Business Cycle Report

Confluence Investment Management

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.

September 24, 2026

The US economy expanded further in August, showing signs of accelerating momentum. Reflecting this strength, our proprietary *Confluence Diffusion Index* posted its 19^{th} consecutive month in expansionary territory. Infrastructure buildout driven by AI, along with sustained consumer spending, continues to surprise to the upside. However, elevated interest rates and persistent inflation remain primary headwinds for the current expansion cycle.

Financial Markets

Financial conditions tightened moderately in August amid growing concerns over rising inflation and potential monetary policy tightening, fueled by hawkish comments from the Fed. During his Jackson Hole address, Fed Chair Kevin Warsh noted that the economy was showing signs of overheating, signaling that the central bank may need to act. The tightening was primarily driven by higher short-term interest rates, while long-term rates were relatively unchanged. Despite these policy concerns, markets held firm as investors remained confident in corporate earnings resilience.

Goods Production & Sentiment

Goods manufacturing was relatively stable last month, though inflation is still a primary concern. The latest ISM report showed that supplier deliveries slowed in August, signaling that production capacity was beginning to stretch. This pressure appears to be driven by reindustrialization efforts, particularly within AI and defense. While growth was solid, inflation continued to weigh heavily on firms and consumers as rising input costs began pushing up goods prices.

Labor Market

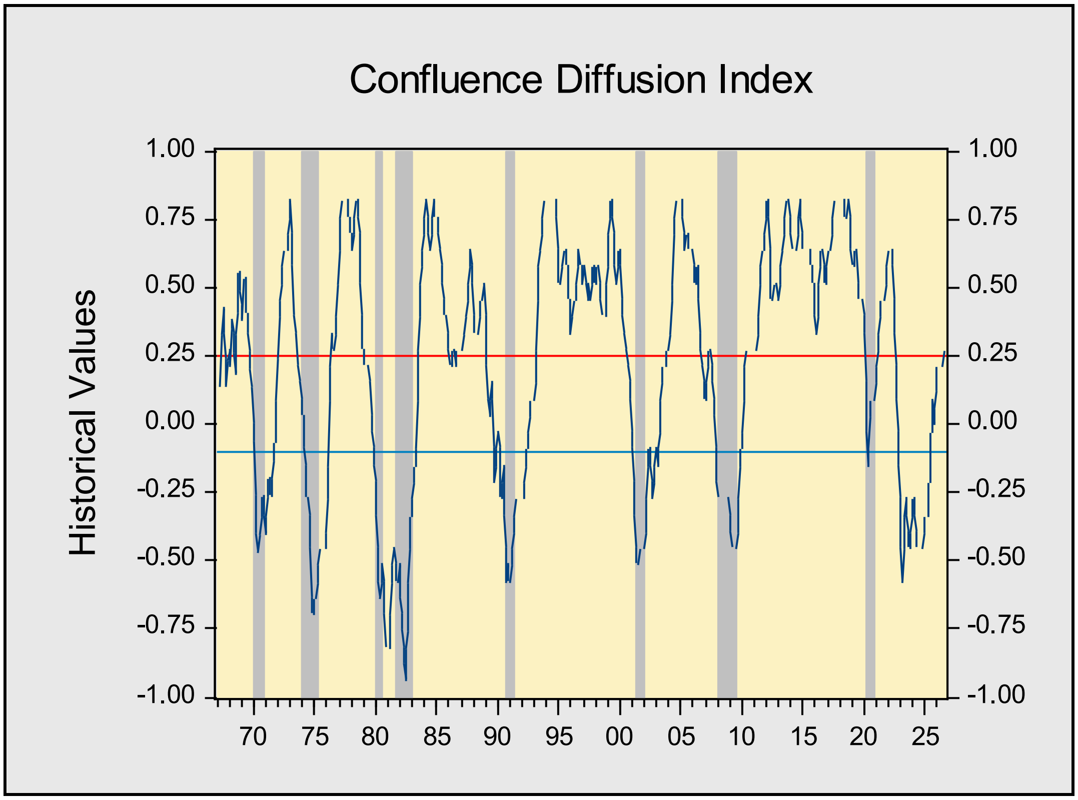
The labor market tightened as labor supply shrank while hiring accelerated. The economy added 162,000 jobs last month, the broadest job growth since March, driven by a pickup in local government and construction hiring. The unemployment rate held steady at 4.1%, with a slight rise in unemployed individuals offset by a decline in overall labor force participation. Layoff risks are low as initial jobless claims continue to hover near historic lows.

Outlook & Risks

Third quarter economic momentum remains strong despite broader concerns. The Atlanta Fed's GDPNow estimate is projecting an annualized 5.1% expansion — the fastest pace since Q4 2021. This acceleration complicates the Federal Reserve's upcoming policy decisions regarding whether to tighten further to prevent overheating. Although near-term growth projections over the next six months are solid, prolonged elevated interest rates pose a medium-term risk to momentum.

The Confluence Diffusion Index for September, which provides a composite view of the economy based on 11 benchmarks, continues in expansionary territory based on August data. The index's value rose from a revised +0.2121 to +0.2727 and has risen above the expansion line for the first time since 2022. The index shows that the economy remains resilient in the face of geopolitical shocks and rising interest rates. Only three of the 11 benchmarks are in contraction.

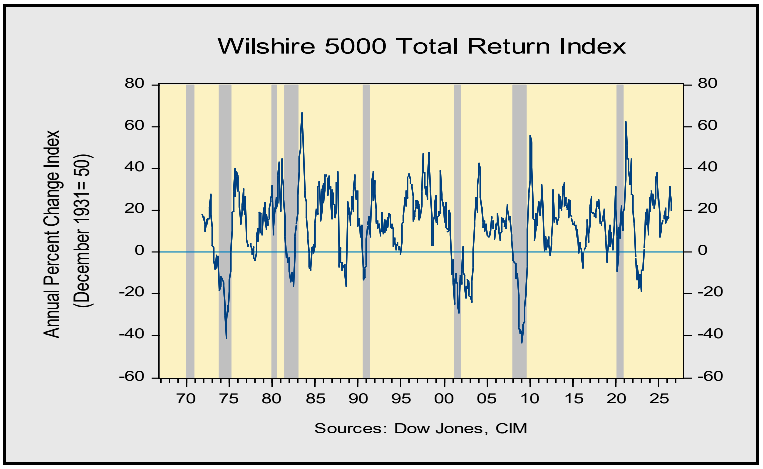
- The hawkish Federal Reserve stance is driving up short-term yields.
- Goods production remains resilient despite persistent inflation.
- Hiring activity has accelerated nationwide.



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

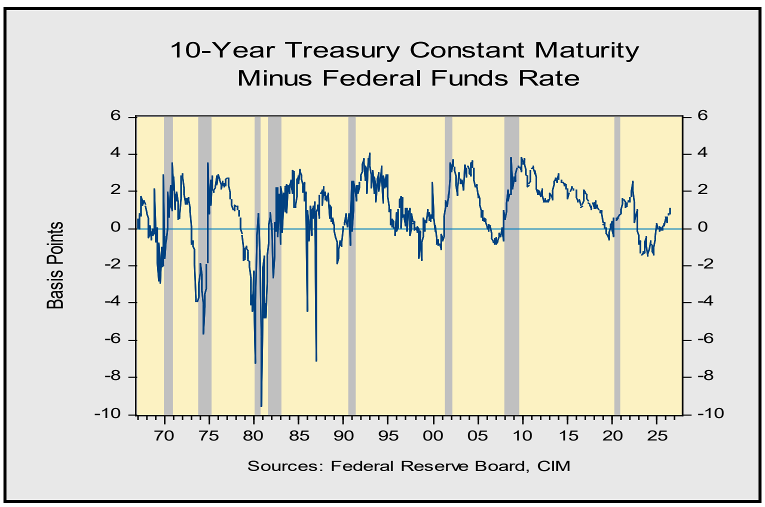
Wilshire 5000 Index



The Wilshire 5000 Total Return Index for August rose 20.1% from the prior year.

- Top-performing sectors: Energy, Information Technology, and Health Care.
- Bottom-performing sectors: Utilities, Industrials, and Real Estate.
- 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 +1.11 to +1.12.

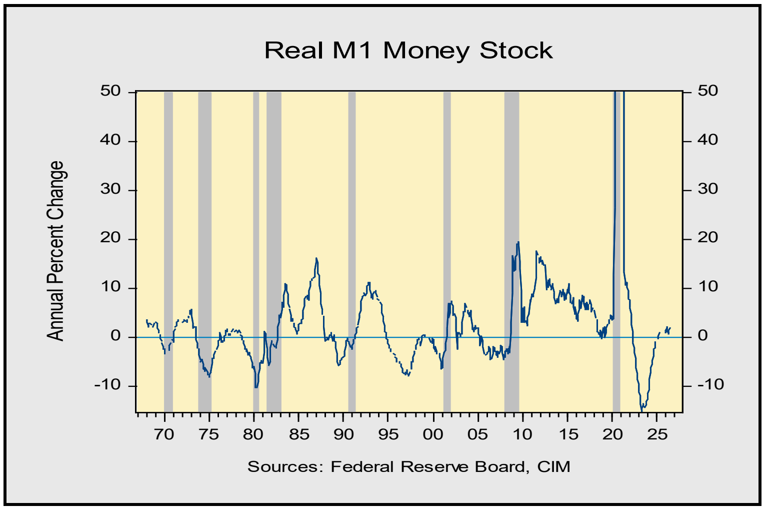
- The effective fed funds rate fell 1 bp to 3.63%.
- The 10-year Treasury was unchanged at 4.75%.
- Indicates recession when the level falls below zero.

10-Year Treasury Minus Three-Year Treasury

The term spread between the 10-year yield and three-year yield fell from +0.41 to +0.35.

- The 10-year Treasury yield was unchanged at 4.75%.
- The three-year Treasury yield increased from 4.34% to 4.40%.
- Indicates recession when the level falls below zero.

Real M1 Money Stock

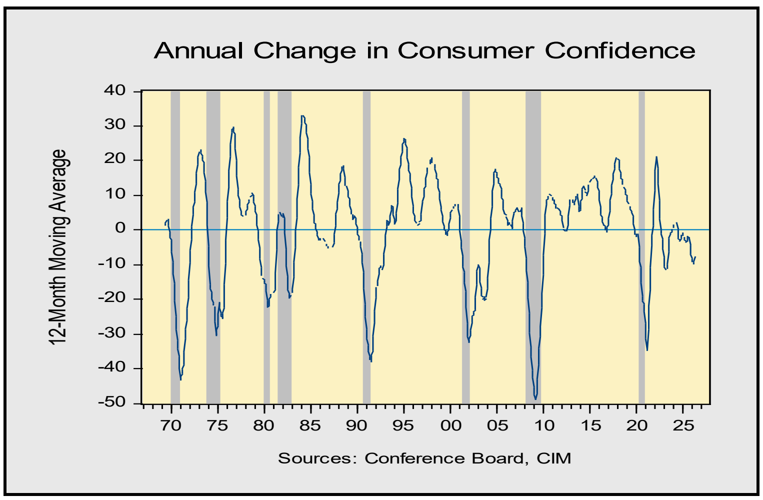


Real M1 money stock rose 2.7% from the prior year.

- Headline CPI rose 3.4% from the prior year.
- M1 money stock rose 6.1% from the prior year.
- Indicates recession when the level falls below zero.

Goods Production & Sentiment

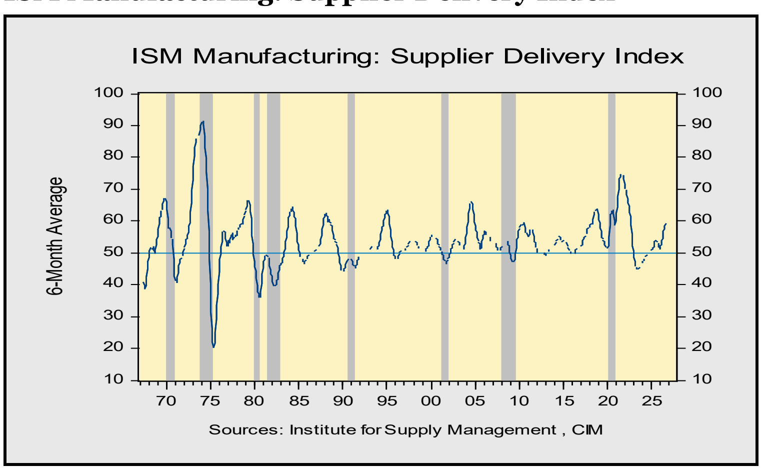
Consumer Confidence



In August, the 12-month moving average of the annual change in consumer confidence fell slightly from -8.25 to -8.30.

- Consumer confidence came in at 89.4, down from 97.8 in August 2025.
- The sub-index for the current situation came in at 121.2, down from 132.4 last year.
- Meanwhile, the sub-index for future expectations decreased from 74.0 to 68.2 in the same period.
- Indicates recession when the level falls below zero.

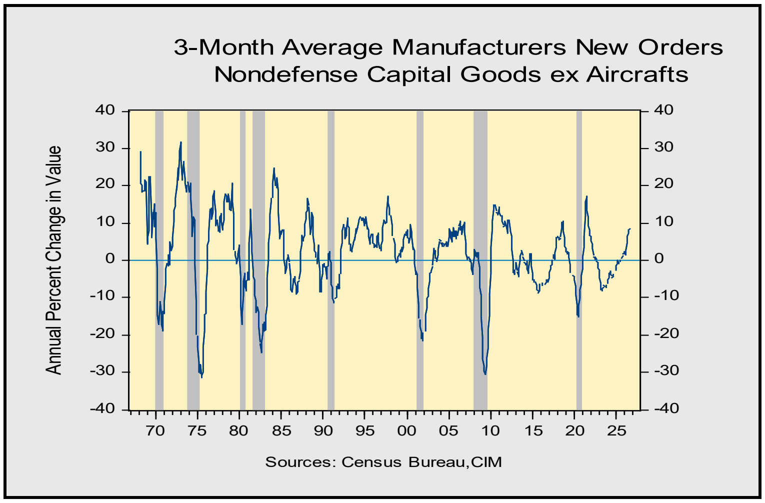
ISM Manufacturing: Supplier Delivery Index



The six-month moving average of the Supplier Delivery Index rose from 58.6 to 59.2.

- The overall index fell from 55.6 to 54.6.
- The Supplier Delivery Index rose from 58.9 to 59.3.
- Indicates recession when the level falls below 50.

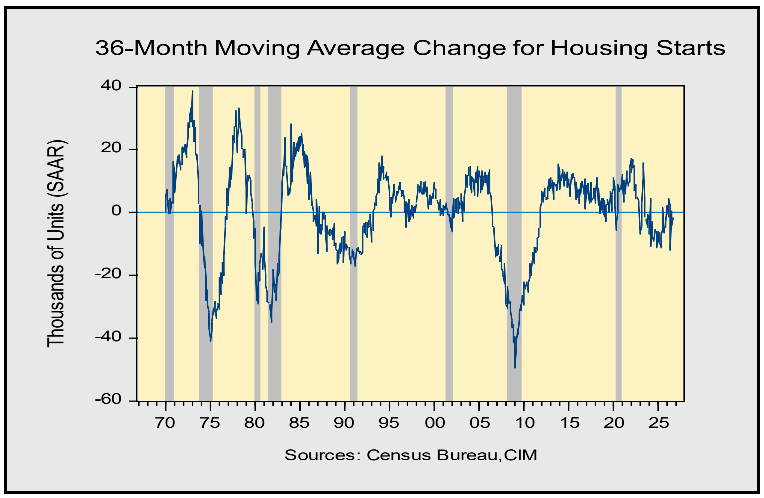
Three-Month Average Manufacturers' New Orders Nondefense Capital Goods excluding Aircraft



The three-month moving average of the annual change in new orders for nondefense capital goods rose 8.6% from the prior year.

- In August, new orders were up 0.1% from the prior month and rose 8.0% from the previous year.
- Indicates recession when the level falls below zero.

36-Month Moving Average Change for Housing Starts

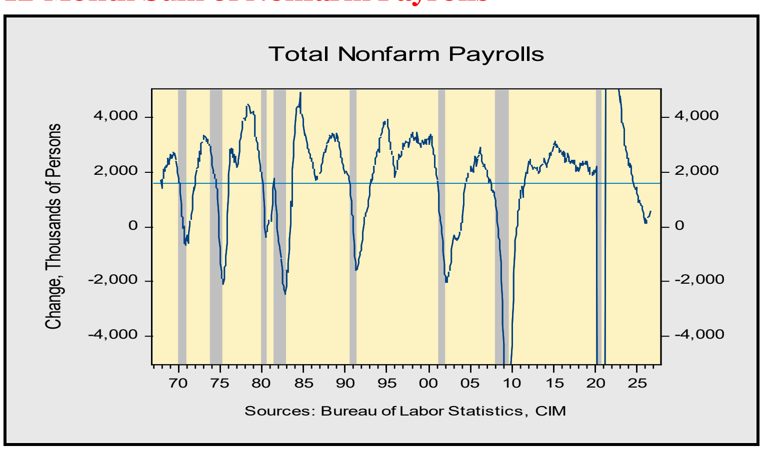


The 36-month moving average change for housing starts improved from -4.3 to -1.3.

- Housing starts expanded at an annualized rate of 1,275k, below the previous month's revised pace of 1,309k.
- Single-family starts rose from 853k to 918k. Multi-family dwellings fell from 444k to 344k.
- Indicates recession when the level falls below zero.

Labor Market

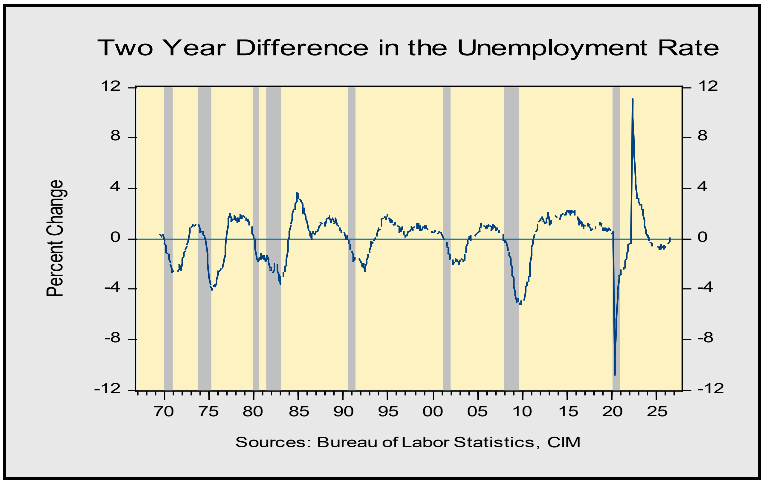
12-Month Sum of Nonfarm Payrolls



The 12-month moving sum increased from a revised 371k to 603k.

- Nonfarm payrolls showed that the economy added 162k jobs in August.
- Service-Providing industries added 86k jobs. The Goods-Producing sector added 41k jobs from the previous month, while the Government sector added 35k jobs.
- Indicates recession when the level falls below 1,500k.

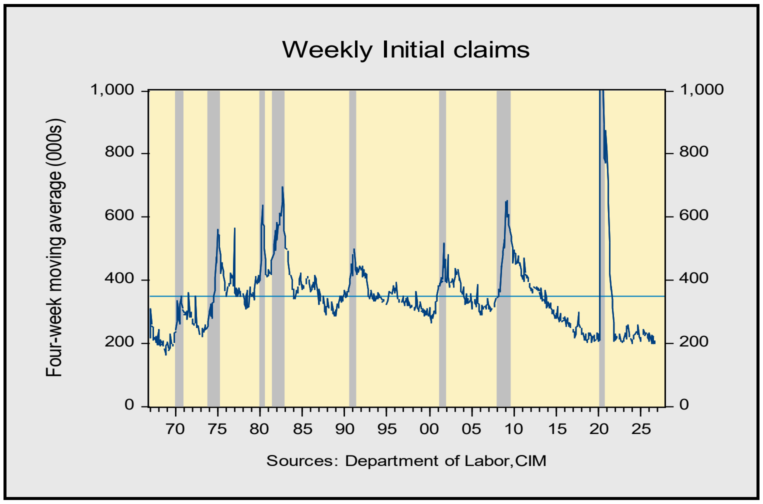
Two-Year Difference in the Unemployment Rate



The two-year difference in the unemployment rate was unchanged at +0.1.

- The unemployment rate was unchanged at 4.1%.
- The number of unemployed rose 1.7% from the prior month.
- Indicates recession when the level falls below zero.

Weekly Initial Claims



Average weekly claims for August was unchanged at 206k.

- Indicates recession when the level rises above 350k.

Thomas Wash, CBE
September 24, 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.