Summary

Economic releases for the week included the index of leading economic indicators continuing its long-running decline. However, retail sales and industrial production surpassed expectations on the upside. Housing data was mixed, as were several regional manufacturing surveys.

Stocks saw negative returns globally, with interest rates rising and concerns over the Chinese economy dominating sentiment. Bonds declined due to the direct impact of those rising yields. Commodities fell due to currency effects and demand concerns in oil and metals.

Economic Notes

(-) The Conference Board's **Index of Leading Economic Indicators** fell by another -0.4% in July, continuing a string of 16 straight monthly declines. In the single month, lower new orders, higher interest rates, and weaker consumer sentiment led the index lower; positives included lower jobless claims and higher stock prices (the latter traditionally viewed as an important leading indicator of conditions).

Over the last six months, the index has fallen -4.0%, which is slightly worse than the -3.7% drop over the prior six months of Jul. 2022 to Jan. 2023. Despite strength in stock prices over that 6-month period, weakness was seen most everywhere else, mostly in the non-financial components, such as consumer expectations for business conditions, ISM new orders, but also the inverted yield curve on the financial side—continuing as an important recession indicator in the list. The overall index continues to point to recession, being the fourth outright negative signal over the last 20 years. (The index downturns in 2001, 2008, and 2020 all ending up being recessions, as were all earlier episodes in 1969-70, 1973-75, 1980, 1981-82, and 1990-91 not shown in the chart below.)

(+) **Retail sales** for July rose 0.7%, surpassing the 0.4% expected. Removing the volatile components of autos, gasoline, and building materials, core/control sales rose 1.0%, twice that of consensus expectations. The headline figure was driven by a drop in auto sales, while food services/drinking places rose over a percent to a record high level. Core sales appeared to be driven by a 2% rise in non-store/online sales, which were connected to Amazon Prime Day (now an event so important it appears as a named factor in U.S. economic statistics), in addition to sporting goods/hobby, clothing, and general merchandise. On the other hand, furniture and electronics/appliances fell by over a percent each. Considering recent tempered inflation readings, 'real' sales saw improvement. However, over the past 12 months, headline sales are up 3%, about in line with inflation, resulting in a zero real retail sales gain.

(+) **Industrial production** rose 1.0% in July, surpassing the median forecast of 0.3%. As a sub-component, manufacturing production rose 0.5%, versus expectations of little change, as auto production increased 5%. Mining rose a similar 0.5%, helped by higher oil prices stimulating drilling activity, while utilities production drove 5.4% higher in July, with obvious impact from a hot summer contributing to substantial cooling needs. For the trailing 12 months, industrial production has steadily fallen to a growth rate of negative -0.2%, down from highs of over 4% year-over-year growth last fall, with a sharp recovery in autos being a positive contributor to offset further declines elsewhere. **Capacity utilization** rose 0.7% to 79.3%. Based on this closely-watched metric, manufacturing continues to trail lower, as goods production lags stronger activity in services.

(-) The **Empire state manufacturing survey** for August saw a decline of -20.1 points, moving from expansion to a contractionary -19.0 reading, in contrast to expectations calling for a more benign -1.0. New orders and

shipments each fell by over -20 points, and employment by -6 points, all into contraction. Prices paid and received each rose over 8 points, further into expansion. However, expected business conditions six months out rose further into expansionary territory, in contrast with the headline figure.

(+) By sharp contrast, the **Philadelphia Fed manufacturing index** rose a dramatic 25.5 points back to an expansionary 12.0 level in August, well above the contractionary median forecast of -10.4. New orders and shipments both improved dramatically, in keeping with the headline number, back into expansion. However, employment fell back further into contraction. Prices paid rose over 11 points further into expansion, while inventories fell further into contraction. Expected business conditions six months out fell by a dramatic -25 points but remained at a positive 4 level.

(+) **Housing starts** in July rose 3.9% to a seasonally-adjusted rate of 1.452 mil. units, above the 1.1% expected gain. Within the data, single-family starts rose 7%, while multi-family fell by -2%. Regionally, the West and Midwest saw gains at or over 10%, while the South fell a slight -1%. Starts remain up 6% over the past 12 months, led by single-family starts up 10%, while multi-family declined -1%. **Building permits** ticked 0.1% higher in July to a seasonally-adjusted rate of 1.442 mil., below the 1.5% gain expected, with single-family gains offsetting a decline in multi-family. Year-over-year, permits included a percent rise for single-family, while those for multi-family were down -31%, with apartment building finally beginning to taper. Progress in building much needed single-family homes continues, with current homeowners reluctant to give up smaller low-rate mortgage payments. The number of homes 'under construction' remains at the highest levels in over 50 years, with some labor and materials issues continuing as hurdles.

(-) The **NAHB/Wells Fargo Housing Market Index (HMI)** fell by -6 points to 50, a neutral reading of equivalent builders seeing conditions positively and negatively. Current conditions, expectations for future sales, and prospective buyer traffic all fell by several points—the latter to the most pessimistic levels. Noted as negative sentiment factors by NAHB rising mortgage and construction costs, with difficulty in finding enough workers, as well as a lack of buildable lots and certain needed utility equipment.

(0/-) **Initial jobless claims** for the Aug. 12 ending week fell by -11k to 239k, just below consensus forecast calling for 240k. Continuing claims for the Aug. 5 week rose by 32k to 1.716 mil., above the 1.700 mil. expected. The strange potential distortions of potentially fraudulent activity in OH and enhanced employment insurance in MN moved even higher; otherwise, initial claims would have been likely lower.

(0/-) The **FOMC minutes** from the July meeting were disappointing to markets, with views on monetary policy a bit more wide-ranging than some expected. While a 0.25% rate hike was voted in, several members preferred to leave rates unchanged, while comments from some committee members pointed to further rate hikes potentially being necessary. However, it was noted generally that while inflation remains 'unacceptably high,' these pressures 'could be abating,' with lower goods price increases helping the effort. These thoughts were in line with standard comments from Chair Powell as of late. While the committee view of recession was no longer the base case, a slower economy continued to be expected, and potential downside risks from 'too much' tightening were noted, including on credit markets. The bottom line is that any additional rate hikes add further negative strains on the economy, placing the Fed in a difficult balancing act, although this monetary tightening cycle appears to be closer to the end than the beginning.

Market Notes

Period ending 8/18/2023	1 Week %	YTD %
DJIA	-2.10	5.52
S&P 500	-2.05	15.02
NASDAQ	-2.55	27.69
Russell 2000	-3.36	6.58
MSCI-EAFE	-3.30	8.06
MSCI-EM	-3.29	2.80
Bloomberg U.S. Aggregate	-0.50	0.13

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
8/11/2023	5.54	4.89	4.31	4.16	4.27
8/18/2023	5.55	4.92	4.38	4.26	4.38

U.S. stocks fell back for the third straight week. Domestic economic data continued at a mixed to decent growth rate; however, the FOMC minutes soured the mood with some officials hinting at further rate hikes potentially being necessary, and negative economic news from China also eroded sentiment.

Every domestic sector lost ground, led by consumer discretionary down over -4% (with several members down, but mostly Tesla), followed by a decline in communications; on the other hand, energy, technology, and typically defensive health care and utilities suffered the fewest losses. Real estate also declined over -3% along with higher interest rates across the board.

Foreign stocks fell slightly more than domestic equities on the week, with currency explaining a bit of the difference. Wage growth in the U.K. and concerns over China affected Europe, due to closer trade relationships. Emerging markets were mixed, with Chinese stocks being the standout to the negative, down upwards of -5% on the week. In addition to slower-than-expected industrial production and retail sales numbers, Chinese policymakers lowered their 1-year interest rate on loans by -0.15% to 2.5%, which concerned global markets, as it has been coupled with weaker industrial and consumer growth, along with higher unemployment in that key market. This is the second straight cut, and the largest since the early pandemic. Officials have also decided to pause the publication of youth unemployment numbers with a rationale of hoping to improve data collection (as the current youth unemployment rate is over 21%, a troublesome level, this has raised some questions from observers). Questions also surround potentially more support for the property sector, where at least several firms are experiencing a debt crisis. The broader global effect remains a question mark, with the largest negative impacts thus far appearing to be on exporters of energy and minerals, which are largely focused in the emerging markets. There are several considerations that have kept Chinese assets under scrutiny this year, including a high general debt load/leverage, slowing demographics via an aging population and low replacement rate, uncertainty in the property market (which represents about a fifth of the overall economy), and ongoing back-and-forth with the U.S. regarding availability of more advanced technology and general geopolitical disagreement. Several or all of these factors could serve to depress economic growth, but current valuations do appear to reflect that poor sentiment.

Bonds were negatively impacted by hawkish Federal Reserve language, alluding to further future rate hikes. Aside from the minimal change in floating rate bank loans, which outperformed all other segments, credit underperformed government debt. Foreign bonds fell in keeping with a stronger U.S. dollar for the week.

The 10-year treasury note yield has continued to climb higher, subtlety reaching over 4.25%, the highest level in nearly a year, as the July FOMC minutes alluded to sentiment supporting further hikes. While the yield curve remains inverted, which usually indicates that short-term rates are assumed to come down (historically in

response to recession), the long end of the curve can move a bit as well—in this case, anchored somewhat to an assumed higher terminal Fed funds rate. The 10-year yield is one of the world's most important interest rates, and contains a good deal of information and assumptions all embedded into a single input. Out of the 10-year come a base level for credit spreads, commercial lending and residential mortgage rates, not to mention discount rates used to value stocks in cash flow models. Has the Fitch downgrade contributed to this? Perhaps on some level, but U.S. debt remains the world's 'risk-free rate,' with no other competitor in a close second at this point. In theory, higher indebtedness and less certainty over fiscal discipline should result in a higher interest rate, although a variety of nations are in the same boat, and consistent demand for high-quality debt has kept rates contained. Somewhat ironically, following such a long period of low risk-free rates, as treasury rates have moved higher (especially due to an improved 'real' rate), so has investor interest.

Commodities were largely down on the week, led by energy and metals, along with a stronger dollar. Crude oil prices fell over -2% last week to $81/barrel, along with eroding confidence in a Chinese economic recovery. Natural gas corrected nearly -7%, with a larger stockpile and cooling of hot weather nationally as we reach the end of summer.

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, 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.

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