Summary

Economic data for the week included U.S. GDP for Q2 unchanged from prior editions, while expectations for Q3 remain far higher than trend. Durable goods orders rose a bit, although after-inflation results remained depressed. Housing data was mixed, with home prices remaining on an upward trend, while new home sales fell sharply.

Global equities fell back last week, as the 'higher for longer' interest rate message from central banks was a worldwide negative. Bonds fell back as well, due to the further rise in yields, with foreign bonds pressured downward by the stronger U.S. dollar. Commodities were mixed with oil up only slightly last week.

Economic Notes

(0) In the third and final release of **U.S. GDP** for the 2nd quarter, growth was unrevised at a 2.1% annualized real rate. Consumer spending and imports were revised downward a bit, offset by upward revisions to nonresidential fixed investment, exports, and inventory investment. That growth pace remains right about the trend level, absent some of the volatility over the past few years. The GDP price index was revised down by -0.3% to an annualized pace for the quarter of 1.7%—that deceleration was a positive. Interestingly, in their once-every-five-years major revisions of prior periods, GDP growth was revised up by about 0.1% a year on average from 2017-2022, to 2.2%. However, the personal saving rate was lowered from 2015-2019, while it was revised higher for the years afterward, including the pandemic.

The Atlanta Fed's GDPNow estimate for Q3 remains quite high, at 4.9%. Consumer spending assumptions in the model remain high, although they've declined from a month ago, representing the only area that has shown meaningful change from optimistically-high earlier estimates. The Blue Chip economist consensus has steadily risen from minimal growth earlier in the quarter to now around 3%. While some economists remain bullish on a soft landing scenario, demonstrated by strong services spending and high Q3 growth estimates, others remain steadfast about more fundamental softening, related to a pressured consumer, easing labor market, not to mention higher oil prices, the autoworker strike, and odds of an eventual government shutdown as examples of tail risks that could provide the cumulative tipping point into a downward direction. As it stands, the question of 'good' or 'bad' economy now rolls into Q4.

(0) **Personal income** in August rose by 0.4%, a tenth below expectations. **Personal spending** rose at the same 0.4% rate, on par with expected. The personal saving rate came down -0.2% from last month at 3.9%. Over the past year, personal income is up nearly 5%, with continued strength in wage growth and rental income, while personal spending is up an even stronger 6% (goods up 3% and services up over 7%). PCE inflation for the month ticked up two-tenths on a headline level to 0.4%, while core ex-food and energy fell a tenth to a 0.1% pace. Year-over-year, headline PCE ticked up to 3.5% and core fell back by -0.4% to 3.9%. The Fed's preferred inflation measure, core PCE is nearly a percent below the pace of levels in the spring, to its lowest level in two years, but is still well above the Fed 2% target.

(+) **Durable goods orders** for August rose by 0.2%, outperforming the -0.5% median forecast. Removing transportation, the index rose 0.4%, due to a drop-off in commercial aircraft orders, while core capital goods orders rose 0.9%. The latter was led by a 0.5% rise in machinery, along with electrical equipment, and computers/electronics. Core capital goods shipments rose 0.7%, relative to expectations of no change. Overall, durable goods orders are up over 3% from last year, while removing transportation orders pares that back to a 1% gain. Then again, when adjusted for inflation, this remains negative 'real' growth, so far less positive than the reading suggests.

(+) The **S&P Case-Shiller 20-city home price index** rose 0.9% in July, exceeding expectations of 0.7%, and now surpassing the previous peak in June of last year. All 20 cities saw gains, led by Seattle and San Diego, which were up at least 1.5%. On a year-over-year basis, prices rose back into the positive at 0.1%.

(+) The **FHFA house price** index for July rose 0.8%, exceeding the 0.5% rise expected. Every U.S. region experienced a gain, led by 1.4% in the Middle Atlantic and South Atlantic sectors. Year-over-year, the gain reaccelerated by another 1.4% to 4.6%. From a moderately longer-term perspective, this broader domestic index has risen on an average annualized basis of 7.5% since Jan. 2012, but a more subdued 4.4% since Jan. 1991—the latter being more similar to longer term data showing that home prices have run just above inflation as opposed to growing at a stock market-like pace. In the current environment, in data calculated by the NAR, based on the ratio of median home price to median income, affordability is even below where it was in prior troughs of 1989-90 and 2006 (both just prior to home price corrections). Of course, higher financing rates 'should' dampen housing activity, absent the extreme lack of supply.

(-) **New home sales** in August fell by a dramatic -8.7% to a seasonally-adjusted rate of 675k units, beyond the -2.2% expected by consensus, although the prior month earned an upward revision. Year-over-year, sales are up 6% on a seasonally-adjusted basis, and up 24% above the July 2022 low. Regionally, the South and West saw the deepest declines, while the Northeast experienced a minor gain; these could well have been weather-related due to recent hurricane activity. The median new home price came in at $430,300, down -1.4% on the month and -2% for the trailing 12 months. Inventory represented 7.8 months' supply, which is far more robust than that of existing home sales. Interestingly, despite the rise over the past year, seasonally-adjusted new home sales are not far above their ~600k-ish level of five years ago, having spiked slightly during the pandemic before retreating.

(-) **Pending home sales** in August fell -7.1%, beyond the -1.0% median forecast. All four regions experienced declines, with only the Northeast outperforming at a meager -1%. Year-over-year, pending sales deteriorated to -19%, -5% further than the prior month. Naturally, this bodes negatively for existing home sales in the coming few months.

(-) The Conference Board **index of consumer confidence** for September fell by -5.7 points to 103.0, below the 105.5 median expectation. Assessments of present conditions ticked up slightly, while expectations for the future declined by nearly -10 points. The labor differential ticked up a bit, largely driven by the stronger 'jobs are plentiful' response. The 'expectations' component has fallen to a level that has been historically consistent with a recession 12 months following. It appeared that the economy has been viewed negatively by respondents, as are continued high prices (especially for gasoline and groceries), the political situation, and high interest rates.

(0) **Initial jobless claims** for the Sep. 23 ending week rose by 2k to 204k, below the 215k expected. Continuing claims for the Sep. 16 week rose by 12k to 1.670 mil., below the 1.675 mil. consensus expectation, keeping the insured unemployment rate at an unchanged 1.1%. Jobless claims remain stable, with no significant upticks, with seasonal distortions a potential feature of results as well.

Question of the Week

Why the sudden change in market sentiment?

The S&P 500 has fallen by nearly -7% since the end of July, with August and September performing their historical roles of spoiling the party. Following last week's FOMC meeting, as well as the steady rise in oil prices, markets were troubled by the realization the Fed could be serious about keeping interest rates 'higher for longer,' per the FOMC dot plot visual and comments the prior week. Sometimes it takes several days after FOMC meetings for markets to let the message sink in. Naturally, higher yields for longer weigh on discount

rates and prices for equities and real estate, with a perceived longer stretch being more worrying than a short spike and quick retreat. This is not to mention apply continued tightening pressure across the economy from the ongoing hikes—some immediate, some with a lag. On the positive side, 'pause' environments where rates have stopped rising have historically been decent environments for both stock and bond returns going forward. This is likely a behavioral response to 'conditions won't get any tighter.'

Additionally, chances of the first U.S. government shutdown in three years remained high last week, with a stopgap spending bill not being signed until late Saturday (being only a temporary measure until mid-November, when this could all flare up again). In addition to general cross-party disagreement, the contention is the desire by some Republicans for deeper spending cuts. For perspective's sake, the last several dozen shutdowns over the past 50 years resulted in fairly limited economic impact, with expectations that an active shutdown could pare tenths of a percent off per week of Q4 GDP growth. Especially sensitive periods include government and military payroll dates (even though any delayed payments would ultimately be made up in arrears). Stock market results have been minimally affected by past shutdown episodes on average, with roughly half of the 21 episodes since 1976 showing negative returns, and half ending positively. One subtle negative during a shutdown is that the economic releases can be delayed, adding to market uncertainty as missing current data creates voids potentially filled by rumor and speculation.

The potential for a government showdown has shed more light on large fiscal deficits from the past few years (8% most recently, as measured by spending less tax revenue), and the realization that levels aren't sustainable. While there hasn't been a direct connection in yields in recent years between higher debt loads and higher Treasury issuance, the risk remains about the rising need for financing these deficits, and now higher financing interest rates (while still manageable now due to a decade-plus of very low rates), leading to concerns of yields being pressured higher. Such already-high spending obligations also potentially limit the ability for government to provide more 'countercyclical buffer' (aka stimulus) to the economy under a particularly severe downturn, such as in 2008 or 2020.

These questions are coupled with the impact of the Fed no longer buying Treasuries and MBS through quantitative easing and is in fact now doing the opposite by unwinding these bond holdings. Also, demand from abroad could potentially wane as global bond markets have also been subject to rate hikes, resulting in more attractive yields in home countries without the dollar-hedging currency risk. Of course, this leads to the theories about the decline of U.S. dollar supremacy. The near-term reality from the perspective of bond strategists points to less impact from these factors than might be feared on the fringes. Then again, it doesn't mean the U.S. fiscal situation doesn't need to be dealt with in some form while it remains manageable.

Market Notes

Period ending 9/29/2023	**1 Week %**	**YTD %**
DJIA	-1.34	2.73
S&P 500	-0.71	13.07
NASDAQ	0.07	27.11
Russell 2000	0.55	2.54
MSCI-EAFE	-1.43	7.08
MSCI-EM	-1.14	1.82
Bloomberg U.S. Aggregate	-0.96	-1.21

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
9/22/2023	5.56	5.10	4.57	4.44	4.53
9/29/2023	5.55	5.03	4.60	4.59	4.73

U.S. stocks were lower again last week, on the heels of the expected government shutdown, UAW strike, higher oil prices, resumption of student loan repayments, and fear of higher rates for longer, as discussed above. By sector, energy led with a gain over a percent, growth stocks suffered minimal declines on the week on net, with flattish results for technology, communications, and consumer discretionary. Utilities suffered the most, down nearly -7% largely due to higher interest rates but also largely the result of a sharp decline in the largest sector component (NextEra Energy), which skewed the results. Real estate also fell back over a percent, being affected by higher interest rates. Mid and small cap stocks bucked their recent trends, showing gains for the week.

Foreign stocks underperformed U.S. stocks, with Japan slightly underperforming other developed markets and emerging markets. A stronger U.S. dollar during the week, going along with higher interest rates, was a headwind. In addition to the already-noted concerns in the U.S., Europe has tended to be more trade-reliant, causing Chinese slowdown news to create a heavier impact. Similar to the U.S. Fed, ECB officials also hinted at a 'higher for longer' rate regime.

Bonds fell back due to interest rates continuing higher, with investment-grade corporates underperforming treasuries, as credit spreads widened. Senior floating rate bank loans again fared best, as has been the case in most rising yield weeks. Foreign bonds fell back over a percent, with the headwind of a stronger U.S. dollar.

Despite the volatility and poor returns in 2022, where the Bloomberg U.S. Aggregate Index fell by -12%, it's easy to forget how volatile some bonds can be, especially for those attempting to time interest rates. For example, several popular long-term treasury funds (as in the 20-year+ duration variety) are down 35-45% cumulatively over the past two years. While some historical stock/bond allocation studies use long-term bonds in the sample, the intermediate-term part of the curve has remained more popular, as they've offered similar yields to the long-term end of the curve, with far lower duration (and matching lower volatility). Of course, for those making interest rate calls, the duration of long bonds can be a very strong performer should rates fall, and one has the fortitude to wait.

Commodities experienced a mixed week, with strength in industrial metals and energy offset by sharp declines in agriculture (higher wheat supply) and precious metals. Crude oil rose almost a percent last week to $91/barrel, representing a calmer week than many this past quarter. A good amount of OPEC spare capacity exists, which is unusual outside of recessions, and again points to that group's planned strategy to withhold supply from market—to keep prices elevated. Demand, on the other hand, has not fallen off. The U.S. Strategic Petroleum Reserve holds about half the barrels it did a decade ago, having already been tapped to easy earlier supply pressures and not yet refilled (at current high prices...the government would prefer oil to be on sale as well). The U.S. storage hub in Cushing, OK holds about half the inventory it did in June, exacerbating domestic low storage worries.

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, FHFA, 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, Vanguard Group, 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.