OBSERVATIONS: *Stocks lower, interest rates higher, oil jumps, and US services economy continue to expand.*

- Markets were weak during the shortened holiday week; the S&P 500 dropped -1.3%, while small cap stocks (Russell 2000 Index) took the brunt of the selling, declining -3.6%. The 10-Year US Treasury yield rose +10bps to retest multi-year highs of 4.3%.[1]
- Oil (WTI) reached $87/bbl (per barrel) last week, the highest level since mid-November 2022 as Russia and Saudi Arabia extended production cuts for three months. With the extension, UBS estimates a 1.5 million barrel per day market deficit for Q4-2023.[2]
- The services economy continued to expand last month with the ISM Services PMI registering 54.5 in August, higher than expectations of 52.5 and higher than July's 52.7 reading. The improvement in the data was in part driven by more robust employment and new orders data. Notably, the prices paid component rose to a 3-month high of 58.9 and was higher than expected (56.8).[1]
- Global PMIs, however, were weaker than expected and are now hovering just above 50—any reading below 50 indicates a contraction of economic activity—with the global composite PMI, a global GDP weighted mix of both services and manufacturing, registering only in 50.2 in August.[1]
- Jobless claims fell 13k to 216k in the most recent week, the lowest level since February 2023 and still below the level (280K) that would signal a meaningful slowing in the labor market.[1]
- The non-farm productivity estimate came in better than expected at 3.5% in Q2-2023. The Q2 productivity report also showed that hours worked in Q2 declined from Q1, which was the first quarter-on-quarter decline in hours-worked since the beginning of the Covid pandemic in early 2020.[1]

EXPECTATIONS: *Fed speakers hawkish, less companies talking about recession, and dollar strength.*

- Several Fed Governors signaled in speeches last week that the Fed was highly likely to hold rates at the present level at their next meeting on 20-September, but most left open the possibility for another rate hike in the final months of 2023.[1]
- FactSet research notes that the term "recession" was cited by only 62 companies (12% of S&P 500) during Q2 earnings calls—roughly in line with the 10-year average. The term has declined for four consecutive quarters after peaking at 238 companies (48% of S&P 500) in Q2 2022. Unsurprisingly, the largest share of "recession" citations came from the financial sector where 22 companies (33% of financials) noted the term.[3]
- The European Central Bank (ECB) meets this week with most anticipating the central bank to raise its main policy rate by 25bps in what is expected to be the last rate hike before turning increasingly data dependent. Since the last ECB meeting, economic data has weakened (see One More Thought), but inflation pressures have persisted, adding to the conundrum for the bank's current policy stance.[1]
- The US dollar gained for an eighth-straight week—which is the longest streak of weekly gains since 2005—as traders digested the notion that the US's economic outlook is better on a relative basis than that of Europe, Japan, or China over the remainder of 2023 and into 2024.[1]

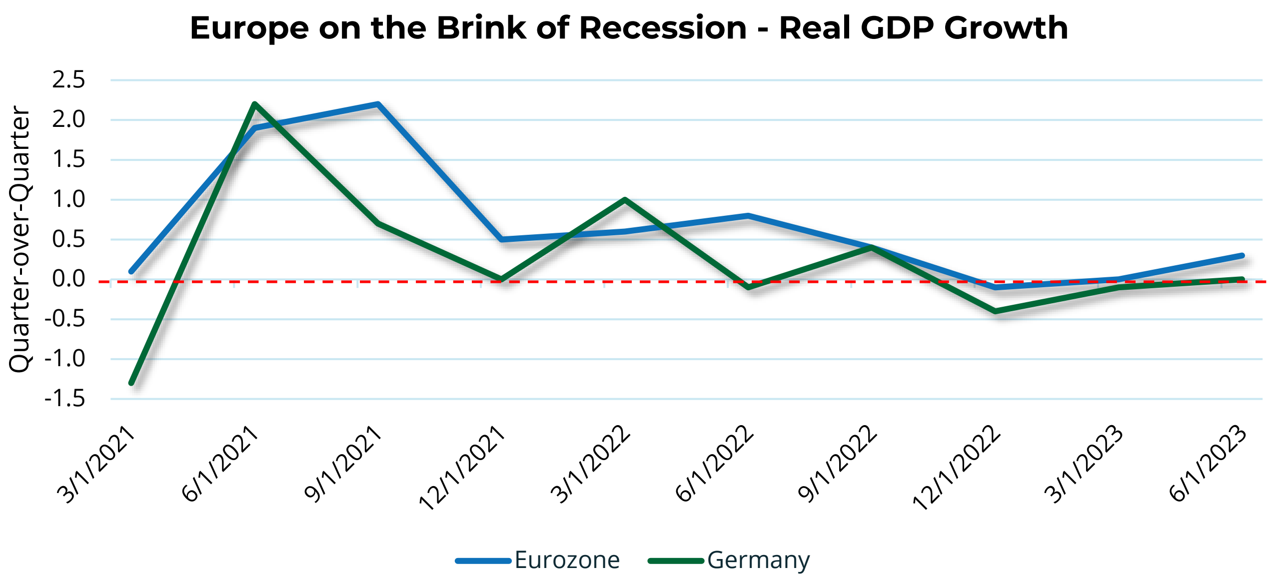
ONE MORE THOUGHT: *Europe is teetering on the edge of a recession, Germany is being impacted by a slowing China.*[4]

A slew of worse than expected economic data over the summer has signaled that economic growth in Europe has slowed materially and that Eurozone—a collection of primarily West European countries that utilize the Euro

[1] *Bloomberg LP*
[2] *https://www.reuters.com/markets/commodities/oil-prices-mixed-receding-support-chinas-steps-revive-economy-2023-09-05/*
[3] *Factset Earnings Insights, 9/5/2023*
[4] *ECB June Economic Outlook; Goldman Sachs "European Views: One for the Road" 8/31/2023*

currency including France and Germany—is edging closer to a recession. The most recent Purchasing Manager Surveys (PMIs) showed contracting economic activity for both manufacturing (43.5) and services (47.9) in August. Data from Q2 shows that real GDP growth has all but stalled (see Chart of the Week) and the German economy, which is more sensitive to global trade and demand from China than some of its neighbors, has already seen real economic growth slightly decline for two-consecutive quarters. In the midst of this slowdown, the European Central Bank is contemplating further interest rate hikes later this year in order to combat inflation. Additional headwinds to the European economy stem from tighter lending conditions as banks reduce lending in the face of the ECB's tighter monetary policy and many of the energy-oriented subsidies designed to get Europeans through last winter—amid the spike in energy prices caused by Russia's invasion of Ukraine—are phased out. The net result of these policies has been a reduction in business investment in the face of weaker global demand, higher interest rates, and uncertain energy prices this winter. The European consumer, likewise, has also begun to pull back spending and consumer confidence measures remain depressed. Last year at this time, many market watchers were wondering if the spike in energy prices in mid-2022 would spur a recession towards the end of the year (2022), but a mild winter and generous government subsidies helped the European economy grind out modest growth in 2022. However, this year fiscal support is likely to be much more limited and should Europe experience a colder than normal winter, the much anticipated but never realized recession of 2022-2023 could occur in the final months of this year.

CHART OF THE WEEK



Source: Clearstead, Eurostat, Bloomberg 9/8/2023

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