Summary

Economic data for the week included retail sales coming in stronger than expected, in addition to gains in industrial production and housing starts. The index of leading economic indicators continued to decline, albeit at a slower rate than the prior month. Political rhetoric on both sides appeared to be a stronger driver of investment sentiment for the week.

Global equities lost ground last week based on a variety of concerns, notably potential tighter chip restrictions on China, which punished technology stocks. Bonds also fell back as yields rose across the board. Commodities were generally down along with a stronger dollar, with declines in industrial metals and energy.

Economic Notes

(0) **Retail sales** for June were unchanged from the prior month on a seasonally-adjusted basis, beating expectations for a -0.3% decline. Core/control retail sales, removing the more volatile components (auto, gasoline, building materials), rose by 0.9% for the month, which exceeded the 0.2% expected. The differential included autos/parts down -2% for the month (with some negative influence from the unique cause of cyberattacks affecting popular car sales industry software) as well as a -3% drop in gasoline sales, offset by a gain in building materials. Within core, non-store/internet retail sales rose nearly 2%, with gains also in health/personal care, clothing, and furniture. On a year-over-year basis, retail sales were up 2.3%, decelerating slightly from the prior month. When inflation is accounted for, that kept the ‘real’ gain negative for the year.

(+) **Industrial production** rose 0.6% in June, a deceleration from the prior month, but exceeded the 0.3% increase expected. That brought the year-over-year gain up to 1.6%. Manufacturing production gained 0.4% for the month, led by a sizable gain in auto assemblies that were positively impacted by fewer maintenance shut-downs than in prior years. High-tech equipment production also continues to rise, helped by the re-shoring of semiconductor building as well as artificial intelligence-related gains, which carries over to segments like data centers and utilities. Speaking of which, utilities production rose 3%, along with high temperatures; mining production, including petroleum, gained 0.3%. **Capacity utilization** rose 0.5% to 78.8%.

(-/0) The **Empire manufacturing index** fell by -0.6 of a point to -6.6 for July, remaining in contraction but slightly stronger than the -7.6 expected. However, the underlying factors were stronger, with new orders rising nearly a half point to -0.6, shipments further into expansion, and employment up but remaining in contraction. Prices paid a few points further into expansion at over 26—still strong. Business conditions looking out six months out fell -4 points but remained at a strongly-expansionary level of 26. This report has been less reliable due to seasonality-related issues and high volatility for the past few years, which has seemed to reduce its impact on those tracking manufacturing data.

(+) The **Philadelphia Fed manufacturing index** for July, on the other hand, rose by 12.6 points to a much more expansionary 13.9, well above the median forecast calling for 2.9. Under the hood, new orders, shipments, and employment all gained substantially, well into expansion. Prices paid fell by a few points but remained expansionary as well. The 6-months ahead business conditions index saw a substantial increase of 25 points to nearly 39. This was a positive report to say the least, offsetting the more volatile, and less reliable, Empire survey.

(+) **Housing starts** rose 3.0% in June to a seasonally-adjusted level of 1.353 mil., reversing the decline of the prior month, even with upward revisions, and above the 1.8% gain expected. The monthly gain was led by the volatile category of multi-family starts, while single-family starts fell by -2%. Regionally, the Northeast and Midwest saw gains of 25-35%, while those in the West fell by -6%. **Building permits** rose 3.4% to a seasonally-adjusted rate of 1.446 mil., above the median forecast of 0.1%. The multi-family segment led here as well, up over 15%, while single-family permits fell by -2%.

(-) The **NAHB/Wells Fargo housing market index** for July fell by a point to 42, remaining in negative territory. This included present sales (nearly 60% of the survey weight) falling a point to 47, expected sales in the next six months rising a point to 48, and prospective buyer traffic falling a point to a still-abysmal 27 reading. Anecdotally, it appeared that higher-for-longer mortgage rates and higher rates for development/construction loans continued to keep a wet blanket on sentiment. To combat a bit of this, over 30% of builders have cut prices on new homes—a percentage that has been creeping up over the last few months—although the average price reduction has been only around 6%.

(-) **Initial jobless claims** for the Jul. 13 ending week rose by 20k to 243k, well above the 229k expected. Continuing claims for the Jul. 6 week also rose by 20k to 1.867 mil., above the median forecast that called for 1.856 mil. It appeared that Hurricane Beryl in the Southern U.S., particularly TX, has been behind much of the claim weakness for the period.

(-) The Conference Board's **Index of Leading Economic Indicators** fell by -0.2% in June, continuing a stretch of declines, although there has been some deceleration in the pace of decline, which points to recovery. Per the index's sponsor, recent weakness continues to be led by "gloomy consumer expectations, weak new orders, negative interest rate spread, and an increased number of initial claims for unemployment." For the first six months of 2024, LEI fell by -1.9%, but was an improvement on the -2.9% drop experienced over the 2nd half of 2023. That semi-annual stretch was most negatively impacted by the inverted Treasury yield curve, which is a classic historical recession signal (albeit yet to come to realization in the current cycle), as well as weak manufacturing new orders and consumer sentiment. Based on the total data, their estimates for the coming few quarters indicate GDP growth potentially slowing to around 1% by Q3, but not including recession quite yet.

Question of the Week

What would be the impact of an increase in tariffs?

Former President Trump's campaign proposal to impose 10% across-the-board tariffs on all U.S. imports (and 60% on imports from China) has brought further awareness again to the use of tariffs as a foreign policy and economic tool. There would be some impact, even if the implementation rates, if put through, ended up well below the initial threatened levels.

Most simply, a tariff is a tax imposed on the goods or services imported from another nation. Tariffs have been used by governments for centuries, for a multitude of reasons, both economic and political. Accordingly, they've tended to cyclically fall in and out of favor. Catalysts for imposing them vary, but one basic objective historically is to raise tax revenue. (This was more important in the U.S. before the standardized federal income tax was initiated in 1913.) In recent years, tariffs have been more commonly applied to protect certain domestic industries, and/or to apply economic pressure by rewarding/punishing certain countries over others. All else equal in the marketplace, assuming that similar domestic and imported goods would be offered at similar prices, tacking on a tariff to the imported items would obviously render them far less attractive to buyers than the domestic choices.

For about 20 years, the world experienced a stretch of falling tariffs in a generally supportive environment of free trade. This coincided with the entry of China into the World Trade Organization (WTO) in 2001, which began a shift of low-cost goods production to Asia. The European Union created in 1993 (like its predecessor arrangements beginning after World War II) were at least partially designed to accommodate freer trade and eliminate tit-for-tat national policies like tariffs. Open trade has been noted as one of the hallmarks of a successful modern global economy, as opposed to one with various barriers.

However, between rising geopolitical competition between the U.S. and China, and the sudden impact of supply shortages during the Covid pandemic, many nations started to question the objective of cost savings gained from widespread globalization. Since, we've seen steps backward toward re-shoring and various forms of

support for domestic industries. This was done for competitive reasons, but also as a pragmatic measure to reduce the impact of potential future supply chain entanglements. This path of ‘deglobalization’ made the case for tariffs far easier than in prior years. In the unique case of the U.S., which has an inherent high degree of global economic leverage, it also provides the ability to reward or punish specific industries in specific countries (China and Russia come to mind).

As with any economic policy choice, pros and cons exist, although determining net results can be complicated. It might not be surprising to learn that typical economists are not fans of tariffs, or anything that encumbers efficient and low-cost trade. This is based on the rationale that each country should produce what it’s best at producing, and already has the existing infrastructure for, and then selling to world markets. This is opposed to an isolationist approach of producing everything itself, which would no doubt cost significantly more (although it does offer benefits such as being less beholden to foreign partners, national security considerations, etc.). So free trade becomes the more efficient way of moving goods made at the cheapest cost to where demand exists, all else equal. As an aside, due to our breadth of domestic industries and natural resources, the U.S. is actually far less reliant on global trade for economic growth than other regions, such as Europe.

This is not a complete list, as noted earlier, the net impact of tariff policy can be complicated with a variety of primary and secondary effects, some of which could offset each other.

Potential positives from tariffs:

- Revenue. Tariffs serve to bring in government tax money, which can supplement other sources (but probably not replace them completely).
- Protection of domestic industries. This is done by raising prices for foreign competitors, taking them out of the picture. Some of these have been put in place to counteract subsidies foreign governments have given to their own producers (e.g., Chinese EVs), so are described as ‘market fairness’ tariffs.
- Limited near-term protection of some jobs and wages. This could help some industries, by raising demand for home-grown goods and services. This may be only an immediate benefit, though, as other studies show that the overall negatives associated with tariffs can have unintended side effects and have tended to eventually reduce jobs across the broader economy, if economic growth is negatively affected.
- Threat effect. The proposal of tariffs by more powerful nations can act as a policy lever to push for concessions by trading partners, especially if they’ve been implemented in the past.

Potential negatives from tariffs:

- Higher costs. From raw materials to intermediate goods, tariffs raise company costs. These must be either swallowed (pulling down profit margins) or passed on to consumers. If the latter, consumers may adjust their product preferences towards cheaper items, which could negatively affect company revenues. On an economy-wide basis, higher cost headwinds can hold back overall output. (One argument against the latter is if tariffs are used to lower taxes elsewhere, which could offset some of that damage.)
- Inflation. As well as with the input cost issue, implementing tariffs raises import prices directly, which can elevate inflation pressures. This has been a key criticism of strong tariff policies in the past, including those in the U.S. In a secondary effect, higher inflation could keep interest rates higher than they might normally be, also a potential headwind to growth.
- Retaliation. Tariffs aren’t imposed in a vacuum. Trade partners have often retaliated with tariffs of their own on desirable exports, muting the net impact but raising the overall cost levels on both sides. This can exacerbate already-existing geopolitical tensions in the worst case, or perpetuate a trade war, which tends to not benefit either side.

- Unintended consequences. The impacts can end up as a burden to those other than the initial target. Some, like those imposed on luxury goods (e.g., French wine/cheese/handbags several years ago) have been largely symbolic and intended to be high profile cultural 'jabs,' but can inflict real damage on foreign industries reliant on the U.S. as a key consumer, and vice versa. Likewise, Chinese tariffs on imported U.S. agricultural products (e.g., soybeans) created a complicated cost relationship with federal government farm subsidies.
- Minimal revenue gains. Based on some analysis, the revenue raised wouldn't be enough to offset the impact of any additional U.S. income tax cuts/extensions or lower the overall federal deficit. (For perspective's sake, tariffs accounted for only 2% of overall U.S. federal revenue in 2022, so a ramp-up would have to be significant to make a dent into enhancing revenue.)
- Difficult exit plan. While free trade has the ultimate goal of getting to and keeping tariffs at zero, once tariffs start, there is often no graceful or coordinated way to exit the policies, with countries engaged in a type of ongoing 'prisoner's dilemma.'

Market Notes

Period ending 7/19/2024	**1 Week %**	**YTD %**
DJIA	0.73	8.01
S&P 500	-1.95	16.30
NASDAQ	-3.65	18.55
Russell 2000	1.69	8.57
MSCI-EAFE	-2.39	7.45
MSCI-EM	-2.96	8.24
Bloomberg U.S. Aggregate	-0.33	0.49

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
7/12/2024	5.43	4.45	4.10	4.18	4.39
7/19/2024	5.43	4.49	4.16	4.25	4.45

U.S. stocks behaved unusually last week, with a sharp reversal downward in large cap growth segments, offset by better returns from cyclicals, which included value and especially strong relative results from small cap stocks. In fact, the partial recovery of small cap compared to large cap was one of the fastest in recent memory. By sector, energy led with a gain of 2%, followed by financials and consumer staples. On the negative side, technology suffered with a -5% loss (highlighted by Nvidia's near -10% decline), along with communications and consumer discretionary, each down nearly -3%. Real estate fared positively, despite interest rates inching higher.

Stocks began the week strongly on Monday, in the aftermath of the former President Trump assassination attempt and start of the Republican national convention leading to a jump in the polls. For stocks in the near-term, this implies the potential for lower taxes and an easier regulatory environment, which could translate to stronger economic growth. At the same time, the odds of a more intensive tariff policy have also risen, with mixed results for foreign markets. Stocks hit a sharp reversal on Wed. and Thu. with Trump's comments that Taiwan should pay for its own defense, in addition to the Biden administration considering further microchip restrictions on China. Friday's mood remained sour due to a global technology outage, affecting air travel, banks, and media specifically, caused by what was termed a faulty update to Microsoft Windows products from the cybersecurity firm CrowdStrike. Over the weekend, President Biden's choice to end his candidacy for reelection did remove one source of market uncertainty from the past several weeks.

Earnings season continued, but it remains early with only 15% reporting results, per FactSet. Of these, 80% have reported a positive earnings surprise. According to data received so far, with a blend of actual plus estimates, expected EPS growth has risen to 9.7%. These expectations continue to be led by communications, health care, technology, and financials—all of which are in the double-digits.

Foreign stocks lost ground as well, with the U.K. faring a bit better, while Europe and the emerging markets underperformed U.S. stocks. After a single rate cut, the ECB kept the key interest rate unchanged at 3.75%, noting that economic risks were tilted to the downside, but not committing to a path. Emerging markets were down as a whole, especially in China and Taiwan, each down -5%, with the tough trade rhetoric from the U.S. creating a more uncertain economic environment looking ahead. Chinese GDP for Q2 came in below expectations at 4.7% (versus 5.3% in Q1), in addition to decelerating retail sales and a drop in property investment. The Third Plenum, the once-every-5-year meeting to determine social and economic policy, concluded with leaders doubling down on boosting domestic technology and modernization, although details have not yet been released. Much of this appears to be in response to continued U.S. restrictions.

Bonds lost ground for the most part for the week, with investment-grade corporates faring a bit worse than U.S. Treasuries as spreads widened. Senior floating rate bank loans outperformed with slightly positive results, as might be expected. Foreign bonds suffered as well, especially in emerging markets due to a risk-off environment and stronger U.S. dollar.

Commodities generally fell back for the week, along with a stronger dollar, led downward by industrial metals and energy. Crude oil fell -3% last week to under $79/barrel, due to a decline in risk sentiment as well as higher supply estimates, and natural gas prices fell -7%.

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, NAHB, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, Tax Foundation, 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.