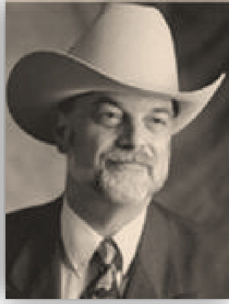

THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

The week that ended on August 4 was another one of those weeks when good economic news flooded in, but the stock market apparently did not like it. The S&P 500 Stock Index (SPX) fell 2.27% to 4478.03, leaving it up 16.63% this year, 25% higher than it was last October, just over 100% higher than it was in March 2020, but still down 6.57% from its record high in January 2022. It is also now about 40% higher than it was three years ago. The CRSP US Mid Cap Value Index joined in the slide with its older sibling and declined 1.46% to 2435.04, leaving it up about 12% since last October and up 4% this year.

The 10-year U.S. Treasury note yield appears to have begun the move we have been predicting for some time as it climbed to 4.05%. We have been unhappily predicting that the severely inverted Treasury yield curve would correct that inversion not just through falling shorter term rates, which are probably still months away, but also through longer term rates rising. What we are seeing now is those longer-term rates climbing, which causes the sale price of a bond on the secondary market to fall. The Morningstar US Core Bond Index has fallen 3.41% over the last three months and has averaged a 4.36% loss annually for the last three years. West Texas Intermediate crude oil (WTI) went the other way as it became clearer that rather than a recession, we may be looking at accelerating economic growth, rising about 2.27% to $82.64 per barrel. WTI has risen about 16% in the last three months.

The Economy

Perhaps the biggest economic news that came out this week was the announcement by the U.S. Bureau of Labor Statistics that labor productivity increased at an annualized 3.7% rate in the second quarter of 2023. U.S. business output rose 2.4%, hours worked decreased 1.3%, while labor costs only increased at a 1.3% annualized rate in the month of June. In plain English, people, on average, worked less and produced more goods and services when compared with past months and years. On the manufacturing side of the economy, where there has been some fear expressed that since manufacturers are not laying people off even as the purchasing managers are saying business is declining, that we would see a substantial decline in productivity. Instead, manufacturing productivity rose 3.6% when compared to a year ago and was up 4.0% in the second quarter.

This is important because our Gross Domestic Product, the official growth rate of our economy, is fundamentally composed of only three major elements, the number of workers, the hours worked, and productivity per hour. If the money being spent, particularly on consumer goods and services, rises faster than the number of workers times the hours worked times productivity, then we have inflation. Certainly, a lot of people are being hired. The Labor Department reported that we created and filled a net of 187,000 net jobs in July. Those new workers joined a work force that just got 2.4% more productive. It is not unusual to see productivity rise when jobs are declining, but when hiring is high, productivity normally declines as not only are the new workers less than optimally productive but experienced, highly productive workers must be taken out of production to train the newly hired workers. We saw that happening in the first quarter as businesses hired at a much higher rate than economists or the Federal Reserve had anticipated; productivity declined at an annual revised rate of about 1.8%.

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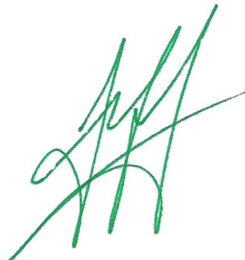
Productivity has seesawed around since the beginning of the pandemic, but the critical data would come when things finally stabilized and supply chains, supply and demand, and things like computer chip shortages and critical labor shortfalls finally stabilized. All those things have largely happened now, and this report has the potential to represent the new normal, post pandemic. One report or even a combination of reports from one quarter does not make a trend, but when we consider that the "experts" warned that about now we should be seeing the U.S. economy contracting and workers being laid off, this is both delightful and amazing news. It also gives the Federal Reserve good cause to hold off on more interest rate increases. If productivity continues to rise like we saw in the second quarter and in July, not normally known as the most productive of months, it could eliminate excess inflation. There are two classic solutions to inflation, either reduce the hours worked or increase the production created in those hours. The second solution is by far the best.
A growing consensus of leading major financial institutions are removing their forecast for a recession this year and grudgingly acknowledging that not only will we not have an economic hard landing to cut off inflation but we may not land at all. Instead, we continue to appear to be on the cusp of a new surge of economic growth.

There is more. There is always more, but particularly this week. A very unusual economic pattern is emerging as the data comes in. Parts of the economy are cooling. Freight railroads are seeing shipping volumes decline. Construction firms are slowing their equipment purchases. Vending machine customers are negotiating lower prices. But… those companies are not laying off workers and those workers are getting paid more, and then spending that money. Albeit somewhat slower than they were before. In short the economy of the United States looks neither too hot nor too cold.

Until next week, try to stay cool and know that we continue to seek better, less expensive, and more productive ways to manage your investment portfolios and provide good advice as fiduciaries, working solely for you.



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