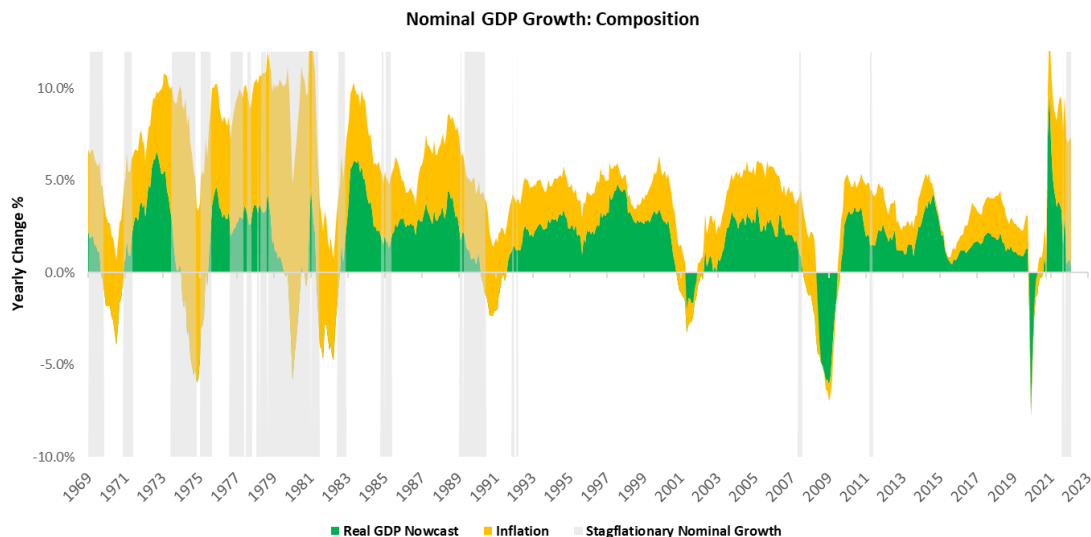


Month In Macro

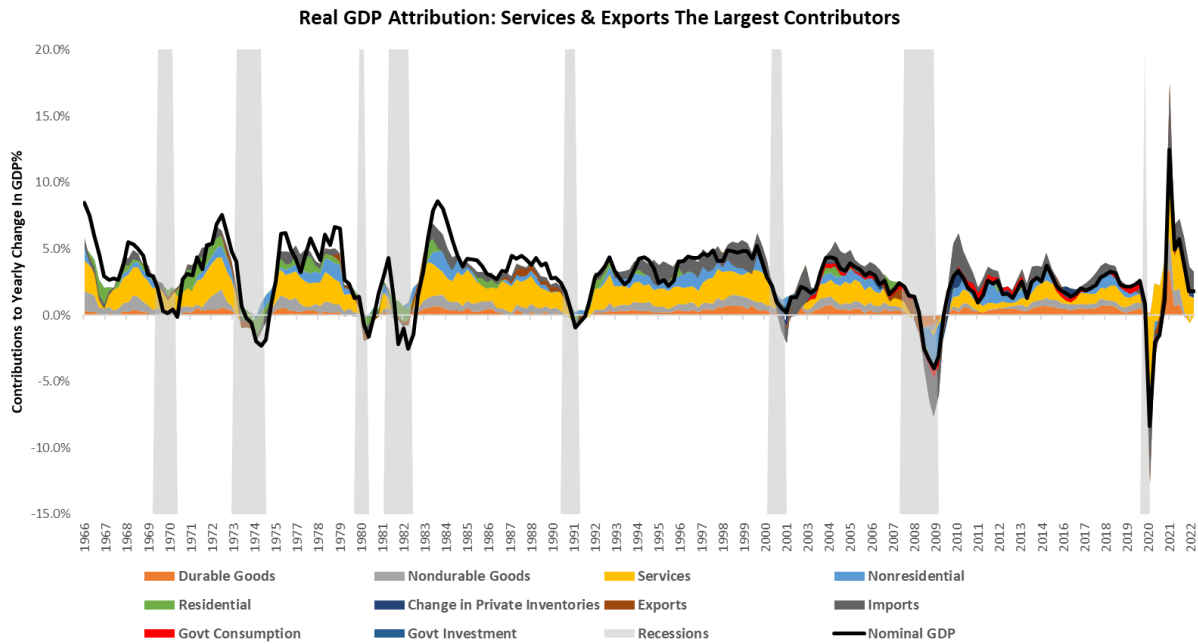
This report is part of our ongoing effort to provide economic and market guidance to our subscribers during a period of historic levels of uncertainty. This note aims to share our research team's internal checkpoint process in evaluating the current state of the economy as it pertains to markets. The pages that follow will have familiar content for those who follow our work but with the added benefit of our connecting the dots across all the economic and financial data our systems use to make portfolio decisions. This report will focus on the economy; future issues will include our market analysis. Our key takeaways are as follows:

- **Nominal growth remains elevated, while the drivers of real economic growth continue to feel pressure.**
- **Inflationary pressures have shown signs of persistence and entrenchment, suggesting the Fed will have to tighten policy further and longer than markets expect.**
- **Liquidity conditions remain bleak, with little reprieve in our tracking of conditions.**
- **Markets have priced a resurgent probability of rising growth, mainly coming from a bear market rally in equities. Looking under the surface of aggregate equity pricing, we find stagflationary sectors driving these moves. Our systems continue to estimate these are countertrend moves worth fading.**

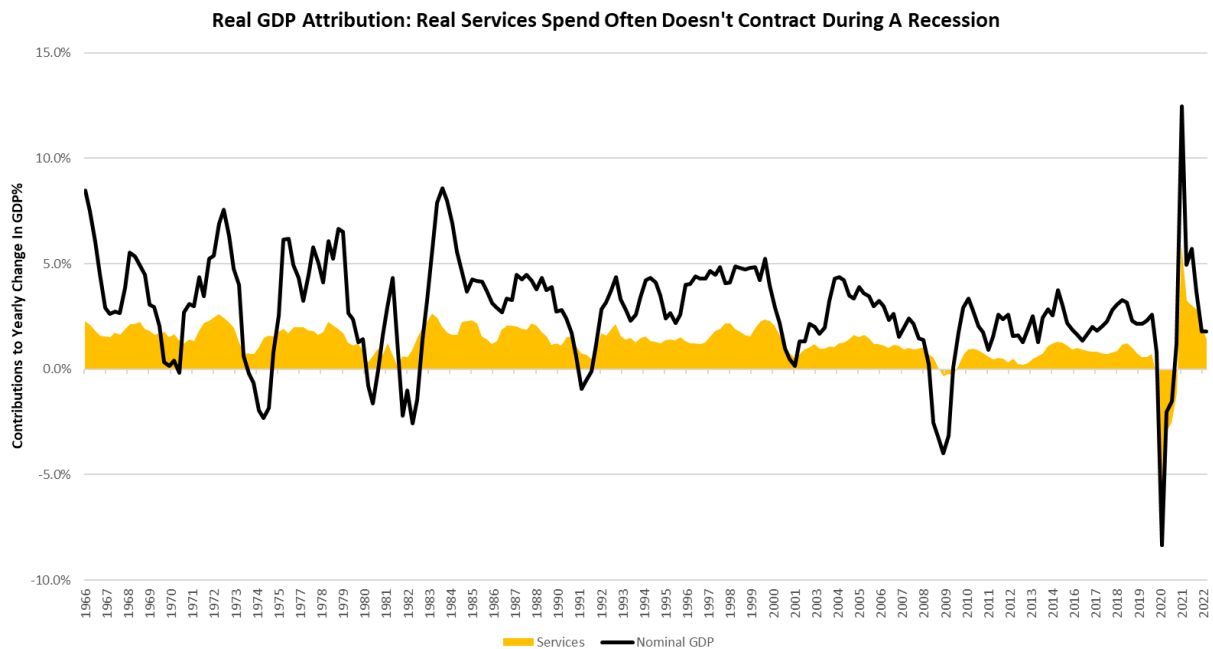
Overall, markets continue to signal that we remain in an environment of stagflationary nominal growth, and our systematic estimates of future growth suggest an eventual transition to stagflation. We believe we are now in the "pain period." What we mean by this is that economic data is likely to remain more resilient than many expect. Those calling for an imminent contraction will likely experience pain in their positioning. Managing risk as the data evolves is paramount in timing a transition. We discuss the logic underlying these conclusions in the pages that follow. We begin by showing our tracking of Nominal GDP growth, broken real growth and inflation. Our GDP Nowcast places real GDP growth at 1.0% versus one year ago, with inflation running at many multiples of this number, i.e., what we call stagflationary nominal growth.



Our Nowcast is consistent with what we have seen in most recent official data, though our Nowcast is more timely. We show the official GDP data below. The headline number for real GDP showed significant strength in Q3, reflecting a tight labor market, and heightened nominal activity. This print is of importance to us because although the headline number is backward looking, its composition offers forward looking insights.



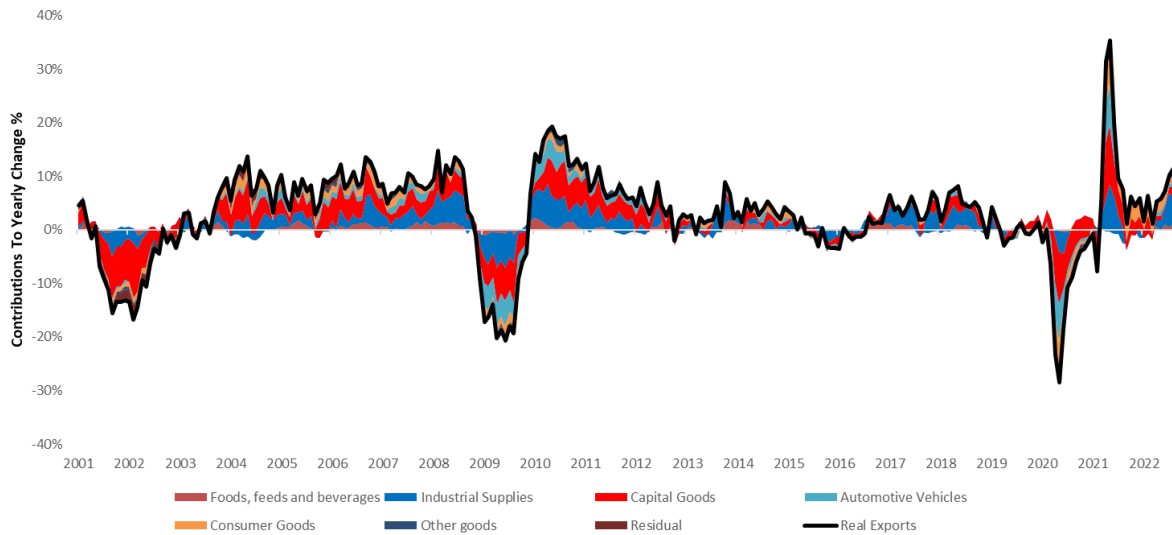
The largest driver of yearly growth in real GDP was services spending, which is an extremely resilient component of GDP. Below, we isolate the services spending contribution to growth, to illustrate how resilient services spending can be:



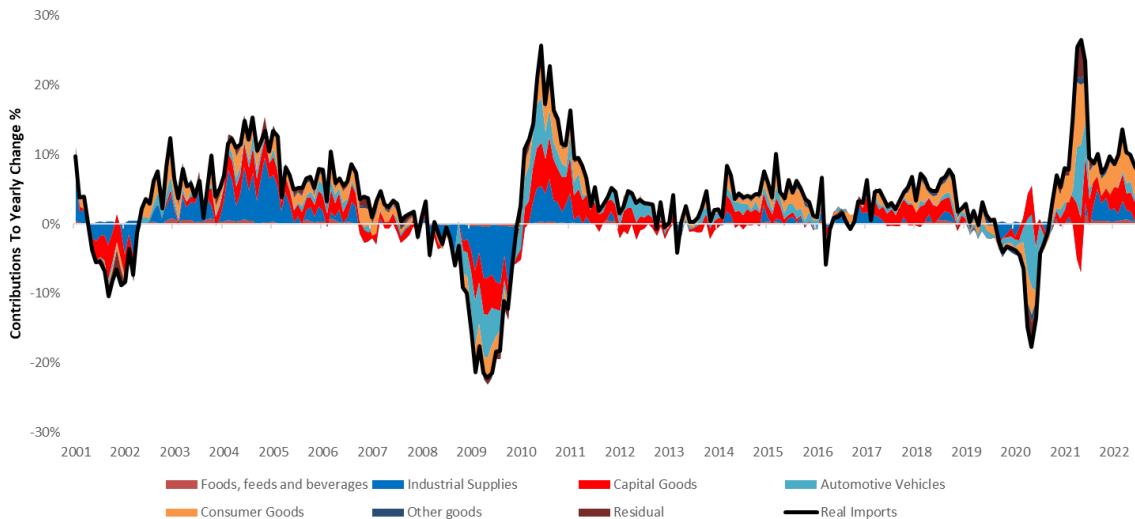
Services spending is largely a function of employment, which remains extremely robust today. However, services spending is currently compensating for contractions in other parts of the economy, i.e., goods spending. Given the tightness of labor markets, along with the Fed's objectives of taming inflation through higher unemployment, it is unlikely that services spending will not weaken. Therefore, marginal weakening in the services sector is likely to contribute to significant weakening in the overall GDP picture.

The second largest driver of this print was export activity, driven by strength in industrial supplies, i.e., a category that has a significant contribution coming from energy related goods. Alongside this increase in industrial supply exports, we saw a decline in imports for the same. It is fairly aberrational for net trade to be an a large contributor to real GDP, and we see these moves primarily driven by strong energy production and demand. Looking ahead, it's difficult to see these contributions continue at the same pace and scale, unless petroleum demand and prices continue to surge.

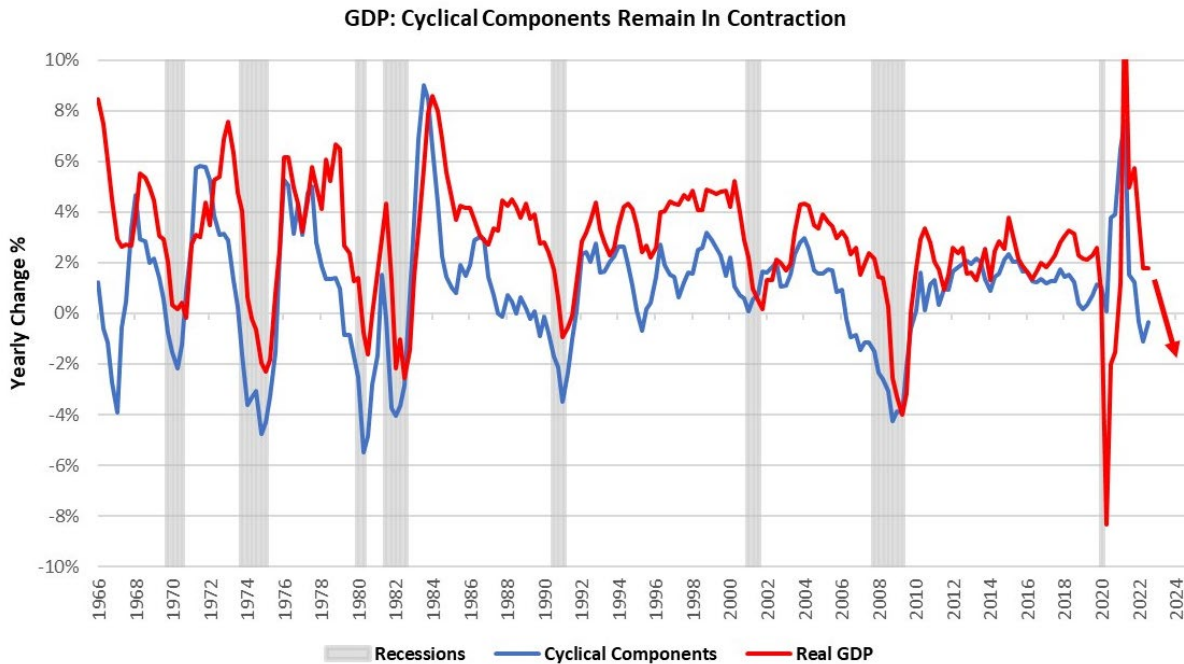
Real Export Contributions



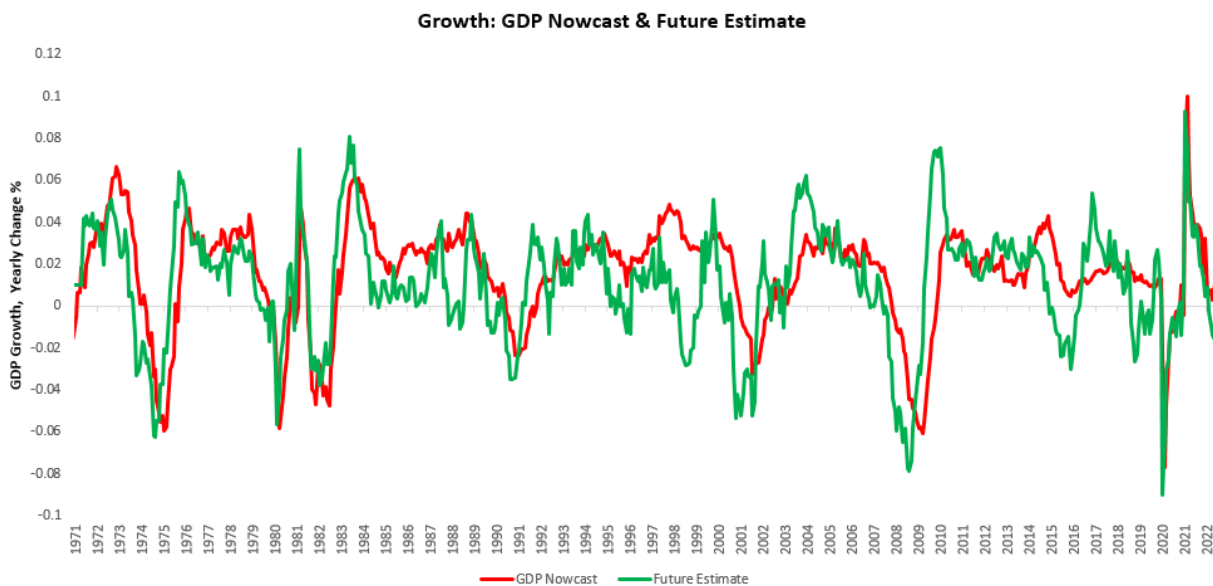
Real Import Contributions



Alongside these positive contributions, we saw continued weakness in cyclical components of GDP, i.e., housing, automobiles, etc. These areas of the economy are far more sensitive to changes in the capital cycle and tend to respond to changes in financing conditions much more than resilient areas like services. Periods of sustained divergences between the cyclical components of GDP and the broader GDP basket have historically resolved themselves in significant slowdowns in growth.

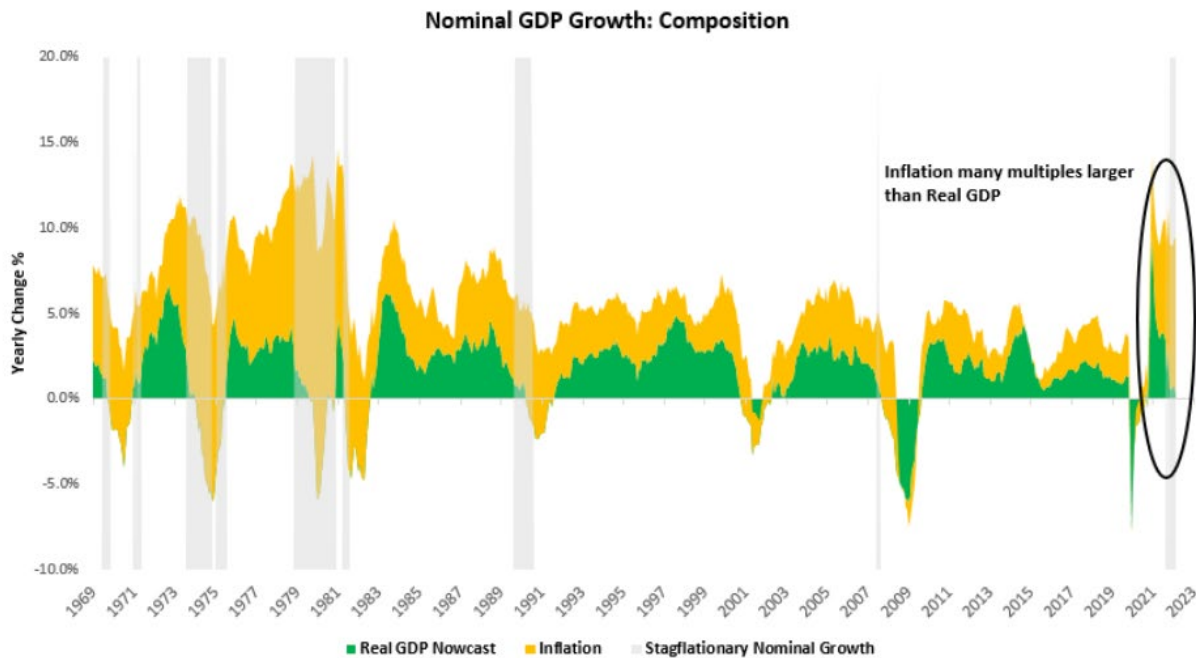


In line with these pressures from cyclical factors, our latest systematic estimates of future growth expect real GDP to move into negative territory over the next six months, increasing the chances of witnessing outright stagflation. We show our Nowcast & our future growth estimates below:



Therefore, our current high-level assessment remains that we are in a period of stagflationary nominal growth, with pressures building to push us into stagflation. To explain the relevance of these dynamics, we re-share a section of a previous edition of the Month In Macro; feel free to skip ahead to our inflation discussion if you are already familiar with this section.

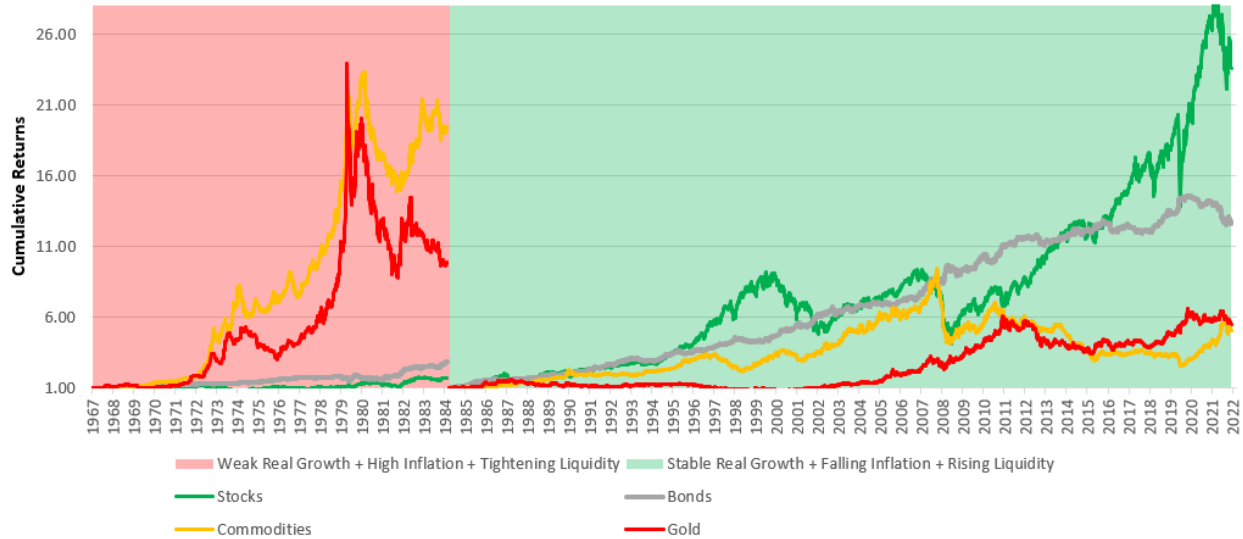
As we have explained in previous editions of The Observatory, this environment is not what is uncommon but rather its extent. To illustrate this dynamic, we show real growth and inflation, and highlight periods that resemble today's growth and inflation dynamics:



Above, we highlight in grey periods of stagflationary nominal growth, i.e., periods that resemble today's growth and inflation dynamics. We do so to illustrate that while today's environment may be anomalous relative to recent history, we have seen periods like this in the past. In particular, the last period we have seen like today was in the 1970s. The 1970s presented a dramatically different set of circumstances to the 2010s and have resulted in many traditional investment strategies hurt by this year's 70s-like market pricing of high inflation, which dramatically contrasts with the last four decades of low inflation. It is pertinent to note that since 1984, markets have spent 65% of their time pricing in falling inflation— an environment beneficial to both stocks and bonds. Stocks and bonds have opposing growth biases, i.e., stocks prefer environments where growth rises because earnings stay healthy. In contrast, bonds outperform when their fixed cashflows look relatively attractive, i.e., when growth falters. Thus, stocks and bonds have been extremely good diversifiers. However, while stocks and bonds have opposing growth biases, they have the same inflation bias— they need stable inflation to perform well. Therefore, when inflation becomes a dominant force in the economy (such as in the current scenario), stocks and bonds perform poorly, both individually and together, in a portfolio.

To illustrate the differences in asset class performance, we divide the history of the data into two periods to display the diametrically opposing market impacts of two secular environments— Stagflationary Nominal growth (1967 to 1984) and Disinflationary Real Growth from (1984 to 2022):

Stagflationary Nominal Growth Vs. Disinflationary Real Growth



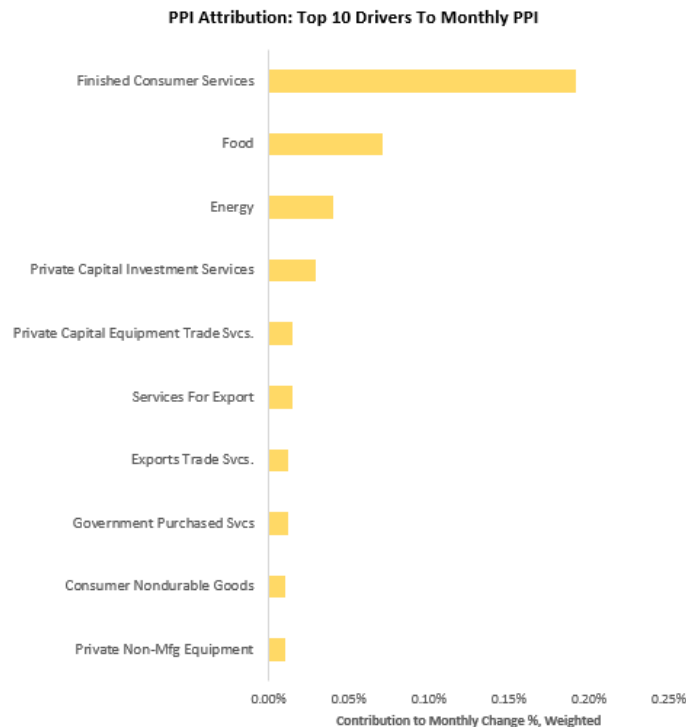
We can see that relative asset class performance during these periods differed dramatically. During stagflationary nominal growth, commodities and gold performed exceptionally well. From 1967 to 1980 (the first peak in interest rates), equities & bonds returned 2% and 5%, respectively, whereas commodities and gold returned 25% each. In contrast, during disinflationary real growth, stocks & bonds returned 10% and 7%, while commodities and gold returned 5% and 6%, respectively. Furthermore, the situation has been exacerbated by tightening liquidity. We define liquidity as the stock of cash and cash like asset that facilitate economic activity. Tightening liquidity reflects the drying up of funding liquidity in the economy, i.e., when the dry powder for future economic and financial activity contracts. Tightening Liquidity conditions manifest themselves in flattening yield curves, widening credit spreads, cheapening valuations, and poor risk asset performance.

Liquidity Complex: Sovereign Impulse

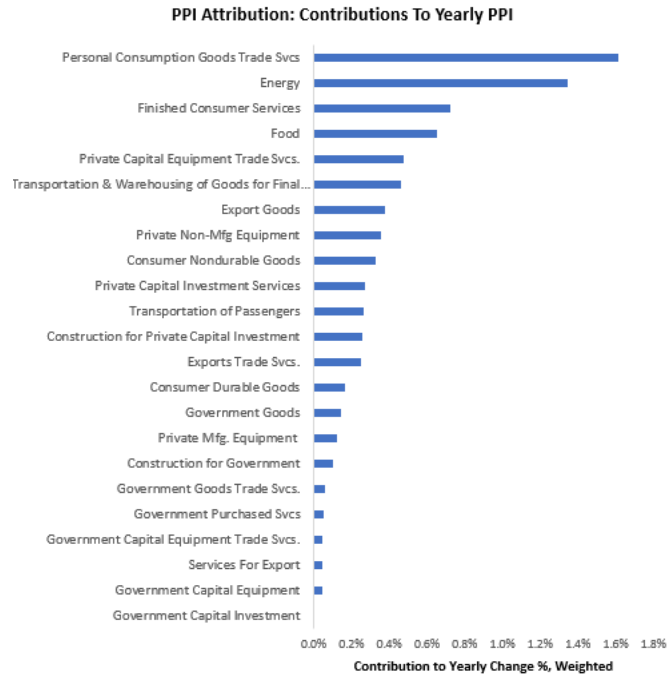


The current climate has been a function of the large amounts of liquidity in both financial markets and in the real economy created by the government authorities and expansionary monetary policy, resulting in both economic and financial inflation. The Fed is moving to curb these excesses but can only act through the financial channel- i.e., impact asset prices and future lending (credit). Meanwhile, cash created in the real economy remains abundant relative to output, resulting in sustained inflationary pressures. The only way to drain this cash would be through tighter fiscal policy, which does not look forthcoming. Therefore, money and credit need to find a new equilibrium relative to existing output, the process of which is inflation. Given that inflation is problematic, authorities can either move to curb inflation either through taxation (less cash) or tighter monetary policy (fewer financial assets). Authorities have chosen the latter and are moving to generate a significant contraction in asset prices through the reduction of financial liquidity.

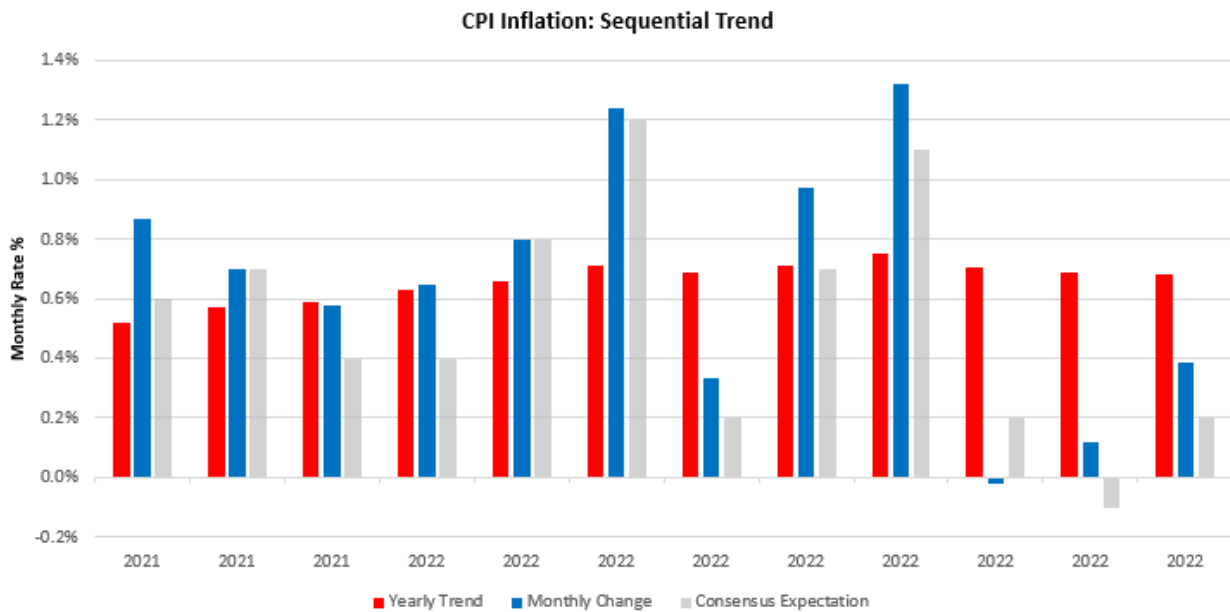
Inflation shows significant signs of entrenchment. Inflation begins with shocks to the balance between money and real resources. Mechanically, once the initial shock has passed, we could see a reduction of inflation if the costs do not make their way through the supply chain to services spending- i.e., transitory inflation. However, if this inflationary pressure permeates through the economy, it reaches a point where nominal spending continues to push nominal demand, creating a self-reinforcing loop, i.e. entrenchment. We are witnessing the latter, with nominal income feeding nominal spending. This dynamic cannot sustain itself forever, as eventually, the nominal costs of producing new items becomes prohibitive to activity- which causes an eventual pull-back. Policymakers are trying to engineer this pull-back by reversing initial conditions, i.e., by tightening liquidity to bring back the balance between money and real resources, but given the entrenchment of pressures, we remain ways off from an adequate contraction in liquidity to drag on inflation. The most recent CPI & PPI data lent credence to the idea that it is hard to tame once inflation takes off. PPI data came out higher than expected and showed significant contributions from consumer services. We show the biggest contributors to this print below:



Furthermore, this outsized contribution of consumer services is not a one-off event; consumer facing prices are now one of the largest drivers of PPI vs one year ago:

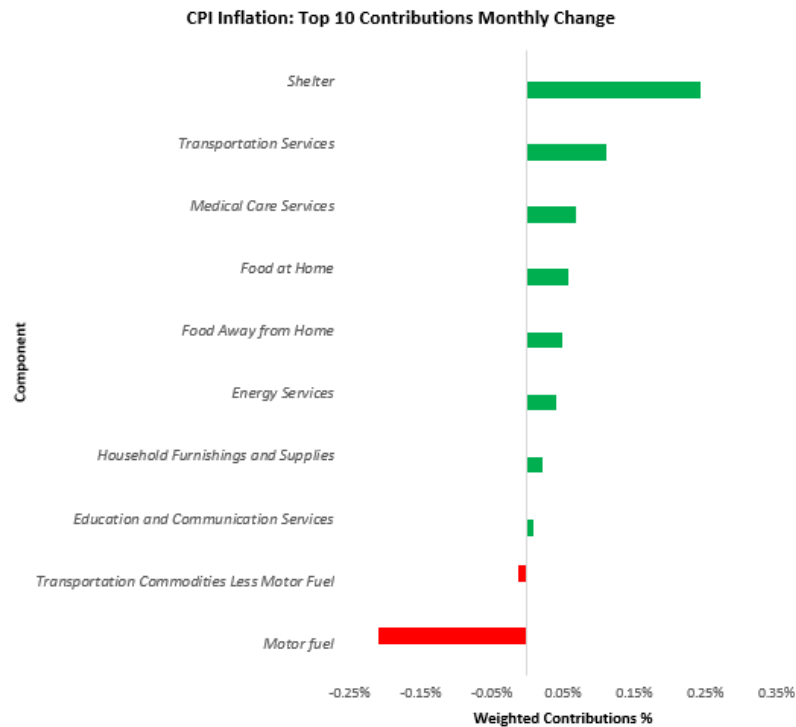


These signs of strong services inflation came ahead of CPI, which also came in higher than expected. CPI Inflation increased by 0.39% in September, surprising consensus expectations of 0.2%. This print contributed to a sequential deceleration in the quarterly trend relative to the yearly trend. Below, we show the monthly evolution of the data relative to its 12-monthly trend and consensus expectations:

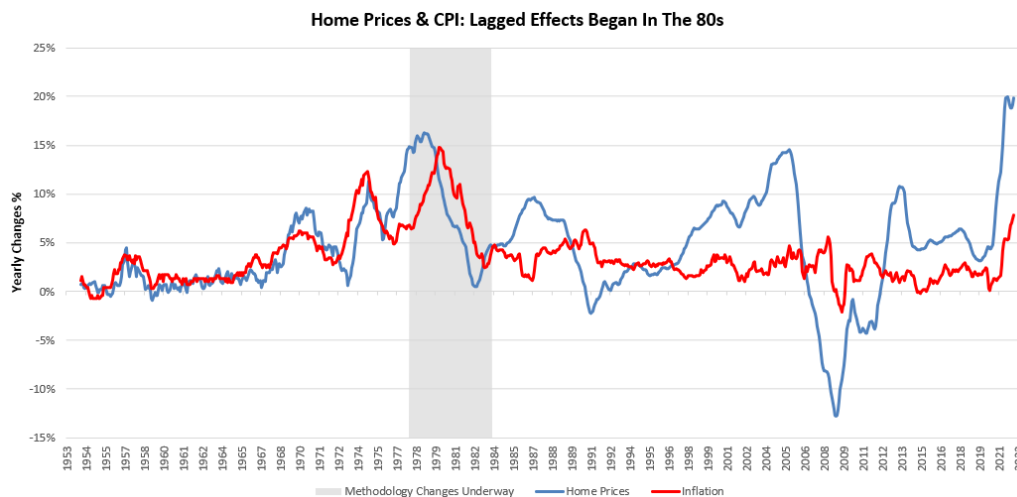


CPI remains elevated and the sharp acceleration in the latest print affirms the broad-based nature of this move. Of particular importance is that headline CPI remained in expansionary territory despite extreme downward pressures coming from energy prices. The composition tells us that there is a

widening of inflationary pressures, enough to offset commodity disinflation. Therefore, even if we continue to experience energy deflation like last month, we can continue to have positive inflation momentum. Below we show the top 10 contributors of the latest CPI print:

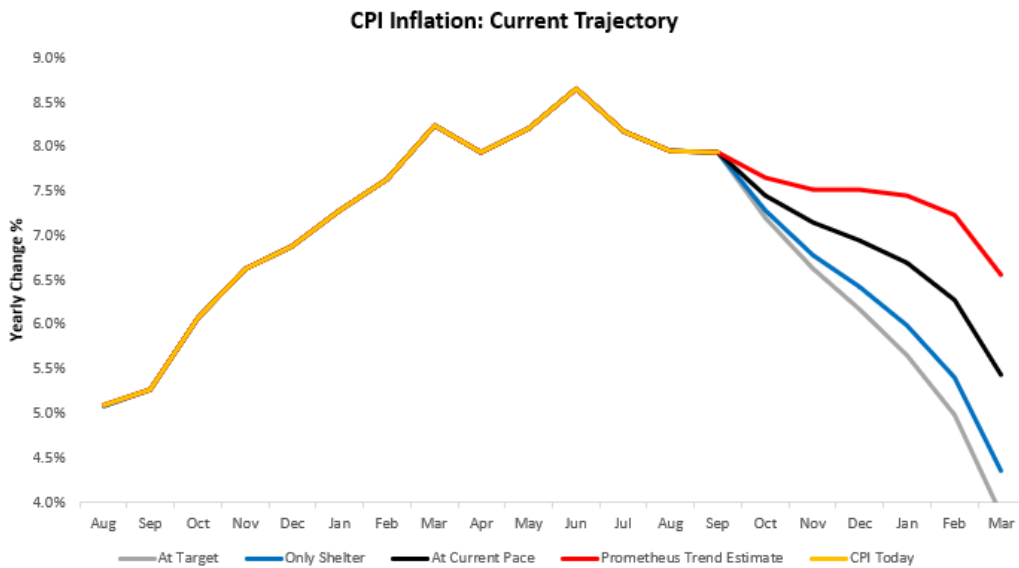


Other core components of CPI and PPI also continue to show stabilization at high levels, largely coming from wage pressures. Additionally, we find the shelter components of the CPI to be of note, as it continues to form a significant undercurrent supporting inflationary pressures. At the current pace of shelter inflation shelter costs alone will keep headline and core CPI above the Fed's 2% target. Furthermore, our expectation is for the component to rise even further. Much of this is a function of the impact caused due the embedded smoothing process within the calculation methodology for OER which only reflects changes in headline statistics 6-18 months later.





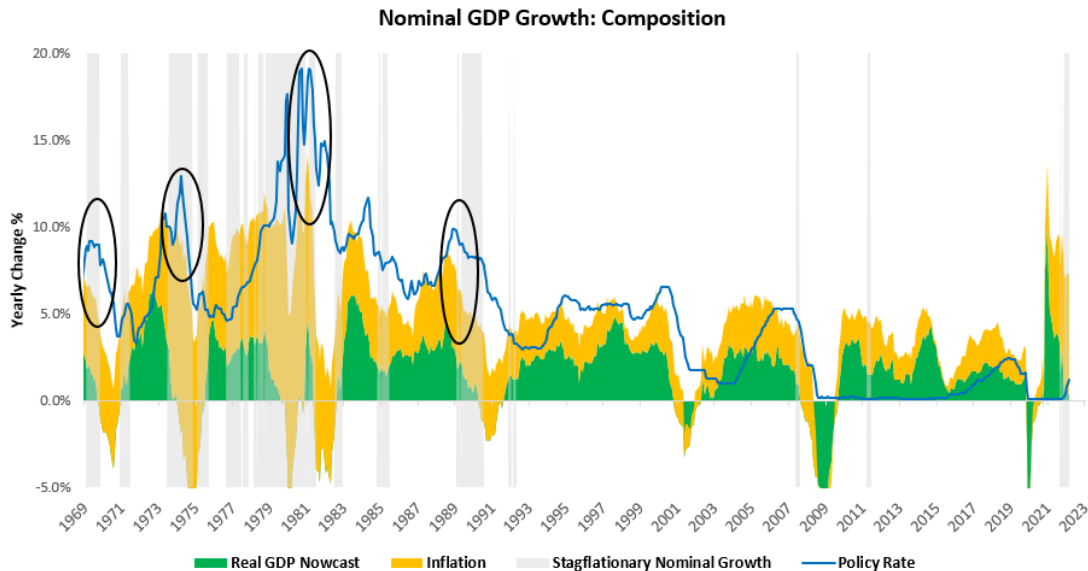
Combining the undercurrent from shelter inflation with the likely persistence of wage inflation, the outlook for CPI remains one where we are highly unlikely to return to the Fed's 2% objective anytime soon. To get a sense of the trajectory of future CPI, we offer the following scenarios below:



Above, we show the future path for CPI based on various scenarios— in red is CPI continuing at our estimate of the annualized trend, in black is the if we continue the pace set by the most recent print, in blue is the path if we only realize shelter CPI at the current rate (i.e., all other inflation is 0), & finally, in grey, we show CPI if the Fed brings every monthly print over the next 6 months in line with its 2% objective. **What is crucial to note is that even if the Fed can bring us back to 2% inflation, we will still end this year with 6.3% inflation. Furthermore, it is highly unlikely that the Fed can do so.** While the Fed may discount year-over-year numbers to a certain extent due to commodity price shocks, we think

it would be dangerous for them to begin to ease conditions before the year-over-year numbers are back to target— lest they make the same mistakes as were made in the 1970s of celebrating too early.

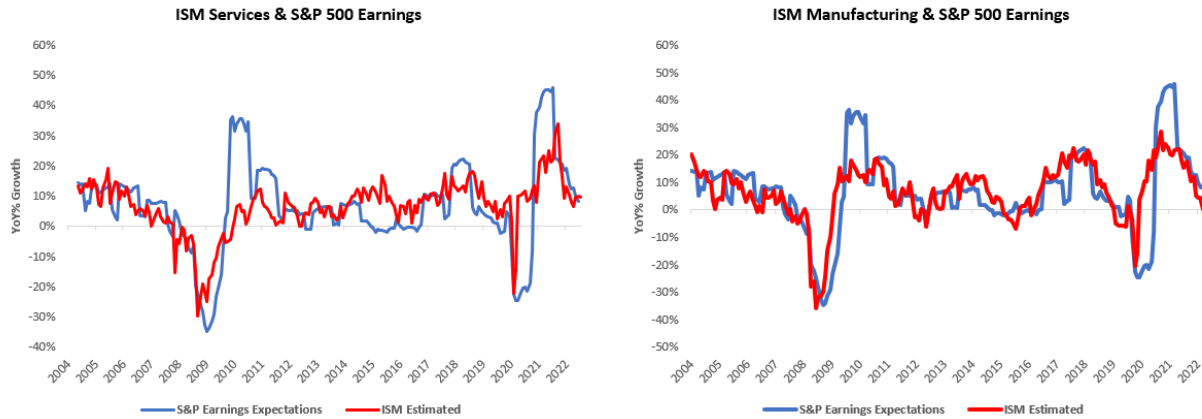
On the contrary, we believe that heightened nominal demand and entrenched inflation are likely to push the Fed to tighten conditions even more than expected. Below, we show how during past periods of stagflationary nominal growth (highlighted in grey), policy rates need to be more than nominal growth to break the inflationary spiral (instances circled):



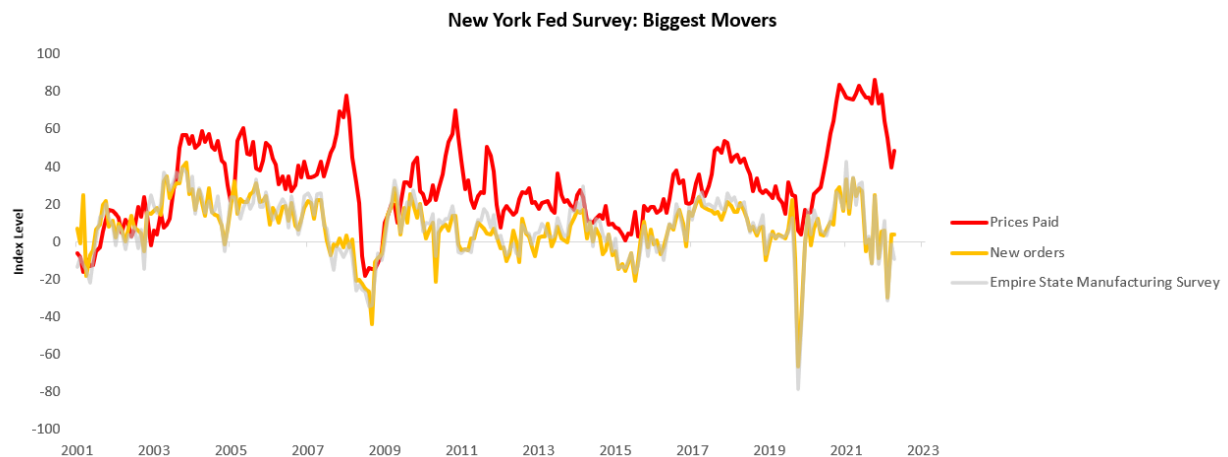
During these tightening cycles, policy rates needed to rise until they exceeded nominal growth by approximately 3-4%. In today's context, if we use a wide range around our estimates of future nominal growth— this would imply a peak Fed Funds Rate between 5.9% (best case) and 8.4% (worst case). **What we think is important is to note that there is a significant range of these outcomes— however, all of them sit above current market pricing of peak policy rates of 5%.**

Consequently, this environment of stagflationary nominal growth coupled with an extremely hawkish Fed, creates a difficult environment for businesses to operate in and produce. It is because in these periods, income gains are not as valuable as in previous periods. When companies distribute incomes to employees, their real consumption power does not improve. Additionally, when companies reinvest their profits, the real output produced for every nominal dollar invested keeps decreasing. This dynamic creates a self-reinforcing spiral lower and increases the pressure on Production to decline. This pressure was reemphasized by the incremental data we received for business output this month.

Both ISM Manufacturing & Services PMIs showed decelerating sequential data within decelerating trends. Nonetheless, it is worth highlighting that there remains a significant gap between manufacturing and services reading, which we interpret as consistent with the strength of nominal demand in the services economy. While many use PMIs as real growth indicators, we think of PMIs as detrended nominal growth indicators. This is because PMI surveys do not ask respondents to differentiate between nominal and real output variables, making it harder to tease the implied impact on real economic data. Consequently, we find the mixed readings from PMIs to largely be a function of elevated nominal demand dynamics.

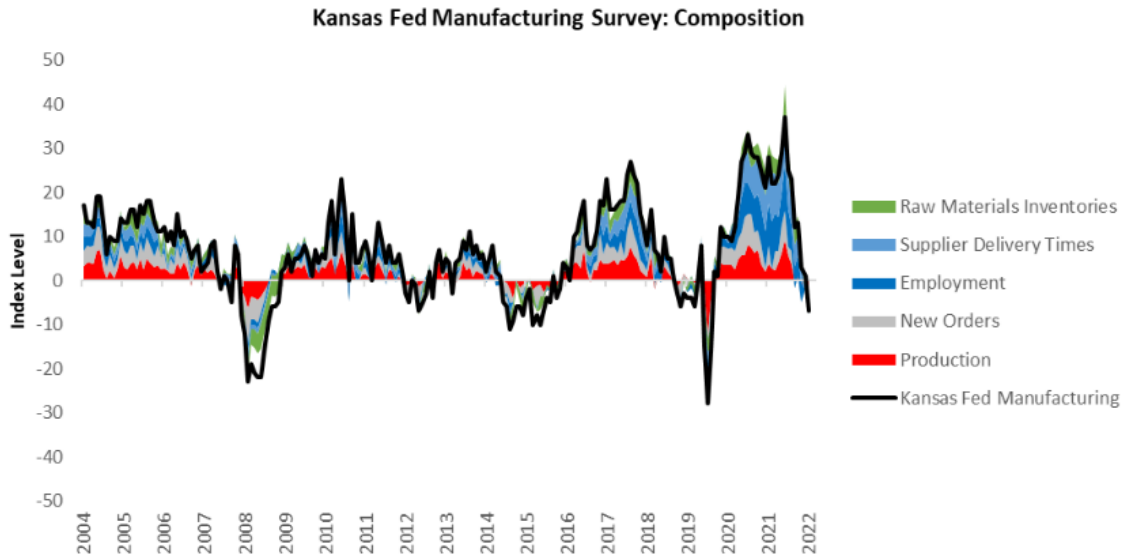


The latest New York Fed Manufacturing survey data showed a contractionary reading of -9.1 disappointing consensus expectations of -4.3 and recorded a sequential deceleration within a decelerating trend. Of note were the Price Paid and New Orders subcomponents in this print. While the price paid component showed strength, in line with the dynamic observed in the most recent PPI and CPI data, New Orders remains roughly flat this print suggesting Unchanged (and already weak) future output prospects.

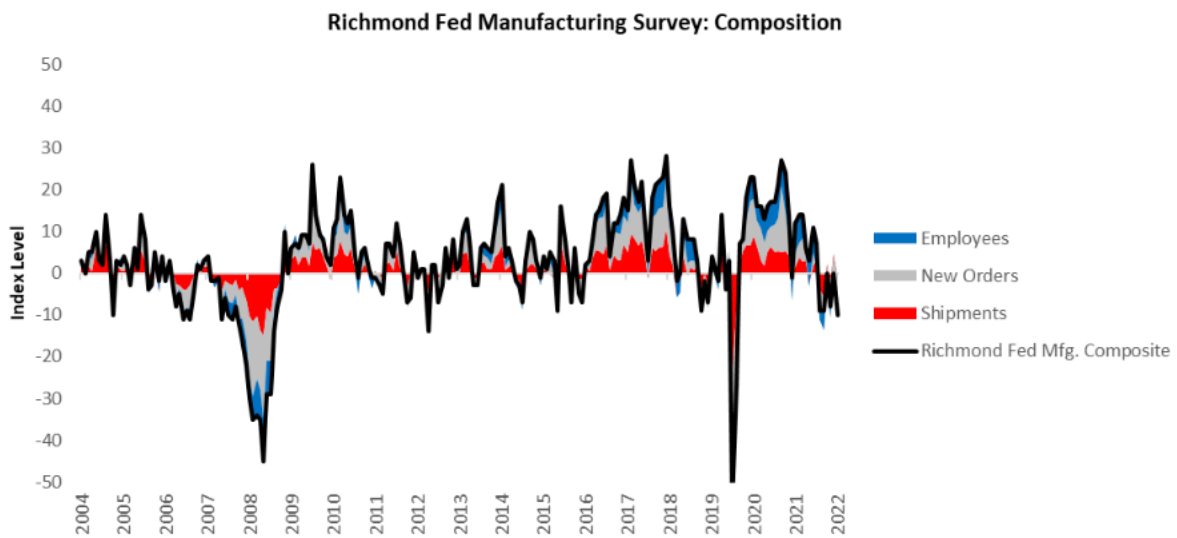


The latest Kansas Fed Manufacturing Survey data showed a contractionary reading of -7, disappointing consensus expectations of -2. This reading implied -7% YoY earnings expectations for the S&P 500. This reading was a sequential deceleration within a decelerating trend. The largest gaining segment was Raw Materials Inventories, and the largest slowdown was in Production.

Date	10/31/2021	11/30/2021	12/31/2021	1/31/2022	2/28/2022	3/31/2022	4/30/2022	5/31/2022	6/30/2022	7/31/2022	8/31/2022	9/30/2022	10/31/2022
Kansas Fed Manufacturing	28.0	22.0	22.0	24.0	29.0	37.0	25.0	23.0	12.0	13.0	3.0	1.0	-7.0
Production	19.0	14.0	11.0	20.0	31.0	46.0	28.0	19.0	-1.0	7.0	-9.0	2.0	-22.0
New Orders	20.0	-2.0	22.0	14.0	32.0	33.0	10.0	15.0	-8.0	-2.0	-16.0	-11.0	-16.0
Employment	49.0	55.0	44.0	38.0	36.0	55.0	42.0	29.0	25.0	23.0	22.0	-2.0	-1.0
Supplier Delivery Times	49	55	44	38	36	55	42	29	25	23	22	-2	-1
Raw Materials Inventories	17	20	17	27	19	32	26	19	23	22	9	6	1



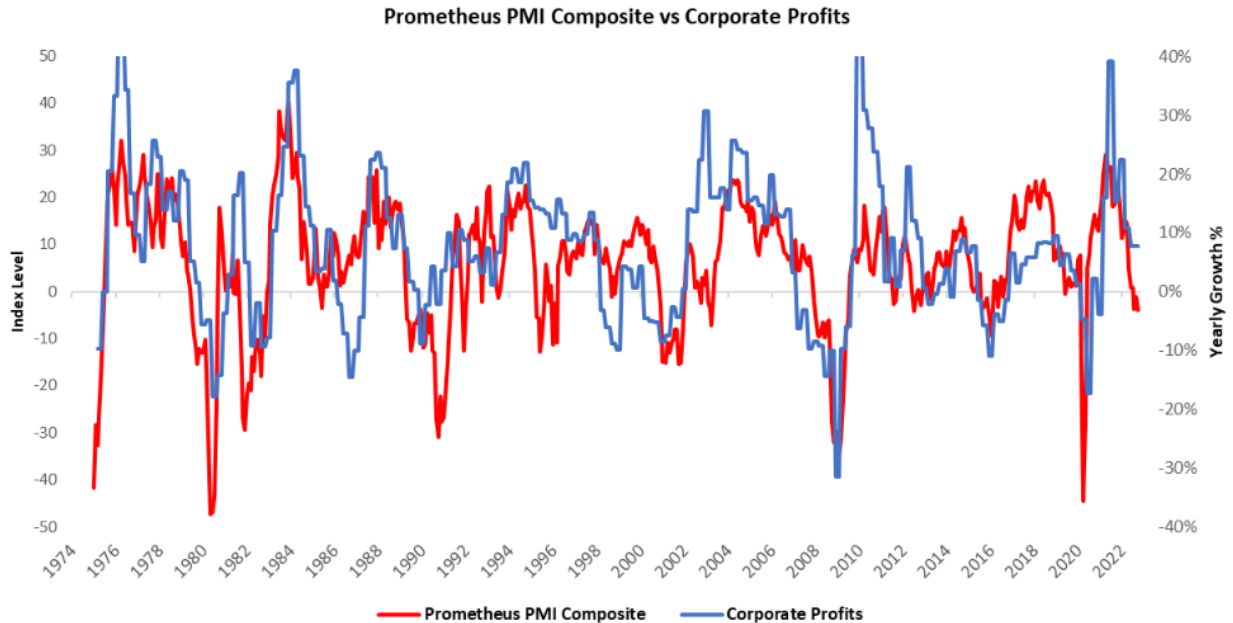
Finally, the latest Richmond Fed Manufacturing survey data showed a contractionary reading of -10, disappointing consensus expectations of -5. This reading implied -3% YoY earnings expectations for the S&P 500. This reading was a sequential deceleration within a decelerating trend. The largest gaining segment was Employees, shedding light on the historically tight labor markets and the largest slowdown was in Shipments, highlighting continued pressure due to supply chain bottlenecks.



	10/31/2021	11/30/2021	12/31/2021	1/31/2022	2/28/2022	3/31/2022	4/30/2022	5/31/2022	6/30/2022	7/31/2022	8/31/2022	9/30/2022	10/31/2022
Richmond Fed Mfg. Composite	12.0	14.0	14.0	6.0	3.0	11.0	7.0	-9.0	-9.0	0.0	-8.0	0.0	-10.0
Shipments	4.0	11.0	8.0	9.0	-8.0	5.0	10.0	-12.0	-17.0	7.0	-8.0	14.0	-3.0
New Orders	9.0	9.0	14.0	3.0	-1.0	8.0	-4.0	-18.0	-20.0	-10.0	-20.0	-11.0	-22.0
Employees	26.0	26.0	20.0	6.0	22.0	21.0	20.0	9.0	16.0	8.0	11.0	0.0	0.0

At an aggregate level our latest PMI Composite (that combines all these incremental PMI data points into a single measure) extended its move within the contractionary territory to -4 from -1, suggesting a weak environment ahead for profits. PMIs offer insight as they are good gauges of the profit cycle due

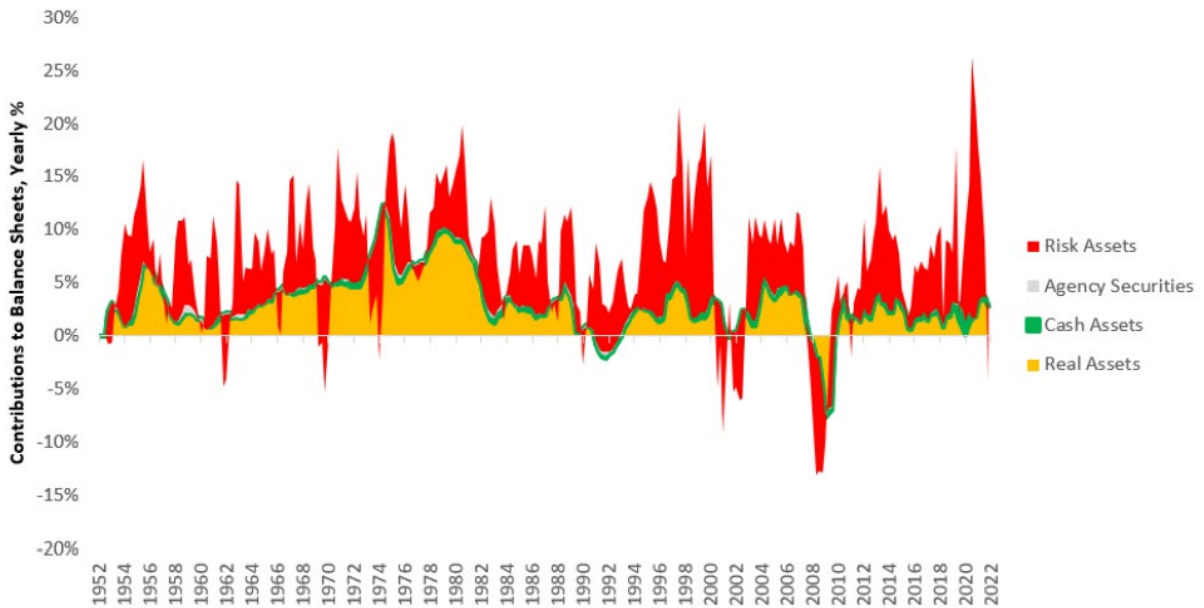
their inherent ability to offer insight into the decisions of purchasing managers who sit at the intersection of business supply and demand while trying to optimize business output for a given level of input.



Recall that this profit reading is nominal, and its inflation-adjusted value is negative. Negative real profits are a significant drag on future output. The purpose of profitability is to decrease your real cost of capital. However, when inflation eats away at profitability, businesses generate less incremental output per dollar reinvested into operations. Furthermore, businesses are not only being impacted via inflation; the Fed is actively causing a contraction in the present value of business assets.

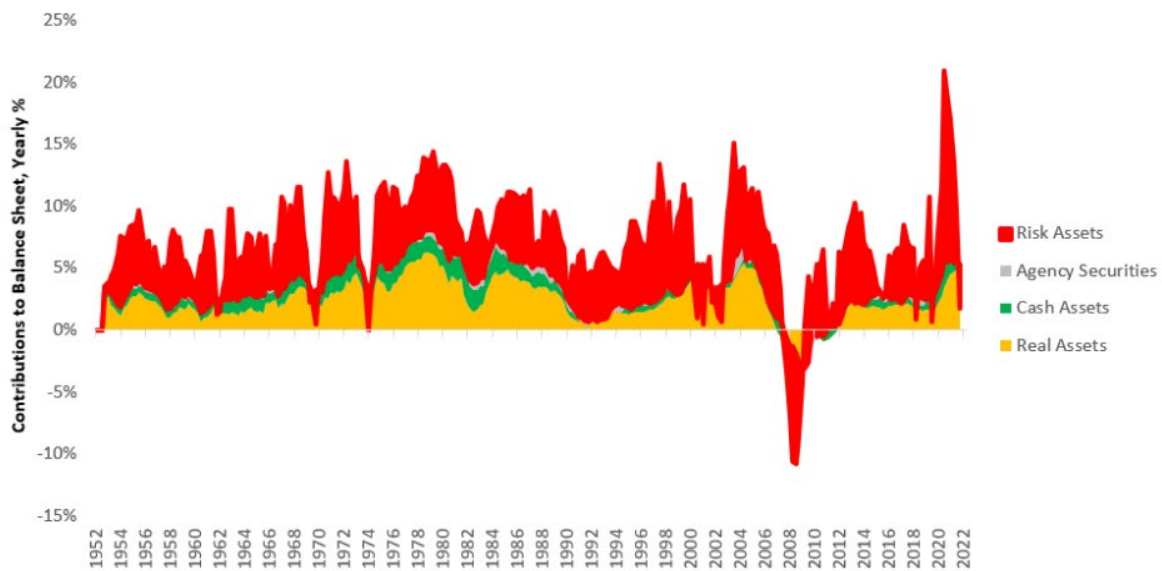
This is reinstated by the fact that in Q2 2022 - corporate balance sheets contracted -by 4.14% versus the previous year, with liabilities increasing by 1.72% and Net Worth decreasing -by 5.86%. Driving these changes, Real Assets increased by 2.81%, Cash Assets decreased -by 0.05%, Agency Securities increased by 0.04%, Risk Assets decreased -by 6.94%, and Financial Liabilities increased by 1.72%.

Nonfinancial Corporates: Balance Sheet Growth



Most of this contractionary force came from the revaluation of corporate equities, i.e., corporate equities declined and caused net worth to fall. This contraction in corporate balance sheets has been consistent with the Fed's objectives of limiting credit creation. As of Q2, some of this impact has also passed onto households, but the effect has remained muted by real estate prices—which remain elevated. Nonetheless, the pass-through of lower equity values onto balance sheets remains significant. With the Fed set on its path to tightening financial conditions, household net worth is likely to contract in the coming quarters.

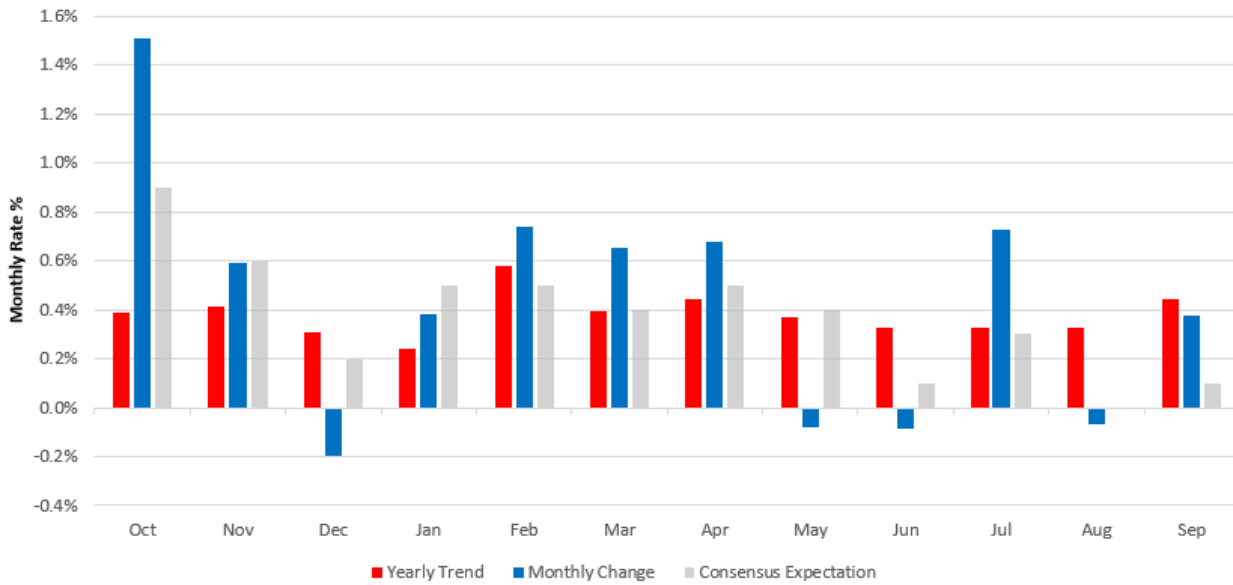
Households & Nonprofits: Balance Sheet Growth



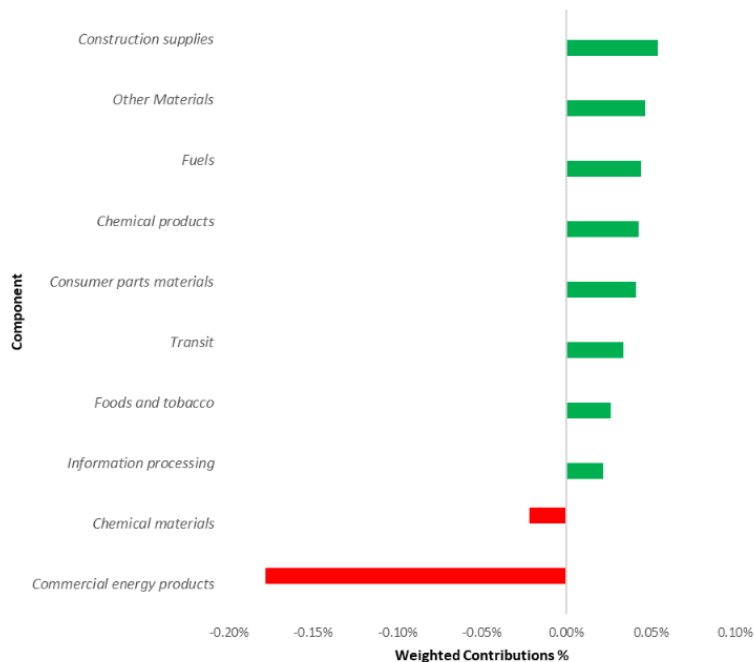
When we combine these issues with an increasing cost of borrowing coming from higher interest rates,

the outlook for future output is weak. This analysis brings us to our discussion on Industrial Production. Industrial Production increased by 0.38% in September, surprising consensus expectations of 0.1% and catalyzing optimism in the markets as an indication of robust Production in the economy. The primary drivers of this print were Chemical products (0.09%), Fuels (0.05%), Construction supplies (0.08%), Commercial energy products (-0.02%), & Other Materials (0.09%). Below, we show the top 10 drivers of the monthly change.

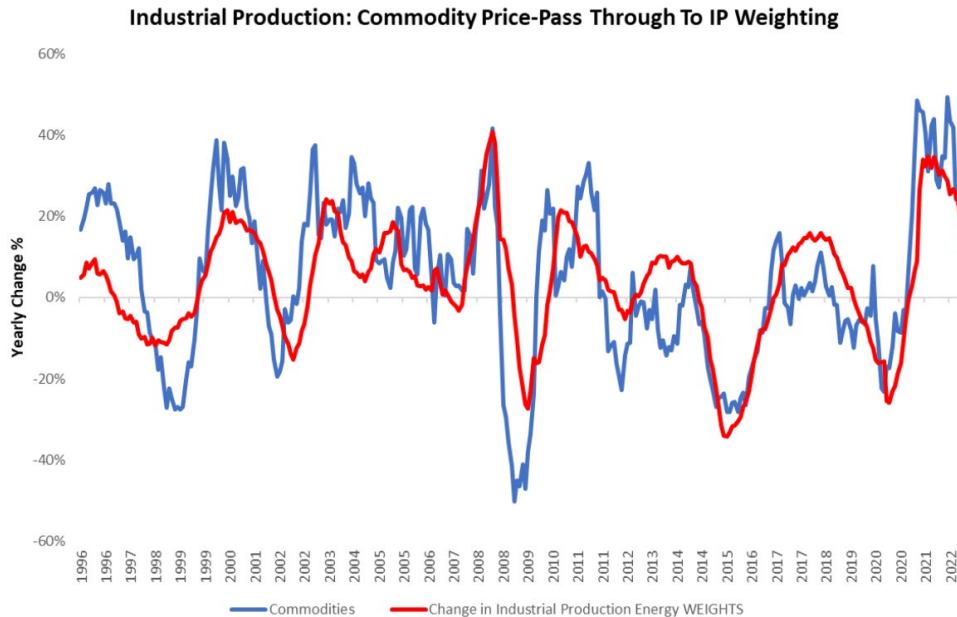
Industrial Production: Sequential Trend



Industrial Production: Top 10 Contributions Monthly Change



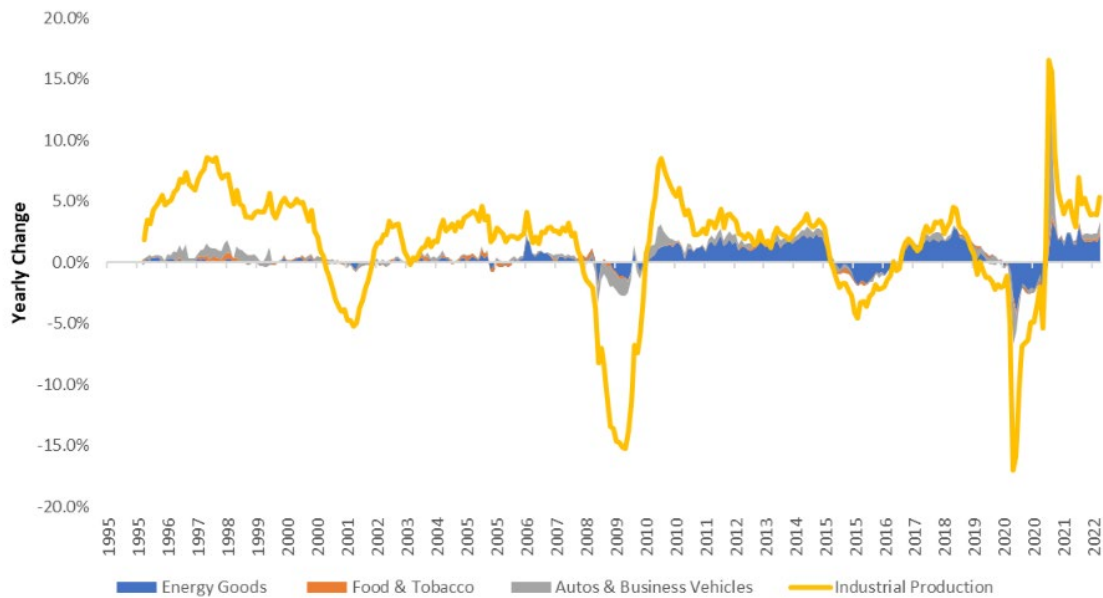
However, when analyzed at a granular level, we see that there are significant nominal effects. First, we observe that stagflationary dynamics are distorting production data. While it is indeed intended for Industrial Production data to be "real," i.e., un-influenced by inflation- we live in a nominal world, and nominal activity seeps into everything. Below, we show how this impacts the weighting of various indices in Industrial Production— using the example of energy:



The weights of subcomponents in IP consider "unit value added OR prices" to decide the weight of components of the index. In today's environment, energy prices are rapidly rising- and the relative importance of energy rises in IP massively, resulting in the index reflecting some degree of nominal activity. This pass-through can be seen in the strong correlation between the weight of energy production and broad commodities indices.

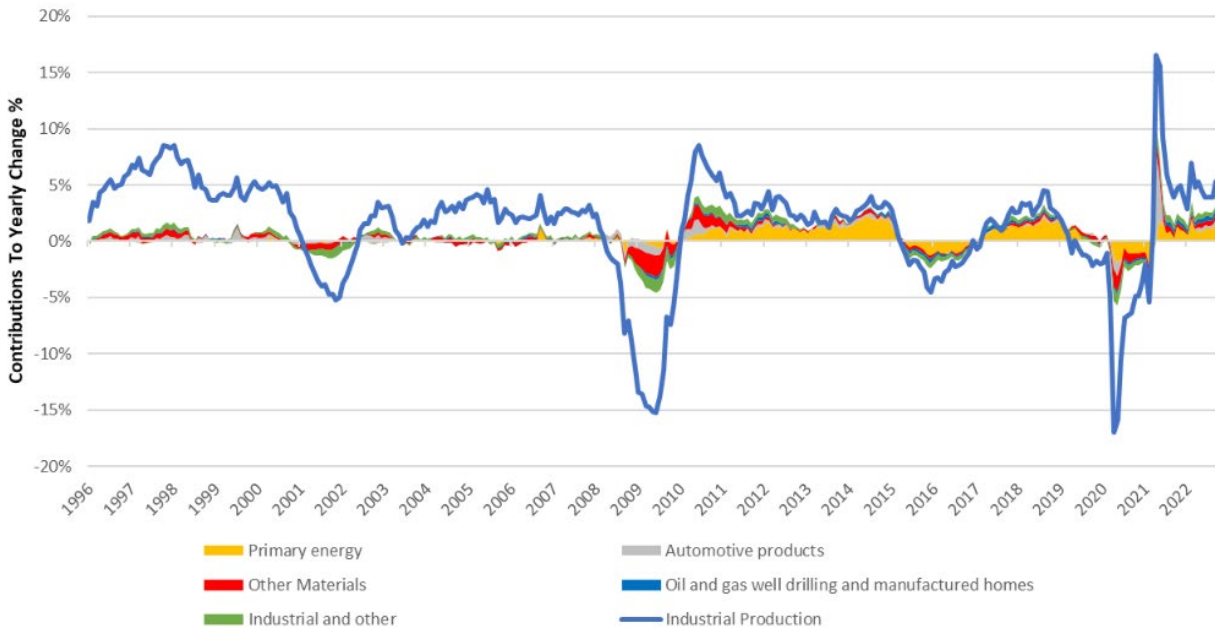
Second, most of the yearly change came from two sectors, i.e., Energy and Business Equipment. We highlight these areas because they are running up on physical limitations in their ability to keep growing and therefore aren't likely to be as conducive to production growth on a forward-looking basis. Furthermore, under the surface of these sector aggregates, we find that Energy, Food, & Autos contributed 3.32% of the 5.3% yearly change in Industrial Production, i.e., 62% of the headline growth in Industrial Production came from food, energy, & automobiles. We focus on Energy and Automobiles as they capture most of these contributions.

Industrial Production: Commodities & Autos Creating Strength



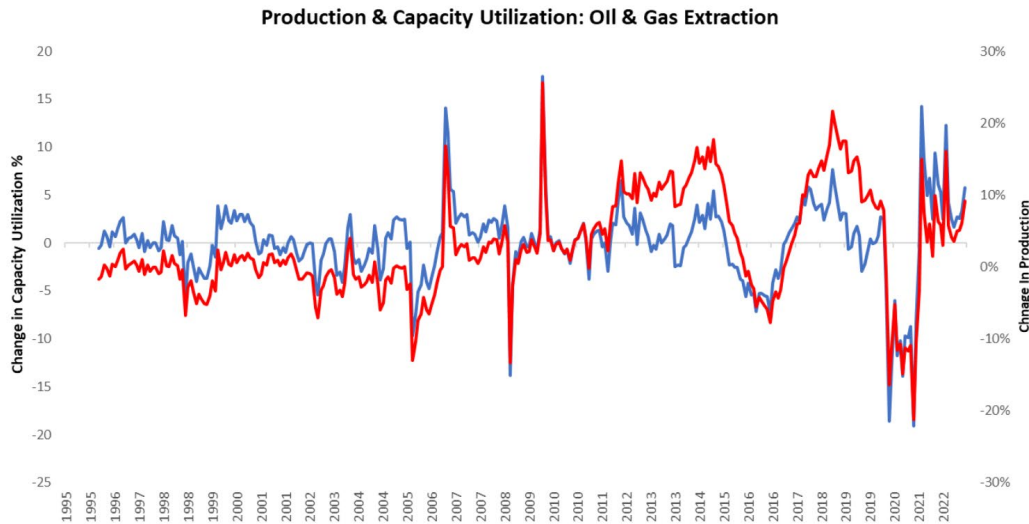
Over the last year, Automotive products (0.55%), Industrial and other (0.39%), Oil and gas well drilling and manufactured homes (0.39%), Other Materials (0.45%), & Primary energy (1.45%). have been the primary drivers of the 5.33% growth in Production. We show the contributions of these items to yearly changes in industrial Production below:

Industrial Production: Top 5 Drivers Of Yearly Growth

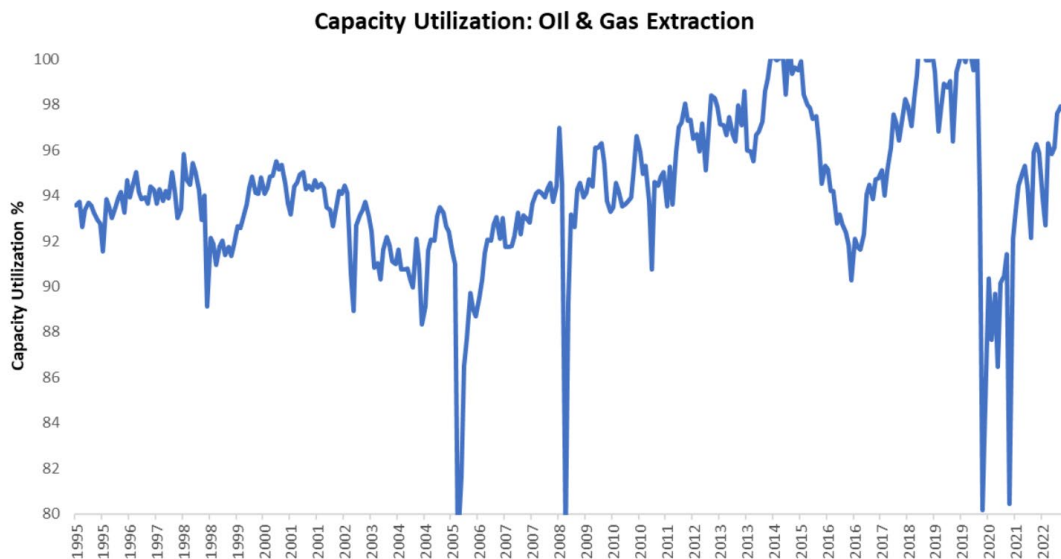


Energy production is unlikely to continue to grow at as quick a pace due to capacity limitations. Production is a function of capacity utilization and the change in existing capacity. Therefore,

to increase Production, one needs to either increase the amount of current capacity usage or increase overall capacity through capital expenditures. Capital expenditures don't instantaneously result in new capacity, and often there can be a lead time of several years until capital expenditures result in increased capacity. Resultantly, most incremental Production is met through the increase of capacity utilization. We show this relationship below for Oil & Gas extraction, i.e., the start of the energy supply chain:



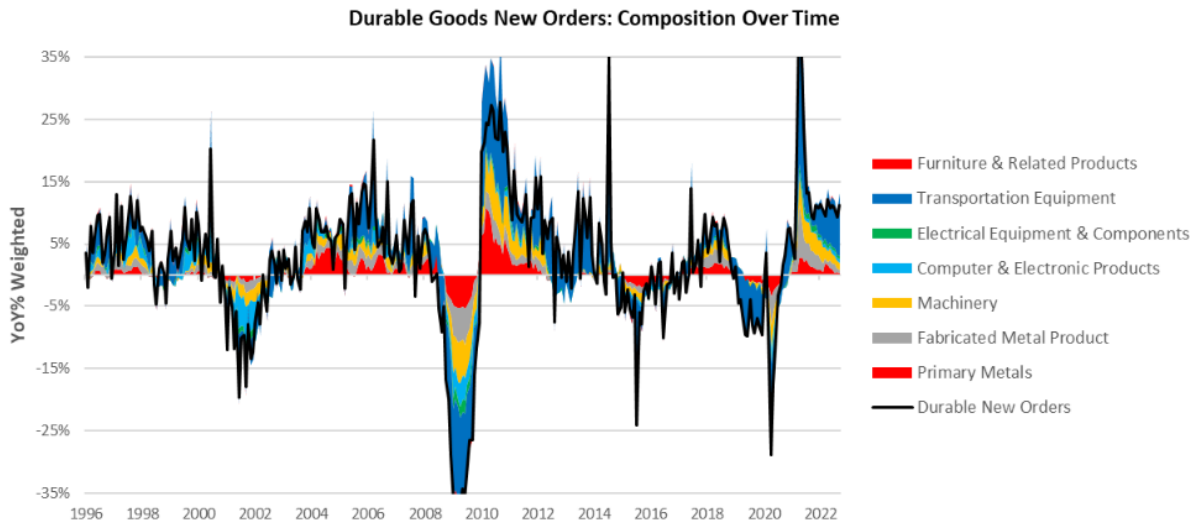
As we can see above, Production is largely met through increased capacity utilization. However, today there remains very little excess capacity left to increase output:



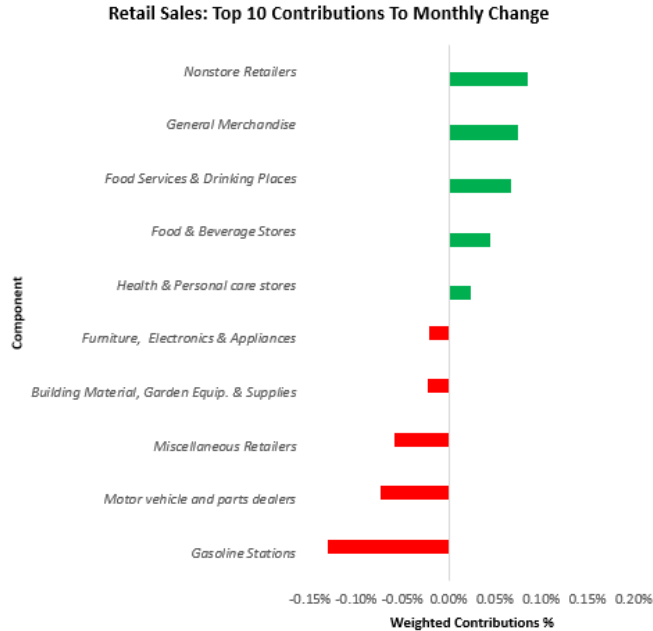
Therefore, while capacity utilization can rise a little further, this dynamic puts a very real cap on how contributive energy production can be to aggregate Production.

Next, regarding automobile production, the final demand for automobiles does not justify continued production expansion. Currently, we are seeing wholesalers and retailers purchasing automobiles but

largely unable to offload them to consumers. Transportation Equipment contributed the most to new orders for Industrial Durable Goods, with a weighted YoY growth of 10.3%. However, final demand for automobiles lacked significantly, as per the latest retail sales data. Resultantly, these produced vehicles are making their way into automobile inventories. We show how Transportation Equipment continues to push new orders on a nominal basis:

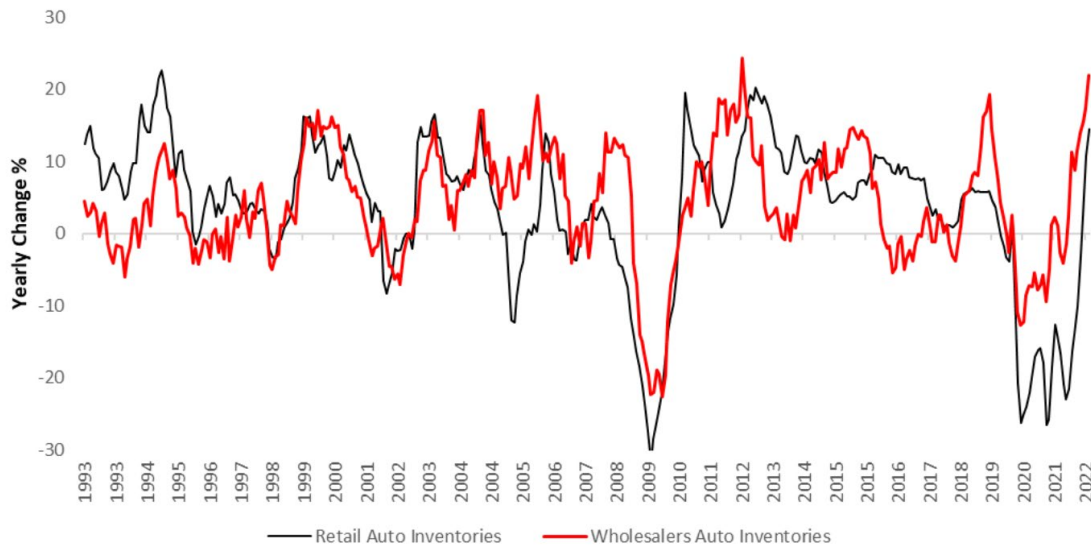


However, retail sales for motor vehicles and parts continues to contract:



Therefore, these produced automobiles continue to make their way into the inventories of both retailers and wholesalers. For the time being, these inventories are protected by price increases, however, volume demand remains weak.

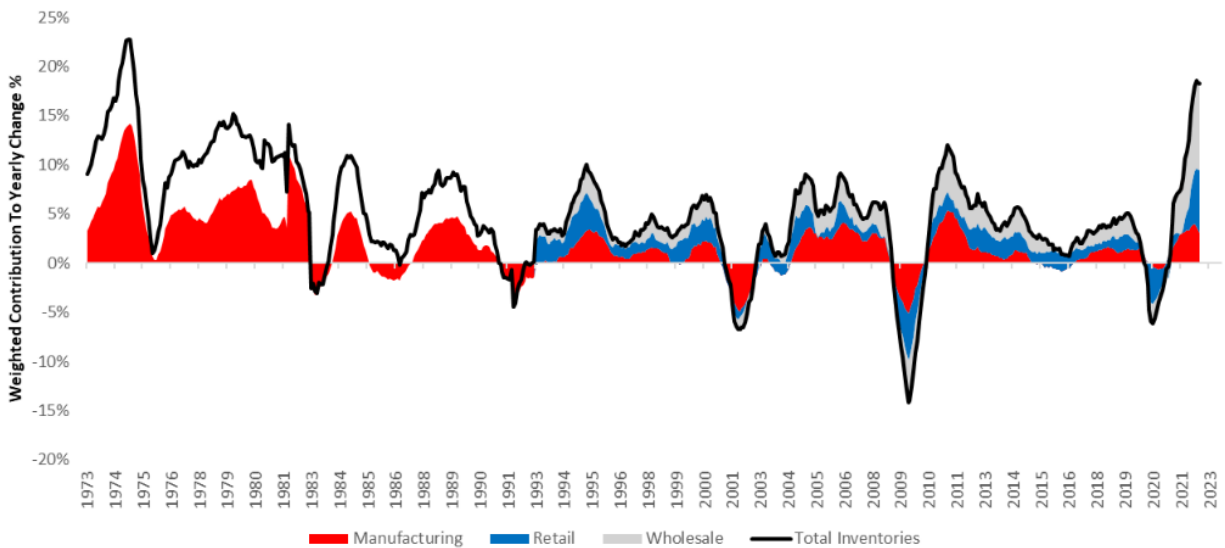
Automobile Inventories: Extremely Strong Growth



Therefore while production constraints limit energy production, automobile production is likely to be limited by demand constraints.

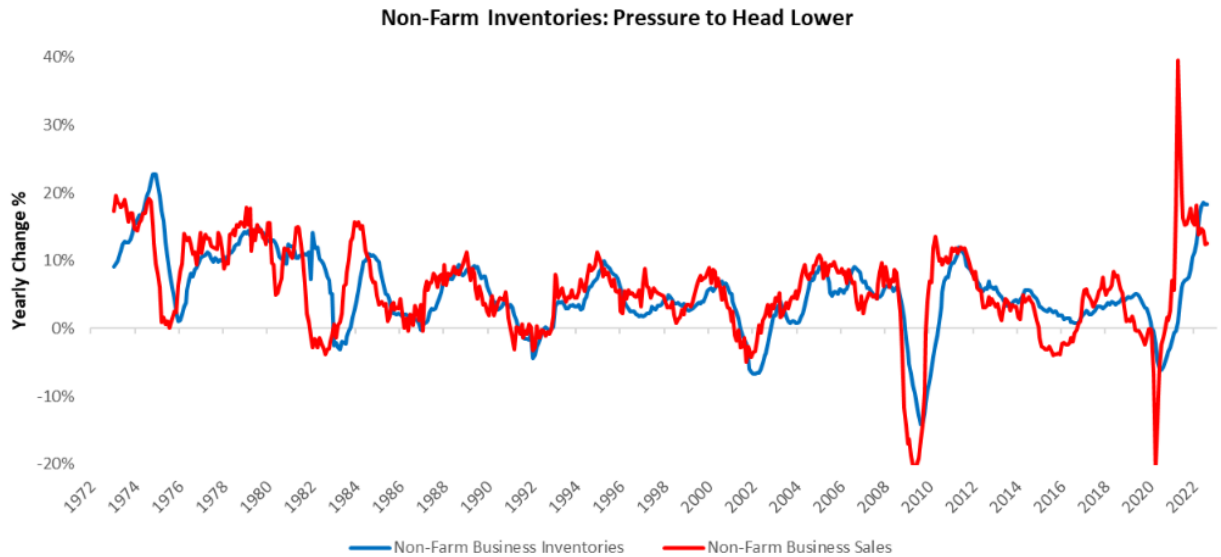
Nonetheless, nominal aggregate inventories continue to rise as a function of high nominal activity. The latest wholesale inventories data disappointed expectations, with a monthly change of 0.8% versus the expected 1%. This data resulted in a 0.83% increase in Total Non-Farm Inventories- with manufacturing, retail, and wholesale contributing -0.05%, 0.41%, and 0.53%, respectively. Over the last year, manufacturing, retail, and wholesale have contributed 3.12%, 6.34%, and 8.87%, respectively to a 18.24% increase in Non-Farm Inventories.

Total Non-Farm Inventories: Composition

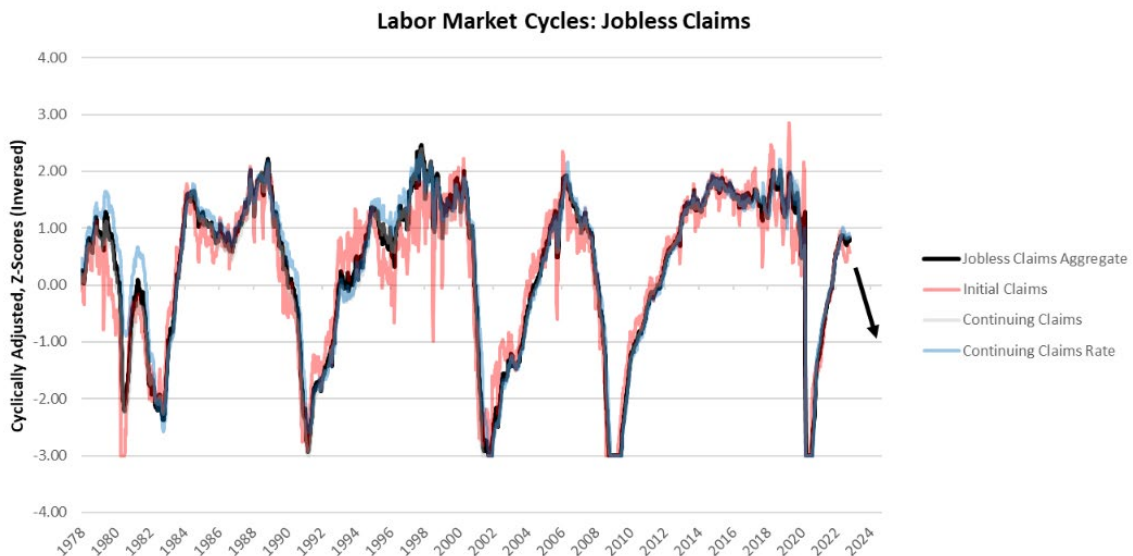


Recall, inventory build can help pad profitability because one business's inventory growth is another business's sales growth. Additionally, inventory build is less penalized during inflationary periods,

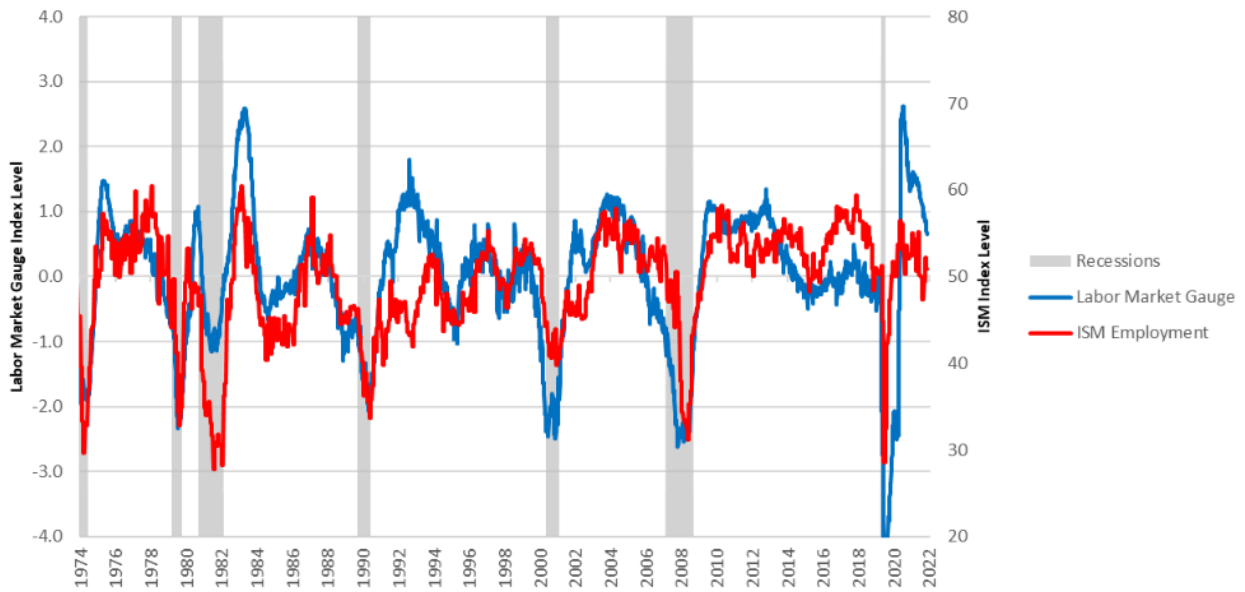
resulting in periods of elevated inventory rise. We judge today to be one of these periods. However, inventory build has limitations and can only go so far as it does not increase productive capacity, and there is a finite ability to add inventories due to physical limitations. Moreover, with nominal sales decelerating on a yearly basis, the pressure is increasing for inventories to fall.



Even though high inflationary pressures and stretched capacity utilization are keeping aggregate activity elevated, we believe that such sectoral concentration in Production can last only so long as nominal activity remains high and real activity remains positive. Eventually, a contraction in output is likely to reduce the need for employees. Both our Labor Market Gauge and the Jobless Claims Aggregate have begun to turn. When these enter negative territory, we expect markets to price significant changes to the growth outlook.

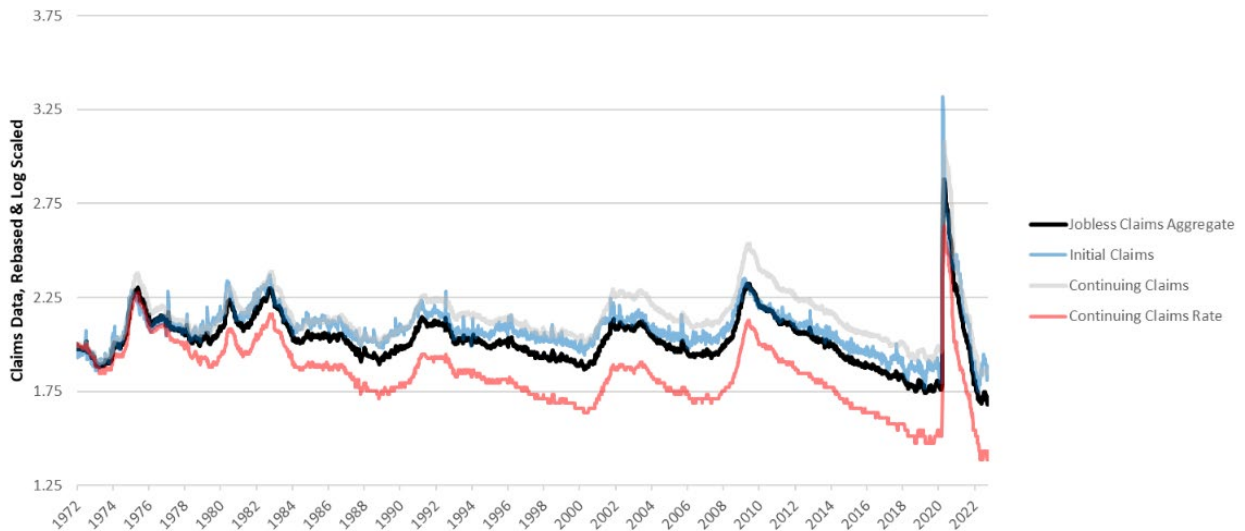


Labor Markets: Cyclical Slowing, But Not Tightening



However, this does little to diminish the fact that currently, we are witnessing one of the tightest labor markets on record. As per the incremental data received on labor markets, the latest reading of initial claims disappointed expectations coming in at 217 versus the expected 220, while Continuing Claims surprised expectations coming in at 1438 versus the expected 1390. Additionally, as per our latest tracking of the recent evolution in Jobless Claims data over the last twelve weeks, we note that we are ways off recessionary territory. It is worth reinforcing that it is this tightness in the labor market conditions that continue to feed services inflation and yet we have only seen the most nascent signs of a turning point.

Labor Markets: Jobless Claims Measures

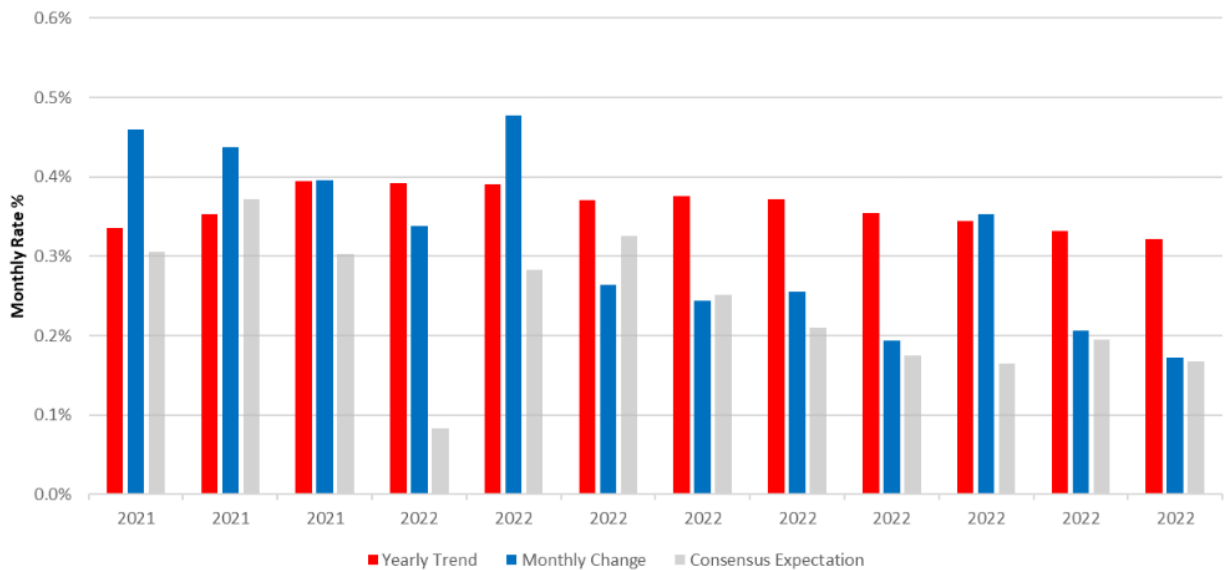


Jobless Claims: Recent History Relative To Recessionary Averages

	Initial Claims	Continuing Claims	Continuing Claims %
7/29/2022	248	1430	1.00%
8/5/2022	252	1434	1.00%
8/12/2022	245	1412	1.00%
8/19/2022	237	1437	1.00%
8/26/2022	228	1402	1.00%
9/2/2022	218	1400	1.00%
9/9/2022	208	1376	1.00%
9/16/2022	209	1346	0.90%
9/23/2022	190	1365	1.00%
9/30/2022	219	1364	0.90%
10/7/2022	226	1385	1.00%
10/14/2022	214	-	-
Recessionary Avg. (Ex-COVID)	473	3395	3.51%
Recessionary Avg	573	3658	3.64%

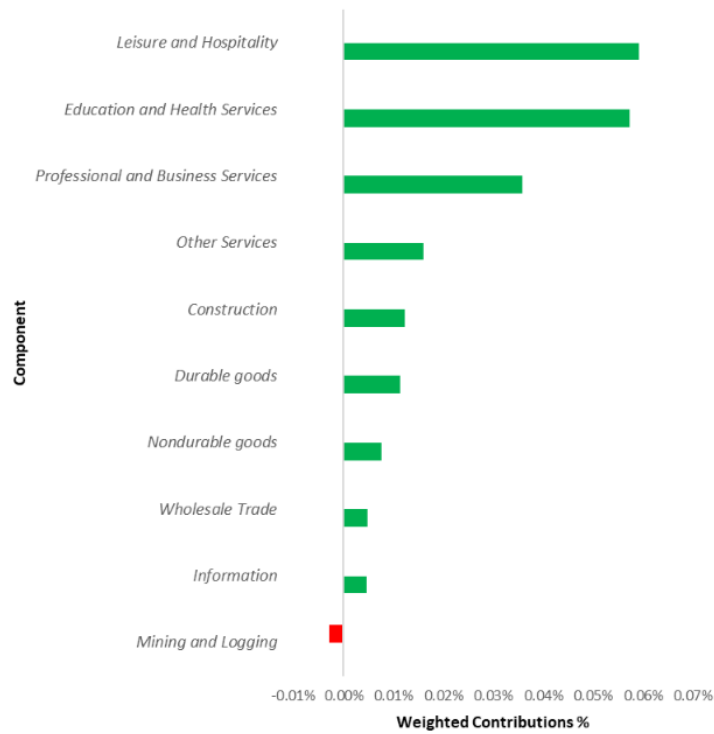
Nonetheless, there are a few key observations to be made of all the Non-Farm payrolls data that was received over the past month. First Nonfarm Payrolls increased 0.21% in September, surprising consensus expectations of 0.17%. This print contributed to a sequential deceleration in the quarterly trend relative to the yearly trend. Below, we show the monthly evolution of the data relative to its 12-monthly trend and consensus expectations.

Nonfarm Payrolls: Sequential Trend



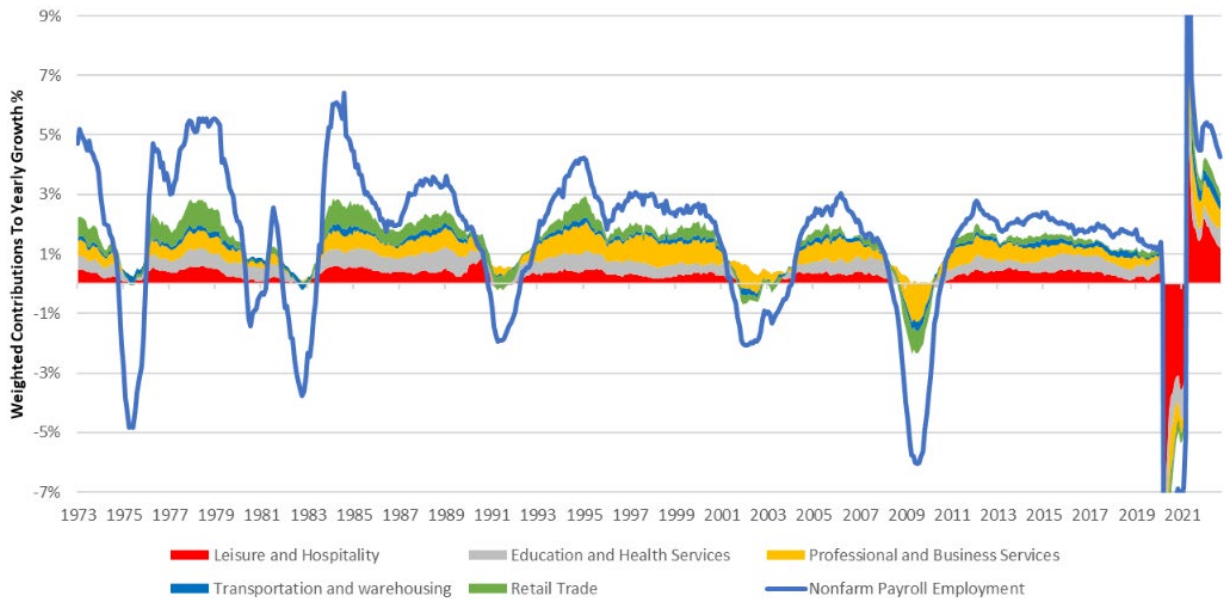
Second, this month we saw signs of marginally weaker hiring in mining and logging, consistent with our observations of stretched capacity utilization. We show this below:

Nonfarm Payrolls: Top 10 Contributions To Monthly Change



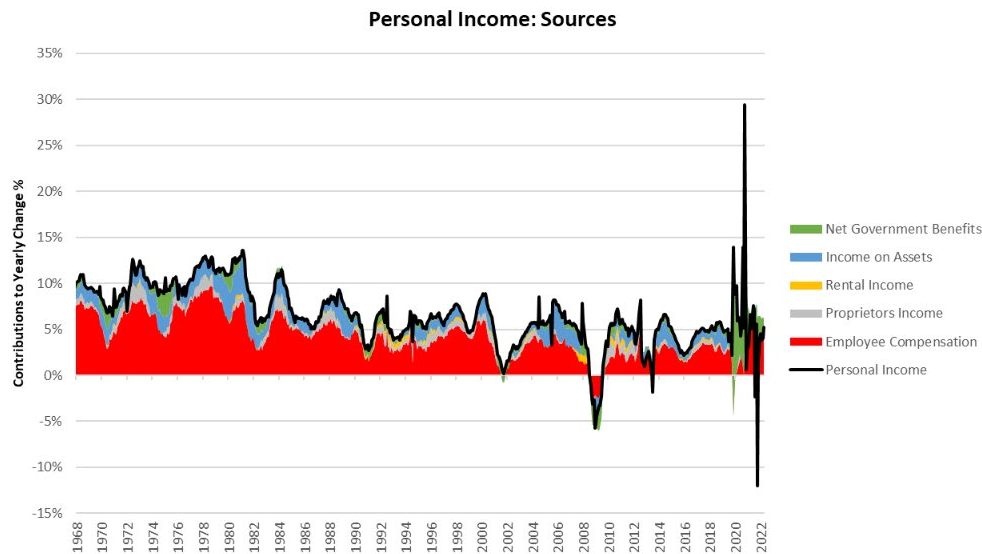
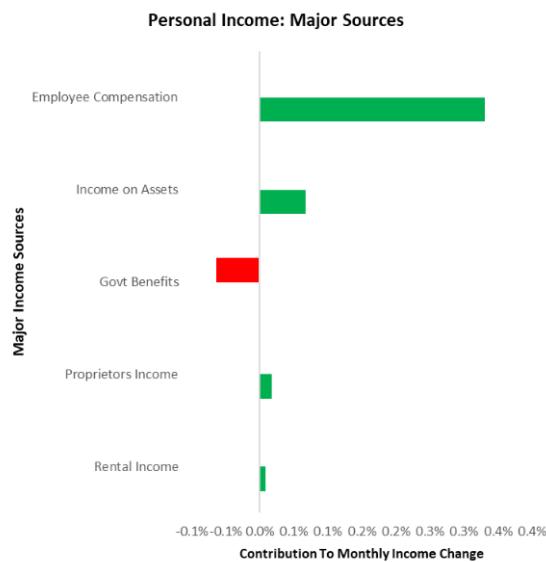
Third, labor market strength is relatively concentrated in the more pro-cyclical sectors of the economy, i.e., Retail Trade (0.25%), Transportation and warehousing (0.32%), & Leisure and Hospitality (1.2%) have been the primary drivers of the 1.77% growth in the labor market. As the cyclical slowdown continues, these areas are likely to see a pullback in employment.

Nonfarm Payrolls: Top 5 Drivers Of Yearly Growth

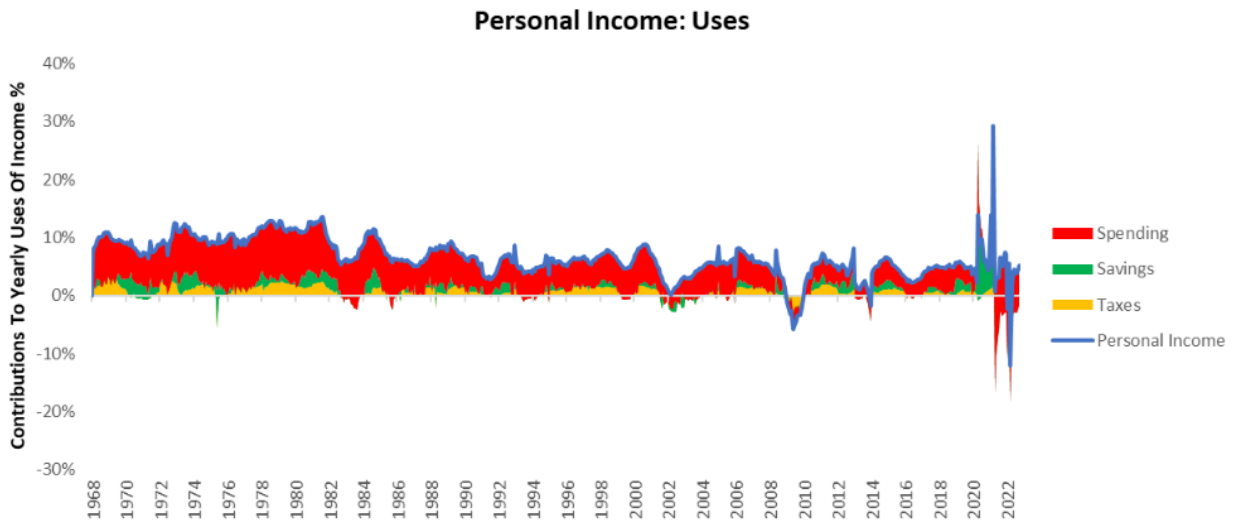


Additionally, it is worth emphasizing that the labor market strength illustrated above will allow the Fed further room to tighten policy, and the eventual contraction in the labor force will likely create self-reinforcing pressures in real incomes and spending. Nonetheless, until we observe labor markets cooling, higher nominal activity complemented with entrenched employment growth will continue to contribute positively to income growth. In fact, this is what we observed in this month's data as well.

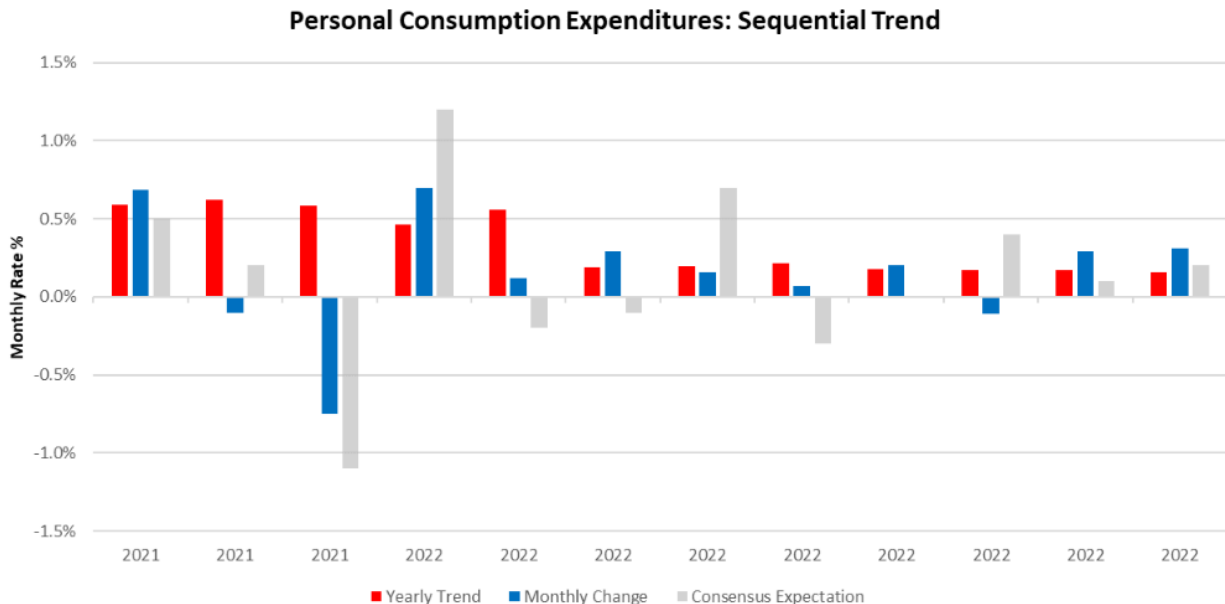
Personal Income increased 0.36% in September, disappointing consensus expectations of 0.4%. This print contributed to a sequential deceleration in the quarterly trend relative to the yearly trend. The primary drivers of this print were Employee Compensation (1.02%), & Income on Assets (0.18%). Over the last year, Employee Compensation (4.75%), Income on Assets (0.76%), & Govt Benefits (-0.99%) have been the primary sources of the 5.2% growth in income. We show the composition of this print as well as the composition of income growth by its major sources below:



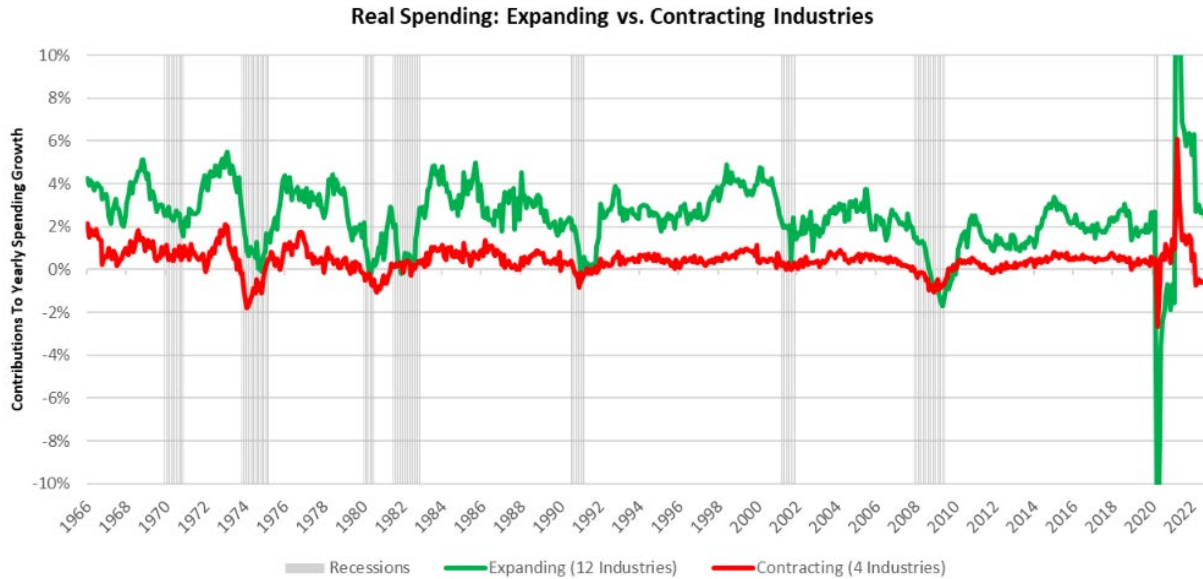
As Personal Income increased in September, this income was primarily spent. Income increased as taxes increased 0.03%, savings decreased -0.25% & spending increased 0.57%. We show the composition of these uses of income on a yearly basis below:



This was further highlighted by the incremental data received on Real Spending. Real Spending increased 0.31% in September, surprising consensus expectations of 0.2%. This print contributed to a sequential deceleration in the quarterly trend relative to the yearly trend. Below, we show the monthly evolution of the data relative to its 12-monthly trend and consensus expectations.



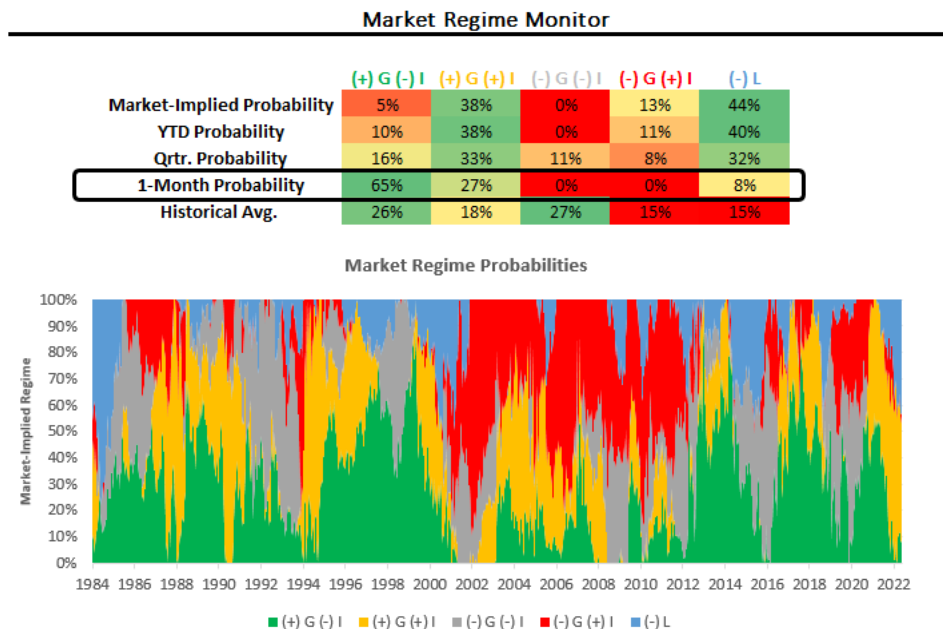
Nonetheless, of the 16 industries that we track – the four industries that are seeing negative spending are Furnishings & Durable Household Equip., Food & Beverages, Clothing & Footwear, & Gasoline & Energy Goods, i.e., cyclical sectors continue to see a slowdown in real spending.



Overall, inventory growth, production, and employment support today's GDP data. However, these areas of the economy have real capacity constraints regarding how much they can continue to contribute to future growth. These areas are likely to remain resilient longer than many expect, but the trajectory remains in the direction of stagflation.

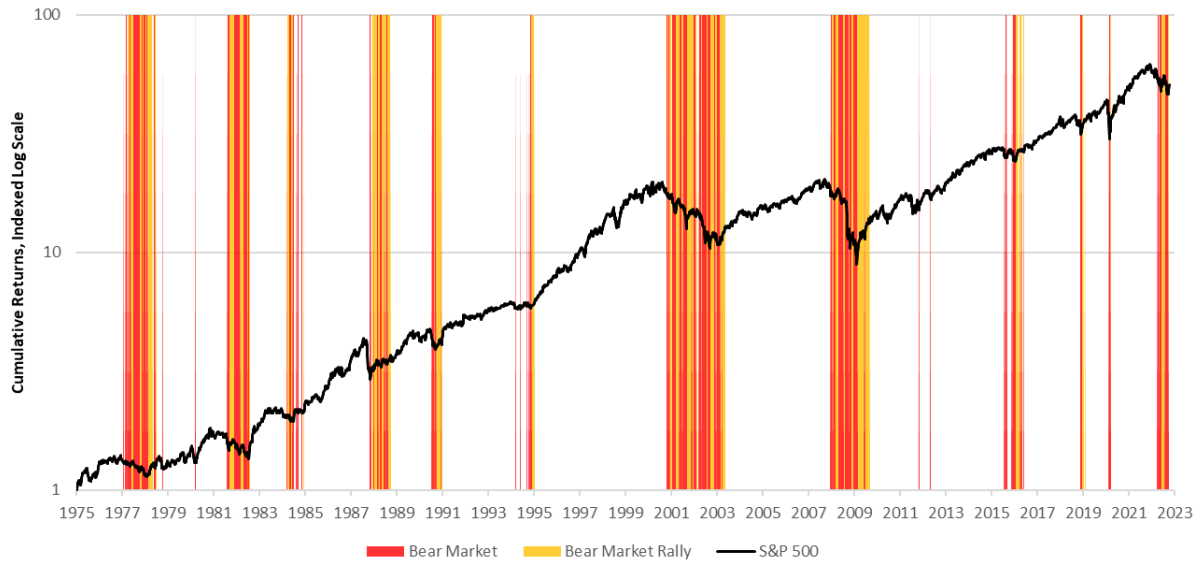
MARKETS OBSERVATORY: STAGFLATIONARY CONDITIONS

We'll keep this section short, but more to come in future editions. Over the last month, asset have priced a resurgence in growth, with a tilt towards disinflationary growth. We show our market regime monitors below:



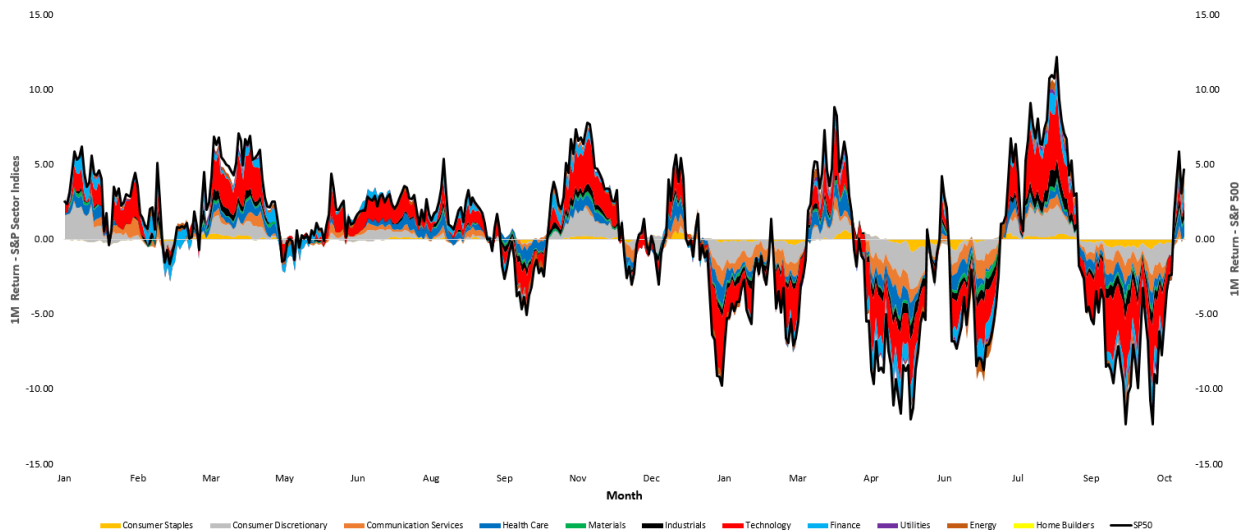
This market regime pricing comes alongside equity price action that our systems have characterized as a bear market rally; we show this below:

Timing Tools: Market Cycle Identification

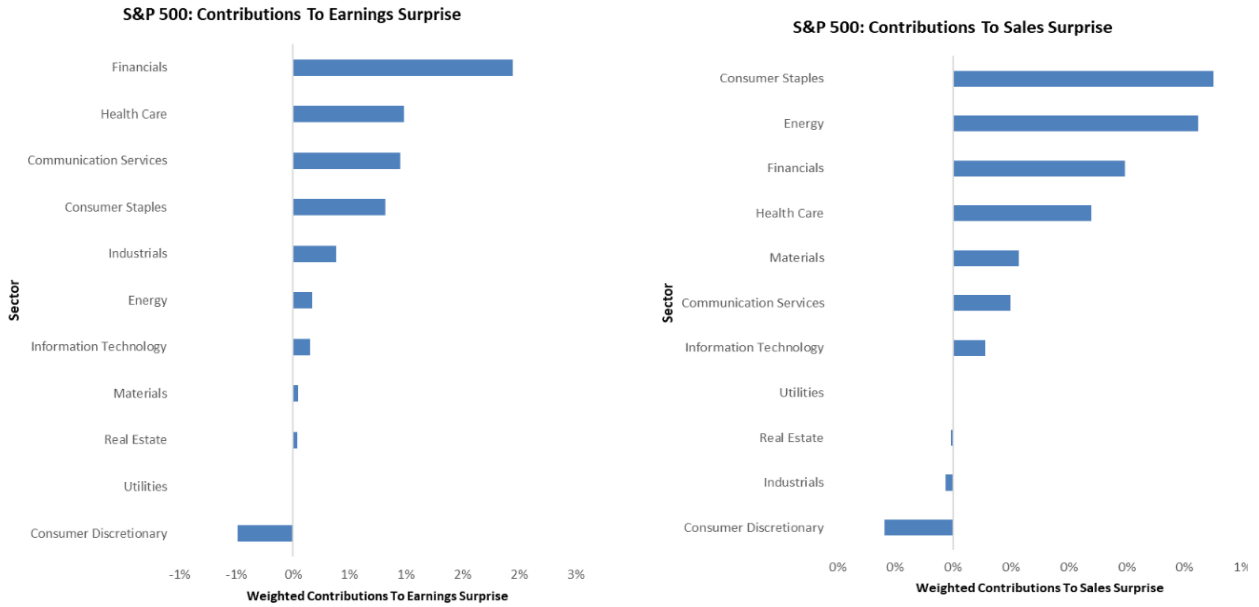


The S&P 500 is up 4.68% over the last month. The sectors that are contributing to the 51% of this return profile are Finance, Energy, and Healthcare. It is worth noting that all these sectors show strength in times of stagflationary nominal growth. Financial companies benefit from higher Net Interest Income in a high-interest rate environment, energy companies benefit from commodity inflation, and healthcare companies benefit from higher-price pass-through and fiscal support.

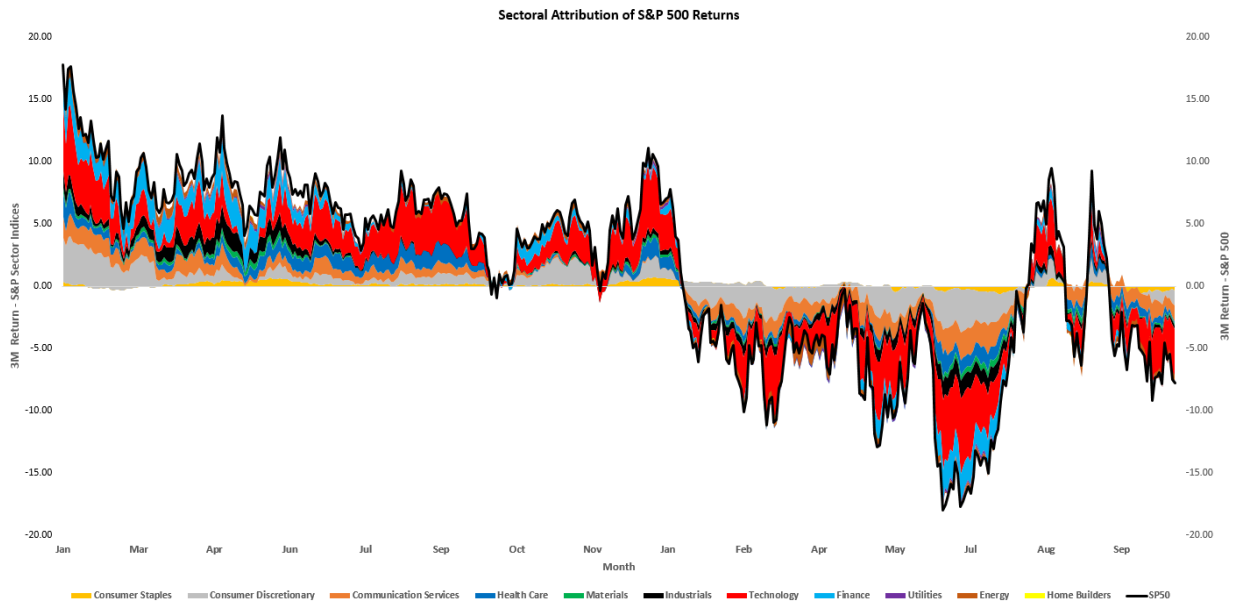
Sectoral Attribution of S&P 500 Returns



Additionally, we are seeing the same industries show significant strength regarding positive earnings and sales surprises. We show this below:



However, on a 3-month basis, S&P 500 is down 7.78%, and the sectors that contributed to 64% of this return profile were Technology and Communication Services. Both of these are sectors that are extremely sensitive to stagflationary growth environments with higher interest rates adversely affecting future cash flows. Below we show the sectoral attribution:



Therefore, while we are indeed in a bear market rally, we don't see these moves as a material change in market-implied real growth prospects but rather markets reflecting the relative attractiveness of variable nominal cashflows (equities) versus nominal fixed cashflows (treasuries). Overall, these moves remain countertrend moves, and we expect equities to continue to see significant weakness over the cycle.