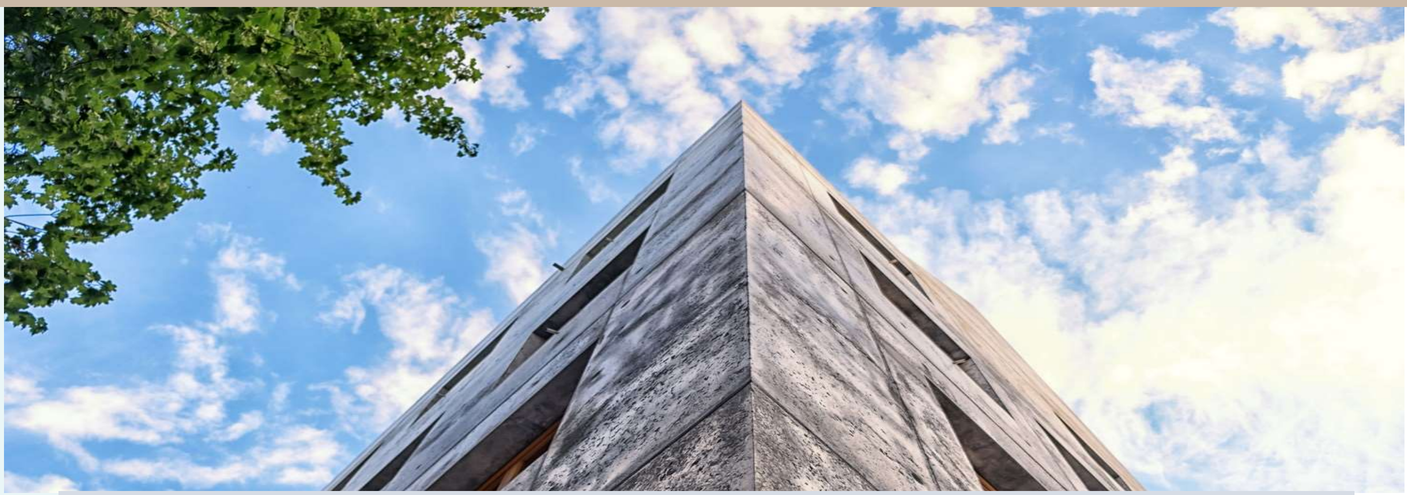
Cornerstone
ASSET MANAGEMENT GROUP, LLC

Economic Indicators | September 2023 | By Kim W. Suchy

www.csamg.com I Kim.Suchy@csamg.com



August is typically a volatile and weak month in the markets as traders, policymakers, corporate decisionmakers and occasionally, a portfolio manager, take their last respite before back-to-school activities dominate family life. Last month was no exception.

In months like August, when market players and newsmakers are absent, markets tend to have big mood swings. When trading volume is light and the news is big (i.e., interest rates rising, political disruptions, earnings releases) a limited number of buyers and sellers are engaged in establishing a fair trading price. As you will surmise, pricing distortions take place. Of course, this does not explain August's soft performance.

The stock market has gone up at a healthy pace over the April through July period and has stalled in August suggesting that the market may have reached overbought status relative to current and prospective earnings. What was the sudden catalyst? Interest rates.

We all see it; interest rates are rising. We see it in Treasury rates, and we see it in mortgage rates which are now breaching the 7.5% level for a 30-year fixed mortgage. The increase in rates has occurred in response to rising inflation, which has necessitated higher policy rates from the Fed. Fed Chair Powell, in his Jackson Hole speech last week, stated the Fed is not done in its inflation fight and he intimated that additional hikes are not ruled out. Practically speaking and all else equal, lower interest rates are better for stocks than higher interest rates, but higher interest rates aren't necessarily an omen for stocks, particularly if rates are driven by stronger than expected economic activity which is good for corporate profit growth.

Higher interest rates, however, create more competition for stocks. They lower the present value of future cash flows for stocks and raise the appeal of investing capital in less risky investments (i.e., money markets, corporate bonds, CD's and Treasuries). When rates were low, investors actually lost money in these conservative investments as inflation and taxes absorbed all of the yield. Fixed income investments have made an about face as yields north of 5% are abundant in certain segments of the Treasury market and municipal bonds yield close to this on a tax-equivalent basis.

Of course, these yields fall short of the SP500 return which is up double-digits year to date. In the past, with fixed income yields so low, it was often stated, “there is no alternative to stocks”, this has changed…and changed for the better. Now, more balanced portfolios can be constructed offering reasonable income derivations as well as healthier risk control through lower overall portfolio volatility.

Here is your look at developments in the global marketplace.

POSITIVE DEVELOPMENTS

- Housing starts increased 3.9% in July and are up 5.9% yoy. Looking at the big picture, during COVID, the combination of very low interest rates and many electing to work from home led to a boom in housing in general, including home construction. Now, keep in mind that many owners of existing homes are reluctant to list their homes and give up fixed sub-3% mortgage rates, so many prospective home buyers have turned to new construction as their best option. This has supported demand for developers and should help construction and all the good things buyers purchase for their new homes going forward.

- From the health care front, advancements in medical technology are taking aim at Alzheimer’s. About 6.5M Americans have Alzheimer’s. Scientists are managing stem cells and various forms of immunotherapy to slow the disease’s progression and eventually find a cure. There is a full pipeline of potential Alzheimer’s drugs in various stages of testing, according to the Alzheimer’s Association. There are 187 Phase 1, 2, or 3 clinical trials assessing 141 treatments as of January 1, and 55 of the trials are in Phase 3. The race for a cure is advancing at a very brisk pace.

- July industrial production report rose the most in six months, driven by increases in motor vehicles and parts, utilities and mining. Motor vehicle production rebounded from June’s 3.9% decline and is up 10.3% y/y, pushing assemblies to 11.9M annualized, 1M million above the 2019 average.

- New single-family home sales increased 4.4% in July to a 0.7M a/r. Sales are up 31.5% yoy. Sales have been on an upward trend over the past year and are now 31.5% above the low in July of 2022.
    - While existing home sales are weak new home sales allow better financing with builders thus higher mortgage rates are not always a concern. In fact, the median sales price of new homes has fallen by 12.1% from the peak late last year, which has helped sales activity begin to recover.

NEUTRAL DEVELOPMENTS

- More progress was made against inflation in July as the Consumer Price Index (CPI) rose 0.2% in July, which matched expectations, and the 12-mo. came in at 3.2%, a huge improvement over the 8.5% 12-mo. change posted a year ago. But wait! The recent surge in energy prices came too late in July to affect the monthly numbers. It will hit in August and could be enough to reverse the decline in YOY comparisons.
- The inflationary pressures remain evident in producer prices. The Producer Price Index (PPI) increased by 0.3% in July. The annual change in producer prices, now at 0.8%, has moderated significantly from the 11.7% peak in March 2022. However, this partly reflects the base effects of the sharp inflation spike following the Ukraine crisis last year, which are now dropping out of the year-over-year calculations. While prices at the producer level are trending lower, they do not appear low enough yet for the Fed to claim victory over prices.
- The U.S. Treasury auctioned a whopping $1.03T in Treasury securities the week of Aug.7. The auctions went well at first until the 30-year Treasury bond auction later in the week. As a result of that messy auction, as well as renewed inflation fears stemming from the “iffy” PPI report, Treasury yields rose from 3.95% pre-30 yr. auction to 4.17% post auction, up 22 bps in a day.
- Retail spending surged almost twice as much as expected in July rising 0.7% vs. the 0.4% consensus. This suggests above-trend economic growth and could force markets to rethink whether the Fed is done hiking. Fed hawks will head into the September meeting with a bit more confidence that more restrictive policy is necessary to slow this healthy consumption pattern.
    - Note, FHN Financial reports that Amazon Prime Day was in July this year, which helped boost the increase in spending at non-store retailers to 1.9%. While a few data reports and surveys have suggested some households were cutting back borrowing and spending to position for student loan payments starting up again this fall, any shift appears to have been totally swamped by strong spending for everyone else.

NEGATIVE DEVELOPMENTS

- Moody's cut the credit ratings of several small to mid-sized US banks and stated that it may downgrade some of the nation's biggest lenders; a warning that the sector's credit strength will likely be tested by funding risks and weaker profitability. The downgrade is what it is, i.e., bearish for the financial sector over the short term….unless M&A activity accelerates and enhances profit margins.

- China's economy has been hit hard of late. One of the country's major property developers, Country Garden, failed to make bond payments amid the country's flailing property sector. Further, demand for China's exports slid 14.5% in July (year over year). Finally, private sector investment is starting to dry up and unemployment rates, particularly amongst younger workers, has risen.

- The financial sector continues to face headwinds. Two weeks ago, Moody's downgraded 10 regional banks. It also placed 6 other, mostly larger banks, under review for potential downgrades, and it changed the outlooks on 11 other regional and superregional banks from Stable to Negative. Sizable commercial real estate exposure coupled with higher interest rates is placing strains on bank financials.

- *Existing* home sales declined 2.2% in July to a 4.1M a/r. Sales are down 16.6% vs. a year ago. Common sense suggests that homeowners remain reluctant to sell due to a "mortgage lock-in" phenomenon, after buying or refinancing at much lower rates before 2022. This will likely limit future existing sales (and inventories).

THE MARKETS

The US stock market rally fizzled early in the month of August and tried to regain its balance late in the month but ran out of gas. The S&P 500 index, the NASDAQ and S&P600 (small caps) were lower as lackluster earnings amongst a few large companies and rising interest rates kept the bulls at bay. In August, energy, communications, and health care were the market leaders while utilities, consumer staples and materials were laggards.

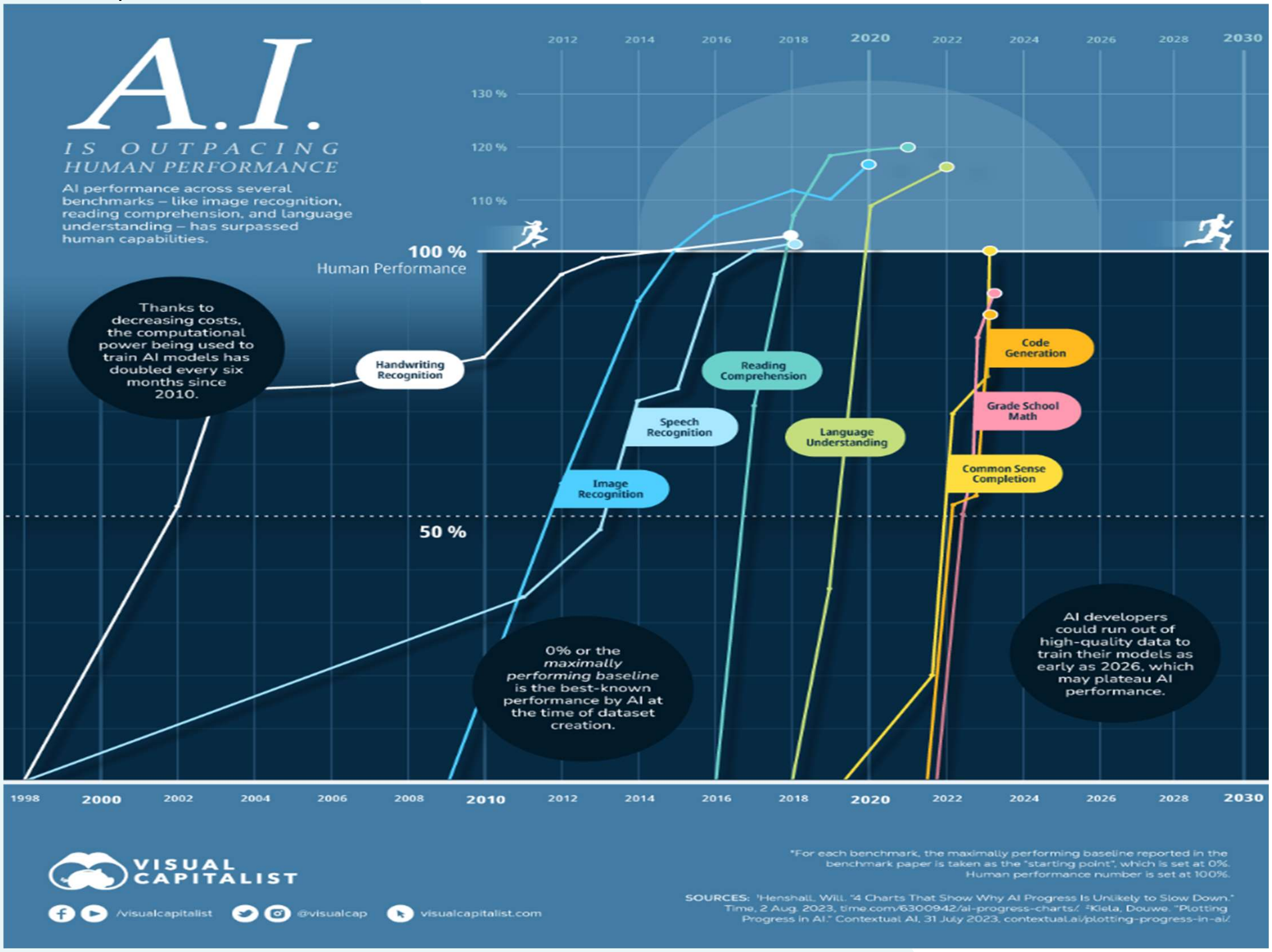
On the international front, most markets legged lower across Europe and Asia. China, which has really suffered of late due to its flailing real estate market has taken most of Asia down with it. Japan (Nikkei) appears to be somewhat insulated from the Chinese contagion, yet it was still lower on the month. The Indian market, BSE Sensex, slipped in August following a very strong July.

Following a rather hawkish mid-month presentation from Fed Chair Powell on the Feds inflation battle, interest rates across the yield curve moved higher. He stated that rate hikes may not be over until the data on jobs and inflation move closer to target. Over the last several days, job data and inflation reports have been quite reasonable, and rates have edged lower, and the stock market rallied. Look for the bulls to surface in September if this data continues to look favorable.

U.S Index	Last Month (% return)	YTD (%)
S&P 500	-1.5	17.4
Dow Jones	-2.5	4.8
NASDAQ Comp	-1.7	34.1
Russell 2000	-4.8	7.7

Source: https://tradingeconomics.com/stocks

Info-Graph of the Month: A.I. vs. Human Performance



Source: https://www.visualcapitalist.com/ai-vs-humans-which-performs-certain-skills-better/

Artificial Intelligence has stolen a lot of headlines in 2023, starting with the rise of ChatGPT and the ensuing hype that captured the public about the next big technological revolution. At the heart of the AI revolution, large companies like Nvidia and Microsoft have enjoyed a strong year on this tailwind, providing a glimpse of the size and scope of the market.

This summer more than 1,000 companies mentioned AI in their quarterly earnings report, up from 36 a decade ago. With that said, anything involving data, or technologies to spot patterns or make predictions, could be considered AI. Due to the hype, some companies have been rebranding things they were already doing as artificial intelligence and has even prompted a handful of companies to change or add AI to their corporate name. Beyond the buzzword, companies are looking for efficiency by employing the technology, and making sure to be proactive, so that they can adapt to rapid change brought on by AI or competitors utilizing AI.

The graph above illustrates the performance of AI vs. human performance on several skillsets. It's clear that AI has surpassed human performance in several areas (including the traditional strongholds of human capabilities: reading comprehension, speech recognition and image identification), and it looks to overtake humans soon elsewhere. Thanks to computing power, data availability, and enhanced algorithms, AI models have become faster and optimized for efficiency compared to a decade ago. This rapid progress is only expected to continue in the next few years with more computing power and algorithmic gains, which has created the exuberance we are seeing about the role AI will play in the economy going forward. However, it is estimated by 2026 that AI models could run out of high-quality data for models to train on, which provides an obstacle for further development.

NEWS YOU CAN USE

With the recent sale of his equity stake in the NBA's Charolotte Hornets, Michael Jordan has now become the richest NBA player to ever live, bearing a whopping $3.5 Billion net worth. Although Jordan retired at 40, his wealth continues to skyrocket at 60, primarily through his licensing deal with Nike. Jordan earned an estimate $256.1 million from Nike in 2022 alone, surpassing his entire NBA career salary earnings.

https://www.thestreet.com/sports/at-3-5-billion-michael-jordan-is-now-the-richest-basketball-player-ever

Novo Nordisk, the Denmark pharmaceutical giant specializing in diabetes and obesity care, announced $7.1 billion in profit for Q2 on August 11 thanks to the recent craze over weight loss effects of blockbuster drugs Ozempic and Wegovy. Novo's market capitalization on 8/31/23 was $419 Billion, which surpasses Denmark's GDP ($406 Billion). Since exports of the drugs have increased dramatically, there has been an influx of currency into the Danish economy, which has led to lower interest rates across the nation.

https://www.entrepreneur.com/business-news/ozempic-and-wegovy-maker-worth-more-than-denmarks-gdp/457799

Taylor Swift surpassed 100 million monthly Spotify listeners on August 29TH, becoming the first female artist in Spotify history to reach this historic milestone. Last month, Taylor notched her 12th No. 1 record to break the record for the most No. 1 albums by a female artist, surpassing Barbra Streisand. Swift is currently on a billion dollar "Eras Tour" which has dominated the music scene. A documentary about the tour is set to play in North American cinemas on October 13th.

https://variety.com/2023/music/news/taylor-swift-spotify-record-monthly-listeners-1235707101/

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

Best regards,

Kim W. Suchy

CEO | Cornerstone Asset Management Group
5411 Commonwealth Ave; Western Springs, IL 60558