Summary

In an oddly quiet week for economic data, consumer sentiment declined, jobless claims were little changed, while the Fed's bank loan officer survey showed continued tighter standards.

Stocks were mixed globally with gains in the U.S. large cap group and a small increase in Europe offset by declines elsewhere due to mixed sentiment, mixed data, and disappointing central bank communications. Bonds generally declined as interest rates ticked back up. Commodities lost ground generally, led by a drop in crude oil prices with fewer geopolitical concerns.

Economic Notes

(-) The preliminary Univ. of Michigan **index of consumer sentiment** for November fell by -3.4 points to 60.4, well below the minimal change to 63.7 expected. Assessments of the current environment dropped by nearly -5 points, while expectations for the future fared better, down by -2 points. Inflation expectations for the coming year rose by 0.2% to 4.4%, in contrast to consensus expectations for a drop to 4.0%, as did expectations for the next 5-10 years to 3.2%, exceeding expectations for an unchanged 3.0% reading. The overall result represented the fourth straight month of declines, with some anecdotal commentary pointing to bad news surrounding continued high interest rates and the conflicts in Gaza and Ukraine pulling down sentiment generally, while for inflation, potentially higher gasoline prices as a result were top of mind.

(0) **Initial jobless claims** for the Nov. 4 ending week ticked down by -3k to 217k, just below the 218k median forecast. Continuing claims for the Oct. 28 week rose by 22k to 1.834 mil., above the forecast of 1.820 mil. It continues to be assumed that seasonal distortions are affecting continuing claims especially, which could continue over the next few months. Otherwise, there appears to be little in initial claims to move the needle, either positively or negatively.

(-) The Federal Reserve's **Senior Loan Office Opinion Survey** for Q3 showed standards tightening further again, but at a slower clip than in Q2 it seemed, at least in some segments. The number of banks that widened loan spreads also declined.

For commercial/industrial loans, standards tightened but at a reduced rate versus the prior quarter, while demand also fell. For commercial and residential real estate lending, demand has fallen back, which is not surprising considering the higher rate environment; standards also tightened in all real estate segments, whether in construction/land development, multi-family, or single-family residential. For consumer loans (including auto and credit card debt), bank willingness to lend fell back slightly, and demand has fallen. (Looking beyond this report, the latter is interesting as periodic reports continue to tell stories of record-high credit card balances, now over $1 tril., per data from the New York Fed. Also, 90-day delinquencies appear to be rising by several percent to pre-pandemic levels, notably among millennials and lower-income borrowers in the auto and student loan segments.)

Most banks noted a worsening economic outlook and/or reduced risk tolerance as the main reasons for further tightening; however, banks that eased noted a more favorable outlook—all pointing to a continued 'up in the air' nature reported by a variety of companies. Interestingly, the smallest banks haven't been tightening as much as might be expected, alluding to balance sheet conditions not being as challenged as expected (relative to fears earlier in the year with the Silicon Valley Bank episode).

In the special questions for the quarterly survey, banks noted they were less likely to approve credit card and auto loan applications for borrowers in the mid-range of FICO score (620-680), but more likely to for higher scores. This is not a surprise, but these distinctions become more apparent at times of greater uncertainty.

Question of the Week

Why is the U.S. economy still so strong?

This question has baffled economists for months. Strength has been seen in a variety of areas, but mostly on the services side, while manufacturing has shown more classic recession-like tendencies (seen in measures like the ISM manufacturing survey falling under the 50 neutral level). Exceptions are some domestic manufacturing segments that could see benefits from government support, particularly under the Inflation Reduction Act and CHIPS Act. Labor markets remain tight, with companies still having difficulty in finding enough qualified workers for skilled jobs, leading to unemployment levels and jobless claims remaining low and job openings still somewhat high. Inflation has improved, but remains above the Fed's target, with higher prices for food and housing weighing on budgets. Generally, inflation expectations aren't exorbitant, but remain higher than the Fed's year-over-year inflation target, with an embedded assumption from consumers and businesses that it'll be difficult to get back down that far in a sustained way.

In the U.S., the short answer for the strength appears to be the consumer, which, being the recipient of trillions of dollars in stimulus funds during the pandemic, first overloaded on goods, and since has been making up for lost time on services (particularly activities like restaurants, travel, concerts, and the like). The question now turns to when is the excess savings running out? This is difficult to measure, although the Fed and private economists have been trying. Based on some data, we could be coming closer to that end point. That has been also possibly revealed by rising credit card balances and delinquencies in auto loans, which have some folks on the credit side more concerned.

Another possibility is that the impact of the 5+% in rate hikes over the past 18 months hasn't fully kicked in yet. Economists still debate the impact of 'long and variable lags' (a well-known description first coined by economist and Nobel laureate Milton Friedman). One camp (which seems to include Fed Chair Powell at times) muses that an sufficient stretch of time is needed for refinancings to occur and credit to tighten enough to affect economic activity; the other side is more skeptical, assuming that the impact of hikes occurs far sooner, as in within the first year of hikes starting. As with many things in economics, perhaps the answer is somewhere in the middle.

The U.S. has been an outlier globally. Economic growth in Europe and the U.K. continues to run at flattish to near-recessionary levels. In key emerging market China, the post-lockdown recovery pace continues to run below earlier expectations, pointing to below-average growth. This points to the next few quarters and 2024 generally as perhaps providing the answer to the global economy's direction toward a broader recession or rebound into a new growth phase. Equity market valuations have generally been valued in line with regional optimism or pessimism.

Market Notes

Period ending 11/10/2023	**1 Week %**	**YTD %**
DJIA	0.72	5.29
S&P 500	1.35	16.60
NASDAQ	2.40	32.76
Russell 2000	-3.11	-1.92
MSCI-EAFE	-0.90	6.17
MSCI-EM	0.02	1.44
Bloomberg U.S. Aggregate	-0.29	-0.82

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
11/3/2023	5.53	4.83	4.49	4.57	4.77
11/10/2023	5.53	5.04	4.65	4.61	4.73

U.S. stocks were mixed on the week, with large caps experiencing gains, while small caps weakened. Equities generally fared well other than Thurs., when Fed Chair Powell reiterated in a speech that policy remains 'restrictive,' and the FOMC is keeping all options open. More directly, he noted the FOMC was 'not confident' that policy was restrictive enough. In contrast to the more dovish post-FOMC meeting message the prior week, this was taken more hawkishly (likely intentionally, to offset the earlier message). Other than communication, however, little else has changed. Threats of a government shutdown in a week loom again, with odds of a temporary extension until the new year remaining the highest probability case.

By sector, technology led the way with a gain of nearly 5%, led by earnings results, followed by more tempered gains for communications and industrials. On the negative side, energy fell by nearly -4% along with weaker oil prices. Along with utilities, real estate also fell back with a move higher in interest rates.

Foreign stocks were mixed, with Europe experiencing gains, while the U.K. and Japan fell back, the latter quite sharply. Lackluster sentiment in Europe and the U.K. (especially) appeared by be led by central bank comments that rate cuts may not be in the cards immediately (they're further along on the pause path, in terms of communications than is the U.S. obviously). Economic data in developed markets remains mixed and flattish, which has brought on the expectations for potential rate cuts. Emerging markets were mixed, with gains in Brazil, India, Taiwan, and Korea offset by China and elsewhere. Chinese prices have again dipped back into deflation, with economic data remaining mixed as well.

Interestingly, South Korea has prohibited the short-selling of stocks until June 2024, in efforts to better level the playing field between retail and institutional investors, with the latter viewed as engaging in unfair activity. This has been tried in some markets before, albeit usually briefly (like the U.S. SEC banning the short sale of financial stocks during the 2008 crisis), and debate persists about the ultimate impact. As with many seeming well-intentioned government policies, there are side effects. Efficient market theorists argue that short-selling is needed to maintain a 'balance' of opinion between those bullish and bearish on a given stock—the free market is the ultimate arbiter and source of price discovery. Otherwise, if only long positions are allowed, it could promote 'excess' ownership, and hence, asset price bubbles.

Bonds declined along with the move higher in rates, led by both the hawkish Fed communication and the results after U.S. Treasury debt auctions. For the auctions, despite fears of U.S. fiscal deficits resulting in too-high supply that wouldn't be well received by markets, key maturities of 3y and 10y debt featured high demand; on the other hand, 30y had a harder time, seeing the lowest demand in several years. (Then again, the 30y year area includes more niche participants, such as pension funds and insurance companies, as opposed to the more traditional parts of the curve.) Weaker auctions naturally raise concern from simple supply/demand reasons, as fewer buyers mean lower prices and higher yields to entice buyers. A ransomware attack targeting a major Chinese bank (and large owner of Treasuries), caused some disruptions in settlement logistics. By segment, floating rate bank loans outperformed, while interestingly, investment-grade corporate outperformed both Treasuries and high yield. International bonds lagged due to a stronger dollar during the week.

Commodities fell back overall last week, with declines in energy and metals. Crude oil fell over -4% last week to $77/barrel, with concerns over the Middle East continuing to ease, as well as concerns over next year's demand, particularly in China.

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.