Summary

Economic data for the week included consumer price inflation coming in at a continued decelerated pace, as were producer prices to a slightly lesser degree. Jobless claims rose modestly, with no major recent change.

Equities were mixed to lower last week, as interest rates rose and summer trading volumes remained low. Bonds fell back as well, due to the duration impact of rates. Commodities were mixed, with oil prices inching up slightly in a continuation of tighter supply conditions.

Economic Notes

(-) The **Producer Price Index** for July rose 0.3% on both a headline level and core, removing food and energy, both a tenth above expectations. When broken out by segment, goods prices only rose 0.1%, while services continued higher at a strong 0.5%. On a year-over-year basis, headline PPI is up 0.8%, while core PPI ex-food and energy is 2.4% higher. Over that full 12-month period, services prices are up 2.5%, while prices for goods have deflated -2.5%. Trends for both reflect demand conditions in those segments post-pandemic, as well as the softening influence of lower energy prices.

(0) The **Consumer Price Index** for July rose just under 0.2% on both a headline and core (ex-food and energy) level. Both were just below median expectations and similar to the prior one-month pace from June. Within the July single-month data, energy commodities rose 0.3%, along with a recent bounce higher in oil and natural gas prices. Medical care commodities also rose a half-percent, followed by shelter, which decelerated to a 0.4% pace, while restaurant meals only rose by 0.2%—the slowest pace in a few years. On the deflationary side, used car prices fell by over -1%, while airline fares fell by another -8%, for the second straight month on a seasonally-adjusted basis.

Using the usually quoted trailing 12-month comparison, headline and core inflation came in at 3.2% and 4.7%, respectively. A normalization in inflation has continued, albeit at a continued sluggish pace. Over the past year, a -13% drop in energy prices has offset a 5% gain in food prices—with offsetting impact on consumer confidence. Due to the common trailing 12-month convention in measuring CPI, rates of change are as dependent on starting levels a year ago as they are for the most recent month. Due to a slowing in inflation during summer 2022, which represented a normalization following the spike in prices after the start of the Ukraine-Russia conflict, the gap has again widened, giving the perception of inflation again creeping higher. Reassuringly, the annualized 3-month rates for core and headline inflation remain in a range of 3.0-3.5%. If inflation were to plug along at a more 'normal' 0.2% per month rate for the rest of this year, by December we would be at year-over-year headline/core rates of around 4%, falling to around 2.5% by next spring at that pace.

(0/-) The preliminary **Univ. of Michigan consumer sentiment reading** for August showed a decline of -0.4 of a point to 71.2, on par with consensus expectations. Consumer interpretations of the current environment improved by about a point, while expectations for the future declined by an equivalent amount. Inflation expectations for the coming year fell by a tenth to 3.3%, several tenths below forecast, as did expectations for the next 5-10 years to 2.9%. These appeared to coincide with the June CPI data, and an easing in consumer concerns surrounding inflation generally.

(0/-) **Initial jobless claims** for the Aug. 5 ending week rose by 21k to 248k, above the median forecast of 230k. Continuing claims for the Jul. 29 week fell by -8k to 1.684 mil., below the consensus estimate calling for 1.707 mil. The unusual claims results from the past several months continued from OH and MN, related to potential fraud in the former and expanded eligibility in the latter (with both responsible for a combined 28k of total claims). It appears that the bankrupt trucking firm Yellow laying off a quarter of their employees also contributed.

Question of the Week

What is the status of the ongoing yield curve inversion?

The U.S. treasury yield curve remains inverted. Since this doesn't happen frequently over the decades, it continues to raise questions for some investors as to what it means and signals for the months ahead. Per FocusPoint calculations, since the 1960s, when measured by the 10-year minus 3-month treasury spread (the latter seen as the most responsive to Fed actions), inversions have tended to last 8-12 months. (We're currently 9 months in.) Also on average, inversions have begun anywhere 6-12 months before a recession has started; this is also keeping in mind recessions are formally identified in hindsight. Some prefer the 10 year minus 2 year as an inversion measure, which has similar characteristics but has historically persisted for longer periods. In fact, the 1980 recession saw the inversion begin nearly two years earlier in 1978. Sadly, it normalized briefly but inverted again later that year, lasting for another year. So, today's inverted curve isn't an abnormal case, but every cycle is slightly different.

The strangeness of inversions is highlighted by what they are not—a normal yield curve where borrowers pay and investors earn higher rates in accordance with the maturity risk in tying up capital. Normal curves create the classic operation of 'borrow short and lend long,' upon which the banking industry is reliant, and by itself explains the one of the two key stresses banks can find themselves in. (The other is credit, which has not become a problem yet, but tends to rear its head before or during recessions.) The inversion is not only counterintuitive and strange, but also economically unviable for long periods of time, which is why inverted curves tend to be both one of the best predictors of upcoming recession, but also a cause, due to the upside-down stress on the banking system.

By contrast to normal, today's short high rates are a nice bonus for investors and savers that had grown used to 0.01% in recent years. However, such perfect conditions for earning high rates but assuming minimal risk tend to end up on borrowed time. While one can lock in 5%-ish rates now for anywhere from 3 months to 2 years at this point, the key consideration of reinvestment risk will come when those bills/notes mature. As it always is, the uncertain variable is what rates will look like at those same maturities 1-2 years out. In a plug for traditional fixed income in a portfolio, the limited duration of short-dated bonds also limits potential price upside should yields fall, as one might see in a deeper economic slowdown or sell-off in risk assets. In that pessimistic case, the current slightly-lower yields of intermediate-term or long-term debt could fare better from a total return perspective. One rarely finds free rides in fixed income, as liquid investment-grade markets have tended to be quite efficient in pricing in aggregated market expectations, although these expectations can change quickly.

Market Notes

Period ending 8/11/2023	**1 Week %**	**YTD %**
DJIA	0.69	7.78
S&P 500	-0.27	17.43
NASDAQ	-1.87	31.04
Russell 2000	-1.62	10.29
MSCI-EAFE	-0.56	11.75
MSCI-EM	-1.94	6.29
Bloomberg U.S. Aggregate	-0.64	0.64

U.S. Treasury Yields	**3 Mo.**	**2 Yr.**	**5 Yr.**	**10 Yr.**	**30 Yr.**
12/31/2022	4.42	4.41	3.99	3.88	3.97
8/4/2023	5.54	4.78	4.15	4.05	4.21
8/11/2023	5.54	4.89	4.31	4.16	4.27

U.S. stocks were mixed during the week, with lighter summer volumes coming along with the contrasting news of flatter inflation coupled with higher interest rates. By sector, energy gained over 3%, followed by health care, which was helped by drug-related news, with defensives generally faring better than cyclicals. Technology fell back nearly -3%, bucking recent strong trends. Financials were mixed as well, as several smaller banks received credit downgrades, which affected the small cap value market specifically.

Earnings for Q2 have almost been wrapped up, with initial expectations of a -9% year-over-year earnings decline now having improved to 'only' -4%. Revenues saw 1% growth, with nearly -1% in profit margin contraction proving to explain much of that gap. For the balance of 2023 and into 2024, the level of oil prices, which translates into energy company earnings, may be what tips the balance of a weak and strong recovery. As of the prior week, the largest 10 stocks in the S&P 500 have accounted for 90% of the index's year-to-date gains; this remains narrow, but broader than returns were several months ago.

Foreign stocks were also mixed, with little change on net for the week in developed market indices, while emerging markets declined nearly -2%. While most EM nations lost similar ground, China lagged with the sharpest declines in the -4% range. In a continuation of their current woes, Chinese producer and consumer price readings have now moved into deflation on a year-over-year basis, which served to heighten investor concerns about the potential ability for the government to inject sufficient stimulus to get things back on track. Imports and exports are also both down in the double digits from a year ago, adding to these worries.

Bonds had a negative week as interest rates ticked higher, along with reports showing current inflation not falling as quickly as hoped—keeping the chances of another Fed hike in play. Only floating rate bank loans and high yield escaped with positive returns. Higher supplies of new issues have also weighed on prices, causing yields to adjust higher as of late. Foreign bonds were held back by a sharp rise in the U.S. dollar.

Commodities were little changed on net, despite the strong dollar for the week which is often a headwind. Slightly higher prices for grains and energy were offset by drops in both industrial and precious metals. Base metals have been notably week, especially copper, along with continued-weak manufacturing demand (in contrast to strong services), specifically in China. Crude oil rose a fraction of a percent last week to $83/barrel, as the number of oil rigs continued to fall back (total U.S. rigs are down significantly since the start of the pandemic). After a challenging year, where oil prices have been pulled down by fears of slower demand related to a potential recession, a recent stealthy price surge of nearly 20% in the last three months has come in response to these supply worries.

Have a good week.

Ryan M. Long, CFA
Director of Investments
FocusPoint Solutions, Inc.

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, Univ. of Michigan, 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.

The information above has been obtained from sources considered reliable, but no representation is made as to its completeness, accuracy or timeliness. All information and opinions expressed are subject to change without notice. The information provided in this report is not intended to be, and should not be construed as, investment, legal or tax advice; and does not constitute an offer, or a solicitation of any offer, to buy or sell any security, investment or other product. FocusPoint Solutions, Inc. is a registered investment advisor.

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