

# 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.*

July 31, 2025

The US economy sustained its expansion in June, and our proprietary *Confluence Diffusion Index* stayed out of contraction territory for the fifth straight month. Most indicators showed improvement or only modest changes from the prior month. Financial markets reflected continued optimism from trade progress, lifting equity sentiment, while bond markets signaled lingering uncertainty over inflation and monetary policy. The real economy is showing resilience, with production levels improving (though still well below their peak) and both business and consumer sentiment on the rise. The labor market also looks stable as firms remain reluctant to cut jobs.

## **Financial Markets**

Equity markets are adjusting to tariff-related headlines as confidence grows that the worst of the disruptions has passed. This optimism has driven a sustained rally, with tech stocks leading the gains. US government bonds have remained rangebound as a decline in the 10-year Treasury yield has pushed the financial spread (measured by the 10-year yield minus the effective fed funds rate) into contraction territory. However, this compression likely reflects shifting expectations around Fed policy rather than underlying economic stress as markets continue to assess the timing and magnitude of potential rate cuts this year.

## **Goods Production & Sentiment**

The goods production and sentiment segments remain the weakest component of the business cycle report. In June, three of the four key diffusion indicators remained in contraction. While consumer sentiment showed an improved household inflation outlook, concerns have shifted toward labor market conditions. Business sentiment also edged higher, with supplier deliveries continuing to signal expansion. On a positive note, housing construction activity picked up modestly, led by multi-family projects. Meanwhile, a proxy for investment spending showed marginal improvement but stayed in contractionary territory.

## **Labor Market**

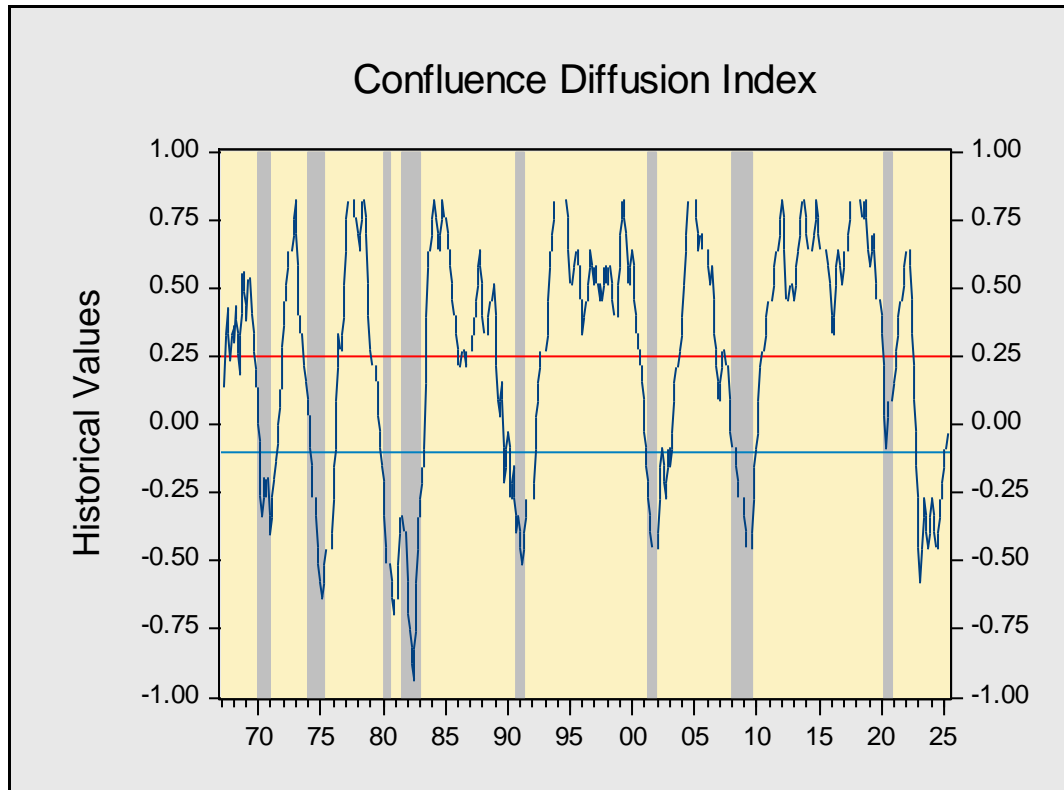
The latest labor market data underscored the economy's continued durability, with the unemployment rate unexpectedly dropping to 4.1% as more people secured jobs, though a deeper dive into the payroll numbers reveals a more nuanced picture. Nearly half of all new positions were created in state and local governments, highlighting the public sector's outsized role in driving recent job growth. The steady decline in jobless claims suggests private employers are also retaining workers, signaling broader labor market strength.

## **Outlook & Risks**

The economy is proving to be remarkably resilient, even with new tariffs in play. As trade deals are concluded, businesses and households should gain a clearer roadmap for navigating this evolving landscape. The new tax bill is a welcome shot of relief and is set to reduce recession risk. We'll get an even better read on its full positive impact over time. Our focus stays squarely on earnings. As long as firms show flexibility and creativity in adjusting, we anticipate continued stability. But if companies shrink their margins, we could still see some economic volatility.

**The Confluence Diffusion Index** for July, which encompasses data for June, remained slightly above the recovery indicator. However, the report revealed that four of the 11 benchmarks remained in contraction territory from last month, and one additional indicator has now crossed into contraction for the month of June. Using June data, the diffusion index was unchanged at -0.0303, above the recovery signal of -0.1000.

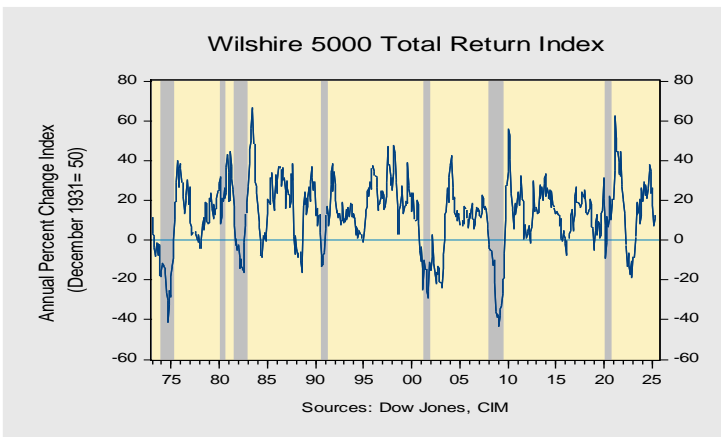
- Stocks sustained the previous month's momentum while bonds remain in holding.
- Sentiment and production showed signs of improvement.
- The labor market has softened but remains tight.



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

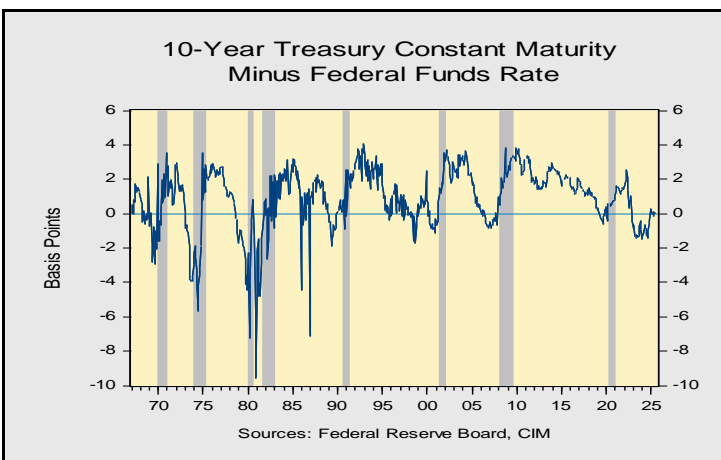
### Wilshire 5000 Index



The Wilshire 5000 Total Return Index for June rose 15.2% from the prior year.

- Top-performing sectors: Information Technology, Communication Services, and Energy.
- Bottom-performing sectors: Utilities, Real Estate, and Consumer Staples.
- Indicates recession when the level falls below zero.

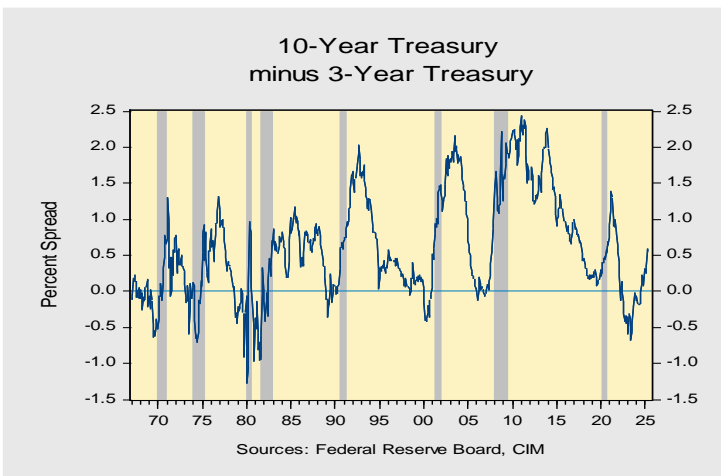
### 10-Year Treasury Constant Maturity Minus Federal Funds Rate



The financial spread, which is the 10-year Treasury yield minus the effective fed funds rate, worsened from +0.08% to -0.09, crossing into contraction territory.

- The effective fed funds rate was unchanged at 4.33%.
- The 10-year Treasury fell from 4.41% to 4.24%.
- Indicates recession when the level falls below zero.

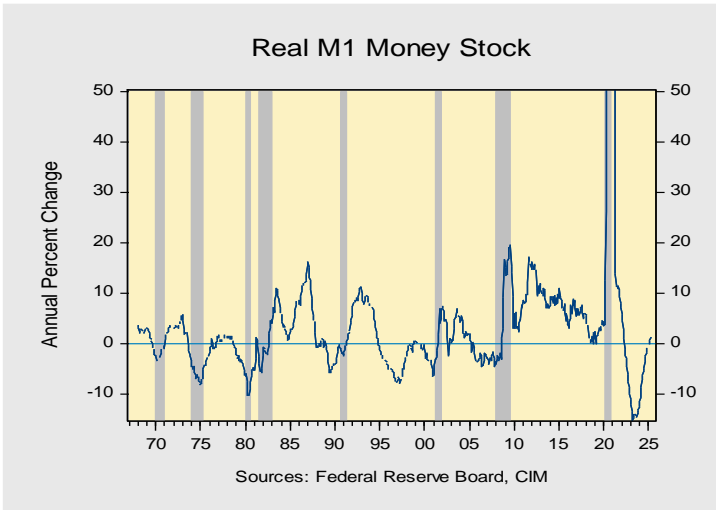
### 10-Year Treasury Minus Three-Year Treasury



The term spread between the 10-year and three-year increased from +0.54 to +0.56.

- The 10-year Treasury yield fell from 4.41% to 4.24%.
- The three-year Treasury yield decreased from 3.87% to 3.68%.
- Indicates recession when the level falls below zero.

## Real M1 Money Stock

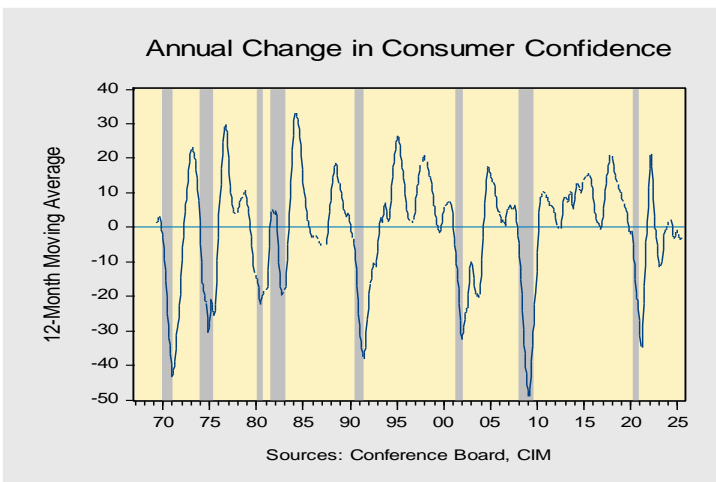


Real M1 money stock rose 1.5% from the prior year.

- Headline CPI rose 2.7% from the prior year.
- M1 money stock rose 4.2% from the prior year.
- Indicates recession when the level falls below zero.

## Goods Production & Sentiment

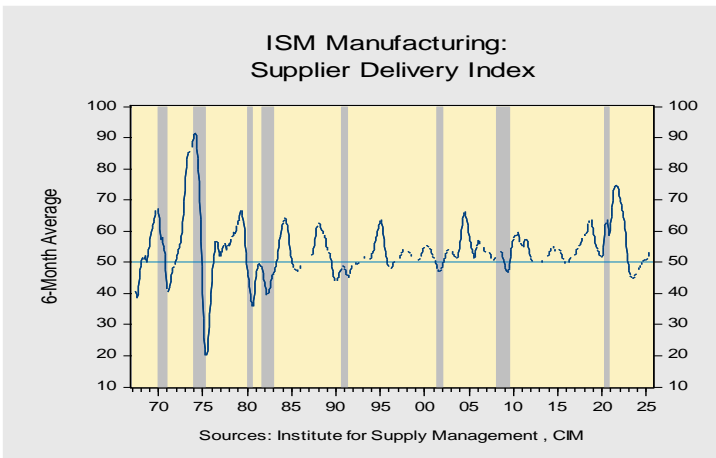
### Consumer Confidence



In June, the 12-month moving average of the annual change in consumer confidence improved from a revised -3.6 to -2.8.

- Consumer confidence came in at 93.0, down from 97.8 in June 2024.
- The sub-index for the current situation came in at 129.1, down from 135.3 last year.
- Meanwhile, the sub-index for future expectations increased from 69.0 to 72.8 in the same period.
- Indicates recession when the level falls below zero.

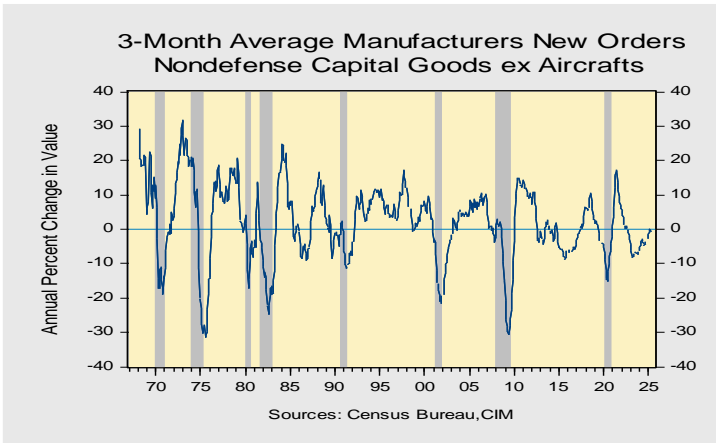
### ISM Manufacturing: Supplier Delivery Index



The six-month moving average of the Supplier Delivery Index rose from 53.4 to 54.1.

- The overall index rose from 48.5 to 49.0.
- The Supplier Delivery Index decreased from 56.1 to 54.2.
- Indicates recession when the level falls below 50.

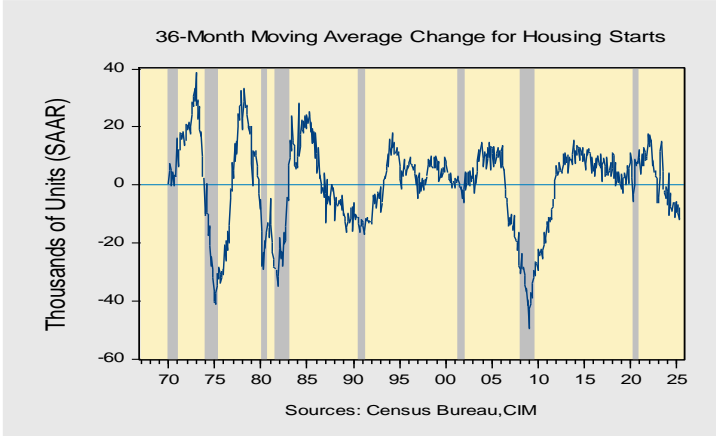
### Three-Month Average Manufacturers' New Orders Nondefense Capital Goods excluding Aircraft



The three-month moving average of the annual change in new orders for nondefense capital goods fell 0.2% from the prior year.

- In June, new orders rose 0.1% from the prior month and rose 0.4% since 2024.
- Indicates recession when the level falls below zero.

### 36-Month Moving Average Change for Housing Starts

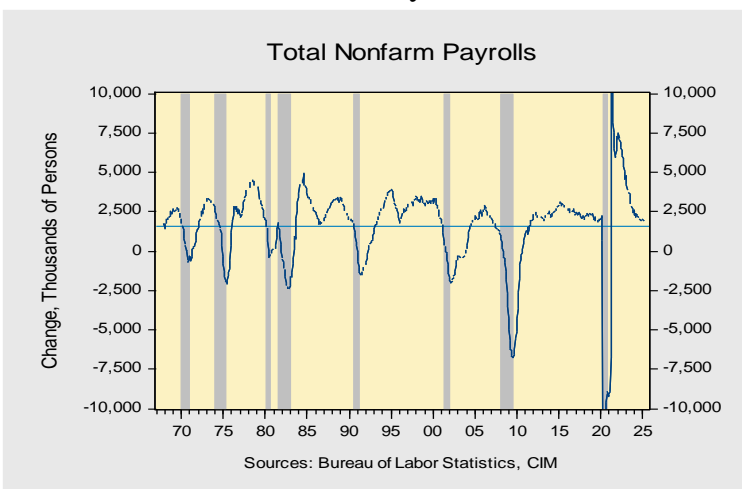


The 36-month moving average change for housing starts improved from -7.33 to -6.39.

- Housing starts expanded at an annualized rate of 1,321k, above the previous month's revised pace of 1,263k.
- Single-family starts fell from 926k to 883k. Multi-family dwellings rose from 317k to 414k.
- Indicates recession when the level falls below zero.

## Labor Market

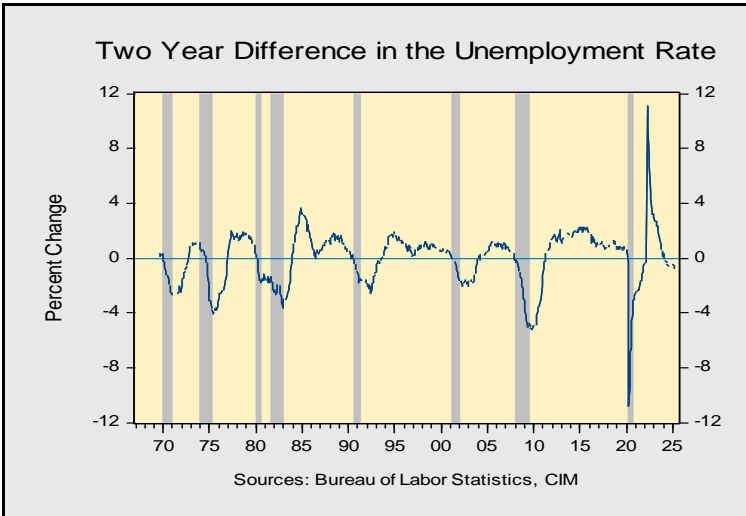
### 12-Month Sum of Nonfarm Payrolls



The 12-month moving sum increased from a revised 1,749k to 1,809k.

- Nonfarm payrolls showed that the economy added 147k jobs in June.
- Service-Providing industries added 68k jobs. The Goods-Producing sector added 6k jobs from the previous month, while the Government sector added 73k jobs.
- Indicates recession when the level falls below 1,500k.

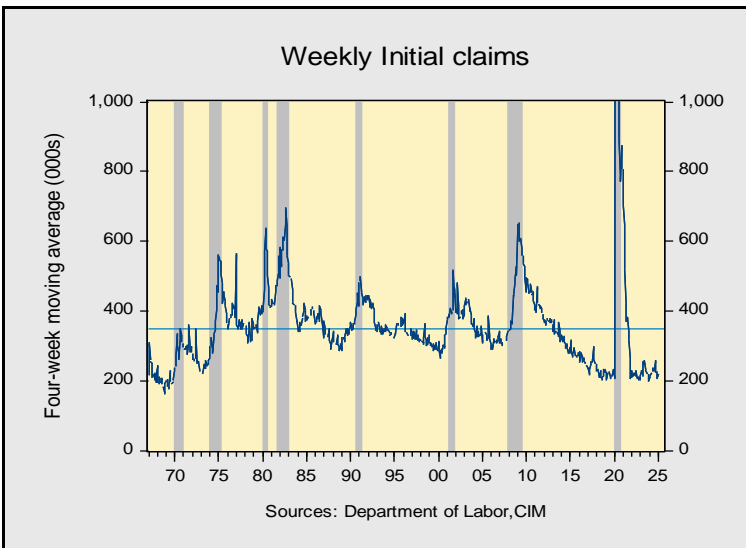
## Two-Year Difference in the Unemployment Rate



The two-year difference in the unemployment rate improved from -0.6% to -0.5%.

- The unemployment rate fell from 4.2% to 4.1%.
- The number of unemployed fell 3.1% from the prior month.
- Indicates recession when the level falls below zero.

## Weekly Initial Claims



Average weekly claims for June fell from 248k to 228k.

- Indicates recession when the level rises above 350k.

Thomas Wash, CBE  
July 31, 2025

*This report was prepared by Confluence Investment Management LLC and reflects the current opinions of the author. It is based on sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change. This is not a solicitation or an offer to buy or sell any security.*

## ***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 June be headed toward a contraction.