Business Cycle Report

By Thomas Wash

The business cycle has a major impact on financial markets; equity bear markets usually accompany recessions. The intention of this report is to keep our readers apprised of the potential for a 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.

August 27, 2026

The US economy expanded further in July, continuing its trend of resilience. Reflecting this momentum, our proprietary Confluence Diffusion Index remained in expansionary territory for the 18th consecutive month. Heavy investment and robust consumer spending fueled overall economic strength. However, elevated inflation and high interest rates persist as key headwinds that continue to drag on sensitive sectors.

Financial Markets

Financial conditions tightened in July, driven by escalating geopolitical risks and mounting uncertainty over future monetary policy. Last month, fears that the Federal Reserve might not raise rates to combat persistent inflation pressures pushed long-term yields higher. This led to a steeper yield curve as investors sought to reduce duration risk. Nevertheless, ample market liquidity continues to buffer against a broader financial downturn.

Goods Production & Sentiment

Overall production was mixed in June. While manufacturing has been resilient, construction activity and consumer sentiment remains subdued. Supplier delivery times lengthened last month, driven by a surge in orders tied to World Cup festivities and the nation's semiquincentennial (250th Fourth of July) celebrations. However, weak consumer sentiment persists as households grapple with affordability concerns, and high input and borrowing costs continue to drag on residential construction.

Labor Market

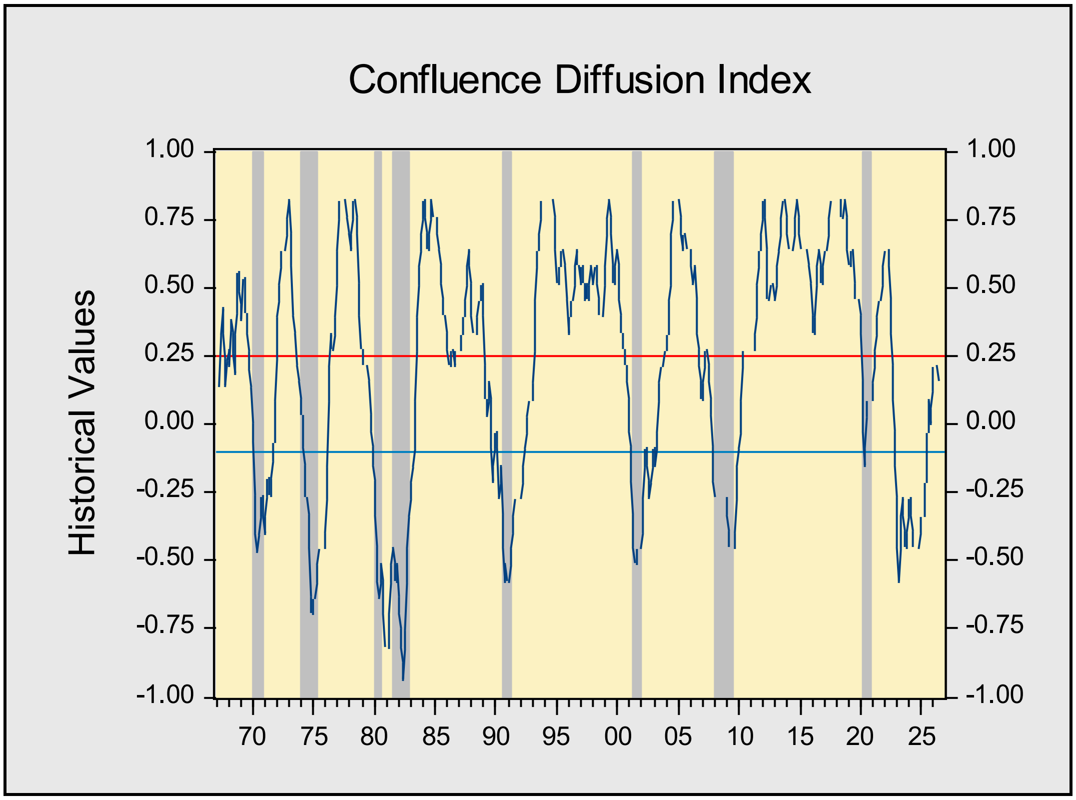
The job market showed signs of improvement, with layoffs remaining low; however, persistently weak hiring numbers continue to raise concerns. In July, US payrolls unexpectedly contracted, driven by a reduction in government employment and only modest gains in service-sector jobs. The unemployment rate fell to 4.1%, its lowest level since June 2025, though this decline was partly attributable to a shrinking labor supply as labor force participation dropped to its lowest point since 2021. That said, jobless claims have remained relatively subdued, suggesting that firms are still not feeling pressured to resort to widespread layoffs.

Outlook & Risks

The latest data indicates that the economy remains in solid shape. July was a particularly strong month for business investment, while firms also capitalized on a boost in spending driven by the holiday weekend and major sporting events. However, signs of cooling emerged as these seasonal catalysts wound down. Looking ahead, mounting uncertainty around geopolitical risks and monetary policy represents the primary headwind to medium-term growth. Nevertheless, we don't see substantial evidence suggesting a broader economic downturn.

The Confluence Diffusion Index for August, which provides a composite view of the economy based on 11 benchmarks, stayed in expansionary territory based on July data. The index's value fell from +0.2121 to +0.1515 but is still well above the recovery signal threshold of −0.1000. The index shows that the economy remains resilient in the face of geopolitical shocks. Only three of the 11 benchmarks are in contraction.

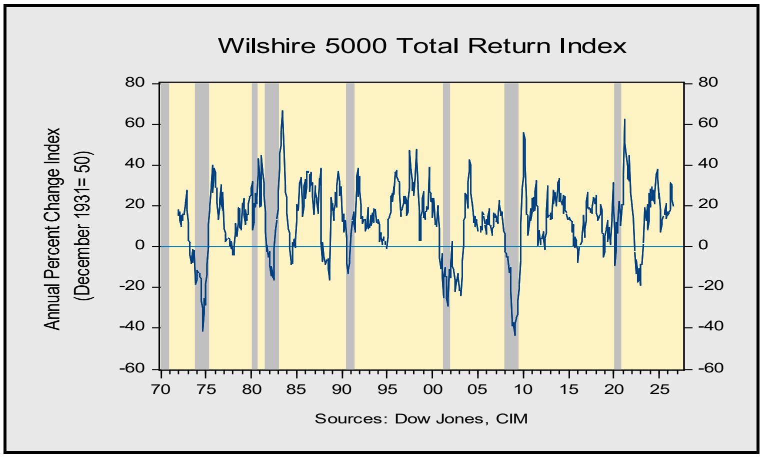
- Long-term yields trended upward due to persistent inflation concerns.
- Output accelerated as firms expanded capacity to meet rising demand.
- Hiring slowed, but firms continued to retain their current workforces.



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. A chart title listed in red indicates that the index is signaling recession.

Financial Markets

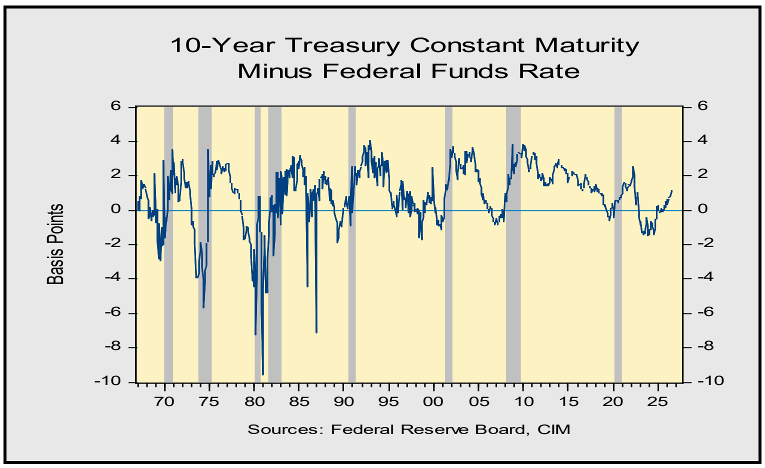
Wilshire 5000 Index



The Wilshire 5000 Total Return Index for July rose 19.7% from the prior year.

- Top-performing sectors: Energy, Financial Services, Health Care.
- Bottom-performing sectors: Information Technology, Industrials, Utilities.
- Indicates recession when the level falls below zero.

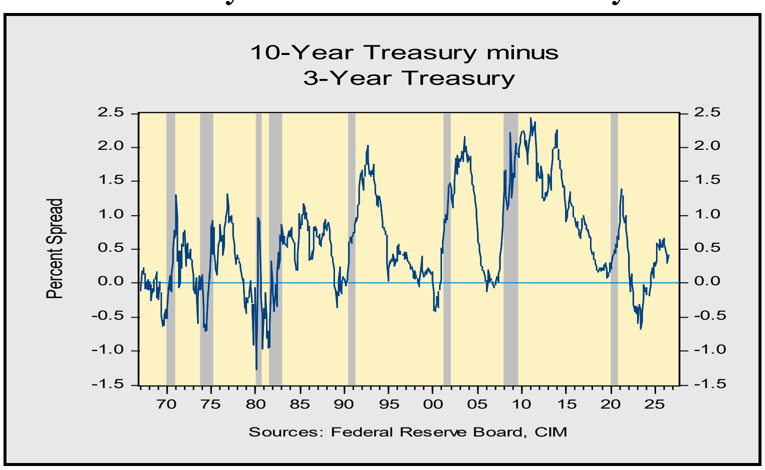
10-Year Treasury Constant Maturity Minus Federal Funds Rate



The financial spread, which is the 10-year Treasury yield minus the effective fed funds rate, increased from +0.81 to +1.12.

- The effective fed funds rate was unchanged at 3.64%.
- The 10-year Treasury rose from 4.44% to 4.75%.
- Indicates recession when the level falls below zero.

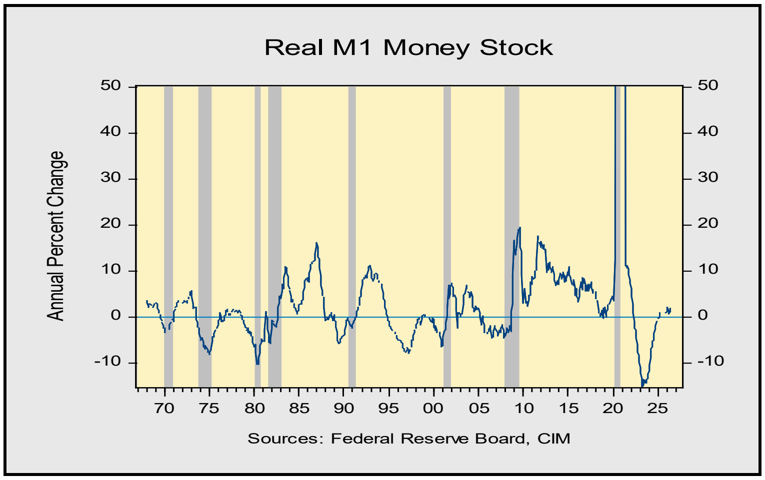
10-Year Treasury Minus Three-Year Treasury



The term spread between the 10-year and three-year rose from +0.29 to +0.41.

- The 10-year Treasury yield rose from 4.44% to 4.75%.
- The three-year Treasury yield increased from 4.15% to 4.34%.
- Indicates recession when the level falls below zero.

Real M1 Money Stock

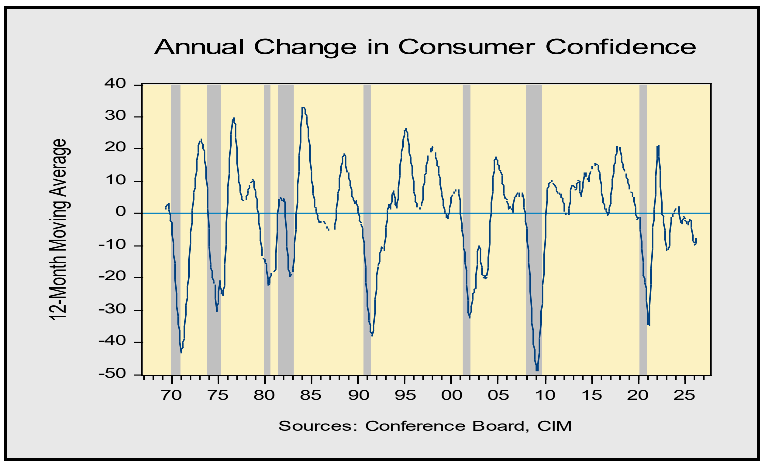


Real M1 money stock rose 2.5% from the prior year.

- Headline CPI rose 3.3% from the prior year.
- M1 money stock rose 5.8% from the prior year.
- Indicates recession when the level falls below zero.

Goods Production & Sentiment

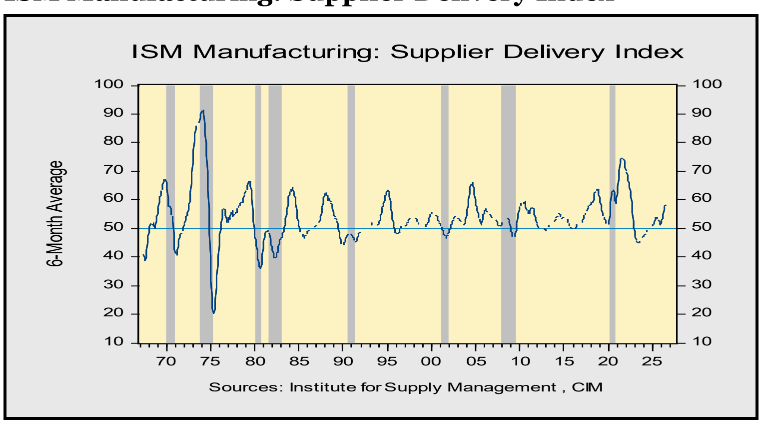
Consumer Confidence



In July, the 12-month moving average of the annual change in consumer confidence was unchanged at -8.2.

- Consumer confidence came in at 90.8, down from 98.7 in July 2025.
- The sub-index for the current situation came in at 114.9, down from 132.8 last year.
- Meanwhile, the sub-index for future expectations decreased from 76.0 to 74.7 in the same period.
- Indicates recession when the level falls below zero.

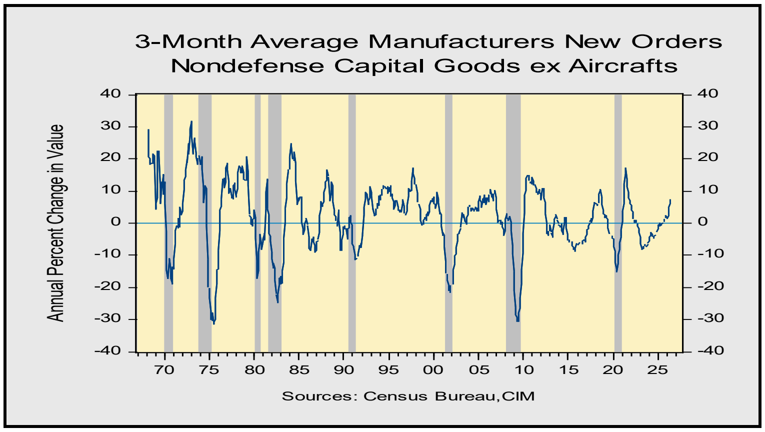
ISM Manufacturing: Supplier Delivery Index



The six-month moving average of the Supplier Delivery Index rose from 57.8 to 58.6.

- The overall index rose from 53.3 to 55.6.
- The Supplier Delivery Index rose from 57.4 to 58.9.
- Indicates recession when the level falls below 50.

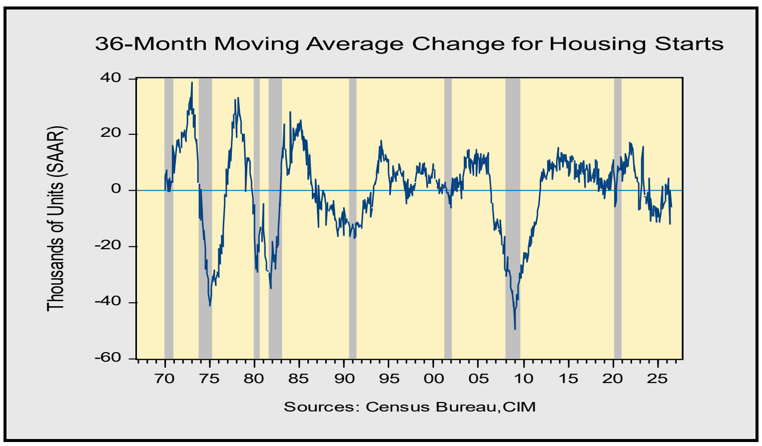
Three-Month Average Manufacturers' New Orders Nondefense Capital Goods excluding Aircraft



The three-month moving average of the annual change in new orders for nondefense capital goods rose 7.9% from the prior year.

- In July, new orders were down 0.5% from the prior month but rose 7.9% from 2025 levels.
- Indicates recession when the level falls below zero.

36-Month Moving Average Change for Housing Starts

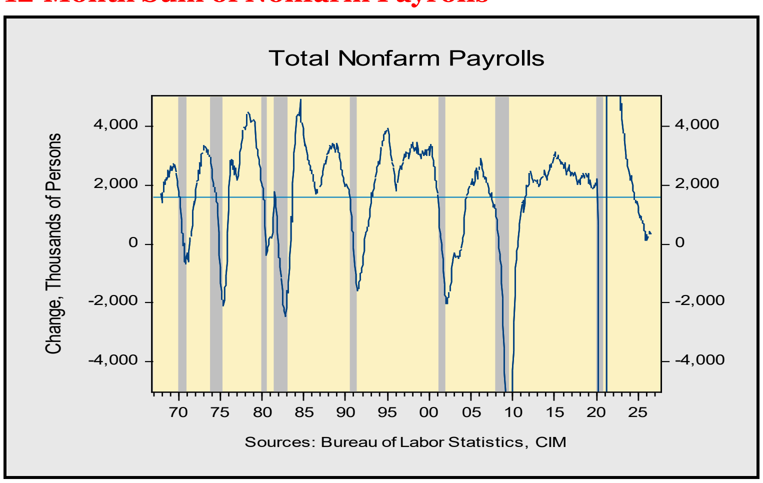


The 36-month moving average change for housing starts decreased from -0.14 to -6.25.

- Housing starts expanded at an annualized rate of 1,239k, below the previous month's revised pace of 1,415k.
- Single-family starts fell from 897k to 808k. Multi-family dwellings fell from 499k to 421k.
- Indicates recession when the level falls below zero.

Labor Market

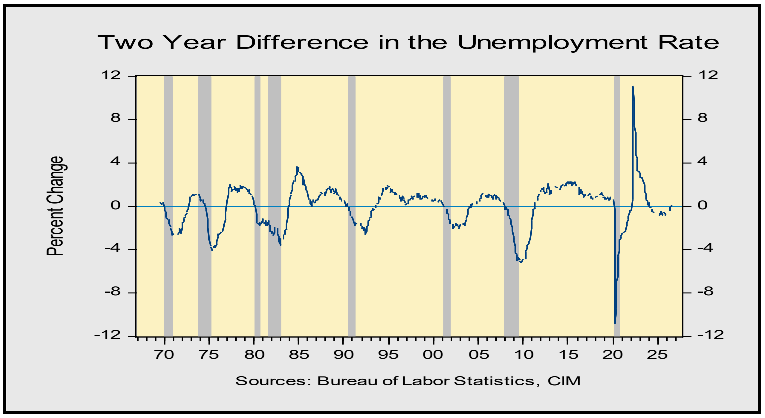
12-Month Sum of Nonfarm Payrolls



The 12-month moving sum decreased from a revised 403k to 316k.

- Nonfarm payrolls showed that the economy lost 23k jobs in July.
- Service-Providing industries added 5k jobs. The Goods-Producing sector added 25k jobs from the previous month, while the Government sector lost 53k jobs.
- Indicates recession when the level falls below 1,500k.

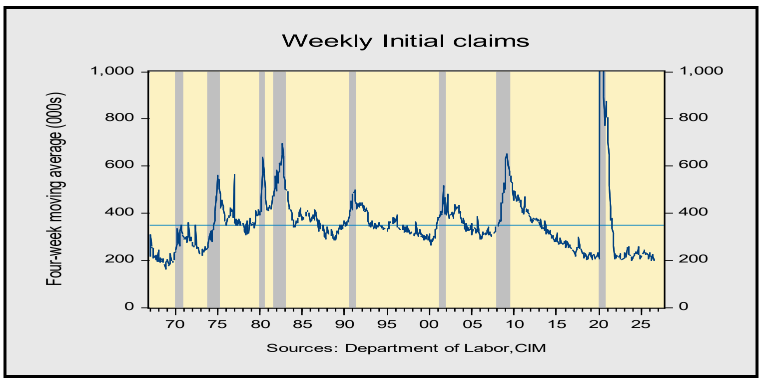
Two-Year Difference in the Unemployment Rate



The two-year difference in the unemployment rate improved from -0.1 to +0.1.

- The unemployment rate fell from 4.2% to 4.1%.
- The number of unemployed fell 2.5% from the prior month.
- Indicates recession when the level falls below zero.

Weekly Initial Claims



Average weekly claims for July rose from 200k to 206k.

- Indicates recession when the level rises above 350k.

Thomas Wash, CBE
August 27, 2026

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 US equity index. The index contains 3,500 stocks and is designed to track the overall performance of the US 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 Aircraft: 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 the 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 intense.

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 April be headed toward a contraction.