Summary

Economic data for the week included the Federal Reserve holding interest rates steady, ISM manufacturing and services both showing declines, gains in home prices, while the employment situation report showed job positive gains, but at a weaker pace than expected.

Equities rose globally as hopes of central bank peak rates looked increasingly likely, and acceptable (not too good or too soft) U.S. economic data. Bonds fared positively as interest rates declined sharply following the FOMC meeting. Commodities were mixed, with crude oil prices pulling back.

Economic Notes

(0) The **FOMC** meeting ended with no change, surprising no one. The post-meeting press conference showed a balanced yet uncertain outlook from the Fed. In regard to potentially finishing their hiking cycle, Chair Powell noted that the committee is not confident that they haven't and also not confident that they have, and that they're continuing to 'proceed carefully.' He reiterated that the tighter financial conditions operate with a lag, so we likely haven't seen the full effects of policy actions yet. Markets took this dovishly, with stronger stock returns the rest of the week, but the message for future Fed meetings still remains less than clear-cut.

(-) The **ISM manufacturing** index for October fell by -2.3 points to 46.7, below the median forecast calling for an unchanged 49.0. The report's composition showed some weakness in the key segments of new orders and employment, which fell several points further into contraction, while production fell a few points but stayed just barely expansionary. Supplier deliveries and prices paid each rose by over a point, but stayed contractionary as well. This report went in the opposite direction of recent trend, which had troughed and then recovered, although it appeared to be affected by the autoworkers' strike. Such data adds more uncertainty in the evaluation of the broader economic environment, which was exceptionally strong in Q3 but with caution growing for Q4.

(0) The **ISM services/non-manufacturing** index for October declined by -1.8 points to 51.8, below the median forecast of 53.0, but remaining in expansion. Under the hood, closely-watched new orders improved by nearly 4 points to over the 55 expansionary level, while business activity and employment fell by several points, but remained in expansion. Supplier deliveries fell by several points, falling into contraction. Prices paid slowed slightly, but still expanded, on par with continued high wage growth.

(0) **Construction spending** rose by 0.4% in September, meeting expectations, while only half the pace of the prior month, after upward revisions. Private residential spending saw gains, as did public non-residential spending, offset by a -3% drop in public residential spending. Since construction costs rose over a percent, 'real' construction spending fell back for the month, which was not quite as positive.

(+) The **S&P Case-Shiller 20-city home price index** rose 1.0% in August, exceeding the prior month and median forecast, each at 0.8%. Prices rose in all 20 cities, led by San Diego and Seattle, at 1.5% or better, followed by Miami and LA at over 1%. Year-over-year, the measure ticked up 0.2% to 2.2%. The timing delay in this report makes an impact in its relevance, with low supplies still appearing to supersede the negative pressures of higher mortgage costs.

(+) The broader **FHFA house price index** in August rose 0.6%, a tenth stronger than expected. For the month, the differentials by region included an over-1% gain in Pacific and East North Central (Great Lakes area), to a small decline in the South Atlantic (MD south to FL). The national year-over-year growth rate reaccelerated by 1.0% to 5.6%. In contrast to the Case-Shiller, this includes all 50 states and 400 cities, including tens of millions of home sales over the past few decades. This allows for an interesting contrast between 'big city' and 'small city' real estate market changes.

(-/0) The Conference Board's **consumer confidence** index fell by -1.7 points to 102.6 in October, but better than the 100.5 estimate. While both elements fell back, assessments of present conditions declined by several points, more than future expectations. The labor differential ticked down just slightly, with the general theme that jobs remain 'plentiful' rather than 'hard to get.'

(-) **Initial jobless claims** for the Oct. 28 ending week rose by 5k to 217k, above the 210k expectation. Continuing claims for the Oct. 21 week rose by 35k to 1.818 mil., above the 1.800 mil. median forecast. The initial claims numbers were led by MI up 2k, which alluded to impacts from the autoworker strike, while CA saw a sharp rise in continuing claims. It's still assumed that seasonal effects are playing a role in this data, which could continue to alter results in coming months.

(+/0) The **JOLTs** job openings report for September showed a gain of 56k to 9.553 mil., above the median forecast of 9.400 mil., albeit with a downward revision the prior month. The positive areas included openings gains in leisure/hospitality (181k), financial activities (94k), and trade/transport/utilities (88k), which were offset with declines in professional/business services (-105k) and government (-81k). On the side of additions, the job openings rate and hiring rate were unchanged, at 5.7% and 3.7%, respectively. On the separation side, the quits rate was unchanged at 2.3%, while layoffs fell a tenth to 1.0%. This delayed data remains stable, and hasn't shown much weakness as of late pointing to a slowdown.

(+/0) The **ADP private employment** report for October showed a rise of 113k, an improvement on the prior month, but below the 150k expected. Services sector jobs rose 107k, with gains in education/health (45k), trade/transports/utilities (35k), and financial activities (21k). Goods-producing jobs also rose 6k, led by construction (4k). While an interesting data point for private markets, the ADP report has seemingly become less important as its correlation with the government nonfarm payrolls has weakened along with changes in methodology.

(0/+) The employment situation report for October came in positive, but weaker than expected, partially due to the impact of the autoworker strike. **Nonfarm payrolls** rose by 150k, short of the 180k expected, well below the average gain of the past 12 months, in addition to over -100k in downward revisions for several prior months. Leading segments included health care (58k), government (51k), construction (23k), and leisure/hospitality (19k). On the weaker side, manufacturing saw job declines (-35k, -30k of which due to the autoworker strike), as well as in transportation and information. The **unemployment rate** ticked up a tenth to 3.9%, above expectations for no change, while the U-6 underemployment rate rose 0.2% to 7.2%. This reflected a -348k drop in household employment, while labor force participation also declined. **Average hourly earnings** rose 0.2%, a tenth below expectations and the prior month's pace; year-over-year, hourly earnings gains decelerated by two-tenths to 4.1%, which was seen as a positive. **Average weekly hours** fell a tenth to 34.3.

A day prior, the preliminary **nonfarm productivity** stats for Q3 came in at an annualized 4.7%, a percent higher than the prior quarter, and above the 4.3% expected, with gains in both output and hours worked. The year-over-year productivity figure reaccelerated by a percent to 2.2%. **Unit labor costs** fell by an annualized -0.8% in Q3, far slower than the 3.2% gain in Q2 and 0.3% rise expected this quarter, while the year-over-year unit labor cost number decelerated by nearly -2% to 1.9%.

Productivity has been studied again more deeply as of late, in light of what types of improvements could be expected from artificial intelligence in the next decade and beyond. The conclusion remains obviously unclear at this point. However, some work by economist Thomas Philippon at NYU has confirmed that some productivity enhancements in prior structural shifts are best looked at on a graph in a more muted 'linear' way as opposed to an 'exponential' way. This really means that new ideas tend to add to rather than multiply the impact on the economy, likely reducing the effects a bit, at least compared to what had always been assumed. This raises caution for those hoping for large enhancements in future productivity gains; rather, it may merely slow the inevitable erosion of gains from prior evolutions. Exceptions have been the infrequent but

transformative productivity paradigm shifts, which have only happened three times since 1500, and with implementation delays: the first industrial revolution (1600s), the second industrial revolution (mid-1800s), and adoption of electricity (early 1900s). These unicorns caused an economic ‘reset’ of sorts, along with several years of above-average productivity growth (before fading again to trend). One may wonder why this is important. The key reason is productivity is one of the few major inputs into GDP growth, with the others being demographics/labor force growth and capital investment, which are more easily estimated.

Market Notes

Period ending 11/3/2023	**1 Week %**	**YTD %**
DJIA	5.07	4.53
S&P 500	5.88	15.05
NASDAQ	6.62	29.64
Russell 2000	7.59	1.23
MSCI-EAFE	4.43	7.13
MSCI-EM	3.12	1.42
Bloomberg U.S. Aggregate	1.99	-0.53

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
10/27/2023	5.59	4.99	4.76	4.84	5.03
11/3/2023	5.53	4.83	4.49	4.57	4.77

U.S. stocks experienced sharp gains last week, in fact the best week of 2023 thus far. Early week results were strong with news of a tentative agreement between the United Auto Workers and GM. The somewhat dovish comments from the FOMC after their policy meeting mid-week also appeared to strongly propel sentiment for several days, as chances for a December hike appear to remain low. Friday’s weaker jobs report also provided some reassurance that labor markets might be cooling, also lessening the chances of further tightening needs. There appeared to be high volume from larger firms as well, including tax loss trades before the common Oct. 31 fiscal year end.

Every sector ended higher, led by the diverse groups of financials and consumer discretionary, each up over 7%, followed by communications. Weakest were the defensives of consumer staples and health care, along with energy, up minimally as oil prices fell sharply. Real estate also gained over 8% on the week, with a tempering in interest rates. Small cap stocks reversed their stretch of weakness by outperforming large caps, with an implied removal of even higher rates as a headwind.

For S&P 500 earnings in Q3, over 80% of companies have now reported, with that same percentage reporting a positive earnings surprise and over 60% showing a positive revenue surprise (per FactSet). Naturally, expectations had been set very low in advance, with companies not meeting expectations being punished far more than normal. The blended growth rate has improved from around flat (-0.3% on 9/30) to a positive 3.7% on a year-over-year basis, turning around a string of weaker quarters. Growth has been driven by firms with more than half of revenue originating in the U.S. (8% earnings growth), in contrast to firms with majority foreign revenues (-4% earnings decline). Earnings estimates for Q4, though, have fallen back several percent in the last few weeks from 8% to now 4%, although 2024 is still expected to see robust earnings growth of 12%. Some economists are skeptical.

Foreign stocks performed largely in line with U.S. equities, with Japan and Europe outperforming, with favorable currency influences, while the U.K. ended with less sizable gains. In emerging markets, commodity-oriented nations Mexico, South Africa, and Brazil (which lowered interest rates by 0.50%) outshined all others, with China also showing gains. The Bank of England remained on hold. Europe is in somewhat the opposite

position as the U.S. Fed, where by keeping rates stable, investor hopes are closer to rate cuts, considering the weaker economic growth environment there, particularly in manufacturing and exports. The Bank of Japan alluded to a relaxing of yield curve control, by removing on a hard cap of 1% on 10-year yields (redefining it now as a 'reference rate'), and an ultimate exit from their quantitative easing program. This allows yields to ultimately drift higher and potentially stop the weakening of the yen, due to the relationship of (all else equal between two currencies) a rising yield tending to result in currency strengthening. Inflation has indeed been lower in Japan than in the U.S. and Europe, but higher than they're used to, necessitating the change.

Bonds gained as interest rates fell back last week, with the 10-year Treasury yield down nearly -0.30%, but mostly in the few days on and after the FOMC meeting. The lack of hawkish rhetoric and some pullback in economic and jobs data also contributed to the yield decline. Investment-grade corporates outperformed governments, while high yield ended best of all. Foreign bonds, mostly in emerging markets, fared strongly with 3+% gains along with the U.S. dollar falling over a percent. There was some question about the size and scope of the Treasury's quarterly refunding auction last week, with $112 bil. in Treasuries sold (lower than expected). Concerns continue to swirl around the size of the likely U.S. budget deficit and subsequent government financing needs, relative to the expected demand for bonds as yields globally move to more attractive levels.

Commodities were mixed, with sharp declines in energy offset by gains in agriculture and industrial metals. Crude oil price fell -6% last week to $81/barrel, with some concern over geopolitical escalation in the Middle East abating.

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.