



Basis Points – February 23, 2023

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Above the Fold

Consumers Continue to Shift to Essentials

As we try to wrap our heads around the domestic economy, there continues to be conflicts in data pertaining to the health of the average consumer. As earnings season winds down, it appears that yes, consumers are still spending, but there is a trend change occurring in their habits. Early data from the National Retail Federation showed holiday sales growing at just 5.3% year over year, which was below expectations and less than the near 7% inflation rate (which essentially negates all growth). Cost-conscious shopping trends emerged last year, and recent earnings data and commentary suggest an increasingly skittish consumer who's less likely to splurge.

Home Depot, which focuses heavily on home-improvement goods, reported flat sales in its most recent quarter and lowered its outlook for the rest of the year as it sees consumers focusing more on essentials (staples) compared with discretionary purchases. Walmart's earnings report supports this theory as the discount retailer, with heavy reliance on consumer staples, experienced larger-than-expected sales growth. Despite the gains that Walmart experienced in its grocery and staples sales, it's still struggling with a glut of inventory, increasing costs, and an increasingly cautious and selective shopper base. Like Home Depot, Walmart also set a more cautious tone for 2023. Most other major retailers have reported similar findings, with even the venerable digital giant Amazon reporting a 2% drop in fourth-quarter online sales. There are major shifts occurring in consumer behavior, as pandemic-driven spending sprees dissipate... and only time (and maybe the Federal Reserve's rate trajectory) will tell how they evolve in 2023.

Three Things

Debt Markets Reverse, Forecast Higher Terminal Rate

During the last couple months of 2022, debt instruments such as U.S. Treasuries and corporate bonds both rallied, sending yields lower (yields fall when prices rise). Though there were several factors involved, the biggest motivation was investors' belief that the Fed's actions were working and that peak interest rates (aka the terminal rate) would end up somewhere around 4.75% or so (where they are right now). After another drop in January, yields on the benchmark 10-year Treasury settled back around the 3.5% mark. But over the last few weeks, yields have begun to surge again, and derivative markets are now pricing at a terminal rate of 5.25%. Rising yields not only indicate higher future interest rates, but also can draw money away from stocks, which is one of the reasons the equity market has come under pressure recently.

China Blocks American AI Chatbots

According to a recent report from Nikkei Asia, China's government is forcing its big-tech firms to disallow public access to AI (artificial intelligence) chatbots such as (U.S.-developed) ChatGPT. The communist regime is concerned that the tools will give "uncensored replies" to politically or socially sensitive questions and spread American "disinformation." Although ChatGPT is not officially offered in China, the service has already gone viral as users gain access through virtual private networks and third-party integrations via chat services such as WeChat. China's propaganda machine is already trying to get ahead of the wave by producing state-media sponsored [videos](#) warning of ChatGPT's "dangers." Chinese tech companies are already working on rival AI chatbots that will conform to government censorship.

New Russian Sanctions Could Send Gas Prices Surging

As spring approaches and the summer driving season grows nearer, gas prices in the U.S., Europe and other developed nations are likely to experience a demand increase. Unfortunately, western sanctions on Russian exposure of refined products could limit our ability to produce

gasoline, sending prices soaring. The critical component is something called vacuum gas oil, or VGO. VGO is essentially a cheap sludge leftover from the crude refining process. Complex refineries in North America and Europe are able to process VGO into gasoline, while Russian refiners cannot. Recent sanctions put into place this month essentially halt Russian exports of VGO, which may further impact production capacity and push fuel prices higher.

In the Know

Google's AI Chat Should Have Just Googled Its First Question

In its first demonstration, Google's AI chatbot, Bard, made a serious factual error. When answering a question about the James Webb Space Telescope, the bot erroneously stated that it "took the very first pictures of a planet outside of our own solar system." The mistake cost Google billions in market cap, but that may have been an unfair punishment.

Delivering nonsense or incorrect responses is a problem with any AI bot, as their means of rationale are NOT querying a database of facts but using their "training" on text and patterns to determine what words should logically come next. Both Google and Microsoft's AI bots are often wrong, and as one scientist put it, frequently "hallucinate" — that is, make up information — because they are really just "autocomplete" systems (at least for now).

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