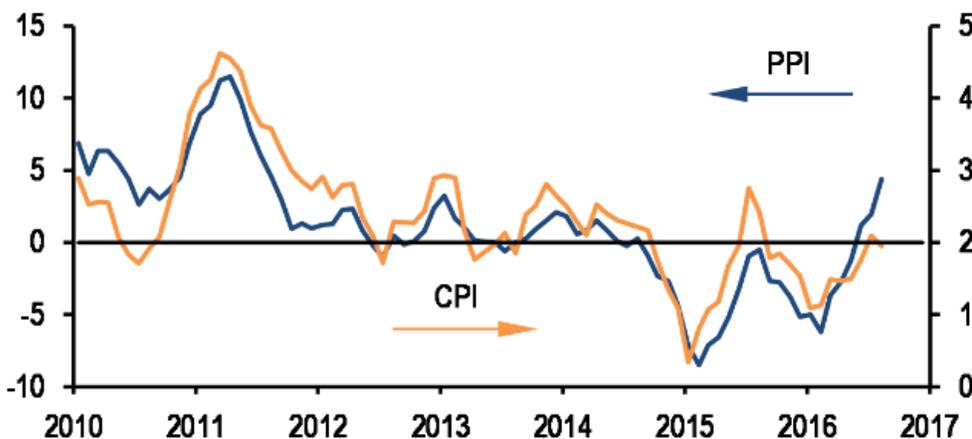
Stocks	1-Week	MTD	3-Month	YTD	1-Year	3-Year
Dow Jones Industrial Avg.	-0.56%	-0.93%	-1.99%	4.09%	7.16%	5.83%
S&P 500	-0.95%	-1.55%	-0.90%	6.17%	9.31%	9.93%
NASDAQ Composite	-1.48%	-1.81%	3.88%	5.15%	10.37%	12.32%
Russell 3000	-1.05%	-1.76%	-0.68%	6.28%	8.75%	9.18%
MSCI EAFE	-1.40%	-2.15%	1.22%	-0.47%	-1.05%	-0.52%
MSCI Emerging Markets	-1.94%	-0.67%	4.15%	15.24%	8.09%	-1.95%
Bonds	1-Week	MTD	3-Month	YTD	1-Year	3-Year
Barclays Agg Bond	-0.16%	-0.67%	-0.50%	5.08%	3.85%	3.81%
Barclays Municipal	-0.41%	-1.03%	-1.30%	2.94%	4.22%	5.27%
Barclays US Corp High Yield	0.10%	0.55%	3.32%	15.74%	11.16%	5.20%
Commodities	1-Week	MTD	3-Month	YTD	1-Year	3-Year
Bloomberg Commodity	0.82%	1.18%	-0.81%	10.16%	-3.95%	-12.27%
S&P GSCI Crude Oil	1.65%	5.20%	9.33%	37.01%	7.60%	-20.88%
S&P GSCI Gold	0.29%	-4.68%	-6.28%	18.42%	6.40%	-0.55%

Source: Morningstar

Chart of the Week: Inflation Watch Follow-Up

Figure 3: Global headline producer and consumer prices

%6m, saar; both scales



Source: J.P. Morgan

As the global inflation chart from JPMorgan (above) shows, consumer and wholesale prices are now on the rise in most corners of the world. This past week's Producer Price Index (PPI) reports from the U.S. and China point to a rapid shift away from deflation at the wholesale level. Global consumer price inflation is moving more slowly, but JPMorgan forecasts the global cost-of-living index (CPI) to increase cumulatively by 1%—to about 2.5%—by mid-2017. The responses to this from the three-largest world economies (G-3) have varied, reflecting their divergent business cycle positions (visible in core inflation) and institutional constraints. The U.S. Federal Reserve appears to be debating how far to push the limits of the Phillips curve** by running a “high

pressure” labor market at the same time that the European Central Bank and Bank of Japan are displaying acceptance that inflation will stay below target for longer.

** The Phillips curve is a historical inverse relationship between rates of unemployment and corresponding rates of inflation that result in an economy. Stated simply, decreased unemployment, (i.e., increased levels of employment) in an economy will correlate with higher rates of inflation.

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Glossary

The **Barclays U.S. Aggregate Bond Index** is an unmanaged index composed of Barclays Credit government bond index, mortgage backed securities index, and asset backed securities index and is generally representative of the US Bond market.

The **Barclays U.S. Corporate High Yield Index** measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging market debt.

The **Barclays U.S. Municipal Bond Index** is an unmanaged, market-value-weighted index of investment-grade municipal bonds with maturities of one year or more.

The **Bloomberg Commodity Index** is a broadly diversified index that allows investors to track commodity futures through a single, simple measure. It is composed of futures contracts on physical commodities and is designed to minimize concentration in any one commodity or sector. It currently includes 19 commodity futures in five groups. No one commodity can comprise less than 2% or more than 15% of the index, and no group can represent more than 33% of the index (as of the annual reweightings of the components).

The **CBOE Volatility Index® (VIX®)** is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. Since its introduction in 1993, VIX has been considered by many to be the world's premier barometer of investor sentiment and market volatility.

The **CRB Index** is a pricing index that measures changes in the price of 22 commodities that are believed to be among the first to react to changes in economic conditions.

The **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.

The **Hang Seng Index** is a market capitalization weighted index of the stocks of the 33 largest companies in the Hong Kong market. The Hang Seng Index is a price weighted/share price index which measures movements in the prices of shares, but not of their dividends.

The **MSCI EAFE Index** (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada.

MSCI Emerging Markets is designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index.

The **NASDAQ 100 Index** is a modified capitalization-weighted index of the 100 largest and most active non-financial domestic and international issues listed on the NASDAQ. No individual listing can have more than a 24% weighting. Launched on February 1, 1985, the index carried a base value of 125.

The **NASDAQ Composite Index** includes all domestic and international based common type stocks listed on The NASDAQ Stock Market. The NASDAQ Composite Index is a broad based index.

The **Producer Price Index** is a family of indexes that measures the average change over time in the selling prices received by domestic producers of goods and services. PPIs measure price change from the perspective of the seller. This contrasts with other measures, such as the Consumer Price Index (CPI), that measure price change from the purchaser's perspective.

The **Russell 3000 Index** measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market.

The **S&P 500** is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

The **S&P GSCI Gold Index**, a sub-index of the S&P GSCI, provides investors with a reliable and publicly available benchmark tracking the COMEX gold future.

The **S&P GSCI Crude Oil Index** is a sub-index of the S&P GSCI and provides investors with a publicly available benchmark for investment performance in the crude oil market.

The **Shanghai Composite Index** is a stock market index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange.

The **STOXX Europe 600 Index** is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 18 countries of the European region: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.