

# 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.*

June 25, 2026

The US economy continued to expand in May, with signs that growth is holding steady. Our proprietary *Confluence Diffusion Index* remained in expansionary territory for the sixteenth consecutive month. That said, several areas warrant closer monitoring. Financial conditions are showing some signs of tightening, although liquidity remains ample. Firms are still investing; however, households remain concerned about rising inflation. Meanwhile, hiring continues to pick up but is still below levels consistent with a solid expansion.

## **Financial Markets**

Bond and equity markets showed signs of cooling as investors braced for rising geopolitical tensions in the Middle East. Equities were notably volatile throughout the month, driven in part by intermittent negotiations between the United States and Iran over reopening the Strait of Hormuz. At the same time, the yield curve experienced a bearish steepening, reflecting an increased willingness by the Federal Reserve to tighten policy in response to persistent inflation. This shift was reinforced by several Fed officials advocating for the removal of language signaling an easing bias in the policy outlook.

## **Goods Production & Sentiment**

Signals from the production and sentiment side of the economy were mixed. Business investment remains resilient, supported largely by continued spending on AI infrastructure and defense. However, there are emerging signs of strain in other sectors. Housing starts declined, partly due to rising materials costs. Meanwhile, both consumer and business sentiment have softened amid concerns about the Middle East conflict and its implications for prices. This is particularly evident among households, which continue to express concerns about their current financial situation compared to a year ago, even as forward-looking expectations have modestly improved.

## **Labor Market**

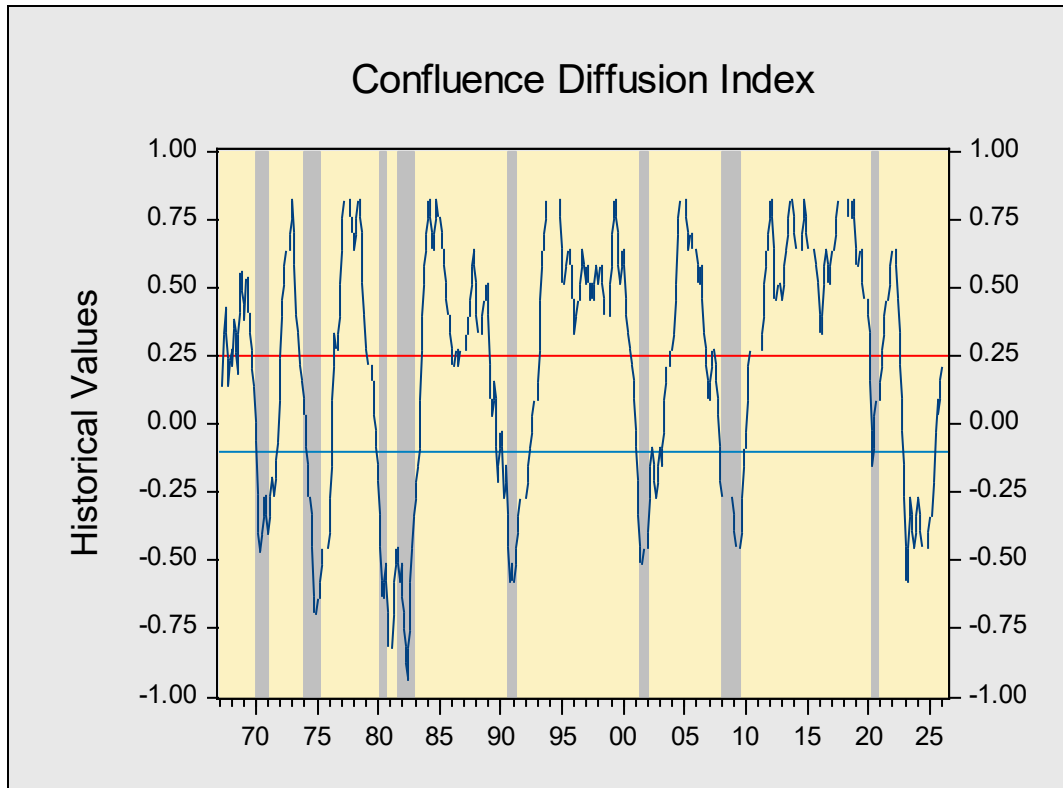
May employment data came in stronger than expected, offering renewed evidence of firm labor demand. Payroll growth significantly exceeded expectations, more than doubling consensus forecasts. Job gains were concentrated in leisure and hospitality, healthcare, and local government, with early signs of a pickup in construction employment as well. Layoffs remain subdued, with the unemployment rate holding steady and initial jobless claims declining the previous month. Overall, the data suggests that labor market momentum may be strengthening.

## **Outlook & Risks**

The economy appears well positioned to sustain the current expansion. Recent data indicates that the economic impact of the Iran conflict has been largely contained, with inflation being the primary transmission channel. Growth continues to be supported by robust capital expenditure in AI and ample credit availability, which has enabled households to maintain spending despite rising prices. While a potential hawkish shift by the Federal Reserve presents a risk to both markets and growth, it may be premature to draw firm conclusions about the policy path given the ongoing leadership transition at the central bank. On balance, near-term economic conditions remain constructive, and the outlook over the next 12 months has improved alongside easing geopolitical tensions.

**The Confluence Diffusion Index** for June, which provides a composite view of the economy based on 11 benchmarks, remains in expansionary territory based on May data. The index's value was unchanged at +0.2121, well above the recovery signal threshold of -0.1000. The index shows that the economy remains resilient in the face of geopolitical shocks. Only four of the 11 benchmarks are in contraction, up one from last month.

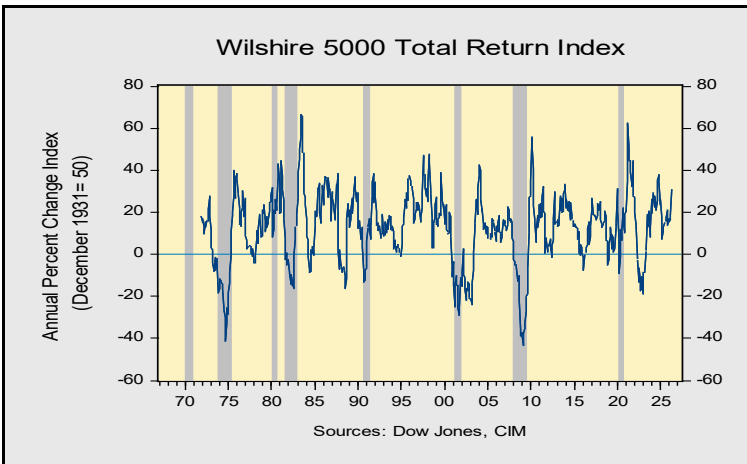
- Expectations of tighter monetary policy led to a flatter yield curve.
- Inflation expectations continued to weigh on consumer sentiment.
- Hiring is showing signs of gaining momentum.



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

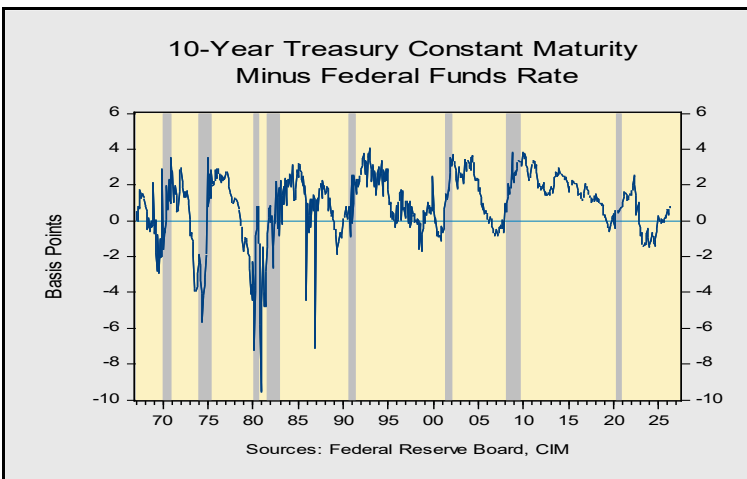
### Wilshire 5000 Index



The Wilshire 5000 Total Return Index for May rose 29.8% from the prior year.

- Top-performing sectors: Information Technology, Health Care, Consumer Discretionary.
- Bottom-performing sectors: Energy, Utilities, and Consumer Staples.
- Indicates recession when the level falls below zero.

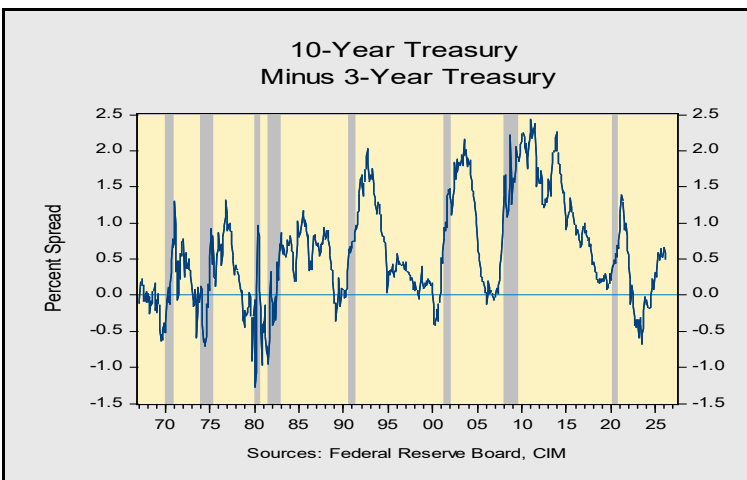
### 10-Year Treasury Constant Maturity Minus Federal Funds Rate



The financial spread, which is the 10-year Treasury yield minus the effective fed funds rate, decreased from +0.83 to +0.78.

- The effective fed funds rate was unchanged at 3.64%.
- The 10-year Treasury rose from 4.40% to 4.45%.
- Indicates recession when the level falls below zero.

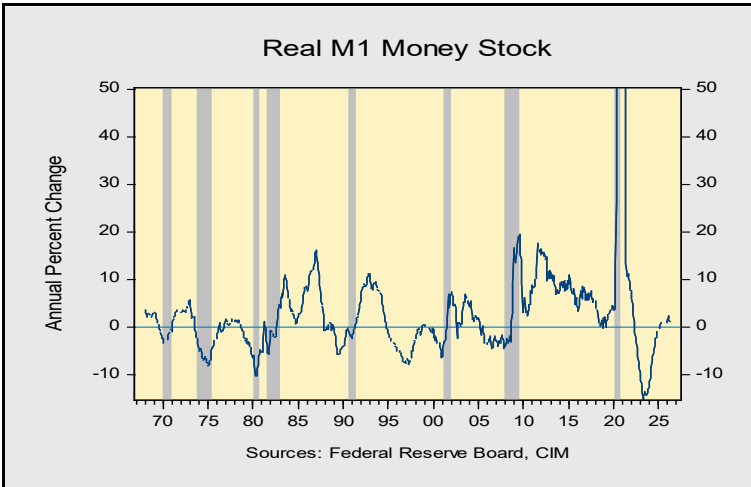
### 10-Year Treasury Minus Three-Year Treasury



The term spread between the 10-year and three-year fell from +0.49 to +0.39.

- The 10-year Treasury yield rose from 4.40% to 4.45%.
- The three-year Treasury yield increased from 3.91% to 4.06%.
- Indicates recession when the level falls below zero.

### Real M1 Money Stock

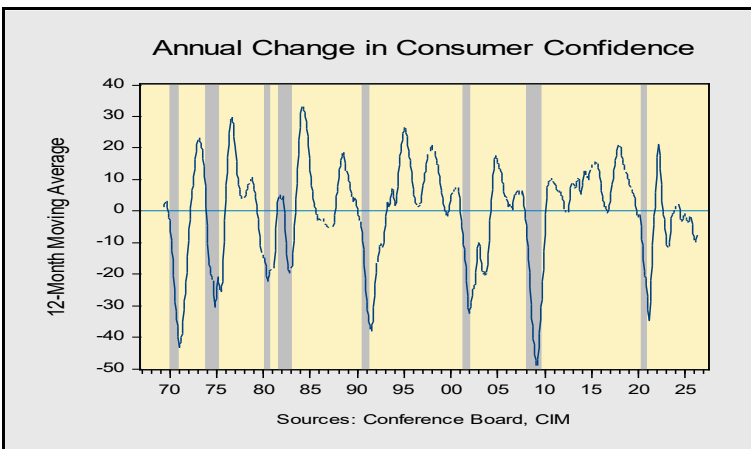


Real M1 money stock rose 1.6% from the prior year.

- Headline CPI rose 4.2% 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

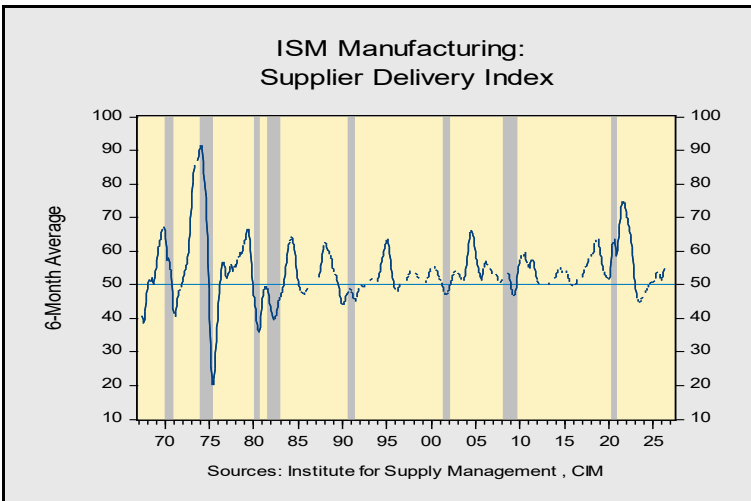
### Consumer Confidence



In May, the 12-month moving average of the annual change in consumer confidence worsened from a -7.4 to -7.6.

- Consumer confidence came in at 93.1, down from 98.4 in May 2025.
- The sub-index for the current situation came in at 121.2, down from 135.5 last year.
- Meanwhile, the sub-index for future expectations increased from 73.4 to 74.4 in the same period.
- Indicates recession when the level falls below zero.

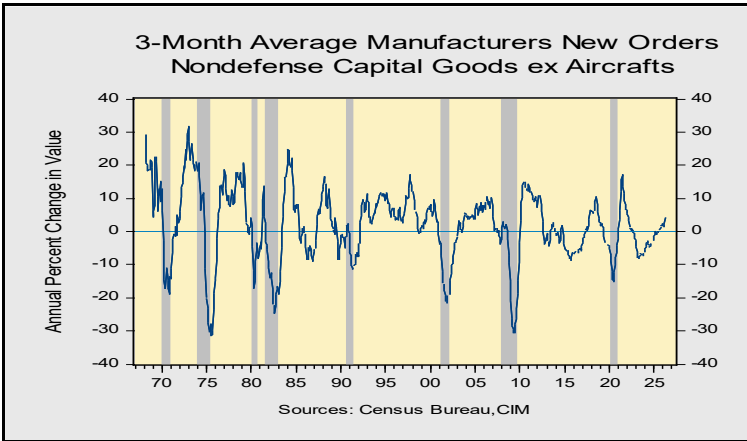
### ISM Manufacturing: Supplier Delivery Index



The six-month moving average of the Supplier Delivery Index rose from 54.9 to 56.7.

- The overall index rose from 52.7 to 54.0.
- The Supplier Delivery Index was unchanged at 60.6.
- Indicates recession when the level falls below 50.

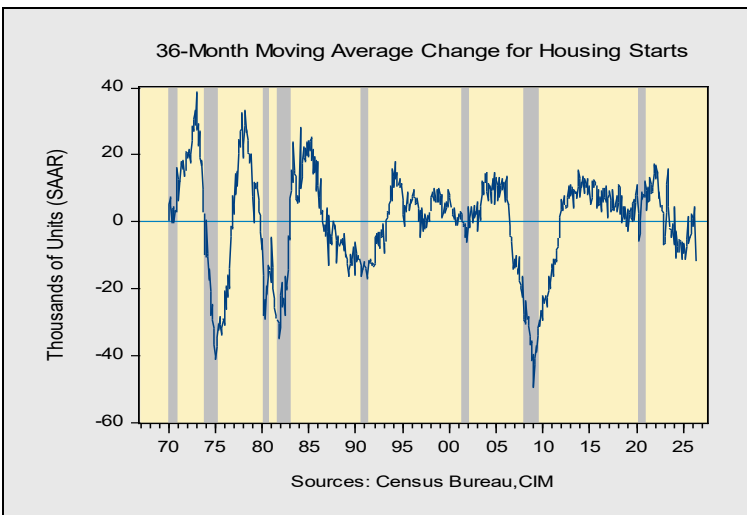
### Three-Month Average Manufacturers' New Orders Nondefense Capital Goods excluding Aircraft



The three-month moving average of the annual change in new orders for nondefense capital goods rose 5.6% from the prior year.

- In May, new orders were up 0.2% from the prior month and rose 4.8% from 2025 levels.
- Indicates recession when the level falls below zero.

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

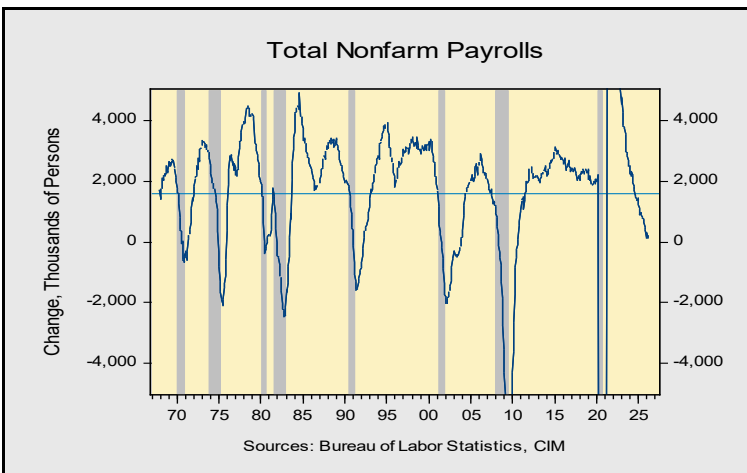


The 36-month moving average change for housing starts dropped from +1.31 to -12.00.

- Housing starts expanded at an annualized rate of 1,117k, below the previous month's revised pace of 1,392k.
- Single-family starts fell from 899k to 882k. Multi-family dwellings fell from 486k to 284k.
- Indicates recession when the level falls below zero.

## Labor Market

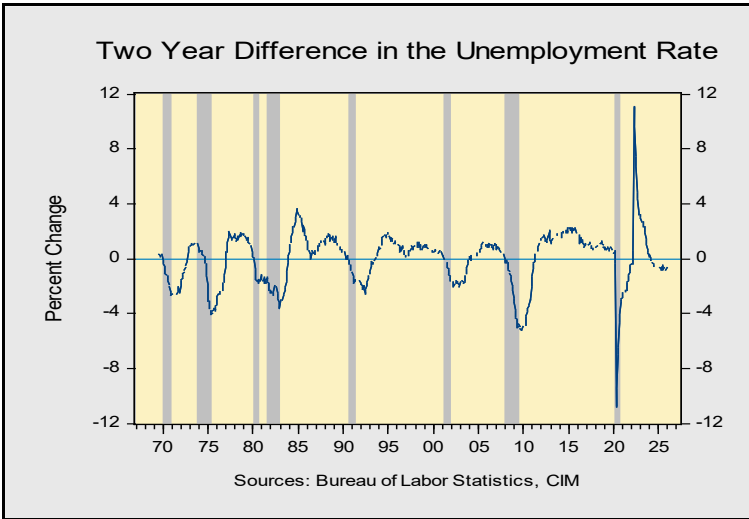
### 12-Month Sum of Nonfarm Payrolls



The 12-month moving sum increased from a revised 344k to 503k.

- Nonfarm payrolls showed that the economy added 172k jobs in May.
- Service-Providing industries added 92k jobs. The Goods-Producing sector added 28k jobs from the previous month, while the Government sector added 52k jobs.
- Indicates recession when the level falls below 1,500k.

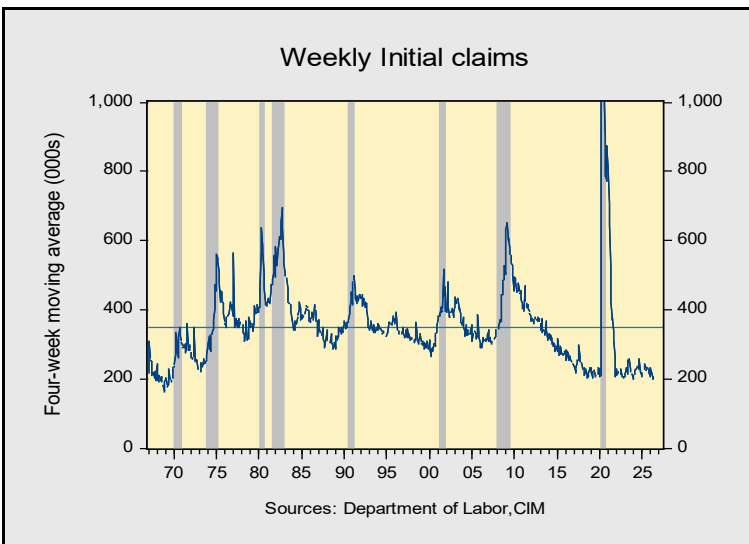
## Two-Year Difference in the Unemployment Rate



The two-year difference in the unemployment rate was unchanged at -0.4.

- The unemployment rate was unchanged at 4.3%.
- The number of unemployed fell 0.9% from the prior month.
- Indicates recession when the level falls below zero.

## Weekly Initial Claims



Average weekly claims for May fell from 225k to 215k.

- Indicates recession when the level rises above 350k.

Thomas Wash, CBE  
June 25, 2026

*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 April be headed toward a contraction.