Summary

Economic data for the week included the Federal Reserve raising rates sharply again in efforts to contain inflation. U.S. GDP growth came in negative for Q2, below expectations, raising concerns about a potential recession. Durable goods orders rose, and consumer confidence was mixed, while several housing metrics continued to decline.

Global equity markets were higher, with developed markets outperforming emerging markets. Bonds were also positive, as interest rates fell back despite central bank rate hikes. Commodities were up last week, due to energy supply concerns and weather in agricultural markets.

Economic Notes

(0) As noted earlier in the week, the **FOMC** raised rates by 0.75%, although a larger move of 1.00% was discussed, according to Fed Chair Jerome Powell at the post-meeting press conference. Although he described the 0.75% pace as 'unusually large', large moves are still possible in the months to come. With the funds rate now at 2.5%, policy is officially at the level of 'neutral'. The Fed has moved to an even more data-dependent pace, which is their code for 'expect us to react perhaps in unexpected ways as month-to-month data changes'. In looking only at fed funds futures markets, the bulk of the heavy lifting has now been done, with the next year looking like a mix of a few final hikes, along with potential cuts in early 2023.

Accordingly, the Fed appeared a bit more balanced (some say dovish) in its discussion last week, leaving markets wondering. Perhaps this was the plan. Similar to the ECB the week before, Powell pulled back on forward guidance, other than noting he didn't believe the economy is in recession, with 'too many areas' that were 'performing too well'. Now that rates are back to that neutral level, this closes the first chapter in policy normalization, in getting rates off the zero-bound floor, and actually provides a bit more leeway for future moves. If inflation remains hot, then we may see continued strong hikes through 2022. If inflation begins to pull back on its own, and/or economic slowing accelerates, the urgency to hike may fade. To a less dramatic degree, this follows the Paul Volcker playbook from the early 1980's where rapid rate hikes were followed by cuts, although this was also a more volatile economic period, which included back-to-back recessions, which reset inflation expectations and spurred a period of more economic consistency (eventually).

(-) The advance report of U.S. **GDP** for the 2nd quarter came in negative at -0.9%, the second consecutive quarter of contraction, and below expectations calling for a positive 0.4% reading. Under the hood, per the BEA, the decline was led by falls in private inventory investment (which pulled down GDP by two percentage points alone), residential fixed investment, federal government spending, state and local government spending, and nonresidential fixed investment. However, these were partly offset by rises in exports and personal consumption. Imports also rose, relative to exports, which detracted from GDP. The GDP price index rose at an annual rate of 8.7%, with core up an annualized 4.4%, as both reflected inflation in a variety of categories.

Does this mean we're in a recession? Despite the conventional definition of two consecutive negative quarters meeting that standard, government economists (and politicians) have been quick to dismiss that it isn't automatic. The National Bureau of Economic Research makes the conclusive call, based on a variety of factors. The NBER hasn't typically declared these until nearly the end, or even after the recession is over, so the mystery may continue. There are other missing elements, such as no post-WWII recession occurring without a decline in payrolls, and personal consumption hasn't gone negative in either quarter (based on strong growth in services). The unemployment rate has also not yet begun to pick up, with a rule of thumb being a few ticks higher compared to the rate of the year prior as a recession predictor.

What does Q3 GDP look like? The first read of the Atlanta GDPNow measure is a positive 2.1%, with a range of blue chip forecasts running between 0% and 3% (median of just below 2%). This is too early to make much of, but there are components of quarter-to-quarter GDP that have a reversion to the mean quality, such as inventories and foreign trade. All-in-all, the potential exists that the recent two negative quarters may end up not being a recession. While the difference in growth between the two definitions may not be significant, but markets may see a finer line with 'recession' indicating the formal end of one cycle and beginning of another.

(0/+) **Personal income** in June rose 0.6%, a tenth better than expectations, led by wages/salaries. Year-over-year, income is up nearly 6%, which implies, considering inflation, that real income has actually been negative. **Personal spending** rose 1.1%, also a tenth higher than expectations, which translates to over-8% on a trailing 12-month basis. Goods spending appeared to lead the way, with influences of gasoline and petroleum prices over the period. The personal savings rate declined by -0.4% to 5.1%. The PCE price index for June rose 1.0% on a headline level, and 0.6% for core—each just a touch higher than expectations. These brought the year-over-year figures to a faster pace of 6.8% and 4.8%, respectively, but still below CPI due to differences in composition.

(+) **Durable goods orders** for June rose 1.9%, surpassing the median forecast calling for a -0.4% decline. Removing transportation lowered this gain to 0.3%, while core capital goods orders rose 0.5%—twice that of expectations. Strength in the month was seen in defense aircraft, autos, and electronics. Core capital goods shipments also rose 0.7%, beating expectations of 0.3%. Overall orders are up 11% from last year at this time, which remains a strong showing.

(0) The **S&P/Case-Shiller home price index** of key U.S. cities rose 1.3% in May, but below the 1.7% pace of the prior month and below expectations of 1.5%. All twenty cities saw gains, led by 2-3% reports in Tampa, Miami, and Dallas. For the year-over-year period nationally, the pace decelerated by -0.7% to a still-quite high 20.5%.

(0) The **FHFA house price index** for May showed a rise of 1.4%, but also below the 1.5% rate expected. All nine regions saw gains, led by New England and South Atlantic up 2% each. Here, the national year-over-year pace also fell back by -0.6% to 18.3%. While these represent somewhat stale data, home price appreciation remains strong on a trailing 12-month basis, but may see faster normalization in coming months due to higher financing costs.

(-) **New home sales** in June reversed course and fell by -8.1% to a seasonally-adjusted annualized rate of 590k units, below the -5.9% drop expected by consensus. This was in addition to a -50k revision downward for the prior month. By region, sales in the Midwest were up by over 20k, while the West saw the largest decline. Year-over-year, new home sales are down over -17%. The median new home price, though, is up 7% from last year at $402,400. Inventories have been ticking up as well; these had been mostly the form of homes not yet started or in progress, but completed homes have also started to rise, due to higher mortgage rates. Months' supply has ticked up by 0.9 to 9.3, a significant improvement from the 5.8 a year ago and 5.6 at year-end.

(-) **Pending home sales** fell -8.6% in June, well beyond the -1.0% decline expected. Every national region saw a decline, led by the West, down over -15%. Year-over-year, pending sales are down -20%, which has reflected the well-known factors of low inventories and recent affordability issues, with price and financing. On the downside, lower pending sales are a precursor of lower existing sales reports in future months.

(-) The Conference Board **index of consumer confidence** for July fell by -2.7 points to 95.7, below the median forecast calling for 97.0. This was the lowest level since early 2021. Assessments of present conditions led the way by falling nearly -6 points, while expectations for the future ticked down a half-point. The labor differential, which measures the ease in finding employment, ticked down by a few points.

(0/+) The final July report of **Univ. of Michigan index of consumer sentiment** rose by 0.4 of a point to 51.5, just above the expected unchanged reading of 51.1. Assessments of current conditions improved by a point, while expectations for the future were unchanged. Inflation expectations for the coming year were flat at 5.2%, while those for the next 5-10 years ticked up a tenth to 2.9%. Anecdotal commentary noted that global concerns eased a bit, but inflation remained the key area of consumer focus.

(0) **Initial jobless claims** for the Jul. 23 ending week declined by -5k to 256k, above the 250k median expectation. **Continuing claims** for the Jul. 16 week fell by -25k to 1.359 mil., down from the 1.386 mil. expected. An unusual spike in initial claims in MA in a prior week and subsequent correction downward has accounted for much of the change, with other states little different on net.

Market Notes

Period ending 7/29/2022	**1 Week (%)**	**YTD (%)**
DJIA	2.97	-8.60
S&P 500	4.28	-12.58
NASDAQ	4.72	-20.47
Russell 2000	4.35	-15.43
MSCI-EAFE	2.11	-15.56
MSCI-EM	0.41	-17.83
Bloomberg U.S. Aggregate	0.64	-8.16

U.S. Treasury Yields	**3 Mo.**	**2 Yr.**	**5 Yr.**	**10 Yr.**	**30 Yr.**
12/31/2021	0.06	0.73	1.26	1.52	1.90
7/22/2022	2.49	2.98	2.87	2.77	3.00
7/29/2022	2.41	2.89	2.70	2.67	3.00

U.S. stocks were hit early in the week with negative reports on the consumer landscape from Walmart and Target, among others. Higher food prices affected margins, as did higher fuel/transportation prices, and an ongoing glut in certain consumer products. As in prior reports, higher goods inventories have been an issue as buyers have converted from pandemic goods buying more towards services. However, markets gained 3% on Wed. after the Fed rate increase, with strong language of needing to get inflation under control, but also noting the impacts of a slowing economy, which has provided more certainty about the fed funds terminal rate discussed earlier. Bullishness remained the rest of the week based on more positive language than expected from blue chips such as Apple and Amazon.

The Build Back Better reconciliation package, long thought dead, has been reinvented as the far slimmer $739 bil. 'Inflation Reduction Act of 2022'—containing provisions for clean energy and lowering of health care costs, underpinned mainly by higher corporate taxes. There are hopes for passage before Congress goes on recess for Aug. After that, campaigning for mid-term elections starts, so this is thought to be the last chance for legislative progress before year-end. It's been noted by some economists that using government spending, particularly using corporate tax increases, to fight inflation is a bit of an oxymoron.

Every sector gained last week, led by energy up 10% alone, followed by normally defensive utilities. On the lagging side, consumer staples, healthcare, and communications were only up in the 1-2% range. Real estate also fared strongly, up nearly 5%, with a drop in interest rates.

For the month of July, the S&P 500 is up 9.2%, which represents a decent rally from lows, and leaving it down a net -13% from the Jan. 3 peak. The next item of potential worry (or not) is quarterly earnings, which so far have been mixed to a bit better than expected. Earnings continue to roll in, with 175 of the S&P 500 members reporting last week, and nearly 60% of the total having done so. The earnings growth rate has improved to 6%, from early estimates of just over 4% year-over-year, with three-quarters of firms reporting an EPS surprise. Declines in EPS estimates were seen in communications and materials, while energy continued to see upward revisions. Through Jul. 22, perhaps ironically, companies with less than 50% of revenues coming from the U.S. saw earnings growth over 10%, while U.S.- revenue heavy (over 50%) firms saw revenue gains of only 1% year-over-year. (Combined, reporting firms saw a 5% rise.)

Foreign stocks in Europe and the U.K. performed largely in line with U.S. equities, and outperformed Japan and emerging markets. European GDP coming in at a positive 0.7% for Q2 appeared to help sentiment, despite risks in future quarters based on Russian natural gas availability. In EM, a sharp commodity-driven gain in Brazil was offset by a decline in China. Chinese stocks were held back by a realization of below-trend GDP growth (compared to published prior expectations) and a rising likelihood of fiscal stimulus ending.

U.S. bonds rose last week, as interest rates fell back across the bulk of the treasury yield curve, despite the Fed's actions to raise rates. The U.S. treasury curve, measured by the 10y-2y remains inverted on the order of -25 bp, which is a positive recession indicator. However, the potentially more accurate 10y-3m treasury slope remains slightly positive. High yield fared over a percent better, along with stronger equities. Foreign bonds were up sharply in developed and emerging markets, due to a weaker dollar for the week.

Commodities gained across the board, for the most part, helped by a weaker dollar. While energy and industrial metals were up nearly 5%, agriculture markets (wheat, corn, soybeans) were all roughly 10% higher along with an especially hot U.S. weather forecast, which can result in crop damage. The price of crude oil rose by 4% to just under $99/barrel, as chances of an OPEC supply increase appeared to lose steam. In natural gas markets, the Nord Stream 1 pipeline, moving gas from Russia to Europe, is back to only 20% of capacity, which has been blamed by the Russians on maintenance issues, while the EU isn't believing it.

Have a good week.

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Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Associated Press, Barclays Capital, Bloomberg, Citigroup, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

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Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.