Summary

Economic data for the week included a flat ISM manufacturing report, continued gains in home prices, stronger consumer confidence, and decent showings in several labor market metrics.

Global equity markets fell back last week along with higher interest rates, but also ongoing concerns over economic slowdown. Bonds declined as well, due to the impact of higher yields. Commodities lost ground as well, led by sharp declines in energy and metals.

Economic Notes

(0/+) The **ISM manufacturing index** was unchanged in August, at 52.8, which actually was a positive surprise compared to an expected drop to 51.9. Being over 50, activity remains in expansionary territory. Underlying results were mixed, with production falling back, barely remaining in expansion, while new orders and employment rose out of contraction and back into expansion. Supplier deliveries and prices paid continued to tick down into the mid-50's, which, while still expanding, are growing at a reduced rate compared to a few months ago. While ISM has slowed, it remains growing and more indicative of a positive economy than negative recessionary one.

(0/-) **Construction spending** for July fell by -0.4%, beyond the median forecast calling for -0.2%, but was coupled with several upward revisions for two prior months. During July, public construction spending in both residential and non-residential saw gains around a percent or better, while private residential fell back by -1.5% to bring down the overall index. Inflation continues to be a significant contributor to the nominal spending numbers, meaning 'real' spending is well lower than the headline figure.

(0/-) The **S&P Case-Shiller home price index** of key U.S. cities rose by 0.4% in June, well short of the 0.9% pace expected and only a third of the gain seen in May. For the single month, 13 of the 20 cities experienced gains, led by Miami and Tampa, at over 2% each; the West Coast suffered declines, with Seattle and San Francisco each down nearly or over -1%. The year-over-year national growth rate decelerated back by 1.9% to a still-robust 18.6%.

(0/-) The **FHFA house price index** ticked up only 0.1% in June, below the median forecast calling for 0.8%, and only a fraction of May's pace. The East South Central (AL, KY, MS, TN) and Middle Atlantic (NJ, NY, PA) regions led with gains of over 1% each, while the Mountain (MT south to NM) and West North Central (ND south to MO) states fell back by nearly -1%. The FHFA year-over-year growth pace decelerated by -2.1% to 16.2%, albeit a still-strong showing compared to history.

Overall, these housing indexes have started to roll over, fueled by rising unaffordability from higher mortgage rates, which has pulled down extremely robust demand seen since the start of the pandemic. Some in the industry have noted a rising rate of house sales contract cancellations, albeit with better borrowing conditions than in 2007, for example, when mortgage borrower quality was far more suspect. Nevertheless, pullbacks in housing have been a feature of most recessions (and slowdowns) in recent decades, although debate continues about the severity of this case due to the tighter levels of housing inventory. The next several quarters should offer much more detail about this developing path.

(+) The Univ. of Michigan **consumer confidence** index for August rose by 7.9 points to 103.2, exceeding the 98.0 consensus forecast. While assessments of present conditions rose by 5 points, expectations for the future gained over 9 points. The labor differential, on the other hand, pulled back by a fraction of a point, implying a slight weakening in job market sentiment. Relief in gasoline prices from a peak in early June appears to be helping sentiment, as is often the case.

(+) The government **JOLTS** job openings survey saw a rise of 199k to 11.239 mil. in July, above the forecasted level decrease to 10.375 mil. Of the total number added, 85k were in retail, 81k in transportation/warehousing/utilities, as well as 53k in arts/entertainment/recreation. It appeared that both recreation and teaching were strong drivers of the results, due to obvious seasonal factors. The job openings rate ticked up a tenth to 6.9%, while the hiring rate was unchanged at 4.2%. On the other side of the ledger, the layoff rate was unchanged at 0.9%, as was the quits rate at 3.1%—the latter remaining at a robust historical level. Overall, the level of job openings remains high compared to the total work force, although this is expected to eventually come down a bit if the economy continues to slow. Employers tend to pull back job openings first rather than trim staff if at all possible as a first measure, but this hasn't been seen en masse yet.

(-) The **ADP private employment** report came in showing 132k new jobs in August, well below the 300k expected. For the month, services jobs were up by 110k, most of which were in leisure/hospitality. Goods-producing jobs gained 22k, almost all of which were in construction. The ADP is using an updated methodology, though, which may explain the shortcoming relative to expectations, with sporadic connection to the government nonfarm payrolls report over the past year or two.

(0/+) **Initial jobless claims** for the Aug. 27 ending week fell back by -5k to 232k, well below the 248k consensus estimate. **Continuing claims** for the Aug. 20 week fell by -26k to 1.438 mil., matching the median forecast. Initial claims levels strangely rose again in MA, while activity in other states was mixed, up or down by no more than 2k. Levels overall remain low and reflect strong labor demand.

(-/0) Nonfarm **productivity** was revised up by a half-percent to a less-negative -4.1% in Q2. This brought the year-over-rate up a bit to a still-negative -2.4%. **Unit labor cost** gains were revised down a bit, from 10.8% to 10.2% in Q2, with the year-over-year rate pulled down by -0.2% to a still-robust 9.3%.

(0/+) The employment situation report for August came in a bit better than expected, but not to an exceptional degree that might elevate fears of the Fed raising rates at a faster pace later this month. **Nonfarm payrolls** rose by 315k, above the 298k expected by consensus, but at a slightly slower pace from the last few months. Private payrolls represented 308k of the total, with job gains focused in professional services (68k), healthcare (62k), and retail (44k); on the other hand, leisure/hospitality, information, and transportation/warehousing job growth gained at a slower pace. Manufacturing jobs rose by 22k, while construction jobs gained 16k—the latter a positive considering a more difficult homebuilding environment.

The **unemployment rate** ticked up by 0.2% to 3.7%, largely affected by rising labor force participation (up 0.3%), which had been lacking. The consensus expectation was for no change. The U-6 underemployment rate ticked up by 0.3% to 7.0%. The household survey component of that report was good, with jobs up by 442k.

Average weekly earnings rose by 0.3%, which was a tenth below expectations. This kept the trailing 12-month increase in earnings at 5.2%, although the pace of growth has decelerated over the last few months. **Average weekly hours** declined by a tenth to 34.5.

Market Notes

Period ending 9/2/2022	1 Week (%)	YTD (%)
DJIA	-2.85	-12.54
S&P 500	-3.23	-16.78
NASDAQ	-4.18	-25.25
Russell 2000	-4.70	-18.70
MSCI-EAFE	-3.01	-20.24
MSCI-EM	-3.41	-19.31
Bloomberg U.S. Aggregate	-1.02	-10.94

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
8/26/2022	2.89	3.37	3.20	3.04	3.21
9/2/2022	2.94	3.40	3.30	3.20	3.35

U.S. stocks flailed downward last week, in a continuation of the prior week's comments from Fed chair Jerome Powell. Those comments had alluded to continued rate increases, including a good possibility of a 0.75% rate hike later this month, rather than the 0.50% first expected. But, this remains a few weeks away. Decent economic and jobs data during the week provided more support to that tightening pace, including a 'Goldilocks'-type jobs report. Also, the announcement of a suspension of Russian natural gas to Germany weighed on sentiment.

Every sector fell back last week, with traditional defensives health care and utilities faring best, with losses under -2%, while technology and materials fell back by -5%. Technology appeared to be affected negatively by a prohibition of certain chip sales by Nvidia in China. Real estate also fell by -4% along with higher interest rates.

Foreign stocks fell back to largely the same degree as U.S. equities. Additional lockdowns in several Chinese cities appeared to weigh on sentiment a bit, with mixed PMI readings there hovering just under the 50 neutral expansion/contraction level. All eyes will be on the ECB this coming week, with expectations of a 50-70 bp rate hike, with concerns over high inflation outweighing those over a fragile economy, with energy risks seeming to rise by the week. (However, at this point, GDP growth is higher than that of the U.S., as is inflation.)

The suspension of natural gas to Germany, and potentially other destinations to Europe is significant, although the possibility has been looming for weeks since the closure and partial reopening of the Nord Stream pipeline. This has been gamed by Russia as contra-punishment for sanctions, as well as discussions by the G7 on implementing Russian oil price caps, using the leverage of Germany's high reliance on Russia for gas sourcing. Natural gas is difficult to transport easily, requiring a liquefying/condensing, and then a re-gasification to be transmitted through to the final destination. Gas can be obtained through alternative sources, such as by ship from the U.S., but these are lengthy and more cumbersome than current pipeline sources. In the worst case, a rationing of natural gas usage is possible, which would likely prioritize residential heating and cooling needs, and limit supplies to industry and manufacturing—a slowdown that could exacerbate a recession in Europe. For investors, if there is good news, this possibility has been priced in for months with current low P/E levels for the MSCI Europe and MSCI U.K. Indexes.

U.S. bonds fell back as interest rates pushed higher, in a continuation of Fed Chair Powell's comments and presumed central bank hawkishness. Treasuries fared better than corporates, as credit spreads widened, although senior floating rate bank loans outperformed. A stronger dollar (in fact, at a two-decade high) held back foreign bonds, which fared worse than domestic debt for the week. The treasury curve remains flat to inverted from the 6m to 30y segment, in keeping with expected Fed movements over the rest of the year. At the same time, the relative lack of significant movement upward on the longer end of the yield curve points to expectations for peak rates and reversion to more normal expectations.

Commodities fell across the board last week, led by weakness in energy and industrial metals. The declines were led by continued fears of economic slowdown, including the new Chinese lockdowns, which threaten demand. The price of crude oil fell by over -6% to just under $87/barrel. As the week progressed, it appeared that OPEC+ may not be reviewing cuts in production after all, while behind-the-scenes discussions with Iran may result in more barrels coming on market (if a deal is made). The combination of rumors/news also impacted the sensitive dynamics behind crude oil prices. Natural gas remains another matter entirely, with S&P GSCI spot prices up over 130% YTD, and up 280% in Europe, including an early surge this morning on the heels of the Russian pipeline closure news.

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.

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