Commerce Trust Market Brief with Scott Colbert
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Scott Colbert: Good morning. It's Tuesday, November 15th, and the markets are open. We're going to focus on the consumer price index and its impact to the markets. And as many of you know, last week the consumer price index [CPI] was reported and it came out lower than market expectations. Because it came out lower than the market was expecting, in other words inflation was a little less than the market was expecting, stock prices have bounced materially, interest rates have declined. And importantly, the expectation for forward interest rate increases have also declined a bit.

Specifically, the CPI on a year-over-year basis declined from 8.2% the previous month to 7.7% this past month on a year-over-year basis. And the core CPI, when we X out food and energy, and food and energy are about 21% of the CPI basket, also fell from 6.6% to 6.3%. Now, the decline to 7.7 on top line CPI, and 6.3% on core CPI, was two-tenths of a percent lower than the market was expecting. And that 2%, or two tenths of percent, lower than the market was expecting was very important.

You may recall earlier in the year, we suggested there were three things likely to have to happen before we could bottom the stock market. Number one was that inflation was going to have to come down faster than the market was expecting. Note this year, this is the first time that's happened. Basically, the market has been behind the surge in inflation as it's gone up, and up, and up for most of the year. And this is the first time that inflation fell more than the market was expecting.

Secondly, of course, we would have to reduce the odds of a forward recession, or essentially increase the probability of a soft landing. And then the third thing we'd have to see is some end to the Fed rate hike tightening.

So, what's happened with this better-than-expected CPI news? Well, the S&P 500 has surged 5.5% from its bottom, and it's still down 16% year to date. But that's 9% better than its low point throughout the year. And interest rates themselves have been reduced materially. The two-year Treasury has fallen by about 25%, or 25 basis points, and is now at 4.3% or so. And the 10-year Treasury, for the first time in the last two weeks, has broken through the 4% kind of floor that it had and is now down to about 3.82% as we sit here today.

And behind all this, of course, the jump in stock prices and the fall in interest rates is a lessening of the financial market tightening that has occurred this year. Probably the most important thought that the market has though, is that forward interest rates, in other words, how high interest rates are likely to get in the short end of the yield curve next year, have been reduced by about 25 basis points. The market had been expecting the Federal Reserve to raise rates probably to something over 5%, but less than

5.25% by May or June of next year. And now the market's terminal rate, so to speak, is just a little bit below 5%. We think the market has this just about right.

And now, given the rollover in inflation and the bounce back in stock prices, the cooling of economic activity, the recession in Europe, the fact that our money supply isn't growing here anymore, we expect The Fed to be able to slow down its interest rate hiking process in December, rather than the 75 basis point hikes that we've been having lately. We think they'll reduce it to 50 basis points. And then that affords them the opportunity to fine tune the market next year with perhaps a quarter and an additional quarter rate hike, with rates peaking at about 5% somewhere around mid-year.

So, we'll be back in a few weeks to discuss how the market is digesting all the more recent economic news, to see how quickly our economy is slowing, to see how much we think the Fed will pivot and slow down its interest rate hiking process. And importantly, digest all the information as we move towards either a softer landing or a recession. The market is still evenly split on this, with many calling for an early recession next year, some calling for no recession at all. And of course, our market call is there's likely to be a mild recession, but it won't start till late next year.

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