Summary

Economic data for the week included the U.S. Federal Reserve keeping key interest rates steady, as expected. On the positive side, pending home sales rose, while negative data included ISM manufacturing, construction spending, and jobless claims. The monthly employment situation report for July disappointed, with fewer jobs and a higher unemployment rate.

Equities fell back globally, with economic and policy concerns outweighing decent U.S. corporate earnings reports. Bonds fared quite well as interest rates plummeted across the curve. Commodities lost ground for the most part, due to demand concerns, with the exception of precious metals.

Economic Notes

(0) The **FOMC meeting** ended with no change in policy, as expected, although the statement seemed to move interest rate cuts closer by emphasizing a greater “balance” of risks. Investors were looking for hints about September—which is now the unanimous base case for starting rate cuts.

In the post-meeting press conference, Fed Chair Powell clarified several top-of-mind items. For one, he implied they had discussed a July cut, but chose not to, and that the bar for a Sept. cut was not very high—essentially that “the sense of the committee is closer to cuts but we’re not there yet,” although they are “moving closer” and “could be on the table as soon as the next meeting in September,” with inflation “so much better” than a year ago, also noting residual seasonality concerns with price change measurements. Current policy is described as policy “restrictive, not extremely restrictive but restrictive.” In short, these hints might be the most obvious one could hope for, with the groundwork being generally laid for a cut in Sept., barring a surprise. In terms of labor market deterioration, he “would not like to see material further cooling in the labor market,” and conditions were being watched closely (the Wed. comments were obviously made before the Fri. employment situation report). Importantly, he reiterated that Fed forecasts “absolutely do not” take into account differences in economic policies of the two presidential candidates, for “an election that hasn’t happened yet,” and “that (politics) would be a line we would never cross.”

(-) The **ISM manufacturing index** fell by -1.7 points in July to 46.8, below the expected 48.8 and further into contraction, where the index has been for much of the last two years. Underlying components were weak as well, with 11 of the 18 sectors showing declines. Overall, new orders fell -2 points to 47.4, production fell several points to 46, and employment was down -6 points to 43. Prices paid ticked up by a point to 53, along with a gain in supplier deliveries, while inventories fell back. Anecdotally, some respondents noted a softening in business activity, which reiterated the weakness in the quantitative data. This was taken negatively by markets, perhaps in the ‘bad news is good news’ (in that it raises the chances of a Fed rate cut) being only valid to a degree, with ongoing bad news pointing to potential cracks in economic growth.

(-) **Construction spending** fell -0.3% in June, similar to the prior month including revisions, and well below the 0.2% increase expected by consensus. Every segment declined in the month, led by -2% in public residential

spending, while the others, including private spending, were all down a few tenths each. As construction costs rose 0.3% in June, overall real construction spending declined by -0.6%.

(+) The **S&P Case-Shiller 20-city home price index** rose 0.3% on a seasonally-adjusted basis in May, largely meeting expectations. The national index rose 6.8% on a year-over-year basis, a half-percent below the pace of the prior month. By city, the past year was highlighted by New York City and San Diego, each up over 9%, while Portland lagged with only a 1% increase.

(0) The **FHFA house price index** for May showed that prices were unchanged nationally, below the 0.2% rise expected, although the prior month was revised upward by a tenth. For May, prices rose 0.3% in New England (from CT north), while they fell -0.5% in the West North Central region (MO/KS north to ND). Year-over-year, the national index rose 5.7%, representing a deceleration from the 6.5% pace the prior month, led by sharp gains in New England, although all areas saw positive results. The FHFA noted the recent slowdown in prices was due to the rises in mortgage rates and housing inventory, with the interplay between the two still being the primary housing story of this year.

(+) **Pending home sales** rose by 4.8% in June, reversing a decline from the prior month, and surpassing consensus expectations of a 1.5% increase. All four regions experienced gains, led by the South and Midwest. Nationally, year-over-year, pending sales remain down -2.6%. This reversal for the month bodes well for a pickup in existing home sales in the coming 1-2 months.

(+) The Conference Board's **index of consumer confidence** rose by 2.5 points in July to 100.3, after revisions for the prior month, exceeding the lesser rise to 99.7 expected. While assessments of present conditions fell by nearly -2 points, expectations for the future rose by over 5 points. The labor differential, measuring the ease in finding employment, fell by nearly -2 points, well below the levels earlier in the year. Interestingly, about two-thirds of respondents continued to feel a recession was on the way in the next 12 months, although the survey timeline did include the ending of President Biden's reelection campaign, with raised uncertainty. In fact, expectations for the future remain as low as they have during actual recessions, going back to the inception of this index series in the mid-1960s. In recent years, this appears to coincide with deeper political polarization.

(-) **Initial jobless claims** for the Jul. 27 ending week rose by 14k to 249k, ahead of the 236k median forecast. Continuing claims for the Ju1. 20 week rose by 33k to 1.877 mil., above the 1.855 expected. Claims were led by a 7k increase in MI, which was assumed to be driven by seasonal auto plant maintenance shutdowns, which tend to be unpredictable. Claims levels also remained higher in TX due to the likely residual effects of the recent hurricane. Financial markets were startled by the sharply higher claims numbers, but additional weeks will be required to determine if underlying conditions are indeed deteriorating aside from the above-mentioned issues.

(0) The **JOLTS** job openings report for June came in showing a decline of -46k to 8.184 mil. after revisions but exceeded the median forecast that called for a round 8.000 mil. Openings gained in trade/transportation/utilities (153k), leisure/hospitality (104k), and government (56k); declines were greatest in manufacturing (-100k), private education/health services (-86k), and construction (-71k). The job openings rate was unchanged at 4.9%, while the hiring rate fell by -0.2% to 3.4%. On the departure side, the layoff rate fell by -0.2% to 0.9%, while the quits rate was unchanged at 2.1%. The labor market turnover stats all remain below where they were pre-pandemic.

(-) The employment situation report for July came in weaker than expected overall, creating a negative financial market response. **Nonfarm payrolls** rose 114k, below the 175k expected, and well below the average of 215k monthly pace of the past year. This was in addition to downward revisions of -29k for the two prior months. The BLS mentioned that Hurricane Beryl in TX had “no discernible effect” on the report, although the number of those not working due to weather rose sharply, as did those on temporary layoff (which could also be related to maintenance shutdowns in the auto industry), with the latter being nearly three-quarters of the newly unemployed. By category, leaders included health care/social assistance led (64k, mostly home health care and hospitals), construction (25k), transportation/warehousing (14k), and government (17k); on the weaker side were information (-20k) and private education (-7k).

The **unemployment rate** ticked up by 0.2% to 4.3%, versus expectations for no change. The U-6 underemployment rate rose 0.4% to 7.8%. The unemployment rate triggered the ‘Sahm Rule,’ a formula based on moving averages of the unemployment rate over the past few months and year and is watched due to it having been an accurate predictor of recessions (like the inverted yield curve). **Average hourly earnings** rose by 0.2% in the month, a tenth below the prior month and current expectations, with a deceleration of -0.2% in the year-over-year rate to 3.6%. **Average weekly hours** declined by a tenth to 34.2.

In an earlier report, preliminary **nonfarm productivity** for Q2 came in at an annualized 2.3% rate, exceeding the 1.8% median forecast and the revised 0.4% increase from Q1. Year-over-year, productivity decelerated a bit to 2.7%. For perspective’s sake, since the quarter just before the pandemic (Q4-2019), productivity has grown at an annualized pace of 1.6%. **Unit labor costs** for Q2 rose at an annualized pace of 0.9%, about half of the 1.7% increase expected. Year-over-year, labor costs decelerated by about half to 0.5%, which is the slowest pace since pre-pandemic, which points to continued easing pressures on the inflation side related to labor costs.

Market Notes

Period ending 8/2/2024	**1 Week %**	**YTD %**
DJIA	-2.10	6.56
S&P 500	-2.05	12.99
NASDAQ	-3.34	12.20
Russell 2000	-6.66	4.86
MSCI-EAFE	-1.96	4.35
MSCI-EM	-1.00	5.48
Bloomberg U.S. Aggregate	2.43	3.21

U.S. Treasury Yields	3 Mo.	2 Yr.	5 Yr.	10 Yr.	30 Yr.
12/31/2023	5.40	4.23	3.84	3.88	4.03
7/26/2024	5.38	4.36	4.06	4.20	4.45
8/2/2024	5.29	3.88	3.62	3.80	4.11

In what some have called one of the more important weeks of the year thus far, the U.S stock market did not disappoint in terms of volatility. While a Wed. rally came along with Fed hints toward a September start to interest rate cuts, by Thu., weaker economic growth, including manufacturing ISM and jobless claims, as well as the employment report on Fri., which reversed that exuberance in a downward direction, raising some concerns the Fed has waited too long to ease and/or that their language about a Sept. cut wasn't quite convincing enough. Non-committal language has often been the hallmark of the Fed, as it's been more focused on keeping itself flexible in response to changing conditions; however, weakening in a few areas certainly does raise the odds for a Sep. cut, as well as potentially for cuts in Nov. and Dec. as well, as needed. In fact, after the weak July jobs report, odds have risen for a -0.50% cut by Sep. (possibly assuming a cut made in-between meetings, which the Fed can do, at the risk of raising market anxiety even further), to a year-end rate of 4.00-4.25% (implying five cuts in total). In addition, some polls have shown a slide in former President Trump's odds versus Vice President Harris, which has caused an unwind for stocks tied to benefits of a pro-business and looser regulatory regime.

By sector, only the traditional defensives of utilities, health care, and consumer staples ended the week with gains, while declines were focused in technology and energy, each down -4%. Real estate also fared positively, up over 4%, as interest rates declined. Value lagged slightly less than growth, while small cap fell back relative to large cap.

Earnings continue to roll in, with last week's reports representing 40% of the S&P's market cap, and a particularly heavy one for big tech—ending mixed. Per FactSet, 75% of S&P 500 companies have now reported for Q2, with 78% having beaten earnings estimates, and 59% beating revenue estimates, now raising the blended earnings growth rate to 11.5%, up nearly 3% from initial estimates a few weeks ago. Despite signs of potential downturn in the economy, analysts have not been lowering earnings estimates for Q3 broadly, which are now over 6% for the index. However, there appear to be some concerns over downbeat descriptions of slowing U.S. consumer behavior.

Considering this year's excitement around artificial intelligence, investors have appeared to become particularly more sensitive to management comments sounding spending on AI, as well as potential uses and payback periods. Of course, much of that is unknowable at this point, but skeptical investors are looking for signs of AI spending going into a 'black hole,' with fewer-than-expected revenue benefits in the near-term. Some companies have also hinted at weaker consumer spending in some areas, which has been closely noted by markets due to that being a key anchor of recent strong economic growth. Microsoft specifically mentioned "constrained" AI capacity and indications that such investments could take over a decade to monetize, while Amazon and Meta also noted high and growing capital expenditures related to cloud AI this year.

Foreign stocks declined to a similar degree as domestic, although a drop of about a percent in the U.S. dollar provided a tailwind of over a percent. U.K. and emerging market equities declined only slightly, offset by larger declines in Europe and Japan—several of which were driven by monetary policy changes and expectations. The

Bank of England cut rates by -0.25% to 5.00%, in their first ease since the pandemic (however, the vote was five to four, with dissents far more common there). However, they noted a very slow easing pace was likely, similar to the ECB. The Bank of Japan, on the other hand, raised policy rates from 0.00-0.10% to 0.25%, the highest level in over 15 years, as well as plans to reduce quantitative easing bond purchases by half. This continues to bring a sense of more normalcy to rate conditions there, even if it means moving in the opposite direction compared to other major central banks.

Bonds fared well as interest rates fell back sharply across the yield curve as economic data deteriorated, and signs pointed to a Fed rate cut sooner than later following the July meeting. U.S. Treasuries outperformed corporates, with investment-grade credit outperforming high yield and floating rate bank loans, each of which fell back slightly on the week. Foreign bonds were propelled higher by the decline in the dollar.

Commodity indexes declined as a whole, with the exception of precious metals, which fared well amidst fears of economic weakness. Crude oil fell nearly -5% last week to under $74/barrel. While prices rose following Israel's military actions against Hamas and Hezbollah commanders, as well as disputed elections in large producer Venezuela, OPEC+ production discussion and economic concerns later in the week pulled down expectations for potential demand.

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.