Conflicts Abound

The macroeconomic data are highly conflicting. Over the past month, initial jobless claims have edged up to around 260k having been as low as 190k last fall. Claims are expected to stay around that level for now. In percentage terms, this is a large enough increase to expect a pullback in hiring, however job gains remain robust. Nonfarm payrolls rose 339k in May and are expected to stay above 200k when the June data are released next Friday. This itself should push the Fed toward another 25 basis point rate hike on July 26th regardless of what the rest of the report shows.

The manufacturing ISM survey has been below 50 for seven consecutive months, and the various regional purchasing series suggest this weakness will persist. The factory workweek has been shortening with the amount of overtime historically low. Yet, the Fed’s industrial production data continues to expand, albeit modestly, while the Commerce Department’s durable goods orders recently made a new high.

The Conference Board’s consumer confidence index unexpectedly improved, consistent with healthy household spending. But its companion series from the University of Michigan shows the opposite, sitting at levels that — in the past — have been consistent with recession.

Housing starts, permits and residential sales have all improved from distressed readings. However, mortgage rates remain high, and home prices continue to soften. Overall housing affordability is still below where it was during the 2007 to 2009 financial crisis.

Headline consumer prices have plunged — they are likely to be up just 3% in June compared to last year’s 9% peak. Inflation expectations are low and stable. But core inflation is hovering near 5%.

Clashing signals have not just been limited to the economic data, of which there are still more examples. The financial markets are also sending a divergent message. The stock market is up over 20% from last October’s low, but the treasury yield curve has been inverting further. Its negative slope is approaching levels last seen before the US regional banking crisis erupted.

Arguably, even monetary policy is conflicted. The Fed has been aggressively increasing interest rates and may still hike more. But at the same time, monetary policymakers have been adding liquidity to the financial system. Higher rates explain the curve inversion while the added liquidity explains the rise in equity prices. How does this economic, financial market and policy tension get resolved?

The Fed wants to slow the economy to increase the unemployment rate which policymakers believe will put downward pressure on core inflation — their focus at present. Since the economy has never experienced a soft landing when the unemployment rate has risen more than half of one percent from its cyclical low, and the Fed’s own forecast shows such an increase, a downturn remains the mostly likely outcome.

Consequently, investors should expect more widespread softening in the macroeconomic data in the months ahead. In turn, this should lead to some retracement in stock prices. The extent of the anticipated downturn, and its duration, will be function of what the Fed’s response is when such an outcome becomes apparent. Stay tuned.
Disclaimers

This document is provided by SMBC Nikko Securities America, Inc. ("SMBC Nikko"), the US-registered broker-dealer affiliate of Sumitomo Mitsui Banking Corporation, for informational purposes only. This document was prepared by SMBC Nikko's economist(s). The views statements, assumptions and forecasts expressed herein are those of the author(s) and do not reflect the judgment of any other person or of SMBC Nikko, it does not constitute an offer, or solicitation of the sale or purchase, of securities or other investments. The information contained herein is obtained or derived from sources believed to be reliable, but SMBC Nikko and the author(s) make no representations as to its accuracy or completeness. In some cases, such information may be incomplete or summarized. This document has been prepared based on assumptions and parameters determined by the economist(s) in good faith. The assumptions and parameters used are not the only ones that could have been selected, and therefore no guarantee is given as to the accuracy, completeness, or reasonableness of any such quotations, disclosures, or analyses. Past performance is not a reliable indicator of any future results.

This document has been prepared for and is directed at institutional investors and other market professionals and is not intended for use by retail customers. It does not take into account any specific investment objective, financial situation, or particular need of any recipient. The information contained herein should, for whatever purpose, be used solely at the discretion and responsibility of the recipient. SMBC Nikko and its affiliates do not accept any liability or responsibility for any results in connection with the use of such information. Recipients are responsible for making final investment decisions and should do so at their own discretion after conducting a careful examination of all documentation delivered prior to execution, explanatory documents pertaining to listed securities, prospectuses, and other relevant documents, and their own independent analysis and assessment of the merits of any transaction. The financial instruments discussed may be speculative and may involve risks to principal and interest.

Conflicts of Interest Disclosures

The views statements, assumptions and forecasts expressed herein may differ from those expressed in globally branded research produced by SMBC Nikko or its affiliates. The trading desks of SMBC Nikko and its affiliates trade or may trade as principal in the financial instruments that are the subject of this material, and the author(s) of this document may have consulted with the trading desks while preparing this document. The proprietary interests of SMBC Nikko and its affiliates may conflict with those of the recipient. SMBC Nikko and its affiliates may seek to do business with the companies mentioned in this material and the trading desks may have accumulated, be in the process of accumulating, or accumulate long or short positions in the financial instruments mentioned and may have acquired them at prices no longer available. The trading desks may also have or take positions inconsistent with the views expressed in this document or may have already traded on those views.

This material is not a research report, and neither this material nor its author(s) is subject to SMBC Nikko policies and procedures that apply to the globally branded research reports and research analysts of SMBC Nikko and its affiliates or to legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research. This means that on the date of this document, SMBC Nikko, its affiliates, and their respective directors, representatives, or employees, may have a long or short position in any of the instruments mentioned in this document and may make a market or trade in instruments economically related to the securities, derivatives or other underlying assets mentioned herein, in each case either as principal or as agent.

No part of the author(s) compensation was, is, or will be, directly or indirectly related to the specific recommendations or views expressed herein. The personal views of authors may differ from one another.

Distribution, possession or delivery of this document in, to or from certain jurisdictions may be restricted or prohibited by law. Recipients of this document are required to inform themselves of and comply with all such restrictions or prohibitions.