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Economic Indicators | July 2023| By Kim W. Suchy

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What recession? The U.S. economy has continued its resilient path over the past few quarters. This despite numerous Fed rate increases and general recession indicators, such as the inverted yield curve, have suggested a material slowdown since the second half of last year. But the economy keeps plodding forward. This resilience has left the Fed scratching its head, talking tough and buying time as it hopes that the lagged effect of their tightening policies kicks in.

Many market pundits want to see rate cuts later this year and we are certain that the fiscal policy folks in Washington D.C. also want monetary policies relaxed going into an election year. However, interest rate futures, at the time of this writing, suggest that the Fed “pause” on rate hikes is just that, a pause, as there is an increasing likelihood that Fed will raise rates later in July.

Remember, the Fed is an autonomous entity. Certainly, the Treasury and others try and indirectly encourage, influence or soft-peddle Fed policy. However, it’s hard to influence a Fed that has two mantras that are objectively measured on an ongoing basis: employment stabilization and inflation. This is where Fed Chair Powell earns his paycheck. Shadowboxing, conviction, and patience have been written into Powell’s job description.

Quite simply, the Fed is thinking that the U.S. economy is running a bit too hot…. while policymakers on the fiscal side of the fence want it to continue plodding forward. However, The Fed is careful not to leak behind closed-door meeting discussions which may reveal that the economy is on an unsustainable path. Inflation remains too high considering the Fed target of 2%, and unemployment is too low from a longer-term price stability perspective.

This combination, in the Fed’s eyes, suggests the economy is running above potential with a positive output gap. A positive gap means that the current level of economic activity cannot be sustained for long as it is beyond the economy’s capacity…too many workers producing goods and services in an inflationary environment is not good policy. In order to close the gap, growth needs to spend more time in a slower operating mode; not necessarily recessed. This is why the Fed pauses. It needs time to see if the lagged impact of rate hikes will be lowering prices, stabilizing employment and narrowing the output gap. In the meantime, Fed Chair Powell works hard in his job, shadowboxing and demonstrating conviction and patience.

Here is your look at developments in the global marketplace.

POSITIVE DEVELOPMENTS

- The invasion of Ukraine by Russia in February 2022 initially caused a large increase in gas prices in Europe. Russia's energy war on Europe, aiming to disrupt support for Ukraine, was widely expected to worsen Europe's energy crisis. But Europe weathered the storm. The availability of sufficient gas inventories coupled with milder-than-expected winter weather resulted in lower heat demands than initially projected, easing the strain on energy supplies.

- The Census Bureau reports that durable goods orders jumped 1.7% in May and rose for the 3rd mo. in a row, boosted by strong demand for passenger planes and new autos. Business investment also rose. The recent increase in orders suggests that manufacturers may have found a bottom.

- The Conference Board Consumer Confidence Index increased in June to 109.7 (1985=100), up from 102.5 in May. The Present Situation Index, based on consumers' assessment of current business and labor market conditions, rose to 155.3 (1985=100) from 148.9 last month. "Consumer confidence improved in June to its highest level since January 2022, reflecting improved current conditions and a pop in expectations," according to Dana Peterson, Chief Economist at The Conference Board.

- Privately owned housing starts in May were at a seasonally adjusted annual rate of 1.6M. This is 21.7 percent above the revised April estimate of 1.3M and is 5.7 percent above the May 2022 rate of 1.5M. This is a significant improvement and bodes well for future GDP outlooks!

NEUTRAL DEVELOPMENTS

- The transportation industry faces one headwind and one tailwind: Unionized employees are pushing for higher wages and fuel prices have fallen. Recently, UPS's Teamsters union voted to initiate a strike if the union and UPS can't agree on a new contract by July 31 (340,000 delivery drivers and logistics workers). On the flip side, the cost of fuel has been declining. This helps margins.

- Industrial production was relatively weak last month, posting the first decline of 2023. The biggest source of weakness in May came from utilities which fell 1.8%, but which are volatile and largely dependent on weather. Given the trend of consumers currently focusing on services and away from goods, it could be that manufacturing activity will remain soft for the near future.

NEGATIVE DEVELOPMENTS

- A higher rate of inflation is one of the pandemic's many problems. It is believed that the CPI should continue to trend lower…without further Fed tightening. Goods inflation already has receded from 14.2% y/y at its peak to 0.6% in May. High rent inflation is stubborn and is holding the headline CPI rate higher, but this should normalize as housing starts are surging.

- The Dept. of Labor reports that over the past 12 months, the economy has added 4M jobs, with approximately 40% of those gains occurring in the first 5 mos. of 2023. The mismatch between labor demand and supply is the largest on record, with 10M job openings compared to only 5.7M unemployed.

- This strong demand for labor has resulted in above-average wage growth, especially for those in lower-skilled occupations. After years of weak wage gains, many workers are now seeing larger paychecks, which is contributing to the spending patterns and mitigating recession.

- Fed Chair Powell, before Congress, stated that, "Nearly all (Fed officials) expect that it will be appropriate to raise interest rates somewhat further by the end of the year." He also added, in his best doublespeak, "But at last week's meeting, considering how far and how fast we have moved, we judged it prudent to hold the target range steady to allow the committee to assess additional information and its implications for monetary policy." Translated from Fedspeak, the Fed must evaluate more data. Powell also stated that an additional two key interest rate hikes may be forthcoming. *The markets did not like this and returned a fair amount of June gains!*

THE MARKETS

Year-to-date, all capitalizations and styles recorded gains, with the Nasdaq 100 surging 31.7% while the SP500 jumped 15.9%. The small-cap benchmark, Russell 2000 posted an advance of 7.2%. In addition, five of 11 sectors rose during this period, led by last year's deepest decliners at the expense of the defensive groups that held up so well during the prior year's downturn.
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This past month, consumer discretionary, industrials and materials were the leaders while energy, financials and consumer staples were laggards.

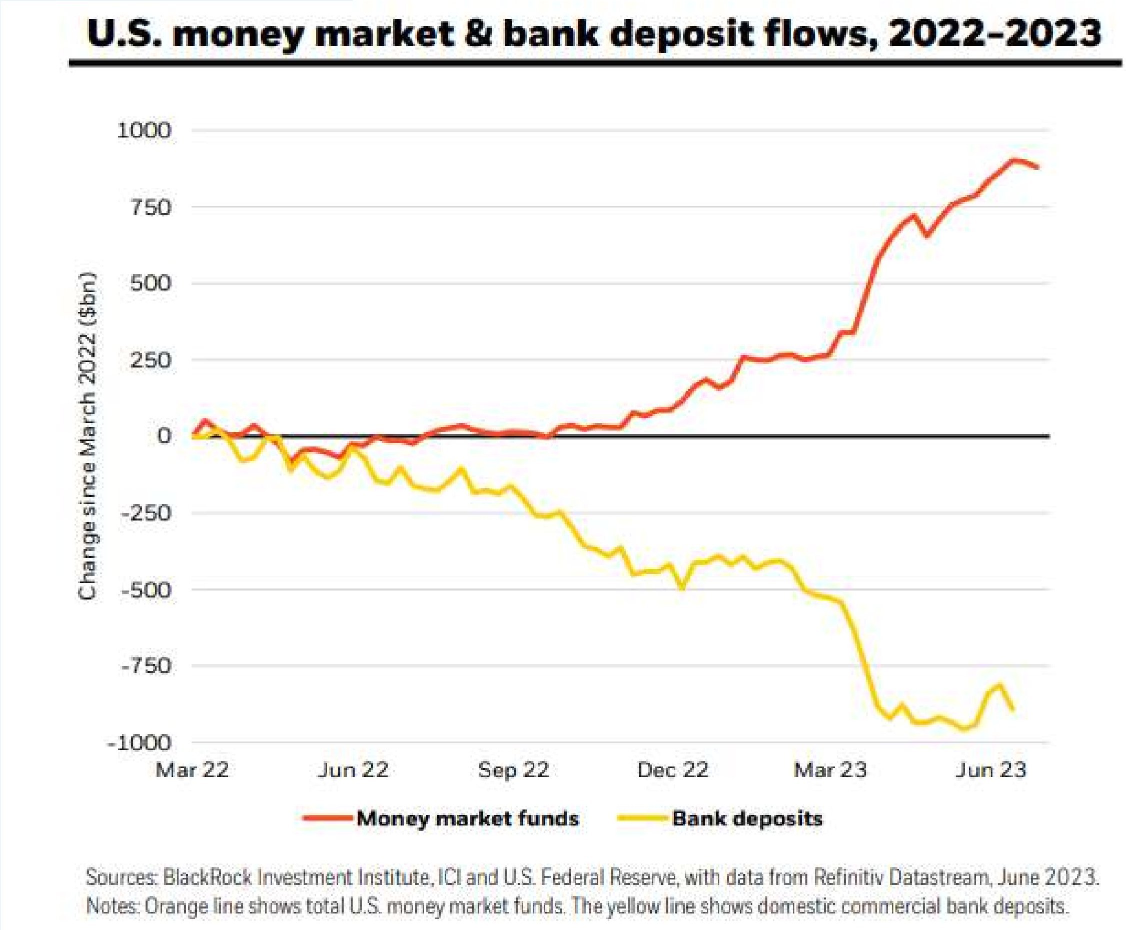
Across the pond, European markets were again weak last month as a result of stubborn inflation and softening economic growth. Asian markets were mixed with Japan and Honk Kong logging positive months while China continues to waffle in and out of positive territory. China's Central Bank has recently lowered rates in an effort to rekindle it's economic engine.

India has been performing remarkably well as the Sensex Index continues to reach new highs.

U.S Index	Last Month (% return)	YTD (%)
S&P 500	3.9	15.9
Dow Jones	1.9	3.8
NASDAQ Comp	4.1	31.7
Russell 2000	3.2	7.2

Source: https://tradingeconomics.com/stocks

Chart of the Month: Bank Deposit & Money Market Deposit Flows



Source: https://www.blackrock.com/us/individual/insights

Americans have moved billions of dollars out of bank deposits into money market funds over the last year. Money market funds are mutual funds that invest in short term debt instruments such as treasury bills, commercial paper, and CD's. They offer investors a way to earn interest on cash while maintaining liquidity and low risk.

Bank deposit interest rates are low, especially when you compare them to the inflation rate. So, savers are losing purchasing power by keeping their money in bank deposits. Banks, in turn, have less capital to leverage their loan base and must be more discerning in issuing credit. This hurts lenders and borrowers. On the flip side, short-term rates have risen at the heels of tightening monetary policy. On 6/30/2023 the 3-month treasury bill, also known as the risk-free rate, was yielding 5.32%. This is a highly attractive return considering very little risk. No wonder we see this directional flow!

What is not taken account in the chart are ETF vehicles that also serve as money market alternatives. The rise of ETF's over mutual funds continues to persist. Consequently, the amount of money market fund flows is much higher than depicted as short-term treasury ETF vehicles have seen considerable inflows. It's been 16 years since the 3-month T-bill was yielding 5+%.

It's important to consider that short-term rates are annualized to compare returns of different investments over a common period. In a Fed tightening cycle, reinvestment is little risk because rates are rising. However, when the Fed begins to ease, investors will not be able to reinvest principal and interest at the same or higher rate. Reinvestment risk is higher for short term investments than long term because interest rates are more likely to change in a shorter time span.

NEWS YOU CAN USE

Domingo Germán of the New York Yankees accomplished one of MLB's toughest feats on June 28th by throwing just the 24th perfect game in the history of Major League Baseball. A perfect game includes no baserunner's (no walks, no hits, no hit by pitch, no errors), retiring 27 straight batters. Domingo's perfect game is the first since 2012 or 11 years ago. It is the fourth perfect game pitched by a Yankees pitcher, the most for any single team.

https://www.cbssports.com/mlb/news/domingo-german-achieves-24th-perfect-game-in-mlb-history-giving-yankees-most-ever-with-four/live/

In other baseball news, Elly De La Cruz of the Cincinnati Reds became the youngest player to hit for the cycle in 51 years. The cycle consists of accomplishing all 4 hits in a game (single, double, triple and home run). It is the seventh cycle in Red's history, with the last recorded Red's cycle in 1989, or 34 years ago. The most astonishing fact is De La Cruz had only been in the Major's for 14 games prior to this accomplishment. He is just the third player since 1901 to hit for the cycle in the first 15 game MLB appearances.

https://www.espn.com/mlb/story/_/id/37906919/elly-de-la-cruz-cycle-propels-reds-12th-straight-win

As of June 29th, there were 497 active Canadian Wildfires mainly focused in Quebec and Western Ontario, of which 229 are out of control. YTD there have been roughly 20 million acres of land burned. The 2023 wildfire season has already exceeded the record set in 1995 for land burned, and the season generally lasts until October. Smoke clouds have even made it as far as Western Europe. Advisory Board, a healthcare research firm, suggested that extended exposure to the smog could be as damaging as smoking 22 cigarettes a day.

https://www.msn.com/en-us/weather/topstories/canada-wildfires-are-still-burning-why-and-when-will-it-end/ar-AA1dgllW

As always, if I can be of additional guidance, please feel free to call me at 312.485.6847.

Best regards,

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