Summary

Last week's news was highlighted by the U.S. Federal Reserve hiking interest rates a bit, for the first time in three years. Other data included positive results for retail sales and jobless claims, flattish industrial production, and declines in housing starts.

Stocks were mixed, but mostly down for the week, with higher yields and energy prices weighing on sentiment. Bonds were also mixed, as several central banks hiked short-term rates. Commodities saw gains in metals, while energy prices were stable.

Economic Notes

(0) The **FOMC** raised policy interest rates for the first time in three years, by a quarter percent to 3.75-4.00%. The primary change in the brief statement was a direct mention of wanting a "timelier return" to their 2% inflation target, which showed firmer policy commitment, and perhaps also reflected frustration by the committee in prices continuing to run hot. Otherwise, the narrative was generally positive, noting strength in overall economic activity, capital investment, productivity, and job gains.

The post-meeting press conference hosted by Fed Chair Warsh noted that current broad financial conditions could be hardly viewed as "restrictive," a notion "widely shared by the committee." The economy was described as "resilient" by members of the FOMC as well, particularly in labor. However, he noted a focus currently on the price stability side of the mandate, and the "plain fact that inflation is too high and has been for too long," with "too many categories" posting increases of over 3%. He was asked about the reasons for the rise in long-term Treasury yields, which he described as being due to three factors (among others): (1) economic strength, (2) competition for capital (including hyperscalers raising funding), and (3) geopolitics (including several 'hotspots') causing rises in commodity spot prices but also derivatives like crack spreads.

Warsh reiterated that a "discipline" should take precedence over analysis of specific changes. Importantly, the "least well-off Americans" (he later defined as those without financial assets and don't own their own home) have the most to gain from stable prices, when asked about a public message. The comments seemed to be a bit more hawkish than expected, especially with the SEP showing 2 total hikes this year, by removing "a dose of accommodation" (implying there are additional doses to come).

(0/-) **Industrial production** was unchanged in August, relative to the 0.3% expected by consensus. Manufacturing production fell by -0.3%, in contrast to a 0.3% gain expected, with larger declines in the segments of furniture, aerospace equipment, and motor vehicles, all of which were down by over -1% each. Utilities production rose by 1.8%, which likely reflects normal seasonal demand from hot summer weather, but also the steady upward force of data center power demands that are growing by the year. Over the past year, total industrial production rose by 1.4%, with utilities up over 6%, with the influences noted earlier. **Capacity utilization** was unchanged at 76.3%, as it appeared a variety of industries are operating below maximum potential, with the possible exception of AI-related areas like electrical.

Interestingly, capacity utilization hasn't been above 80% in almost 20 years, or over 85% since the late 1980s.

(+) **Retail sales** rose by 1.2% in August, exceeding the 0.8% expected, and the decline of the prior month. Core/control retail sales, ex-autos, gasoline, and building materials, boosted the gain to 1.3%. Headline gains were led by gasoline (up 3%), as well as nonstore/online retail (which bounced back after a few months of volatility due to an earlier-than-normal Amazon Prime Day), as well as restaurants/bars, electronics/appliances, and sporting goods. Building materials were the sole laggard, down a few tenths for the month. Year-over-year, total retail sales were up 6%, from both a headline and core level, representing about 2.6% growth on a real, after-inflation level.

(-) **Housing starts** fell by -2.6% in August to a seasonally-adjusted annualized rate of 1.275 mil. units, well below the 6.7% gain expected by consensus, but a slight improvement on the prior month's drop of -9% (albeit upwardly revised by a few percent). By segment, multi-family starts were responsible for the drop, down -22%, while single-family starts rose 8% for the month, a sliver of optimism within the report. Regionally, starts in the West rose by 32%, with declines everywhere else, led by the Northeast, down -45%. Over the past year, national starts were down -1.2%, with single-family up 5.2% and multi-family down -14.6%, as apartment building has pared back in light of higher supplies in the U.S. (these tend to be cyclical and self-correcting). Interestingly, completions fell sharply in Aug. to seven-year lows, which continues to point to volatility in the sector. **Building permits** fell by a similar -2.7% for the month to a seasonally-adjusted annualized rate of 1.394 mil. units, a bit below the -1.5% median forecast declined expected. Permits were up 3.5% for the year, although single-unit permits only gained over a percent.

(-) The **NAHB housing market index** for September declined by -3 points to 32, well in deficit of the 50 level indicative of neutral on this diffusion measure. By segment, while prospective buyer traffic was unchanged at an already-poor 23, current sales fell -4 points to 35, and sales expectations 6 months out fell by -6 points to 37. Regionally, the Midwest led the way, albeit with only a reading of 41. Builders cutting prices during the month rose by a few points to 38%, and the use of sales incentives also rose again. No doubt, higher interest rates and the resulting tighter mortgage environment (rates reaching 7% recently) have kept sentiment challenged, to put it mildly, keeping a difficult business environment for builders intact.

(+) **Initial jobless claims** for the Sep. 12. ending week declined by -10k to 196k, below the slight gain expected to 207k. Continuing claims for the Sep. 5 week fell by a more dramatic -39k to 1.730 mil., below the 1.779 mil. expected. Claims increased in OH and KY, and declined in MI and by lesser amounts in a variety of other large states. While continuing claims were the lowest since early 2024, some of the initial claim declines could be seasonally-related due to the later Labor Day holiday. These continue to show contained layoff levels, pointing to a benign labor market.

(-) The Conference Board **Index of Leading Economic Indicators** declined by -0.1% in August, more than offsetting the 0.2% rise of the prior month. On the other hand, the coincident economic index rose by 0.1% and lagging indicator rose by 0.2% for the month. The six-month period ending in Aug. declined by -

0.1% as well, although that was an improvement on the -0.6% drop for the prior six months ended Feb. 2026. However, the diffusion index remained positive, pointing to a continued signal of no recession. The monthly data (and six-month as well) included gains in all financial components of stock prices, credit, and positive interest rate spread (10y minus Fed funds), as well as ISM new orders; however, these were offset negatively by a substantial drop in consumer sentiment, and to building permits to a lesser degree. The Conference Board forecasts GDP to rise at 1.9% this year, and 1.8% in 2027 (revised down a tenth).

Poor **sentiment** has remained an anomaly over the past few years, certainly in the U.S., but also globally to perhaps a lesser extent. Some recent work by Goldman Sachs has attempted to put it into context, with some recent blame cast on the obvious consumer stressors of persistent high inflation and an environment of policial divisiveness, but also a general nondescript 'gloom' about the world that began around the time of the pandemic, without specific causes identified. As economic activity has continued regardless, it's possible consumer sentiment may have become a weaker near-term signal than it has been historically.

Question of the Week

How should interest rate hiking cycles be viewed?

Interest rate change cycles can raise angst or excitement among market participants, based on which direction yields are assumed to be moving.

Monetary policy changes are a blunt instrument, akin to the hammer in the Fed's toolbox, and really the most important one they possess. Though, rate hikes or cuts aren't capable of solving every problem. For instance, the Fed can't necessarily control government fiscal spending policy decisions, or single-handedly solve problems of socio-economic inequity, climate change, or other mandates that have been floated for them to get involved in.

In short, hiking interest rates is a monetary tightening mechanism. The objective is to slow lending through higher, less appealing rate levels, ultimately decreasing leverage, and in turn slowing business and consumer economic activity. For instance, if a capital project is expected to return a particular gross IRR, borrowing at a higher rate reduces the profitability spread. There are also related impacts on shrinking the present value of future cash flows, which can lower equity valuations.

In the first use case, when done gradually and methodically, hikes have been seen as appropriate for a fast-running economy at risk of overheating, in an attempt to put on the brakes, so to speak, and slow down the train to a more sustainable pace. A variety of economists agree that the U.S. economy today is running smoothly enough at a near-trend pace (around 2%) to absorb a few rate hikes without incident, especially considering the stresses of tariffs/trade frictions and the Iran war/energy prices.

The second use case involves inflation, less directly. Hiking rates for that reason can accomplish the same slowing of economic activity, through the specific channels of lowering demand, which has been one of the few ways to bring down goods and services prices (on the classic economic chart, if supply remains the same but demand falls, prices should fall). Unfortunately, addressing inflation directly has always been difficult, other than responding forcefully (risking other side effects) or just waiting for the effects of prior shocks to wear off and ‘pass through’ (which can take more time than patience). The Fed has mentioned the latter many times through the pandemic and since in response to last year’s tariffs and this year’s Middle East conflict, resulting in frustration by policymakers and markets. A drawback in waiting is obviously the potential length of time required (now six years), and concurrent risk of inflation expectations becoming more deeply embedded into other parts of the economy. These can be most significant in areas like worker wages, which can be harder to slow down once they start.

This also gets into the definition of how long is ‘too long,’ as prior Fed discussions around inflation targeting have mentioned a potentially acceptable cycle of, for example, a cycle of below-target inflation (e.g., 2010-19), followed by a cycle of above-average inflation, which all ‘nets out’ to around 2%. While that makes sense in theory (if the divergences aren’t too extreme), there were doubters.

Responding by forceful rate hike action, of course, runs the risk of applying the brakes too hard, and causing a recession. Fed Chair Volcker did this in the late 1970s-early 1980s intentionally as a last-ditch effort to get inflation under control by slowing everything down. It did work and serves as a rough central bank template for such extreme situations. However, it also helped generate back-to-back recessions and was likely related to a change in political leadership in the U.S., so policymakers might be reluctant to repeat it.

While bringing on a recession is no Fed Chair’s ideal case, the FOMC has made it clear in the past that a mild, short recession, if necessary, could be preferable to having inflation run too hot for a decade. Inflation remains a moving target, so time will tell how quickly or slowly Fed actions, a Middle East de-escalation, or simply the passage of time, serve to normalize conditions. Perhaps all could be helpful.

Market Notes

Period ending 9/18/2026	**1 Week %**	**YTD %**
DJIA	-1.65	8.82
S&P 500	-0.06	12.71
NASDAQ	0.73	14.61
Russell 2000	-1.47	16.22
MSCI-EAFE	-1.58	10.73
MSCI-EM	-0.56	23.62
Bloomberg U.S. Aggregate	-0.03	-1.46

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
9/11/2026	4.07	4.63	4.78	4.96	5.35
9/18/2026	4.14	4.76	4.86	5.01	5.34

U.S. stocks experienced a mixed week and began down on Monday as the prior week's gloomy predictions about AI's future continued to rattle general sentiment and some stocks in the sector. To some degree, this surrounded the calls for a curtailment, or at least a slowdown, in advancement of the technology, which would obviously impact the current buildout of infrastructure and advanced chip production. By Thu., stocks had celebrated the Fed rate hike, in terms of commitment to fighting inflation. Small cap stocks reacted worst to the Fed hike, as they're notoriously more sensitive to higher rates than large caps, as they carry more short-term and floating debt.

By sector, health care (medical equipment more than pharma), technology, and communications were the sole gainers for the week, while utilities and financials lagged by the largest amounts, down several percent each (Bank of America fell back after expectations of flat trading revenue for the quarter). Real estate also fell back by -2% as interest rates rose.

Foreign stocks performed positively in local currency terms, but fell back after adjusting from a headwind from a stronger U.S. dollar, which was up about a percent for the week, along with the rate hike. Europe fared slightly worse than other groups, largely due to declines in France and Italy. In addition to the U.S. rate hike, the Bank of Japan raised rates by 0.25% to 1.25% (the highest level since 1995), while the Bank of England held steady at 3.75%, but pointed to potential future hikes due to high energy prices. Inflation concerns overseas remain high, due to the closer connection to Middle East oil shipments. In EM, Taiwan and China showed the sole positive results, while most other nations fell back, including Türkiye, which suffered from redemptions involving a few scandal-plagued investment funds.

Bond indexes were little-changed last week, as shorter- and intermediate-duration bonds lost ground as yields rose, while long-term bonds actually gained with a leveling off in yields. The Fed raising rates was an obvious catalyst, but the move and dot plot solidified market expectations for the coming few months, settling things down. Unhedged foreign bonds lost ground, as the value of the dollar rose. Long-term rates continue as a market concern, as the 10yr and 30yr hover around to above yields of 5%+. However, as recent Capital Group/Robert Shiller data reminds us, long-term rates have been in the 3-6% range for 62% of all monthly observations from 1870-2025, so the recent return to long-term 'normal' continues to be something investors still aren't used to, following years of ultra-low rates and minimal expectations for fixed income.

Commodities were mixed, with minor gains in industrial and precious metals, offset by small declines in energy and agriculture. Crude oil bounced around last week but ended up down less than a percent to $99/barrel, with few major escalations in the Middle East to speak of and Saudi pipeline damage revealed to be less than first feared.

Have a good week.

Ryan M. Long, CFA

Sources: Advisory Solutions Group, LLC, 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, NAHB, 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.

- **Why do bond yields matter to investors?**

  Bond yields can affect income expectations, borrowing costs, and how investors compare the value of stocks, bonds, and cash. Changes in yields may also influence the price of existing bonds and broader market sentiment.

- **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.

- **Why does the Federal Reserve matter to the markets?**

  The Federal Reserve influences short-term interest rates and monetary policy. Markets often respond to Fed commentary because it can affect borrowing costs, inflation expectations, and investor assumptions about future economic growth.

- **Should investors react to short-term market news?**

  Short-term news can be important, but it should not automatically drive major portfolio decisions. Investors are generally better served by reviewing market developments within the context of their goals, risk tolerance, liquidity needs, and time horizon.

- **How can investors stay disciplined during market volatility?**

  A written investment plan can help investors avoid making emotional decisions during volatile periods. Discipline often comes from understanding why a portfolio is positioned the way it is and how it supports long-term objectives.