Summary

Economic data for the week included ISM manufacturing data continuing to contract, while ISM services continued in a trend of positive growth. A variety of labor data components showed a gradual weakening in conditions.

Equities fell back globally in the midst of mixed economic and earnings data. U.S. stocks were negatively affected by the surprise credit downgrade of U.S. treasury debt by Fitch. Bonds declined with higher yields, and negative impact abroad from the stronger dollar. Commodities were mixed with higher oil prices offset by weaker agricultural prices brought on by higher expected supply.

Economic Notes

(0/-) The **ISM manufacturing index** for July rose by 0.4 of a point to 46.4, below expectations calling for 46.9. By component, new orders and production rose nearly 2 points each, but remained in contraction; employment fell by nearly -4 points, further into contraction. Supplier deliveries and prices paid each rose a fraction of a point but remained in contraction. While July saw an improvement on the negative growth pace, this still falls in contractionary territory, in line with what tends to be seen in recessions or pre-recessions, for which ISM manufacturing tends to be a well-correlated indicator.

(0/-) The **ISM services/non-manufacturing index** in July declined by -1.2 points to 52.7, a bit below the median forecast calling for 53.1. All key components declined a bit, including new orders, employment, and business activity, but all remained in expansion. Supplier deliveries rose but remained in contraction; prices paid ticked a bit higher and further into expansion. This overall measure remains in expansion, albeit to a lessening degree, with the services part of the economy remaining the key driver of the economy, offsetting a consistent slowing environment in manufacturing. Inflation also continues to be more robust in services than in manufacturing, which is largely related to wage growth.

(+) **Construction spending** for June rose by 0.5%, just a tick under the median forecast rate of 0.6%. By segment, private residential spending rose nearly a percent, which offset little change in other categories like non-residential spending, including a small drop of a few tenths in public residential spending. Construction costs actually fell by over a half-percent in June on a seasonally-adjusted basis, which pushed the ‘real’ spending figure to twice the official level.

(-) **Initial jobless claims** for the Jul. 29 ending week rose by 6k to 227k, just above the 225k level forecast. Continuing claims for the Jul. 22 week rose by 21k to 1.700 mil., below the 1.705 mil. expected by consensus. The anomalies of recent weeks in OH and MN have continued; if removed, claims appear to be near their lower levels earlier in the year.

(-) The **JOLTs government job openings** report for June showed a decrease of -34k to 9.582 mil., below the median forecast calling for 9.600 mil. Openings were highest in education/health care (123k), ‘other’ services (46k), and government (10k), while declines were most pronounced in trade/transports/utilities (-96k), leisure/hospitality (-81k), and manufacturing (-26k). On the job entrance side, the openings rate was unchanged at 5.8%, while the hiring rate fell by -0.2% to 3.8%. In terms of exits, the layoff rate was flat at 1.0%, while the quits rate fell two-tenths to 2.4%.

(+) The **ADP private employment report** for July showed a gain of 324k jobs, far surpassing expectations of 190k, yet short of the 450k+ result from June. Services jobs rose by 303k, of which two-thirds were in leisure/hospitality. Goods-producing jobs rose a meager 21k, with a 48k gain in natural resources/mining, offset by a -36k manufacturing decline. Wage growth on a year-over-year basis fell several tenths to a still-high 6.2% for those in the same job, while it rose 10.2% (down a percent from the prior month) for those changing jobs.

(0/+) The employment situation report for July was mixed but continued to show a gradual slowing of labor market strength. **Nonfarm payrolls** rose 187k for July, below the 200k median forecast, but several prior months were revised lower by a total of -49k, weakening the net result. Payroll gains were seen in healthcare (87k) and construction (19k), with other contributions from leisure/hospitality (17k) and government (15k); declines were seen in professional services (-8k), information (-12k), and manufacturing (-2k). Importantly the breadth of payroll increases continued to fall across sectors, but there remained more gaining sectors than losing sectors.

The **unemployment rate** fell by a tenth to 3.5%, remaining near cycle lows, while the U-6 underemployment rate declined by -0.2% tenths to 6.7%. The labor force participation rate was largely unchanged, after rounding, along with a 268k gain in the household employment survey, which included a rise in multi-job holders offset by a decline in the self-employed.

Average hourly earnings rose 0.4%, a tenth above expectations, which brought the year-over-year increase to 4.4%, and 3-month annualized pace to 4.9%—both unchanged from the prior month. The average workweek ticked down a tenth to 34.3.

In earlier data, **nonfarm productivity** came in at an annualized rate of 3.7% for Q2, due to stronger output, in contrast to expectations calling for 2.2% and the prior reading of -1.2%. Year-over-year productivity ticked up by over a half-percent to 1.9%. **Unit labor costs** rose an annualized 1.6% in Q2, below the 2.5% consensus estimate, as well as the prior 3.3% figure. The year-over-year pace of unit labor costs fell by a third to 2.4%. 'Real' after-inflation compensation remains negative but has improved by some measures.

(-) The Federal Reserve **Senior Loan Officer Opinion Survey** for Q2 showed that overall lending standards tightened at a faster pace than in Q1. Banks noted that worsening economic conditions, reduced tolerance for risk, lower expected liquidity, and regulatory concerns being the primary catalysts for tightening. Most banks surveyed expected standards to continue to tighten through the course of the year.

For commercial/industrial loans, standards tightened at a faster clip than the prior quarter, for firms of all sizes. However, the smallest banks aren't tightening as much as expected, pointing to perhaps lesser stresses than feared earlier. Demand for loans also fell, which would be expected given the outlook and higher interest rates/spreads. In real estate lending, commercial property activity saw both tightening as well as lower demand. Credit standards were unchanged to just slightly higher on the residential side. Banks also appeared mixed willingness in extending consumer installment loans, with auto loan standards not radically changed, coupled with lower demand. Credit card standards tightened, while demand was little changed from the prior quarter (seen in other data showing higher credit card balances to replace stimulus income).

Market Notes

Period ending 8/4/2023	**1 Week %**	**YTD %**
DJIA	-1.11	7.04
S&P 500	-2.26	17.75
NASDAQ	-2.84	33.53
Russell 2000	-1.19	12.10
MSCI-EAFE	-2.38	12.38
MSCI-EM	-2.37	8.39
Bloomberg U.S. Aggregate	-0.59	1.29

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
7/28/2023	5.52	4.87	4.18	3.96	4.03
8/4/2023	5.54	4.78	4.15	4.05	4.21

U.S. stocks had a mixed week, with both earnings releases and Fitch downgrade of U.S. debt (described in more detail below) dominating sentiment, as perhaps a convenient reason for a retreat. By sector, energy led, being the only sector in positive territory on the week, while technology (due to Apple) and utilities fell by the largest degrees. Real estate declined by -2% as well, upon higher interest rates.

In a bit of a surprise, ratings agency Fitch downgraded the sovereign rating of U.S. debt from AAA to AA+. In doing so, they noted several negative structural inputs, which included fiscal deterioration over the next several years, a 'high and growing general government debt burden,' and erosion of governance relative to other AA and AA-rated issuers. This change followed (with a bit of a delay) Standard & Poor's downgrade over a decade ago in 2011 after the last big bout of debt ceiling uncertainty. As was the case at that time, there was little expected practical impact from the downgrade, such as forced selling of treasuries, etc. This is largely because U.S. treasuries have tended to be considered in their own category of asset either equivalent to or even above the highest AAA rating, at least in more formal investment policy statements, prospectuses, and other similar guidelines for asset ownership restrictions. In fact, the 2011 debt ceiling crisis featured a worse reaction from the stock market, with assets flooding the safe haven of treasuries, which many found counterintuitive. This year's debt ceiling battle created far less volatility in U.S. and foreign markets than expected. Despite the negative comments from Fitch about high and growing debt burdens (which would be especially troublesome for a corporation), this should also be looked at in the context of other sovereigns in the developed world, which tend to have similar high debt profiles, as measured by classic total debt-to-GDP measures, albeit most nations don't have routine debt ceiling negotiations.

Foreign stocks fell to a similar to slightly worse degree as U.S. equities, with consistent negative performance across all regions. In Europe, inflation continued to slow, albeit still at a higher rate than in the U.S., while economic growth for Q2 was revised higher to a positive 0.3%—out of a technical recession. The Bank of England decided to raise rates by 0.25%, as inflation has fallen a bit further than expectations. They've been significantly more challenged than the U.S., including impacts from Brexit, which have raised costs for labor and goods generally, converse to the ease in trade that was removed by the linkages to Europe. In China, economic data continued to disappoint relative to expectations of a stronger post-pandemic upswing, which was offset by moderately supportive language from government officials offering support for both consumers and residential real estate. The Central Bank of Brazil cut their key interest rate by -0.50%, in response to moderating inflation, which appears to be the start of a change of sentiment in several emerging market nations which were the first to hike rate during the pandemic to fight high inflation readings.

Bonds fell back as interest rates ticked higher. U.S. treasuries were little affected by the change in Fitch's rating, retaining their safe-haven status, with equities bearing more of the brunt. The yield change appeared more to do with the relative strength of economic data as well as higher issuance levels, raising supply. Floating rate bank loans outperformed traditional debt slightly. Foreign bonds were held back by strength in the dollar, particularly in emerging markets.

Commodities saw mixed results, with gains in energy coupled with declines in metals and agriculture. Crude oil prices rose nearly 3% last week to $83/barrel, due to weaker rig counts, weighing on views of market supply. Natural gas prices, on the other hand, fell by over -2%. In particular, wheat prices dropped by -10% on the week, with reports of U.S. oversupply in production, which has offset concerns over lower exports caused by the Ukraine-Russia conflict.

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.