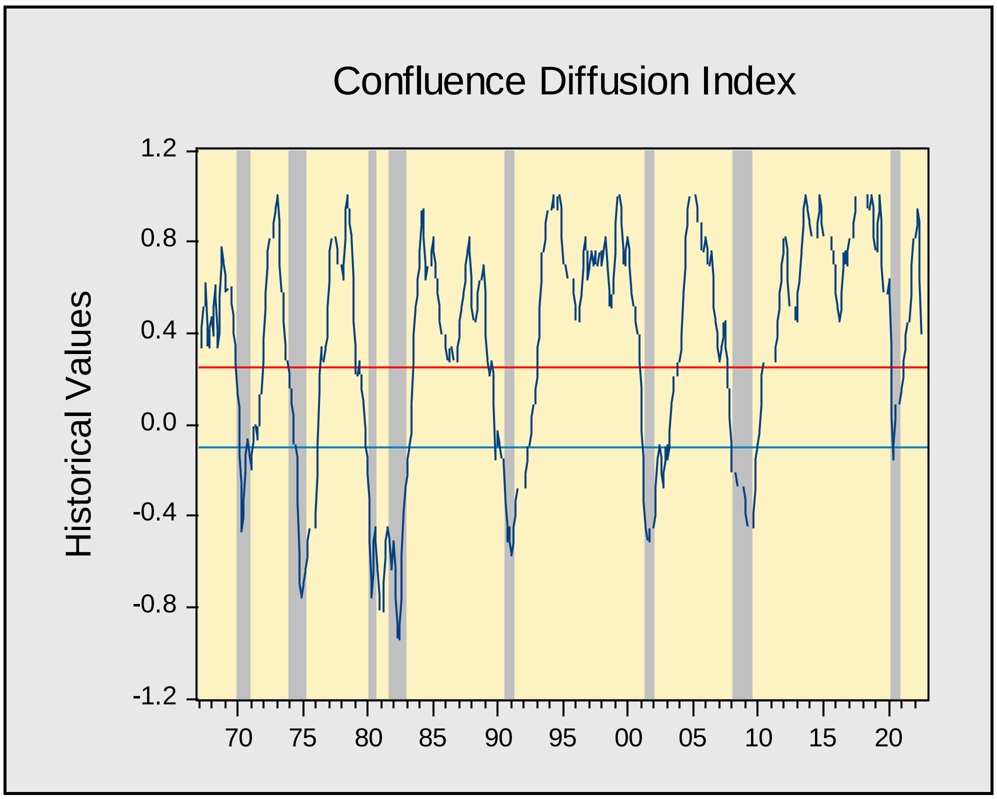
Business Cycle Report

By Thomas Wash

The business cycle has a major impact on financial markets; recessions usually accompany bear markets in equities. The intention of this report is to keep our readers apprised of the potential for recession, updated on a monthly basis. Although it isn't the final word on our views about recession, it is part of our process in signaling the potential for a downturn.

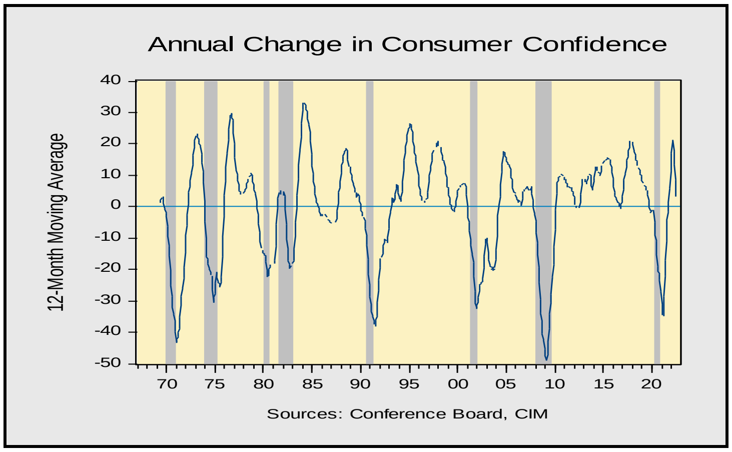
The Confluence Diffusion Index declined for the third consecutive month. The latest report showed that seven out of 11 benchmarks are in expansion territory. The diffusion index declined from +0.6364 to +0.3939 but remains above the recession signal of +0.2500.

- Poor economic data weighed on financial market indicators
- Goods production slowed due to a labor shortage and a decrease in business sentiment.
- Labor conditions remain strong but show signs of softening.



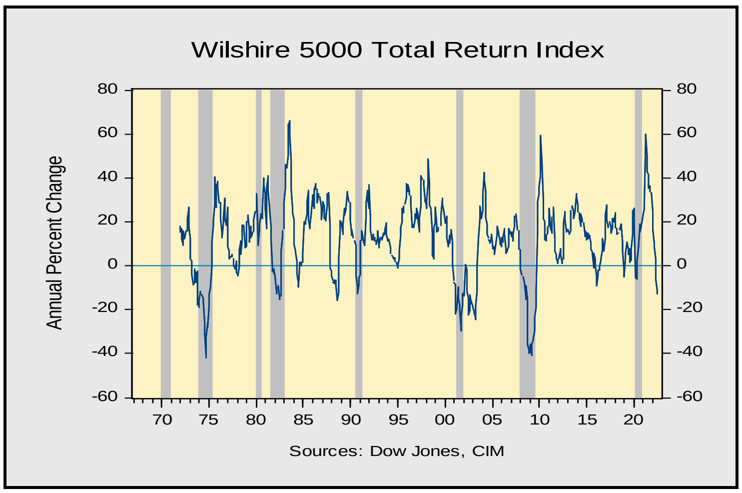
The chart above shows the Confluence Diffusion Index. It uses a three-month moving average of 11 leading indicators to track the state of the business cycle. The red line signals when the business cycle is headed toward a contraction, while the blue line signals when the business cycle is in recovery. The diffusion index currently provides about six months of lead time for a contraction and five months of lead time for recovery. Continue reading for an in-depth understanding of how the indicators are performing. At the end of the report, the *Glossary of Charts* describes each chart and its measures. In addition, a chart title listed in red indicates that the index is signaling recession.

Consumer Confidence



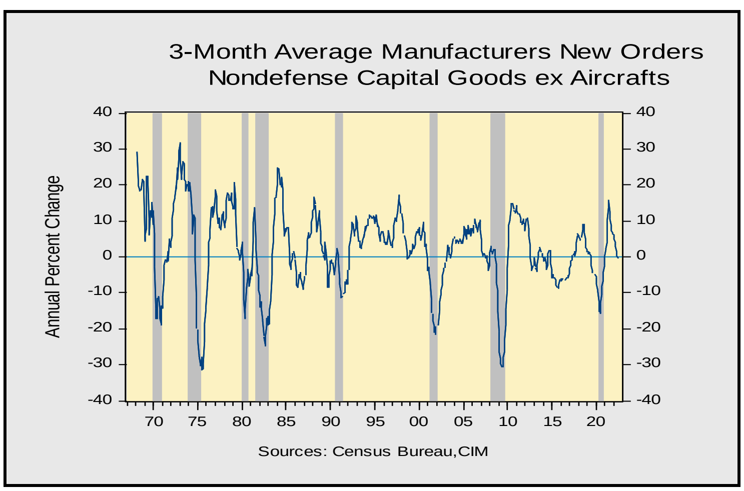
- The 12-month moving average of the annual change in consumer confidence slowed from 8.25 to 3.02.
  - Consumer confidence fell from 98.4 to 95.7.
  - The Present Situation Index dipped from 147.2 to 141.3.
  - Consumer expectations slipped from 65.8 to 65.3.

Wilshire 5000 Index



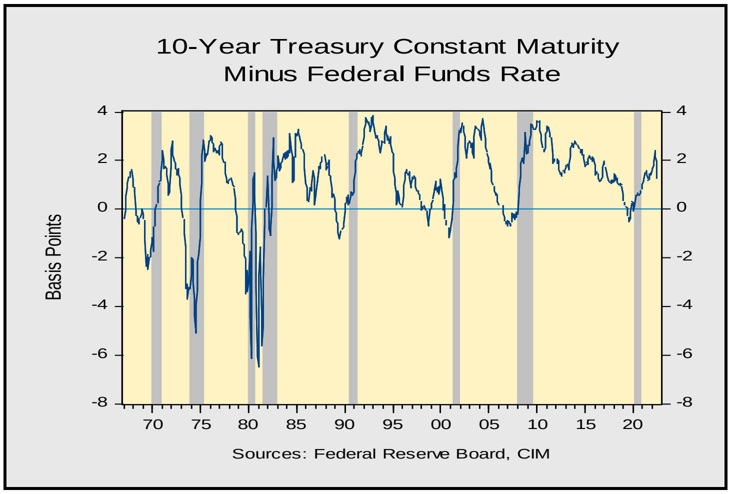
- The Wilshire 5000 Total Return Index fell 13.1% from the prior year.
  - Top-performing sectors: Consumer Discretionary, Technology, and Energy.
  - Bottom-performing sectors: Consumer Staples, Healthcare, and Communication Services.

Three-Month Average Manufacturers' New Orders
Nondefense Capital Goods excluding Aircraft



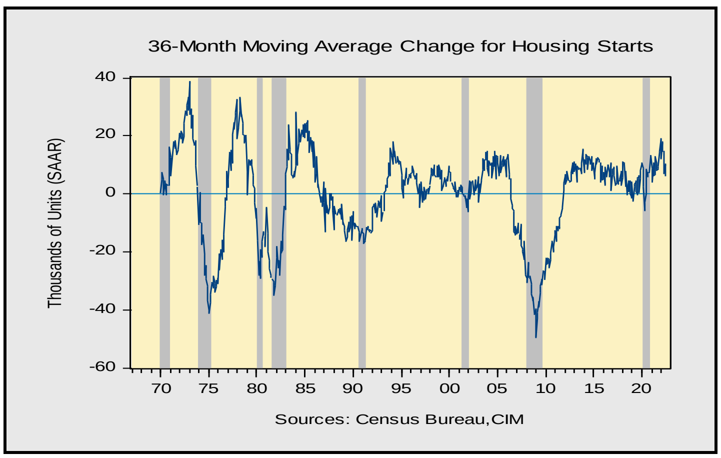
- The three-month moving average of the annual change in new orders for nondefense capital goods fell 0.21% from the prior month.
  - In July, new orders rose 0.1% from the prior month but declined 0.9% from the prior year.

10-Year Treasury Constant Maturity
Minus Federal Funds Rate



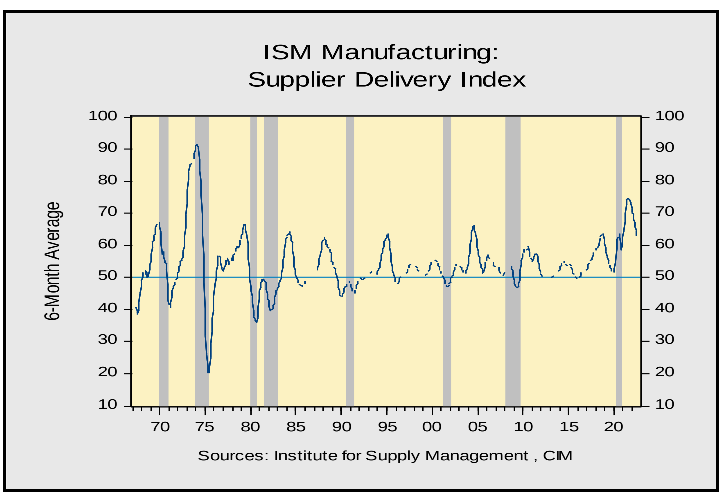
- The financial spread, the 10-year minus effective fed funds, narrowed from 1.93% to 1.22%.
  - The effective fed funds rate rose from 1.21% to 1.68%.
  - The 10-year Treasury fell 24 bps from 3.14% to 2.90%.

36-Month Moving Average Change for Housing Starts



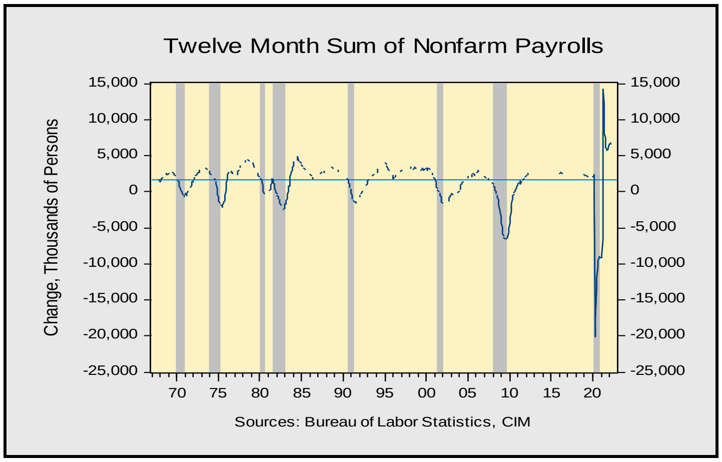
- The 36-month moving average change for housing starts rose from 10.11 to 5.94.
  - Housing starts expanded at an annualized rate of 1,446k, slightly slower than the previous month's revised pace of 1,599k.
  - Single-family starts fell from 1,019k to 916k.
  - Multi-family dwellings fell from 580k to 530k.

ISM Manufacturing: Supplier Delivery Index



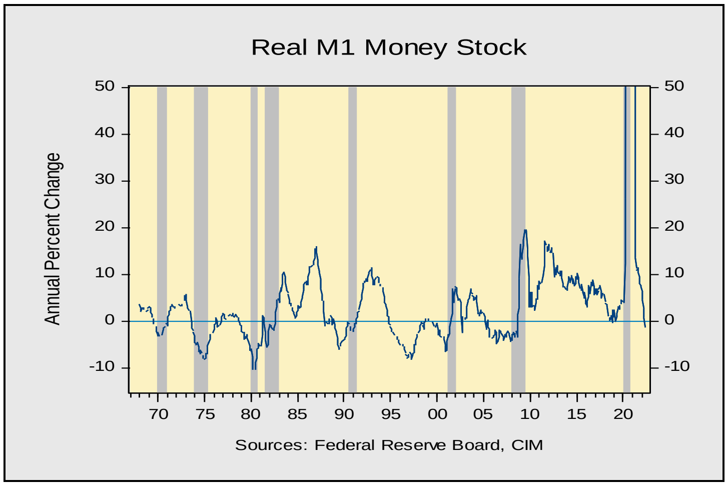
- The six-month moving average of the Supplier Delivery Index slowed from 64.38 to 62.81.
  - The overall index increased from 55.4 to 56.1.
  - The overall Supplier Delivery Index slowed from 65.7 to 57.3.

Twelve Month Sum of Nonfarm Payrolls



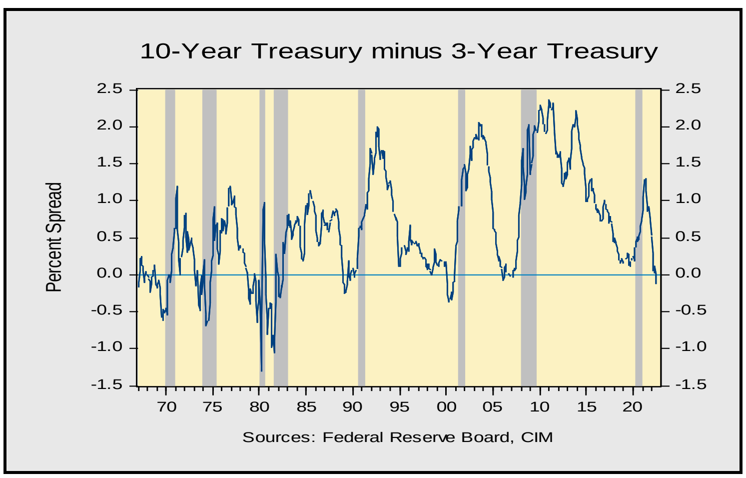
- The 12-month moving sum declined from 6,310 to 6,149.
  - Nonfarm payrolls showed that the economy added 471k jobs in July.
  - Service-providing industries added 402k jobs.
  - The Goods-Producing sector added 69k jobs while the Government sector added 57k jobs.

Real M1 Money Stock



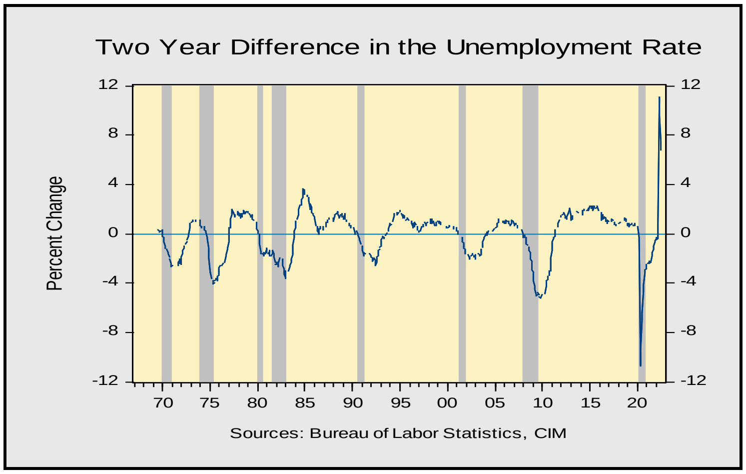
- Real M1 money stock fell 3.3% from the prior year.
  - Headline CPI rose 8.5% from the prior year.
  - M1 money stock rose 5.2% from the prior year.

10-Year Treasury Minus Three-Year Treasury



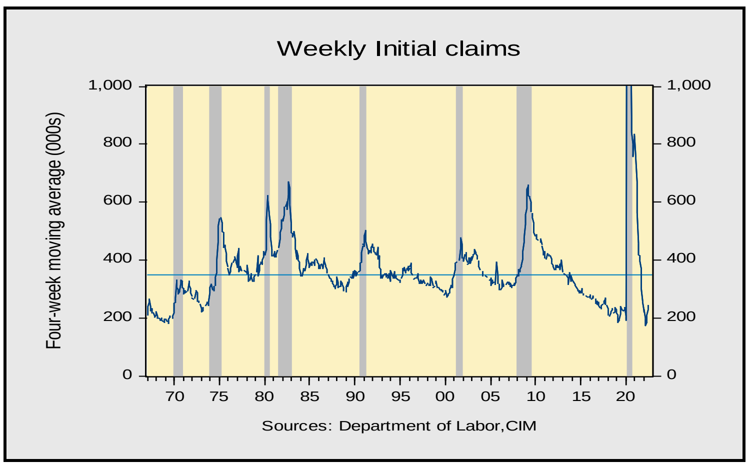
- The term spread between the 10-year and three-year spread narrowed from -0.01 to -0.13.
  - 10-year Treasury fell from 3.13% to 2.90%.
  - 3-year Treasury fell from 3.15% to 3.03%.

Two-Year Difference in the Unemployment Rate



- The two-year difference of the unemployment rate declined from 7.4% to 6.7%.
  - The unemployment rate dipped from 3.6% to 3.5%.
  - Labor force decreased by 0.04% from the prior month.
  - The number of displaced workers decreased by 4.09% from the prior month.

Weekly Initial Claims



- Average weekly claims for July rose from 233k to 247k.
  - The recession indicator is 350k.

Thomas Wash
August 25, 2022

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Glossary of Charts

Consumer Confidence: The Consumer Confidence Index is an economic indicator that measures the level of consumer optimism about the overall state of the economy and consumers' personal financial situations. This chart shows the 12-month moving average of the annual change of the index.

Wilshire 5000 Index: This chart shows the annual change in the Wilshire 5000 Total Return Index, which is the broadest U.S. equity index. The index contains 3,500 stocks and is designed to track the overall performance of the U.S. stock market. It is an important indicator because steep equity pullbacks have often coincided with economic contractions.

Three-Month Average Manufacturers New Orders Nondefense Capital Goods excluding Aircrafts: This chart shows the annual change in the value of core capital goods orders. This indicator gives insight into the amount of business investment spending. A positive report suggests that manufacturers are optimistic about future demand.

10-Year Treasury Constant Maturity Minus Federal Funds Rate: This chart shows the spread between the 10-year maturity and the Fed funds rate. It reflects market sentiment of the future state of the economy. Generally speaking, a negative spread suggests a contraction is likely to occur within 24 months.

36-Month Moving Average Change for Housing Starts: This chart shows the 36-month moving average of the annual change in housing starts. This is an important indicator because it provides a gauge of future construction activity. If housing starts are strong it implies that builders are optimistic about future demand.

ISM Manufacturing (Six-Month Average): The ISM Manufacturing Index is a report that monitors employment, production, inventories, new orders, and supplier deliveries. This index specifically focuses on the six-month moving average of supplier deliveries section in ISM, which we believe is a good gauge of future levels of manufacturing activity. A reading above 50 signals that manufacturing activity is expected to expand, while a reading below 50 signals that manufacturing activity is expected to contract.

Total Nonfarm Payrolls: This chart shows the 12-month moving sum of total nonfarm payrolls. This report represents the total number of workers added to the workforce, excluding proprietors, private household employees, unpaid volunteers, farm employees and incorporated self-employed. It is a significant indicator of the strength of the labor market. A moving sum that exceeds 1,600 suggests the demand for labor is strong.

Real M1 Money Stock: The Real M1 Money Stock report measures the annual change in the money supply minus inflation. M1 is the measure of currency in circulation and represents the amount of money being held for transaction purposes, therefore it can act as a proxy for economic activity.

10-Year Treasury Minus Three-Year Treasury: This chart shows the spread between the 10-year and three-year Treasury and gauges investor sentiment. A widening spread suggests investors are optimistic about the state of the economy, whereas a negative spread suggests pessimism. This indicator is less sensitive than the financial spread as it is less affected by the Fed's decisions.

Two-Year Difference in the Unemployment Rate: The two-year difference in the unemployment rate measures the amount of slack in the labor market. When the difference of the two-year unemployment rate falls below zero, it indicates the labor market is becoming less tight.

Weekly Initial Claims: This chart shows the four-week moving average of initial jobless claims. A rising initial claims number means the demand for labor is weakening, likely due to a worsening business environment. If the four-week moving average rises above 350K, it signals the economy may be headed toward a contraction.