

Summary

Economic data for the week included the FOMC cutting interest rates more than many expected, beginning a new policy phase of easing. Retail sales and industrial production rose, exceeding expectations. Housing starts increased, recovering from a hurricane the prior month, while existing home sales declined. The index of leading economic indicators continued its negative path, albeit to a lesser degree than the month before.

Equities gained globally in response to the Fed's rate cut and turn to easing policy. Bonds were mixed, however, with falling short yields offset by longer yields, although emerging market bonds fared well. Commodities gained as crude oil and natural gas inventories fell.

Economic Notes

(0) The September **FOMC** meeting ended with a -0.50% cut in interest rates, which only about one in ten economists (at least those more formally surveyed) were expecting, relative to the more typical quarter-point change. Michelle Bowman was the first actual Fed governor to dissent since 2005, in favor of a smaller cut. (Later in the week, per normal convention, she published an essay to explain her decision as to avoid giving the impression the Fed had prematurely declared victory on inflation as well as “unnecessarily stocking demand,” which would be reasonable to those thinking the cut was too much.) In contrast to many historical periods of larger rate cuts, the tone of Chair Powell's press conference was generally optimistic about the economy, noting decent growth and inflation progress, emphasizing that the U.S. economy was “basically fine,” and even labor being in “solid shape” and unemployment as “very healthy,” but it's the right “time to recalibrate” to a “sense of neutral,” but that “conditions have continued to cool” in the labor market. Half-point rate cuts have historically been associated with sharply deteriorating financial conditions, which the Fed attempted to downplay. One of the more important comments was probably, “We now see the risks to achieving our employment and inflation goals as roughly in balance, and we are attentive to the risks to both sides of our dual mandate.” Overall, it seemed the Fed was intent on not getting ‘behind the curve,’ which led to the larger cut, perhaps with some hindsight regret about not cutting earlier in July as some economists had called for. Accordingly, getting back to that R-star theoretical interest rate (which is perfectly neither tight nor loose) as fast as possible should perhaps be the lens through which this move is viewed.

However, it's possible now, based on rate expectations, that cuts have merely been front-loaded as opposed to getting more severe in magnitude over the next year or so, although a lot can happen over a year. In terms of the dissent, Powell noted there was an “excellent discussion” with all participants indicating multiple interest rate cuts in the SEP this year, pointing to the common ground. The importance of the dual mandate was also noted, in response to a variety of questions about labor. (“The question isn't the level, but rather the change...”) Hypothetically, one might also wonder how this policy might have changed had the Fed not been subject to the unique dual mandate, and only the inflation/financial stability objective like most other central banks, but that is a moot point. Importantly, in response to political meddling in the activities of interest rate-setting and other operations, Powell reaffirmed that the data is clear that countries with independent central banks aren't subject to political whims in either direction, and have lower inflation than those that don't.

(+/-0) **Retail sales** for August rose 0.1%, exceeding expectations calling for a -0.2% decline. Removing autos didn't change the result, while the core/control measure that removes the most volatile components upgraded the growth number to 0.3%. The headline number was pulled down by gasoline station sales down over -1% (with falling gas prices). In other segments, gains in misc. retail (up 2%), non-store/internet retail, health/personal care, and sporting goods offset declines in electronics (-1%), furniture, food/beverage, and clothing. Overall, retail sales are up 2% in the past year, which equates to minimal change when inflation is considered, and 4% for core. Overall, this remains a mixed bag in terms of signs of growth.

(+) **Industrial production** rose 0.8% in August, exceeding the 0.2% rise expected, and reversing the decline of the prior month. With auto plants reopened after summer factory retooling closures, auto assemblies rose 17% for the month. Manufacturing production consequently rose nearly 1% for the month, with the auto impact as well as a

2% rise in high-tech equipment. Mining production also rose nearly a percent, while utilities fell slightly. **Capacity utilization** rose 0.6% to 78.0%. Year-over-year, industrial production was flat overall, with gains of almost 10% in high-tech equipment and a few tenths in auto production being offset by a -1.5% drop in business equipment.

(+) The **Empire Manufacturing Index** rose by 16.2 points for September back into expansionary territory at 11.5, relative to expectations for a less dramatic change to -4.0. Under the hood, new orders and shipments each rose by over 17 points into expansion, while employment improved but stayed in contraction. Prices paid declined slightly, but stayed solidly in expansion. The business conditions index six-months ahead rose by 8 points to an expansionary 31 level. This regional index has been quite volatile, and subject to likely continued seasonality issues after the pandemic, so has to be discounted to some degree as it has been prone to more extreme readings and reversals.

(+) The **Philadelphia Fed manufacturing index** rose by 8.7 points back to an expansionary 1.7 for September, above expectations of a neutral zero level. However, much of the report showed weaker results, including declines in new orders and shipments, back into contraction. On the other hand, employment improved back into expansion, while prices paid also rose back into stronger expansion at a 34 reading. On the positive side also, business conditions six-months out improved by a fraction of a point to a 16 level.

(-) **Existing home sales** fell -2.5% in August to a seasonally-adjusted annualized rate of 3.86 mil. units, relative to the -1.3% expected decline. Single-family sales drove the change, being down -3%, while condos/co-ops were unchanged. The Midwest led with little change in sales, while the other three regions saw declines, led by the South down 4%. Year-over-year, overall sales have fallen nationally by -4%. The median existing home sales price is up 3% over the past 12 months to \$416,700, while inventory has grown by about a month over the past year to 4.2 months' supply, which is still down from what is considered 'normal.' Ever-optimistic, the NAR was quick to note the "powerful combination" of lower mortgage rates with increasing inventory.

(+) **Housing starts** rose 9.6% in August to a seasonally-adjusted annualized rate of 1.356 mil. units, above the 6.5% increase expected, and in a sharp reversal to a decline the prior month. Single-family starts rose 16%, while those for multi-family declined by -4%. Regionally, starts in the South (100k) led, with a likely rebound from the effects of Hurricane Beryl the prior month, along with gains in the Midwest and West as well, while those in the Northeast fell by over -40k. **Building permits** rose 4.9% to 1.475 mil. units, well above the 1.0% gain expected, and led by multi-family up over 9%, with a lesser gain in single-family of 3%. This is welcome news for a housing market starved of inventory.

(+) **Initial jobless claims** for the Sep. 14 ending week fell by -12k to 219k, below the 230k median forecast. Continuing claims for the Sep. 7 week fell by -14k to 1.829 mil., well below the 1.850 mil. expected. Claims were closely tied to the largest states, as usual, with no unusual activity reported. It's possible some residual seasonality is still embedded in this series, but there haven't been signs of labor deterioration of the type that the Fed has been closely attuned to.

(-/0) The Conference Board's **Index of Leading Economic Indicators** for August declined by -0.2%, representing the sixth straight down month, but an improvement on the -0.6% drop for July. The two weakest indicators for the month included the interest rate spread (due to the inverted yield curve, which in their definition is the 10-yr. U.S. Treasury minus Fed funds), ISM new orders (at a one-year low), and consumer expectations for business conditions. These were offset by gains in building permits, credit, jobless claims, and average weekly hours, so not all were in bad shape. During the six-month period ending in August, LEI fell by -2.3%, led by those three negative drivers for the most part, which was also an improvement on the -2.7% drop for the semiannual period from Aug. 2023 to Feb. 2024. Per The Conference Board, the U.S. LEI "remained on a downward trajectory," and "continued to signal headwinds to economic growth ahead." They expect U.S. GDP growth to "lose momentum in the second half of this year as higher prices, elevated interest rates, and mounting debt erode domestic demand." However, there was no mention of recession, with some expected help from Fed rate cuts, and expectations for improvement in 2025.

Market Notes

Period ending 9/20/2024	1 Week %	YTD %
DJIA	1.67	13.21
S&P 500	1.39	20.78
NASDAQ	1.51	20.21
Russell 2000	2.10	11.00
MSCI-EAFE	0.43	10.58
MSCI-EM	2.26	10.37
Bloomberg U.S. Aggregate	-0.22	4.70

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
9/13/2024	4.97	3.57	3.43	3.66	3.98
9/20/2024	4.75	3.55	3.48	3.73	4.07

U.S. stock market response to the Fed's rate cut was mixed on Wed., although Thurs. featured a good deal more positivity, with gains of nearly 2%. By sector, energy, financials, and communications saw the biggest gains, close to 4%, while defensive consumer staples and health care lagged with declines. Real estate also fell back a percent as longer-term interest rates rose and anticipated rate cuts came to fruition, leaving fewer positive expectations.

Foreign stocks saw gains as well, mostly strongly in Japan and emerging markets, with muted results in Europe and the U.K. The Bank of England kept policy rates on hold last week (in an 8-1 vote), as services inflation/wages have continued to rise (in addition to perhaps continued hopes to help the pound regain strength), although the signal for the November meeting was biased toward another cut as economic growth remains a concern. The Bank of Japan also stayed put, noting that upside inflation risks had eased. In emerging markets, Brazil raised rates by a quarter-percent, while Indonesia cut rates. This is indicative of the mixed drivers in emerging markets, although a cutting Fed has tended to be a positive influence on that market segment, due to an easing in financing conditions and often weakening of the U.S. dollar. In EM, Chinese stocks gained nearly 5%, with the Fed effects but also continued lackluster data that point to the rising chances of additional government stimulus. South African stocks gained to a similar degree, with a quarter-point central bank rate cut of their own.

Bonds lost ground for the week. Although short-term U.S. Treasury yields fell along with the Fed's rate cut, notes/bonds 5 years out and longer saw yields rise a bit. High yield saw the best results for the week, followed by floating rate bank loans, with the assumption that easier policy ultimately aids such companies. While developed market bonds fell back, emerging market bonds gained, especially in local currency terms, along with historical tailwinds associated with an easier Fed.

Commodities rose broadly for the week, led by energy, and minor gains in industrial and precious metals. Crude oil rose 5% to \$71/barrel, with help from the Fed rate cut, still-high Middle East geopolitical tensions, and drawdowns of U.S. stockpiles. At the Cushing, OK pricing location, crude oil inventory was noted as approaching 'tank bottom,' which is obviously a bit ominous-sounding. Natural gas prices rose to a similar degree as oil, along with storage building less than expected, mixed extreme weather events around the country, as well as potential hurricanes building in the Gulf (this being the peak of hurricane season).

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