Summary

Economic data included consumer price inflation that ticked a bit higher, but showed a more promising trend of deceleration, while producer price inflation came in flat, and a bit of a surprise. Retail sales and existing home sales both fell, with the former due to a return to normal from an early high-profile discount day.

Equities were positive globally, as some easing in inflation was pared with decent earnings and economic results. Bonds were little-changed for the week domestically, while a stronger dollar held back unhedged foreign bonds. Commodities gained, based on higher energy and agricultural prices.

Economic Notes

(0/+) The **Consumer Price Index** rose an upwardly-rounded 0.1% in July, matching expectations. Core CPI, removing and energy prices, rose as expected also, up 0.2% for the month. The differential was largely due to energy prices being down -1.5% for the month, and -2.9% for energy commodities specifically. As highlighted by the BLS, rising index prices included medical care (0.6%), airline fares (2.2%), communication (0.6%, along with stronger electronics prices generally reporting the highest price gain in 5 years), education (0.5%), recreation, and hotels (the latter of which likely fell back as the World Cup events ended). The falling price side included motor vehicle insurance (-0.3%).

Year-over-year, headline CPI decelerated by about a tenth of a percent to 3.4%, as did core CPI to 2.5%. The impact was mixed, with nondurable goods prices up 5.6% for the year (which included energy, up 15%), while those for durable goods fell by -0.2%. Shelter costs remained robust, gaining 3.2%. he interesting core-core category of “All items less food, shelter, and energy rose a mere 1.9% for the trailing 12 months, still pointing to some light at the end of the tunnel. No doubt, inflation remains a problem for policymakers and consumers, and frustration would be an understatement. Though, the report continued to show (slow) improvement toward lower levels, still hinged on a more sustained resolution in the Middle East. The report was significant in terms of CME Fed funds probabilities, as it moved the needle from two expected rate hikes in the next few months to now just one in December.

(0) The **Producer Price Index** for July was unchanged on a headline level, and rose 0.2% on a core basis, after removing food and energy—each a few tenths lower than expectations. Within the report, energy prices fell by over -3% (a -6% drop for gasoline), while food fell -1%. Some areas seeing a rise, such as portfolio management fees, were tied to other factors, with that example being a byproduct of a rising stock market creating more fee revenue. Year-over-year, headline PPI was up 4.7%, with core PPI up 4.2%. Those included goods prices up over 6%, led by energy, with services up 4%.

(-) **Retail sales** declined by -0.6% in July, in contrast to the 0.1% increase expected. After removing the volatile components of autos (down nearly 2%), building materials, and gasoline (-1%), core sales fell by -0.4%, which reflected revisions downward of -0.2% for each of the prior two months. Most of the core July decline was due to a -2.2% drop in non-store/internet retail, offsetting gains in clothing, health/personal care, and misc. stores. It's been assumed that an early Amazon Prime Day, which occurred in June rather than the usual July, might have been a partial culprit causing the damage in that segment. It's another indicator of the growing influence of online shopping as a percentage of the retail landscape, which had been steadily rising before the pandemic, but certainly accelerated during and since. Retail sales gained 5% over the past year, on both a headline and core level, despite the large impact of gasoline prices, and pointing to real gains after inflation.

(-) **Existing home sales** for July fell by -1.7% to a seasonally-adjusted annualized rate of 4.06 mil. units, beyond the -1.0% decline expected by consensus. However, June sales growth was revised up by a percent to trim the earlier decline a bit. By segment, single family sales fell nearly -2%, while condos/co-ops were little-changed. Regionally, the South and Midwest saw declines of -2% to -3%, while sales in the Northeast rose by 2%. Nationally, sales rose just under 1% for the past year. The median existing home sales price fell -2% in the month to $434,100, but represented a 2% rise over the past 12 months. Months' supply came in at 4.6, remaining below the 'normal' inventory level of around 5. Often optimistic, the NAR noted that sales have been "remarkably stable," despite the higher mortgage rates of the past few months. The lock-in effect from current owners with low-rate mortgages (some paying rates half or more below of today's levels) appears to be an ongoing hurdle to increasing existing sales, with high outright rates a continued challenge to potential owners of new homes.

(-) The preliminary **Univ. of Michigan consumer confidence index** for August fell by -4.2 points (-7.6%) to 51.0, well below the minor decline to 55.0 expected. Within the report, assessments of current conditions fell by -6% while expectations for the future declined by -9%, with Republicans especially unhappy relative to prior months. Year-over-year, the total confidence index saw a decline of -12%, led by the current conditions component. Inflation expectations for the coming year rose a tenth to 4.3%, while the expectations for the next 5-10 years were unchanged at 3.3%. Anecdotal comments in the report noted that business conditions worsened more than personal finances, but it was mentioned that "notably large reductions" in sentiment occurred among those who were older and lower-income, described as "particularly vulnerable" to negative purchasing power effects from inflation.

(0) **Initial jobless claims** for the Aug. 8 ending week rose by 9k to 209k, just above the 202k expected. Continuing claims for the Aug. 1 week fell by -22k to 1.777 mil., below the 1.794 mil. median forecast. These continue to run within a tight range, and don't point to any pickup in more widespread layoff activity.

Question of the Week

Are we any closer to an artificial intelligence (AI) bubble (update to questions from a year ago)?

It's an ongoing debate, and can refer to whether the 'bubble' over excitement around the technology itself or financial market response to it. Keeping to the financial market component, there has certainly been a good deal of exuberance about AI's potential, although the perception of 'winners' has continued to evolve through a progression as investors track outbound capex spending, as well as financing levels and techniques. Other key issues involve whether AI-related revenues justify the current spending, the availability of electricity and water to increasingly-controversial ('not in my backyard') data center projects, and the growing threat of open-source AI models to established paid platforms, in particular, seen through the competition between the U.S. and China.

Following the public release of ChatGPT in late 2022, financial markets have rewarded several of the Magnificent 7 stocks, notably the hyperscalers (including Alphabet, Amazon, Meta, and Microsoft), which were seen as best positioned to take advantage of and monetize AI technology. As they spent increasing sums to upgrade, sentiment drifted to semiconductor and memory companies, being manufacturers of needed hardware components in short supply. Despite long being market darlings due to high and recurring captive revenue, certain software firms were punished as investors evaluated the possibility such strong economic moats could be quickly undone by AI. (Although immediate displacement appears to be unfounded, long-term analysis of impact is ongoing). So, evaluation of AI's impact has evolved to a more granular company-by-company basis.

As the economics of various technological innovations have been difficult to line up in an apples-to-apples way over various generations, using standardized measures such as capital spending as a percentage of total GDP can be instructive. Spending on AI is expected to ramp up to several percentage points of GDP by 2032. For the sake of contrast, by some historical estimates and per Bloomberg data, the largest capex spending booms in U.S. history included railroads (1870-1890) at just over 2%, followed by telecom/fiber (1996-2003) and the interstate highway system (1956-1973) at around 1% each, and lastly by electrification (1905-1925) and the canal system (1836-1841) at roughly a half-percent of GDP.

There is little doubt these innovations produced benefits for the U.S. and global economies, as the capex spending made its way to a wide share of households. On the output side, hopes are that AI will add to total factor productivity, defined as the byproduct of economic growth not determined by capital or labor force inputs. (Labor force growth has been in decline due to several factors including aging demographics, lower fertility rates, baby boomer retirements, immigration policy changes, and labor force participation, all of which could benefit from a positive offset.) However, the timeline is gray, with productivity enhancements expected from the internet not materializing for years beyond initial expectations. This has been referred to by economists as the 'productivity paradox.'

These were also highlighted by instances of exuberance around securities expected to benefit in the near-term, with most problems ultimately stemming from overly demanding price multiples or overuse of financial leverage. The railroad example featured not only rampant speculation on stocks and bonds during the era, but also fraud, which has been a hallmark of historical bubbles at times. However, it should also be looked at in light of that being in a period before the modern securities regulation framework, which didn't come into play until the 1930s. Of course, the telecom boom of the late 1990s ended with the 2001-2002 'dot com crash' still embedded in many investors' memories and is occasionally seen as having gone through a potentially similar parallel path to today's AI build-out, not the least of which being that both are technology-related.

As it often has historically, the bond market could provide useful signals. Credit spreads have tended to widen in response to perceived stress before the same concerns make their way to the stock market, since being paid back and avoiding default has been the primary concern of lenders. The hyperscaler companies have evolved toward more debt financing, which markets have begun to track more closely. After first funding capex using their abundant free cash flow (rather than for internal growth, acquisitions, dividends or share buybacks, eventually upsetting some investors), the firms have begun to raise capital through debt to fund AI-related infrastructure expansion. They are also adding off-balance sheet financing, such as project financing through special purpose vehicles, to which can still create economic obligations, but not counted as debt officially in financial ratios. The good news is that these firms, traditionally being asset-light, didn't start off with much debt, so a runway for expansion is there. As with prior innovations, a key focus will be on ensuring the leverage doesn't become excessive, especially if revenue payback becomes less certain.

Innovation cycles seem to occur every few decades and raise a great deal of excitement (as well as angst in some circles, in particular potential impacts on employment). Financial markets have often participated in optimism as well, with the level of risk control seeming dependent on spending and expectations staying sensible given the potential return. At the same time, so much talk of the term 'bubble' already could encourage more investor caution and reduce the current risk and likelihood of one unfolding. Though, when one hears 'bubbles no longer exist,' that could be a time to become leery.

Market Notes

Period ending 8/14/2026	1 Week %	YTD %
DJIA	-0.53	12.83
S&P 500	0.39	14.54
NASDAQ	0.16	15.40
Russell 2000	1.15	24.47
MSCI-EAFE	0.58	14.76
MSCI-EM	2.66	22.70
Bloomberg U.S. Aggregate	-0.14	-0.24

U.S. Treasury Yields	3 Mo.	2 Yr.	5 Yr.	10 Yr.	30 Yr.
12/31/2025	3.67	3.47	3.73	4.18	4.84
8/7/2026	3.87	4.19	4.35	4.65	5.19
8/14/2026	3.86	4.17	4.36	4.68	5.25

U.S. stocks lagged in the first part of the week before recovering by Friday, as favorable inflation news was taken positively. By sector, energy stocks gained over 7% with another rise in oil prices, followed by utilities, with a variety of sectors rising about a percent for the week. Consumer discretionary stocks and communications were the only laggards, down -2% and -1%, respectively with the former due to weakness in Amazon. Real estate saw a slight gain as well.

Foreign stocks were mixed, with gains in Japan and Europe offset by a decline in the U.K. Japanese tech exports fared positively with a weaker yen, and economic conditions in Europe have continued to plug along slowly, while earnings have fared better, in the double-digits, while U.K. sentiment has been mixed as the new administration is facing still-high inflation and interest rates, fiscal policy constraints, and potential tax hikes to close the gap. Emerging markets fared positively, led again by gains in South Korea especially, which have been tied to AI and technology sentiment more than other countries in the space, and offset declines in Brazil, China, and India.

Bonds were mixed with little change across the U.S. Treasury yield curve, with short-term rates falling slightly along with reduced chances of a near-term Fed hike, coupled with a small rise in long-term rates. Floating rate bank loans and high yield bonds outperformed other groups. International bonds lagged, along with a stronger U.S. dollar.

Commodities gained, due to strength in energy and agriculture (wheat and corn). Crude oil rose over 5% last week to $82/barrel, as Middle East tensions continued at the Strait of Hormuz, with no immediate signs of resolution. The trading range has evolved to a tighter band of roughly $70-90 more recently.

Have a good week.

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Sources: Palouse Capital Management, 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, 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.

Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.

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- What caused the market to move this week?

Market movement is often driven by a combination of economic data, interest rate expectations, corporate earnings, investor sentiment, and geopolitical developments. A single week's movement should usually be viewed in the context of longer-term trends rather than as a stand-alone signal.

- Why do interest rates affect stock and bond prices?

Interest rates influence borrowing costs, consumer spending, corporate profits, and the relative attractiveness of different investments. When rates move meaningfully, both stocks and bonds can reprice as investors reassess risk, income, and future growth expectations.

- How does inflation impact investment portfolios?

Inflation can reduce purchasing power and influence interest rate policy, bond yields, consumer behavior, and company margins. Investors should evaluate inflation in relation to their income needs, time horizon, and overall asset allocation.

- What does economic data mean for investors?

Economic reports can influence expectations for growth, inflation, employment, and interest rates. Investors should consider economic data as one input in a broader planning and investment process rather than a reason to make reactive decisions.