Summary

On a shortened holiday week, economic data was positive, which included ISM services sentiment coming in stronger than expected, and jobless claims falling a bit.

Global equities fell back as interest rates rose in conjunction with the still-decent U.S. economic data. Bonds fell in line with slightly higher yields, and a stronger U.S. dollar held back foreign debt markets. Commodities were mixed, with weaker metals offset by a continued rise in the price of crude oil.

Economic Notes

(+) The **ISM services/non-manufacturing index** for August rose 1.8 points to 54.5, exceeding the expected slight decline to 53.5. Under the hood, new orders, employment, and business activity all ticked higher, and further into expansion in keeping with the headline figure. Prices paid also rose several points, further into expansion, which is likely related to still-robust wage growth. This took the overall services index further into expansionary territory, reiterating the resilience of economic growth this year; this is in contrast to the ISM manufacturing number, which has remained in contraction (although not getting worse). As has been the case over the past few quarters, the recession or no recession debate still depends on the respective paths of these two engines of the economy. The 'soft landing' camp has again grown as of late, with some private-sector economists showing increasingly lower probabilities of a downturn, despite the steadfastness of the index of leading economic indicators still pointing to high recession odds. The solution to this puzzle remains inconclusive, and may creep into 2024.

(+) **Initial jobless claims** for the Sep. 2 ending week fell by -13k to 216k, contrary to expectations for a rise to 233k, on a seasonally-adjusted basis, with OH and MN still persistent outliers. Continuing claims for the Aug. 26 week fell by -40k to 1.679 mil., compared to the unchanged 1.719 mil. consensus estimate. As has been the case over the past several months, levels have crept up from ~200k level earlier in 2023, touching the ~250k level, and now again retreating, with no substantive breakout. Similarly, the insured unemployment rate tracked by the Dept. of Labor has risen from a low of around 0.9% last summer to 1.1% today, which is also down from a high of 1.3% earlier in the year. For context, this rate was fairly contained in a range of 1.0-1.5% in the five years prior to the pandemic, before spiking and reversing.

(0) The Federal Reserve's **Beige Book** provides a commentary on granular and anecdotal economic conditions, and is published eight times a year, with contributions from each of the 12 regional banks. This edition covering July and August described overall growth as 'modest,' with highlights stemming from consumer spending, particularly in travel and leisure, as one would expect in the summer months. On the less optimistic side, it was noted in several districts that consumer pent-up savings from the pandemic are being increasingly exhausted, and replaced by debt, seen by increasing loan balances and rising delinquencies on consumer credit lines. In general, spending on services continued to surpass that of goods, with continued low housing inventories holding back that sector in nearly every region. In labor, job growth has been subdued nationally, although conditions appear balanced due to a persistent lack of skilled workers in some sectors—an ongoing problem since the pandemic. On the inflation side, price growth appeared to slow nationally, particularly in goods as demand there slowed, although wage costs ate into profit margins. All-in-all, there were few surprises in this anecdotal data, but reiterated conditions across the U.S. that continue to be 'not bad' and even improving on some fronts, such as the inflation picture.

Question of the Week

What's in store from a seasonal standpoint?

The Labor Day weekend has tended to signal the start of the 'New Year' on Wall Street. Call it premature, but often around now, after market participants return from summer vacations, expectations and predictions for the economy and company earnings begin to be punted toward the next year. The list of ongoing considerations for 2024 includes the still-present risk of possible recession (as a variety of indicators still point to), and continued uncertainty around the path of the Federal Reserve's interest rate policy (in both directions, whether it be the potential for further hikes vs. cuts).

By looking at nearly 100 years of monthly U.S. large cap stock data from 1926-2022[1], several historical tendencies stand out. September has been one of the worst-performing months of the year, in fact, with a net negative return, although outright declines have occurred only one-half of the time. October has been one of the more volatile months as measured by annualized standard deviation, featuring a larger-than-normal number of volatility episodes, including financial 'crashes' (1929 and 1987 stand out as the most well-known). After the typical autumn turmoil, November and December have historically been among the highest returning months of the year, as has the fourth quarter generally—a tendency often referred to as the 'Santa Claus rally.' No single year falls in line with these historical averages perfectly, making this no lay-up in terms of easy profits, but the long-term tendencies are interesting, and expectations can sometimes become self-fulfilling as they're often brought up in the news media this time of year to add additional drama.

After a stretch of strong returns since the lows of Oct. 2022 (of over 25%), it's also worth a reminder about periodic financial market drawdowns. Over the long haul, stocks have tended to move at a pace of several steps forward and one step back. It's easy to become complacent during bull market stretches, and downturns can be subtle. As we've seen historically, -5% pullbacks have tended to occur several times a year (as we saw in early August, followed by a reversal again back up). Specifically, since World War II, 'corrections' of -10% have tended to happen about once every 1-2 years. Moves of -15% have tended to be seen about every 3-5 years, and -20% 'bear markets' have occurred once every 6-7 years or so, similar to the frequency of recessions. For investors having stayed the course, recoveries from downturns have tended to be sharply better in the immediate 12- and 24-month periods after a market trough. After experiencing more-dramatic-than-normal stock pullbacks in 2018 (-20%), 2020 (-34%), and 2022 (-25%), it would not be surprising for investors to be afflicted with the behavioral finance malady of 'recency bias,' making one more sensitive to recent volatility versus long-term averages, and hesitant to become too optimistic.

After a run essentially straight up from March to July of this year, there are several factors that have likely contributed to the recent choppier movements in equities. The lagged but persistent impact of higher treasury yields has been a primary catalyst, brought on by not only the Fed's actions, but also stubborn inflation and stronger-than-expected economic growth data at least in services sectors (the latter being another example of a 'good' thing not necessarily interpreted as such by markets). On the additional negative side, concerns continue over whether or not earnings will experience another leg down in Q3, following a better-than-expected Q2 (albeit growth was still negative). Worries over China's lack of perceived rebound in consumer and export growth, as well as the overhang of real estate debt woes have created the potential of slower global growth. All of these get to the usual core of the issue—growth and recession probabilities.

Unfortunately, also 'seasonal' are the rising odds of a government shutdown if Congress is unable to approve a budget package by Sept. 30 for the coming fiscal year. Per past episodes, if they occur, shutdowns don't tend to be overly long-lasting. However, they can act as a negative dampening influence on GDP somewhat, as government spending (which is not a small part of the GDP calculation) falls off a cliff, as does the spending of affected government employees and contractors. The length of any shutdown would be the driver of its ultimate impact. Normally, after a certain point, public pressure takes a toll on government stand-offs as the potentially negative economic impacts finally outweigh the need for making a political statement.

Market Notes

Period ending 9/8/2023	1 Week %	YTD %
DJIA	-0.70	5.99
S&P 500	-1.26	17.45
NASDAQ	-1.92	32.27
Russell 2000	-3.58	6.22
MSCI-EAFE	-1.38	9.08
MSCI-EM	-1.17	3.90
Bloomberg U.S. Aggregate	-0.30	0.59

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
9/1/2023	5.53	4.87	4.29	4.18	4.29
9/8/2023	5.55	4.98	4.39	4.26	4.33

U.S. stocks fell back in the shortened holiday week as decent economic data (stronger ISM services and lower jobless claims) resulted in a creep higher for interest rates. However, later in the week, some Fed comments were taken dovishly, that policy rate hikes may be finished. By sector, conditions were mixed, with gains in energy coming along with higher petroleum prices, as well as defensive utilities. By contrast, industrials, materials, and technology all experienced declines of several percent each. In particular, large index component Apple was hampered by the news of Chinese government employees to be restricted from using iPhones, as well as uncertainty over the potential popularity of the new iPhone models assumed to be rolled out next week. Real estate also fell back by a percent, in keeping with higher interest rates.

Foreign stocks lost ground last week as well, to a similar magnitude to U.S. markets. Japan and the U.K. fared slightly better than Europe, with the latter still plagued by expectations for higher interest rates, estimates for growth coming down, and continued weak industrial numbers—particularly in Germany. Conversely, Japanese GDP rose at a 4.8% annualized pace in Q2, although that was weaker than expected. As it stands, the region has been bordering on recession. Emerging markets suffered the deeper decline, as continued weakness in China pulled down the broader index, notably in services and exports.

Bonds declined a bit last week as interest rates ticked about 0.05-0.10% across the Treasury yield curve. The worst performer was high yield, in line with weaker equity returns, while floating rate bank loans earned a small gain. Foreign bonds ended in the negative, due to a rise in the U.S. dollar of nearly a percent.

Commodities were mixed, with gains in energy were offset by declines in industrial and precious metals. Crude oil rose over 2% last week to $87/barrel, as inventories continue to be drawn down and production kept low. From lows in mid-June, spot crude prices are up 30% due to these factors.

Have a good week.

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[1]FocusPoint Solutions calculations based on monthly Morningstar and Ibbotson data.

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.