Summary

Economic data for the week included ISM manufacturing staying in contraction, but continuing to improve, while ISM services slowed a bit, but continued to expand at a rapid clip. The employment situation report surprised to the upside, as did job openings earlier in the week.

Global equities were mixed, with net gains in U.S. large cap, while small cap and international stocks declined. Bonds also fell back again due to interest rates inching higher. Commodities declined as crude oil prices pulled back sharply.

Economic Notes

(0) The **ISM manufacturing index** for September rose by 1.4 points to 49, above the 47.9 expected, but staying in contraction. In Sept., new orders rose to over 49, the highest in a year, while production and employment both moved over 50—into expansion. Supplier deliveries remained in contraction, as did inventories, while the latter has normalized in recent months generally. Prices paid fell back, further into contraction, despite the inflationary impact of higher oil prices. Anecdotally, respondents noted that fears about weaker demand, higher prices, and recession fears continued to weigh on conditions generally for goods. This index has fallen for nearly a year straight in a contractionary trend, but far less so in recent months, with signs of some improvement toward the neutral 50 level.

(+) The **ISM services/non-manufacturing index** for September fell by -0.9 of a point to 53.6, just above the 53.5 estimate, showing continued expansion. Of the 18 sectors measured in the index, all but five continued to demonstrate growth. While new orders and employment both declined, they continued to show expansion. Anecdotally, the employment component appeared to be more hampered by lack of labor supply, which held back hiring, as opposed to coming from layoffs. Supplier deliveries rose several points reversing back into expansion. Prices paid were flat, continuing to expand, while business activity rose a few points to expand further, near the very robust 60 level. As has been the case for months, services continue to lead the economy, offsetting the weaker manufacturing segment (albeit the latter seeing recent improvement).

(+/0) **Construction spending** for August rose by 0.5%, matching consensus expectations. Both the private and public construction sectors saw similar gains, with the key laggard being public residential spending, down -1%. However, construction costs rose by over 1% during the month, transforming the nominal gain into an overall decline in ‘real’ terms. This feature of recent ‘growth’ in a variety of economic indicators has been glossed over somewhat, but points to results that are far less positive than headlines would suggest.

(+) The government **JOLTs** job openings report for August saw a rise of 690k to 9.610 mil., relative to the expected 8.815 mil. Leading groups included professional/business services (509k), finance/insurance (96k), and state/local education (76k). Declining areas included trade/transport/utilities (-109k), leisure/hospitality (-54k), and information (-20k). While the job openings rate again rose 0.4% to 5.8%, the hiring rate was flat at 3.7%. On the departure side, both the quits and layoff rates were unchanged, at 2.3% and 1.1%, respectively. While a strong report, JOLTs data can be volatile from month to month, with the possibility that a few weaker earlier months were exaggerated lower, implying the growth in this report was exaggerated higher.

(0) **Initial jobless claims** for the Sep. 30 ending week rose 2k to 207k, just below the 210k median forecast. Continuing claims for the Sep. 23 week fell -1k to 1.664 mil., under the consensus estimate of 1.671 mil. The insured unemployment rate was steady at 1.1%. On a non-adjusted basis based on U.S. Dept. of Labor data, initial claims are little changed on net over the past year, while continuing claims are running a few hundred thousand higher than same time the prior year.

(-) The **ADP private sector employment** report for September showed a gain of 89k, well below the 150k median forecast, running about half of August's gain. Services jobs rose by 81k (with a 92k leisure/hospitality gain offset by declines elsewhere), while goods producing jobs rose 8k on net (led by a 16k rise in construction). This report hasn't been seen in quite the same light as in the past, with lower correlations to the government employment situation report, but all labor data has some degree of usefulness.

(+) The employment situation report for September came in far better than expected, although investors didn't exactly celebrate the news. **Nonfarm payrolls** rose by 336k, well above the 170k expected, and included revisions higher for Jul. and Aug. The key gains were in leisure/hospitality (96k, two-thirds of which were in food/drinking places that have now returned to pre-pandemic employment levels), government (73k, mostly in education, along with school back in session), health care (41k), professional/scientific/technical services (29k), and retail (20k). Construction job gains decelerated (to 11k), while information and temp jobs fell slightly. In reviewing details of the report, aside from a few areas, job gains weren't as strong as the headline suggested, particularly in goods production. Obviously, some seasonal skews on the education side stand out.

The **unemployment rate** was consistent at 3.8%, while the U-6 underemployment rate fell a tenth to 7.0%, with the associated household survey adding only 80k jobs. **Average hourly earnings** rose by 0.2%, consistent with the prior month, which caused the year-over-year wage growth figure to decelerate a tenth to 4.2%. **Average weekly hours** were stable at 34.4.

Mortgage applications (measured weekly, ending Sept. 29) continue to fall unsurprisingly to their lowest levels since 1995. This came along with the 30-year fixed rate average reaching 7.53% (per the MBA), the highest level since 2000. The historical norm for the 30-year fixed rate home mortgage has been about 1.5-2.0% above the 10-year Treasury yield—the current spread is 2.75%. Not only is falling monthly payment affordability a factor, but so is additional credit scrutiny from lenders, as well as the removal of Fed quantitative easing/bond buying from MBS markets, which provided a large source of mortgage funding. Interestingly, adjustable-rate mortgages have been again rising in popularity, now to roughly 8% of overall originations, due to rates running about a percent lower than fixed-rate products.

Market Notes

Period ending 10/6/2023	**1 Week %**	**YTD %**
DJIA	-0.24	2.48
S&P 500	0.52	13.66
NASDAQ	1.62	29.17
Russell 2000	-2.19	0.29
MSCI-EAFE	-1.85	5.10
MSCI-EM	-1.61	0.18
Bloomberg U.S. Aggregate	-1.17	-2.36

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
9/29/2023	5.55	5.03	4.60	4.59	4.73
10/6/2023	5.63	5.08	4.75	4.78	4.95

U.S. stocks ended positively, despite starting weaker, due to Fed comments continued to allude to 'higher for longer,' in respect to policy interest rates. This was in addition to decent economic data earlier in the week, such as the ISM reports and JOLTs. Rep. McCarthy was removed as Speaker of the House, which doesn't bring any immediate impacts, but alludes to the trickle-down effect of rising chances for a government shutdown in mid-November when the temporary stopgap bill runs out. To end the week, Friday's surprisingly strong employment situation report reversed prices back into the negative before recovering. This represented more 'good news is

bad news' in the vein that a continued strong labor market provides the Fed with even more cover for their higher-for-longer narrative. Going into the new week, conflict in Israel over the weekend is expected to add to near-term volatility, as oil prices have often been affected by instability in that region.

By sector, growth stocks saw a bounceback, led by 3% gains in technology and communications; this offset -3% declines in energy and defensives consumer staples and utilities, as well as declines in U.S. small cap. Real estate also declined over a percent along with still-higher interest rates.

Foreign stocks ended in the negative, with developed and emerging markets similar on net, on the heels of widespread fears of global interest rates staying higher for longer. Europe fared a bit better than Japan, with mixed but slightly better economic data, while in EM, Brazil and Mexico underperformed due to a higher exposure to commodities. Chinese markets were closed for autumn holiday last week.

Bonds declined across the board as interest rates ticked higher again, with government and corporate credit down by a similar magnitude. Senior floating rate loans performed slightly better. Foreign bonds in developed markets were in line with U.S. markets, while emerging markets sold off by several percent. Bonds have continued to experience volatility in recent weeks, as long-term interest rates rose to meet 'higher for longer' expectations brought on by recent Federal Reserve comments. This doesn't refer so much to many, if any, additional rate hikes, but a lack of interest in ultimately cutting rates in 2024. This has led to a 'bear steepening,' which refers to the steady un-inversion of the yield curve via the long-end rising as opposed to the short-end falling, which is less common. Interestingly, unwinds of yield curve inversions have tended to occur closely before recessions begin, at least in recent decades, with curves during recessions turning positive as expectations for the future improve. Many investors find this relationship surprising.

Commodities were largely down last week, driven by energy and industrial metals. Crude oil prices fell by -9% last week to under $83/barrel, due to reports of expected demand slowing in 2024 along with a strong rebuild in U.S. gasoline inventories. Natural gas prices have begun to slowly rise again in anticipation of winter heating needs following a sharp price downturn so far this year. Gold prices have fallen off as of late, which has surprised some due to their tendency to fare better when stocks weaken, but this appears largely due to a rise in treasury real yields—their main competition for 'risk-off' asset flows.

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, Mortgage Bankers Association (MBA), 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.