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 26, 2025

The US economy extended its expansion in May, with the composite economic index remaining above contraction territory for the fourth consecutive month. While financial conditions broadly improved, the goods-producing sector sent mixed signals and the labor market showed tentative signs of softening. Against a backdrop of lingering tariff uncertainty, we are closely monitoring labor market conditions and goods production for early indicators of economic stress.

Financial Markets

Investors largely shrugged off trade tensions amid progress in negotiations with China, the UK, and India. Optimism that tariffs may not escalate further buoyed risk sentiment, fueling rallies in major tech stocks. Meanwhile, rising sovereign debt concerns in developed markets pushed long-term Treasury yields higher, steepening the yield curve. As a result, the financial spread moved into positive territory for the first time in three months — a potential signal of improving growth and inflation expectations.

Goods Production & Sentiment

The goods-producing sector was the economy’s softest segment in May, with three of the four key diffusion indicators in contraction. Consumer sentiment remained subdued due to persistent inflation expectations and tariff uncertainty. Housing construction slowed under pressure from elevated interest rates and rising material costs. While a proxy for investment spending improved slightly, it remained in contraction territory. Business surveys indicated lingering supply chain pressures, with slow delivery times suggesting a sustained demand for factory goods.

Labor Market

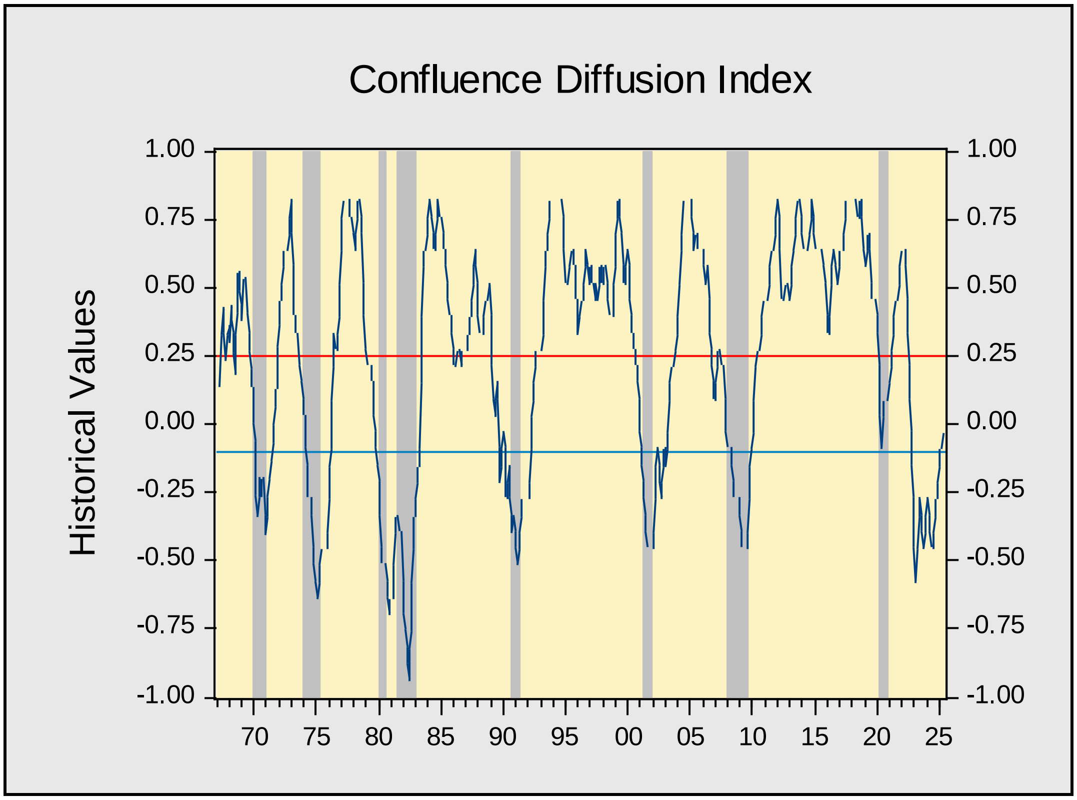
The labor market continued to moderate but remains robust by historical standards. The unemployment rate held steady at 4.2%, suggesting that while labor conditions have eased from their peak, they remain tight. However, initial jobless claims rose noticeably and payroll growth slowed in May, both early signs that employers may be scaling back hiring. For now, the data does not yet warrant policy intervention, but further softening could shift the Fed’s outlook.

Outlook & Risks

The economy continues to demonstrate resilience, supported by steady consumer and business spending. However, much of this strength may reflect drawdowns of pre-tariff inventory stockpiles. While we do not anticipate a near-term recession, the critical question is whether firms can absorb higher tariff costs through compressed margins or would they be able to pass them on to consumers without stifling demand. The coming months will test the economy’s ability to adapt to these persistent headwinds, but we still think this remains a good time to increase risk exposure.

The Confluence Diffusion Index for June, which encompasses data for May, remained slightly above the recovery indicator. However, the report showed that four out of 11 benchmarks are in contraction territory. Using May data, the diffusion index improved to -0.0303, above the recovery signal of -0.1000.

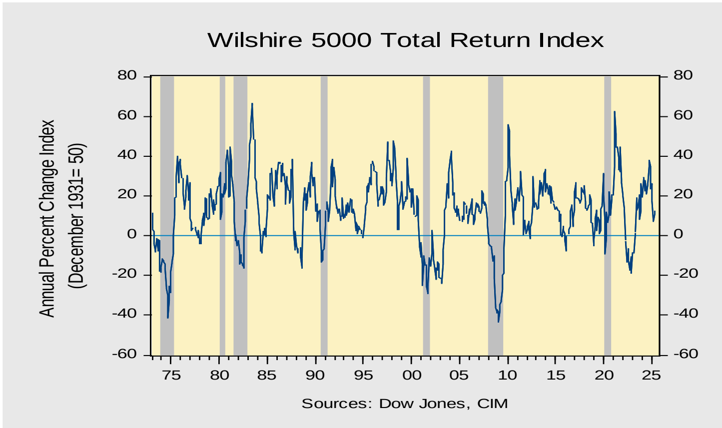
- Stocks gained momentum as progress in trade negotiations boosted investor sentiment.
- Rising input costs continue to weigh on the manufacturing sector.
- A noticeable uptick in jobless claims points to a potential softening in the labor market.



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

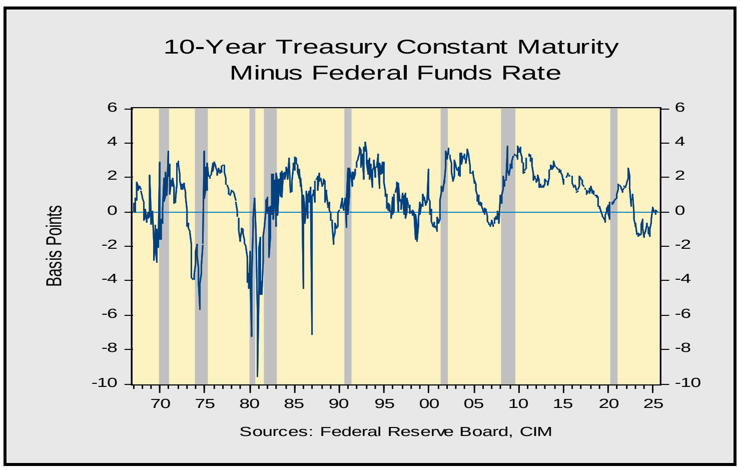
Wilshire 5000 Index



The Wilshire 5000 Total Return Index for May rose 13.0% from the prior year.

- Top-performing sectors: Technology, Industrials, and Consumer Discretionary.
- Bottom-performing sectors: Health Care, Real Estate, and Consumer Staples.
- Indicates recession when the level falls below zero.

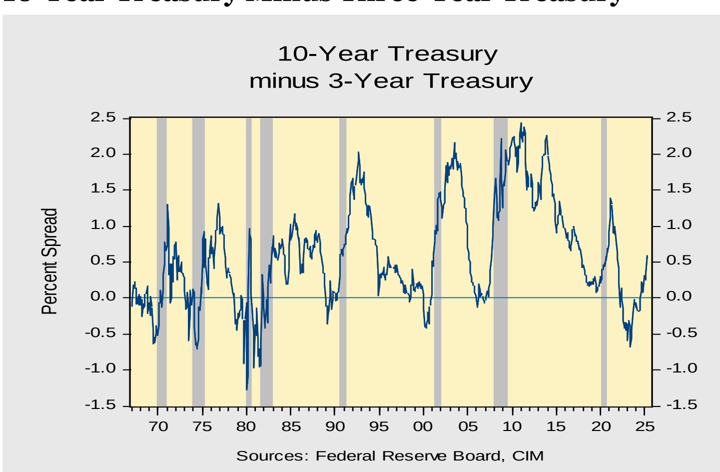
10-Year Treasury Constant Maturity Minus Federal Funds Rate



The financial spread, which is the 10-year Treasury yield minus the effective fed funds rate, improved from -0.16% to +0.08%.

- The effective fed funds rate was unchanged at 4.33%.
- The 10-year Treasury rose from 4.17% to 4.41%.
- Indicates recession when the level falls below zero.

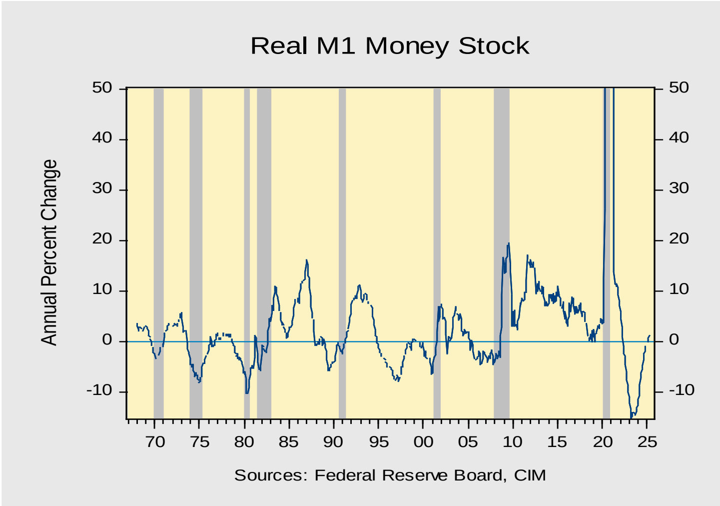
10-Year Treasury Minus Three-Year Treasury



The term spread between the 10-year and three-year decreased from +0.59 to +0.54.

- The 10-year Treasury yield rose from 4.17% to 4.41%.
- The three-year Treasury yield increased from 3.58% to 3.87%.
- Indicates recession when the level falls below zero.

Real M1 Money Stock

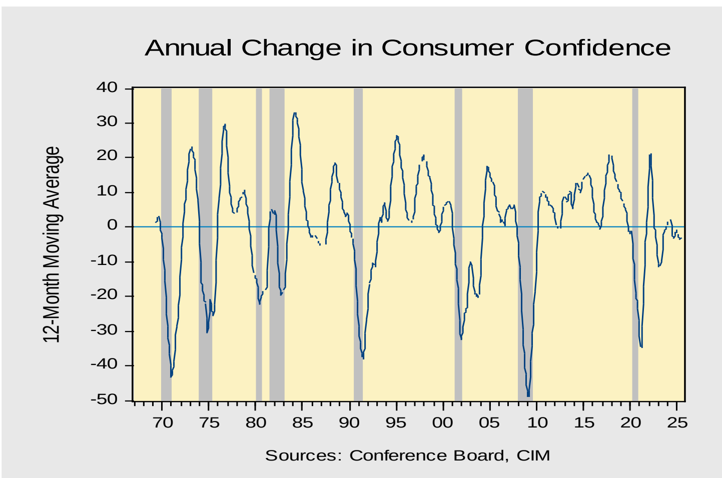


Real M1 money stock rose 1.5% from the prior year.

- Headline CPI rose 2.4% from the prior year.
- M1 money stock rose 3.9% from the prior year.
- Indicates recession when the level falls below zero.

Goods Production & Sentiment

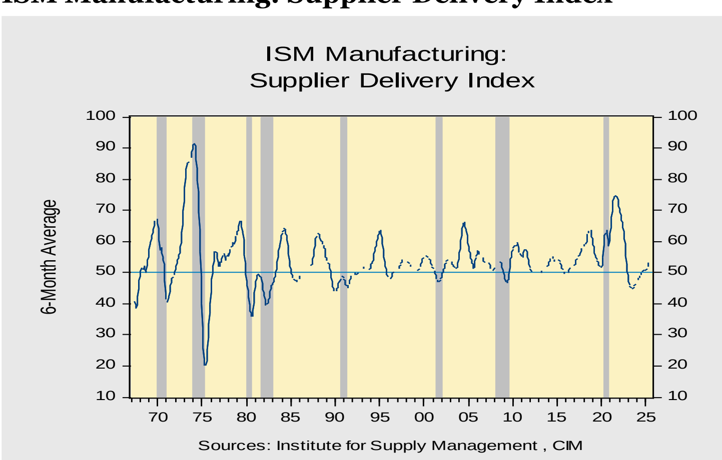
Consumer Confidence



In May, the 12-month moving average of the annual change in consumer confidence fell from -3.4 to -3.5.

- Consumer confidence came in at 98.0, down from 101.3 in May 2024.
- The sub-index for the current situation came in at 129.1, down from 140.3 last year.
- Meanwhile, the sub-index for future expectations decreased from 74.9 to 73.6 in the same period.
- Indicates recession when the level falls below zero.

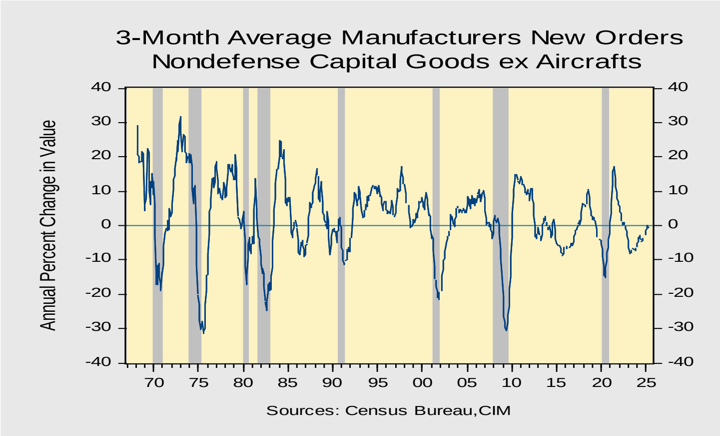
ISM Manufacturing: Supplier Delivery Index



The six-month moving average of the Supplier Delivery Index rose from 52.2 to 53.4.

- The overall index fell from 48.7 to 48.5.
- The Supplier Delivery Index increased from 55.2 to 56.1.
- Indicates recession when the level falls below 50.

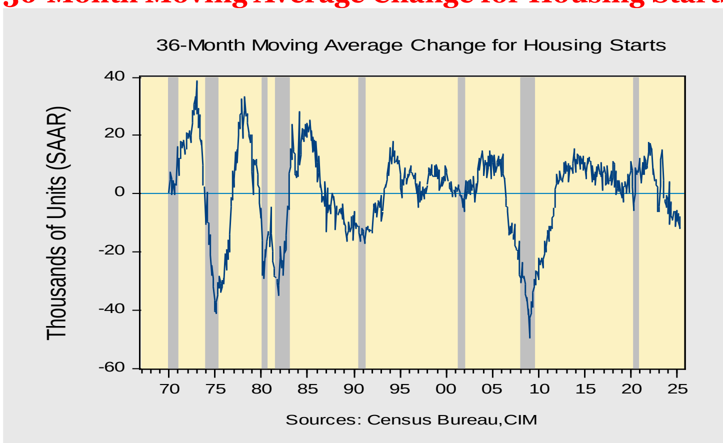
Three-Month Average Manufacturers' New Orders Nondefense Capital Goods excluding Aircraft



The three-month moving average of the annual change in new orders for nondefense capital goods fell 0.6% from the prior year.

- In May, new orders rose 0.9% 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

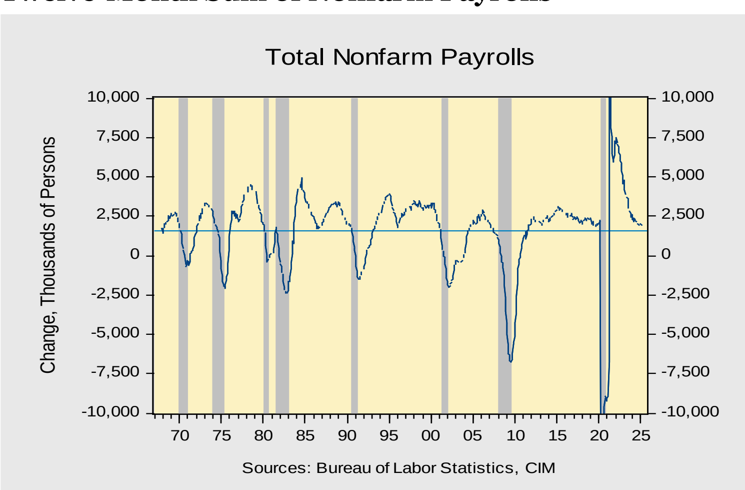


The 36-month moving average change for housing starts improved from -11.89 to -7.64.

- Housing starts expanded at an annualized rate of 1,256k, below the previous month's revised pace of 1,392k.
- Single-family starts rose from 920k to 924k. Multi-family dwellings fell from 454k to 316k.
- Indicates recession when the level falls below zero.

Labor Market

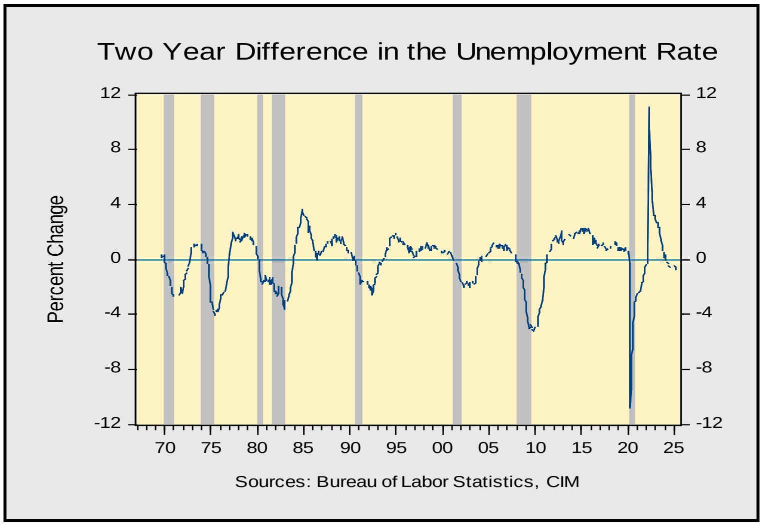
Twelve-Month Sum of Nonfarm Payrolls



The 12-month moving sum decreased from 1,787k to 1,733k.

- Nonfarm payrolls showed that the economy added 139k jobs in May.
- Service-Providing industries added 145k jobs. The Goods-Producing sector lost 5k jobs from the previous month, while the Government sector lost 1k jobs.
- Indicates recession when the level falls below 1,500k.

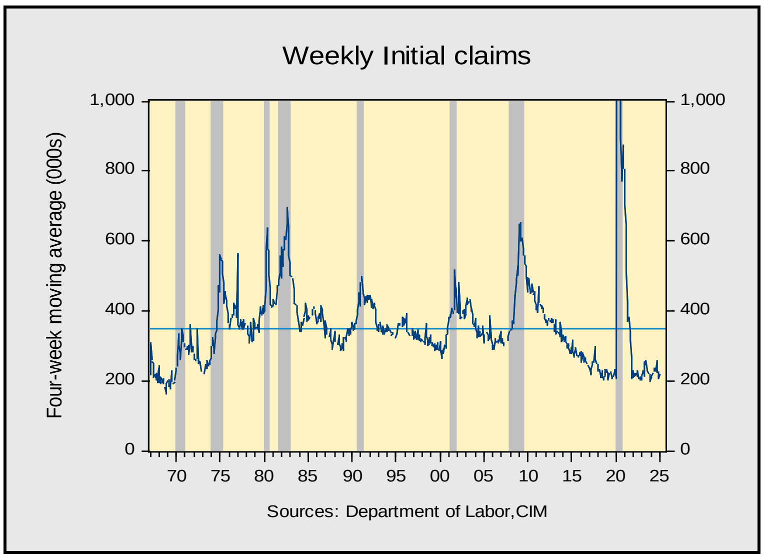
Two-Year Difference in the Unemployment Rate



The two-year difference in the unemployment rate improved from -0.8% to -0.6%.

- The unemployment rate was unchanged at 4.2%.
- The number of unemployed rose 0.9% from the prior month.
- Indicates recession when the level falls below zero.

Weekly Initial Claims



Average weekly claims for May rose from 229k to 248k.

- Indicates recession when the level rises above 350k.

Thomas Wash, CBE
June 26, 2025

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 may be headed toward a contraction.