Summary

Economic data for the week included the leading economic indicator index continuing to fall back. Housing data was mixed with existing sales down but starts up. On the positive side, retail sales and industrial production gained for the prior month.

Equities lost ground worldwide, due to uncertainty over the Israel/Gaza conflict, and interest rates continued to tick higher. Bonds struggled due to the same interest rate concerns. Commodities earned small gains in a variety of sectors.

Economic Notes

(-) The Conference Board's **Index of Leading Economic Indicators** for September showed a decline of -0.7%, a bit below the -0.5% drop of the prior month. This marked a year and a half of consecutive declines, with negative contributions from 9 of the 10 underlying measures. Over the past six months, the index is down -3.4%, which is actually an improvement on the -4.6% decline of the prior six months from Sept. 2022 to Mar. 2023. Over the most recent 6-month stretch, non-financial components of consumer expectations for business conditions and ISM new orders saw the weakest results, along with the financial components of interest rate spread (due to inverted yield curve) and credit. Several other data points have been flat over that period, with only the S&P 500 as a positive influence, seeing gains. Again, this index doesn't include data that hasn't already been released but serves as a reminder that most classic indicators continue to point to recession in coming quarters, with this index's consistent track record of correlations to predicting past recessions.

(+) **Retail sales** for September rose 0.7%, exceeding the median forecast calling for 0.3%. Removing the more volatile components of gasoline, autos, and building materials brought the core/control measure slightly down to a 0.6% gain, far above expectations for little change. Food services saw nearly a 1% gain for the month, while non-store/online sales rose just over a percent, in addition to misc. store gains. These were offset by clothing and electronics/appliances, perhaps as a drop-off from summer high season. With solid gains overall, the 'real' retail sales figure after inflation appears decent as of late. On a year-over-year basis, total retail sales gained 4% on a nominal basis, leaving growth roughly flat after taking CPI into account. Naturally, the bad news is that the continued strength in consumer spending keeps the Fed on the defensive.

(+) **Industrial production** in September rose 0.3%, exceeding consensus expectations of a flat reading. The manufacturing production segment rose 0.4%, on the heels of stronger auto production, offsetting business equipment declining by -0.7%. Mining production, which includes oil extraction, rose by 0.4%, while weather-dependent utilities production fell by -0.4%. **Capacity utilization** ticked up 0.2% to 79.7%. Interestingly, industrial production has been picking up steam as of late, along with energy sector ramp-up and general troughing in ISM manufacturing, yet remains barely changed on a trailing 12-month basis.

(-) The regional New York Fed **Empire manufacturing survey** fell by -6.5 points for October, back to a contractionary -4.6 level, but better than the expected -6.0. New orders fell sharply back to contractionary territory, while shipments also fell by -11 points but remained slightly expansionary; however, employment improved back into slight expansion. Prices paid and received each decreased, but remained high and expansionary. Also, the 6-mo. ahead business conditions index fell by several points, but remained solidly in expansion.

(0/-) The **Philadelphia Fed manufacturing index** rose by 4.5 points to a still-contractionary -9.0 level in October, not quite reaching the -7.0 level expected. However, underling components looked stronger, led by gains in new orders, shipments, and employment, which all rose in the double-digits back into expansion. As in the NY report, prices paid and received each fell back, but continued to expand solidly. Business expectations six months out fell back a bit but remained solidly expansionary as well.

(-/0) **Existing home sales** for September fell by -2.0% to a seasonally-adjusted annualized rate of 3.96 mil. units, which was a slight improvement on the median forecast assumption of -3.7%. Single-family and condo/co-op results were largely similar, with gains in the Northeast of over 4% offset by declines everywhere else, especially in the West down -5%. Year-over-year, existing home sales are down over -15%. The median sales price has trailed down to $394,300, but still represents a 3% rise on a year-over-year basis. Inventory has improved a bit, rising slightly to 3.4 months' supply, but remains extremely low compared to history. One issue with existing home sales is that they reflect transactions initial contracts signed in prior months, which may not fully reflect the most recent further mortgage rate increases, which have reached 8%. In looking longer term, other than the financial crisis, sales haven't been this low since the late 1990s, with home loan applications also having dipped to lows last seen around that same timeframe. Some strategists have reiterated that overly tight supply continues to be the swing factor in keeping prices elevated, noting any increase in supply could have a direct result in home prices moving in the other direction. Historically, seeing activity dry up with far more expensive financing costs isn't unusual, with the duration of how long expensive mortgages last being a critical component looking ahead for the sector.

(0) **Housing starts** for September rose 7.0% to a seasonally-adjusted annualized rate of 1.358 mil., below the 7.8% increase expected, along with a revision lower for August, which had seen a sharp decline. The volatile multi-family component rose 18%, driving two-thirds of the gain, while single-family starts also ticked up by 3%. Regionally, Midwest starts were up 35%, offset by a -25% decline in the Northeast. **Building permits** for the month fell -4.4% to a seasonally-adjusted pace of 1.473 mil., slightly better than the -5.7% decline expected, and a bit better than the decline the prior month. Here, too, multi-family led with a drop of -14%, while single-family rose 2%. For multi-family, this appears to be the start of an unwinding in apartment oversupply in building, while single-family has showed gains for almost every month this year and represents a positive sign for overall needed housing supply.

(-) The **NAHB homebuilder index** fell by -4 points to 40 in October, as sentiment continued to decline as mortgage rates remained high. All three categories remained below the 50 'neutral' level, especially in prospective buyer traffic, which fell back to a pessimistic 26 reading, near where it was earlier in the year.

(0) **Initial jobless claims** for the Oct. 14 ending week fell by -13k to 198k, well below the 210k forecast. **Continuing claims** for the Oct. 7 week rose by 29k to 1.734 mil., far above the 1.706 mil. consensus expectation. With improvement in the former and large increase in the latter, it's assumed that seasonal distortions could be playing a role.

Market Notes

Period ending 10/20/2023	1 Week %	YTD %
DJIA	-1.57	1.67
S&P 500	-2.38	11.47
NASDAQ	-3.16	24.87
Russell 2000	-2.25	-3.40
MSCI-EAFE	-2.59	3.37
MSCI-EM	-2.70	-1.05
Bloomberg U.S. Aggregate	-1.73	-3.13

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
10/13/2023	5.62	5.04	4.65	4.63	4.78
10/20/2023	5.58	5.07	4.86	4.93	5.09

U.S. stocks fell back last week, pressured by Middle East geopolitical concerns, higher interest rates, and central bank comments that tilted hawkish. Earlier in the week, strong retail sales and industrial production weighed on markets as the 'good news is bad news' narrative took hold; then, Fed Chair Powell reiterated that inflation still remains 'too high' and the Fed should remain 'cautious' amidst strong economic growth. This added to the rising possibility of another policy rate hike—while not signaled for the next few weeks, the last meeting of the year remains a possibility. CME Fed funds futures for the Nov. 1 meeting still point to 99% odds of no change, while they've risen to over 30% for December. While several members have noted that we may be at 'peak rates,' others are less committal or even hawkish, adding to the uncertainty that markets dislike.

The S&P 500 has fallen back towards the 200-day moving average, which is considered an important potential support point on the shorter-term technical side, assuming it holds. Small cap stocks are amazingly back near bear market territory, down almost -20% from highs in early 2022. By sector during the week, only energy and consumer staples experienced slight gains of under a percent each, while all others saw declines. Consumer discretionary led on the negative side, down over -4%. Real estate also fell back nearly -5% with interest rates again moving higher.

S&P earnings for Q3 continue to trickle in. As measured by FactSet, 17% of companies have reported through Friday, so the season is quite early yet. Nearly three-quarters of those report an upside earnings surprise, and two-thirds show a positive revenue surprise. The blended (already-reported plus estimates) year-over-year earnings growth rate remains -0.4%. This weakness is due to revenue growth of just under 2%, as well as profit margins down a half-percent from the pace of a year ago, with cost-cutting largely done, and continued high wage costs. Overall results are expected to be led by communications and consumer discretionary, while energy and materials are still expected to lag. Most interestingly, results for Q4 and 2024 as a whole are expected to revert back to growth, with earnings growth for next year estimated to be a well-above-average 12%.

Foreign stocks largely followed the same path as U.S. equities, held back by geopolitical concerns and related oil price worries, along with higher rates, with Europe faring slightly better than other regions and emerging markets. Earnings also appeared to come in a bit weaker than hoped. Chinese stocks led EM nations down, falling -4% on the week, as a major property developer announced further stress in paying back debt to offshore investors.

Bond prices moved lower as interest rates again moved higher, after a bit of a reversal the prior week following the Israel-Gaza conflict. (Per history, conflicts have the tendency to create 'risk-off' environments.) All bond groups were down, with floating rate bank loans holding up best with minimal declines, in keeping with their less correlated nature. Foreign bonds also lost ground, with local currency emerging market debt faring a bit better as the U.S. dollar weakened.

The 10-year U.S. Treasury touched the 5.00% yield level, in another milestone of 'first time in X number of years' (July 2007), resulting in a re-flattening of the yield curve. As with a variety of financial assets, round numbers tend to take on a stronger-than-normal technical importance, and can also represent support and resistance points. A key question has become: is a 5% level really justified by long-term growth and inflation expectations that tend to drive rates at that part of the yield curve? (Many economists think it isn't.) At the same time, 5% represents a somewhat 'normal' anchor point, if one is looking at ranges of interest rates over the past few decades, demonstrated by the arbitrary past 40 years (9/30/1982-9/30/2023, starting just after the period of peak rates during the Volcker era) registering an average monthly yield 5.2% for the 10-year Treasury. This also happens to match the average yield since the end of World War II (Sept. 1945). Granted, these averages mask a good deal of volatility along the way, with monthly average rates falling within a band of 0.6% to 15.3% during that time, where inflation and economic growth were both higher and more variable.

Commodities were up slightly on average across major groups last week, led by precious metals, which have 'shined' under geopolitical stress, as well as energy. Crude oil ticked up 2% last week to $88/barrel; natural gas prices fell -9% as inventories rose far higher than expectations and weather remained temperate on the East

Coast. As in the prior week, the Middle East conflict has pushed crude prices higher, largely due to fears of wider regional involvement (such as Iran). In particular, the explosion at a Gaza hospital (where each side blamed the other) was the focus last week. Such a commodity market response has been the case for decades, although the world's increasingly lower reliance on crude has muted this impact somewhat, compared to say, 1973. At the same time, the U.S. has been working with Venezuela to ramp up production, in another unique turn of diplomatic events.

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, Mortgage Bankers Association, Morgan Stanley, MSCI, Morningstar, NAHB, 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.