

OBSERVATIONS

- Markets traded higher last week as investors became more certain the Fed was on pace to begin cutting rates in the Fall. The S&P 500 gained +0.9% and US small caps (Russell 2000) gained +6.0%, marking the largest weekly outperformance over the S&P 500 since March 2020. The yield on the 10-year Treasury fell -10 basis points (bps) to end the week at 4.18%.¹
- Small business optimism marginally improved in June moving up to 91.5 from May's 90.5 reading—but still well below the 50-year average of 98—as inflation continues to be the top concern of small businesses.¹
- Headline and core inflation eased further in June. The topline CPI fell -0.1% month-over-month (MoM), while core-CPI, which excludes food and energy, rose +0.1% MoM. Compared to last year, the CPI was up +3.0% year-over-year (YoY) and core-CPI was up +3.3% YoY both lower than the YoY figures from May.¹
- In contrast, the Producer Price Index came in higher than expected in May at +0.2% and April's figure was revised higher. On an annual basis, PPI is up +2.6% YoY in May versus +2.4% YoY in April and core-PPI increased to +3.0% YoY up from April's core-PPI figure of +2.6% YoY.¹
- Initial unemployment claims fell -17k last week from the prior week to 222k new claims, which suggests that the labor market remains stable and little evidence of a rapid rise in unemployment.¹
- The Univ. of Michigan consumer sentiment indicator fell to 66—the lowest level in nine months—as inflation and uncertainty over the trajectory of the economy continues to weigh on consumer sentiment.¹

EXPECTATIONS

- Fed Chairman Powell testified before Congress last week and generally reassured markets the Fed was making slow, but steady, progress towards getting inflation to move sustainably towards its 2% target. After the testimony, Fed Funds Futures adjusted to the market's evolving expectations for rate cuts this year. Prior to the testimony, markets had priced in a 78% chance of a 25-bps rate cut in September, which moved up to 98% after Powell's testimony; markets also anticipate a second cut in December.¹
- The Fed's Beige Book—a qualitative assessment of regional economic activity—showed that national economic activity continued to expand from early April to mid-May as most districts reported slight or modest growth and two noted no change in economic activity.²
- Q2 earnings season kicked off last Friday with several of the largest banks reporting. Overall, bank earnings were neutral to positive—Wells Fargo saw earnings fall by -1%; Citi grew its earnings by +10% on only a +4% increase in revenue; JP Morgan beat on earnings but largely due to one-off items.¹

ONE MORE THOUGHT: Sahm Rule Almost Triggered Amid Signs of a Cooling Economy¹

There is growing evidence that the US economy is slowing. In recent weeks we have seen a number of indicators showing signs of moderating economic activity. These measures include sub-50 readings from both the services and manufacturing PMIs in June, softer retail sales in May, downward revisions to Q1-GDP estimates, and recent declines in consumer sentiment that all suggest the US economy is cooling. Potentially adding to these signs of a moderating economy is the Sahm Rule. The Sahm Rule was created by former Fed economist, Claudia Sahm, as a useful signal to indicate that the US was in a recession. The Sahm Rule signals a recession when the three-month moving average of the national unemployment rate (so called "U3-measure") rises by 0.5 percentage points (pp) or more relative to its previous 12 month low—after smoothing the data using a 3-month moving average. This signal

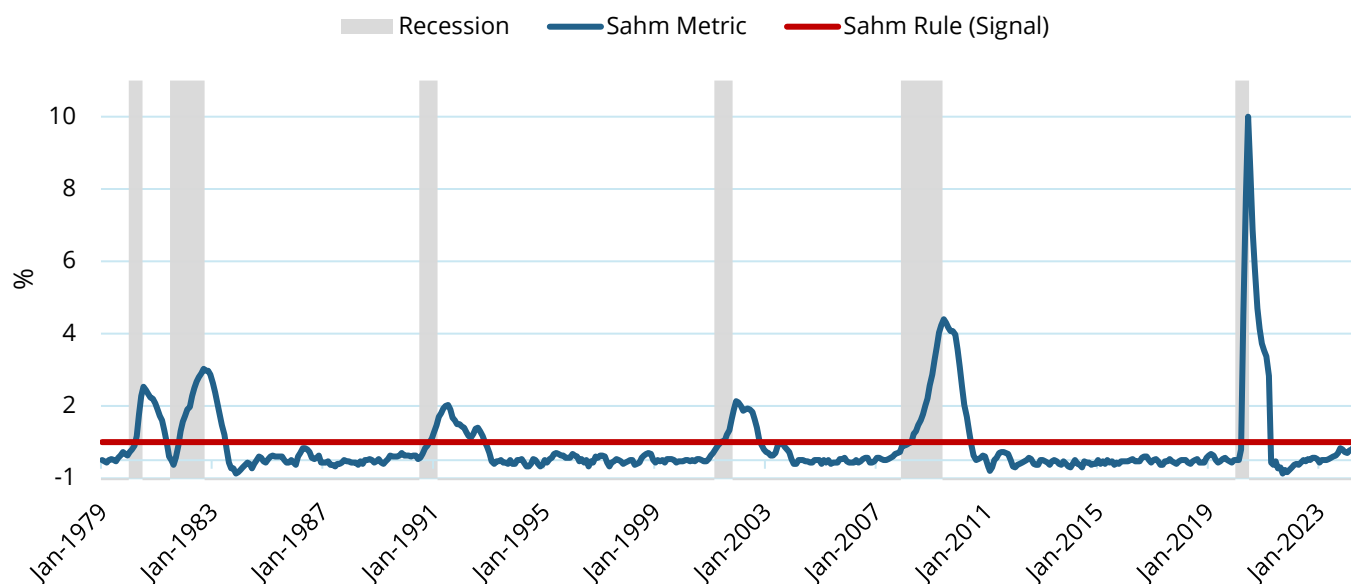
¹ Bloomberg LP, 7/12/2024

² <https://www.federalreserve.gov/monetarypolicy/beigebook202405-summary.htm>

is not a leading indicator, but a coincident indicator of a recession and typically does not rise above the 0.5 percentage-point threshold unless the US is in a recession—note that the National Bureau of Economic Research does not usually officially announce a recession until months after a typical recession has begun. Contrary to what has been in some of the financial press, the Sahm Rule has not yet been triggered, but it is very close to the recessionary threshold—See Chart of the Week. By our calculations if the unemployment rate rose to 4.2% for this month (July)—the July data won't be released until 2-August—then the Sahm Rule would be triggered. However, if the unemployment rate stays the same in July at 4.1% then the Sahm Rule will not signal a recession—but just by a hair's breadth. The fact that the Sahm Rule is close to being triggered suggests the labor market is not nearly as tight as it was a year ago and Fed Chairman Powell recently told Congress that the labor market was in better balance and that it was no longer a “source of broad inflationary pressures for the economy.” Overall Clearstead's view is that the US economy is in a soft patch—a few quarters of sub-trend growth between 1% to 2%—but that the risk that the US economy slips into recession is low. Just like the Fed, our outlook is data dependent and if the Sahm Rule is triggered, we may be forced to re-assess this outlook.

CHART OF THE WEEK

Sahm Rule & Recessions



Source: Clearstead, BLS, St. Louis Fed 7/12/2024

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