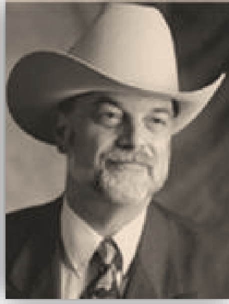

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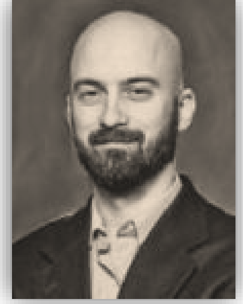

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TPWC Market and Economic Update

The Markets

It was a rough week in the U.S. Stock Market. The S&P 500 Stock Index (SPX) fell 2.31% to 4369.71, leaving it down about 4.5% in the last three weeks. The culprit appeared to be the steady stream of good economic news that kept showing up in the news feeds. More specifically, the fall in stock values is credited to the severe decline in the bond market. From a longer perspective, the SPX still looks quite good, though. It ended the week 13.81% higher than it started the year, about 22% higher than it was last October, about 95% higher than it was in March of 2020, and about 34% higher than it was at this point three years ago. Still, it is about 8.83% lower than its all-time high at the beginning of 2022. Notably, earnings reports for the SPX are about all in for the second quarter, and about 90% of them are above what was expected. As it usually does, the CRSP US Mid-Cap Value Index trended in the same direction as its older sibling, falling 3.12% for the week to 2351.62; however, it remained positive for the year-to-date, if only by 0.51%, and is about 9.5% below its high point in January 2022.

For all the noise about the stock market, the bond market was where the unhappiness centered this week. The yield on the benchmark 10-year U.S. Treasury note rose to 4.26%, its highest yield since October 2022. Since bond prices fall as yields increase, the values in the bond market fell accordingly. The Bloomberg US Aggregate Bond Index is now down 3.20% this year and has averaged about a 4.5% per year loss for the past three years, even with all interest reinvested. The Treasury yield curve remains decidedly inverted, but less so than we have seen in some time, not because short-term rates have fallen, as the annualized yields for maturities of less than one year remain above 5.5%, but because the longer-term maturities have risen, with the 20-year bond now yielding 4.55%. West Texas Intermediate crude oil (WTI) reversed its recent upward trend and closed out the week at $81.40 per barrel, down almost 2%. WTI is still about 14% higher than it was three months ago when the consensus was that a recession was sure to arrive in the near future.

The Economy

The U.S. economy is healthy and growing. From the perspective of businesses and most of the rest of us, that is excellent news, confirmed several times during the week, but for the worry generators who write and broadcast, it is further reason to create the “wall of worry” that bull markets like to climb. One of the more reliable forecasting indicators, the Housing Starts Index, turned positive in May and rose 7% in July, despite mortgage rates rising to 7.06%, the highest they have been in over 20 years. Capacity utilization, the amount of available industrial capacity being used in the United States, also surprised economic watchers as it rose from June’s already high 78.6% to 79.3% in July.

Industrial production is still down 0.2% from one year ago, but considering that last year at this time, it was almost universally considered by economists to be running too hot to sustain as the economy rebounded from the pandemic, this year’s numbers certainly look healthy. As we have reported, a great deal of manufacturing investment in buildings and durable goods has occurred in the last year. That was the key, at least to us, that manufacturers did not see a recession coming but rather appeared to be gearing up for ongoing growth. After that data was released, Moody’s Analytics, one of the more historically reliable economic forecasting services, raised their estimate for U.S. third-quarter GDP to be rising at an annualized rate of 4.3%!

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As if that wasn't enough "good" news, U.S. retail sales posted their fourth straight month of healthy growth in July, with total sales up 0.7% after rising 0.3% in June and 0.7% in May. Year over year, sales were up 3.2%. The Labor Department announced that job gains appear to be stable at around 200,000 per month, a bit higher than they were pre-pandemic but well below the unsustainable rates that had members of the Federal Reserve expressing concern.

In that otherwise delightful set of economic numbers and Moody's forecast are the seeds of what has the bond markets in a funk and stock traders feeling glum. Longer-term interest rates are rising, not because of anything the Federal Reserve is doing, but because there is a growing demand for loans coming from a growing economy.

In the midst of all of that positive economic news and the stock market's typically perverse reaction, there was one dark cloud that seemed to be getting darker and bigger. The mainland China economy looks increasingly like it is at the tipping point of deflation and potentially a major recession. The Chinese government's reaction was to eliminate reporting on unemployment; we suppose on the theory that if it is not reported, it must not be happening. Then, Evergrande, perhaps the world's largest real estate company, filed for bankruptcy. The potential for a banking collapse in China not unlike the one we saw in the Western world in 2008-2009 is very real.

Until next week, know that even in 100-degree-plus weather and from wherever we have relocated to escape it, we remain your obedient fiduciary servants, always seeking to improve our management of your portfolios and to provide you with the best fiduciary service possible!

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