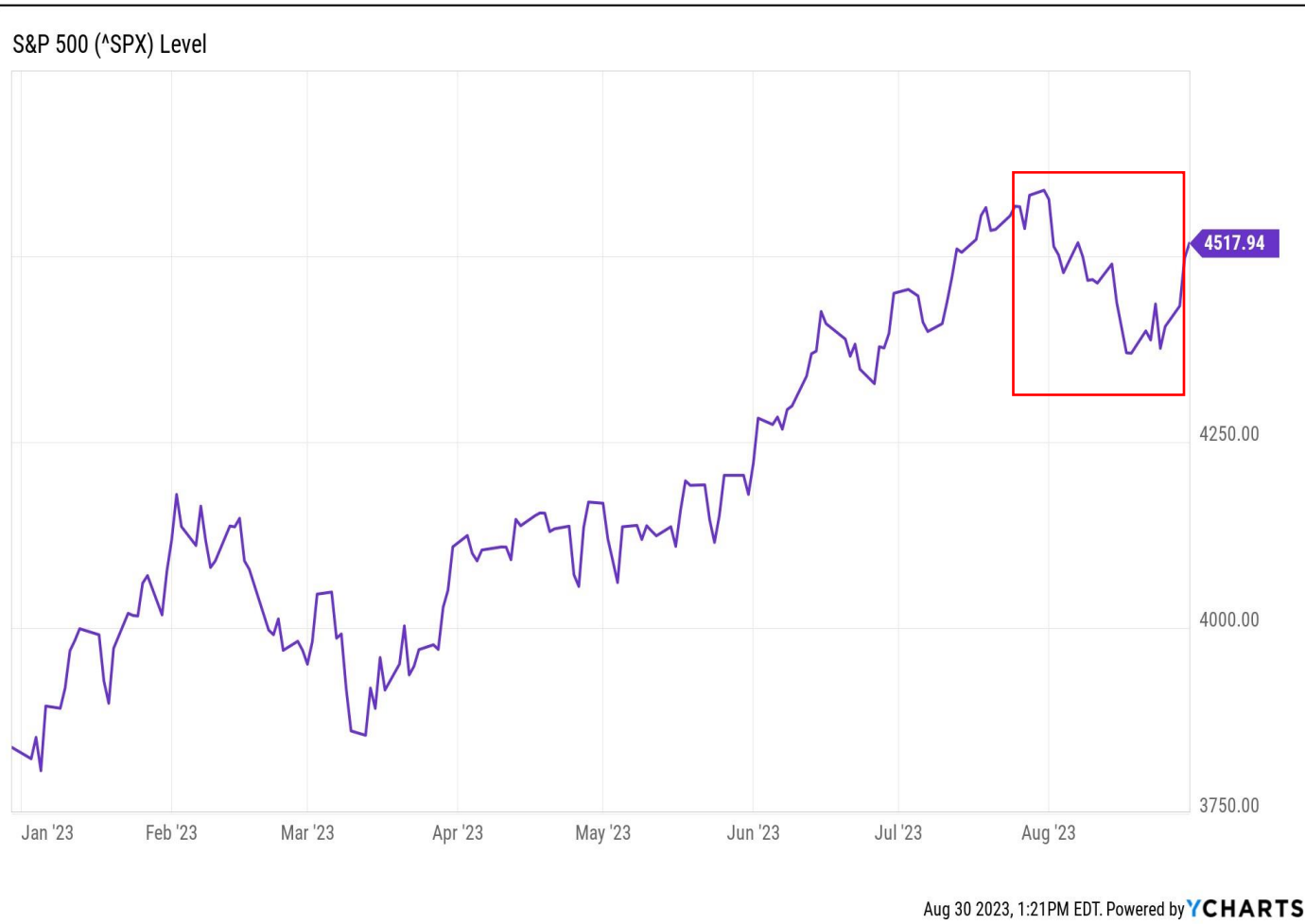


## **Sevens Report Alpha Webinar – Update on Inflation and the Economy**

**August 31<sup>st</sup>, 2023**

**Tom Essaye, President Sevens Report Research**

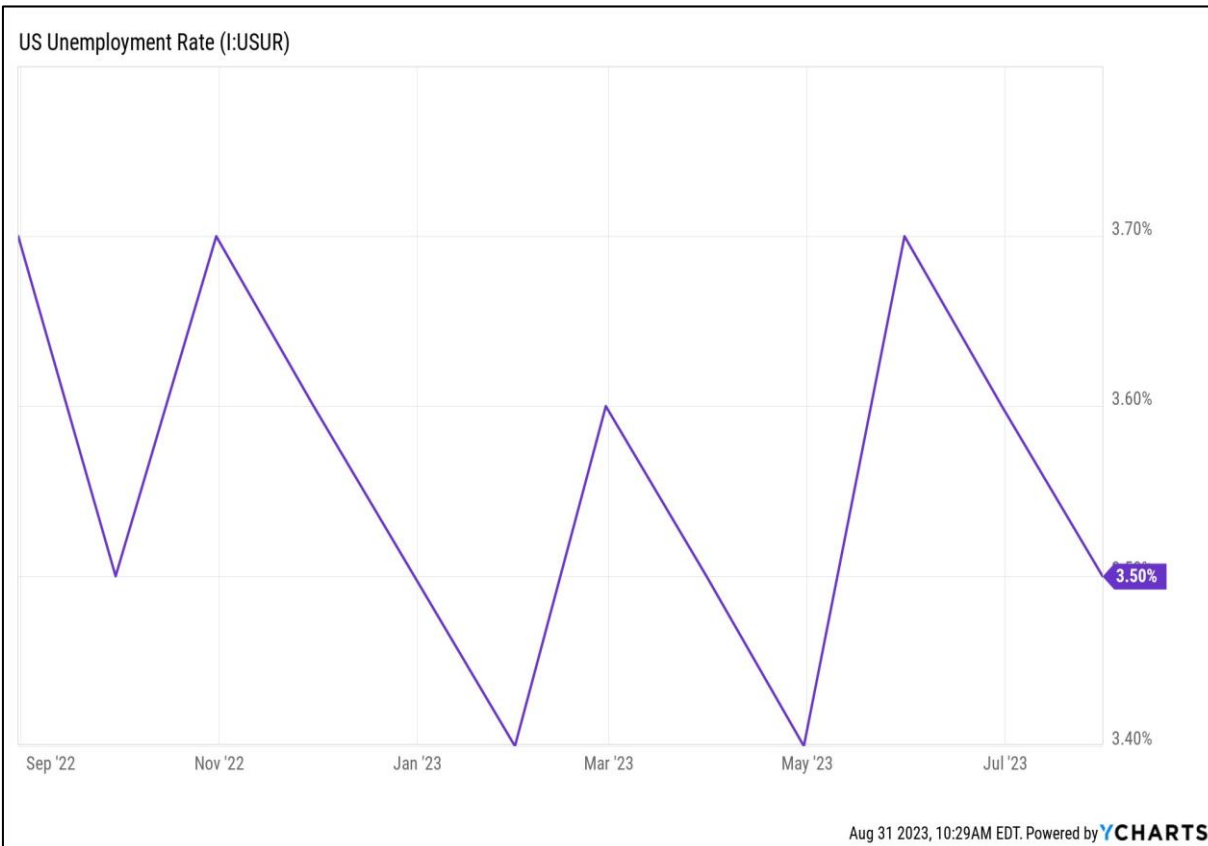
## Two Key Questions



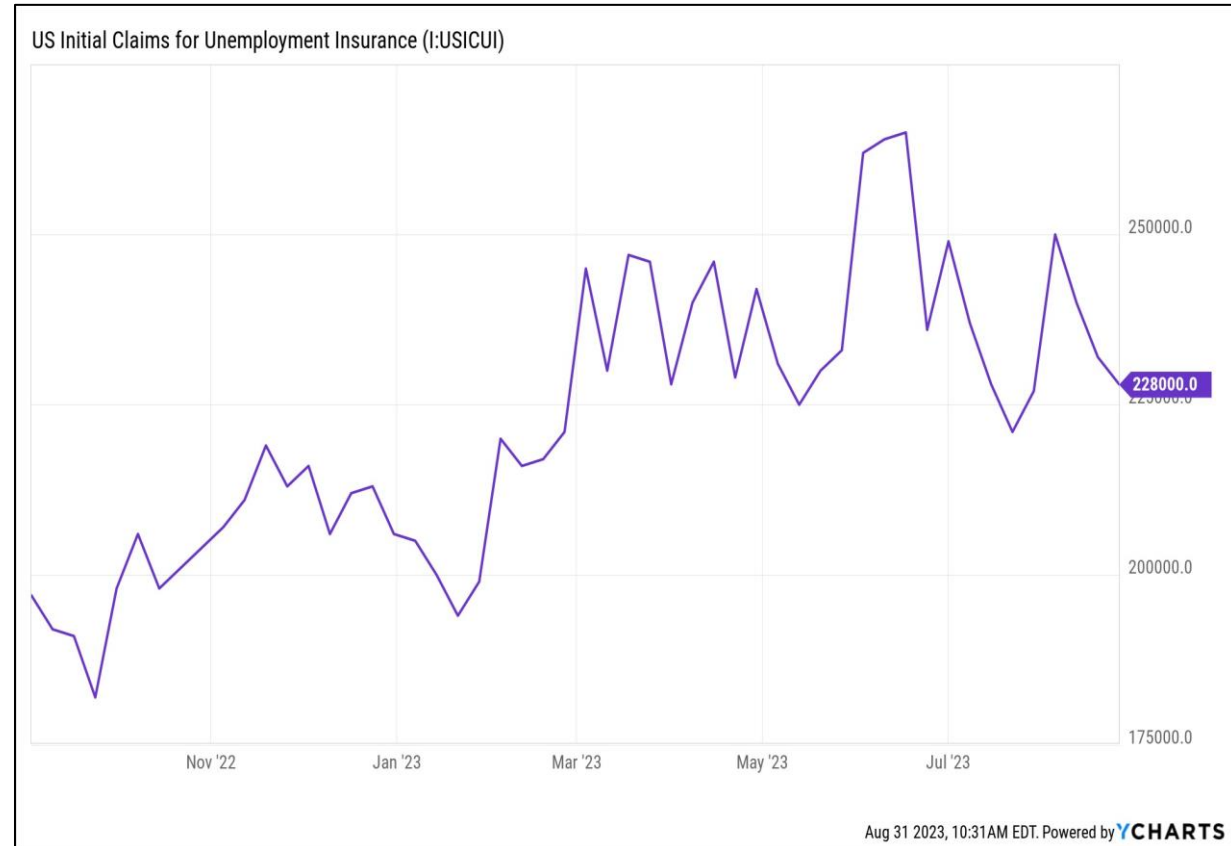
- The 2023 rally has stalled as economic data has become more mixed and now there are two important questions facing investors:
- Is an economic soft-landing still likely?
  - If yes, buying opportunity.
  - If no, markets are overvalued.
- Will inflation stay higher for longer?
  - If yes, rates are moving higher and that means more valuation pressure on stocks.
  - If no, buying opportunity.

# Labor Market

**There are no real signs of a slowdown in the labor market, as unemployment and jobless claims remain low.**



**For the labor market to show clear signs of deterioration, we'd need to see claims move towards 260k-300k and the unemployment rate move above 4.0%.**

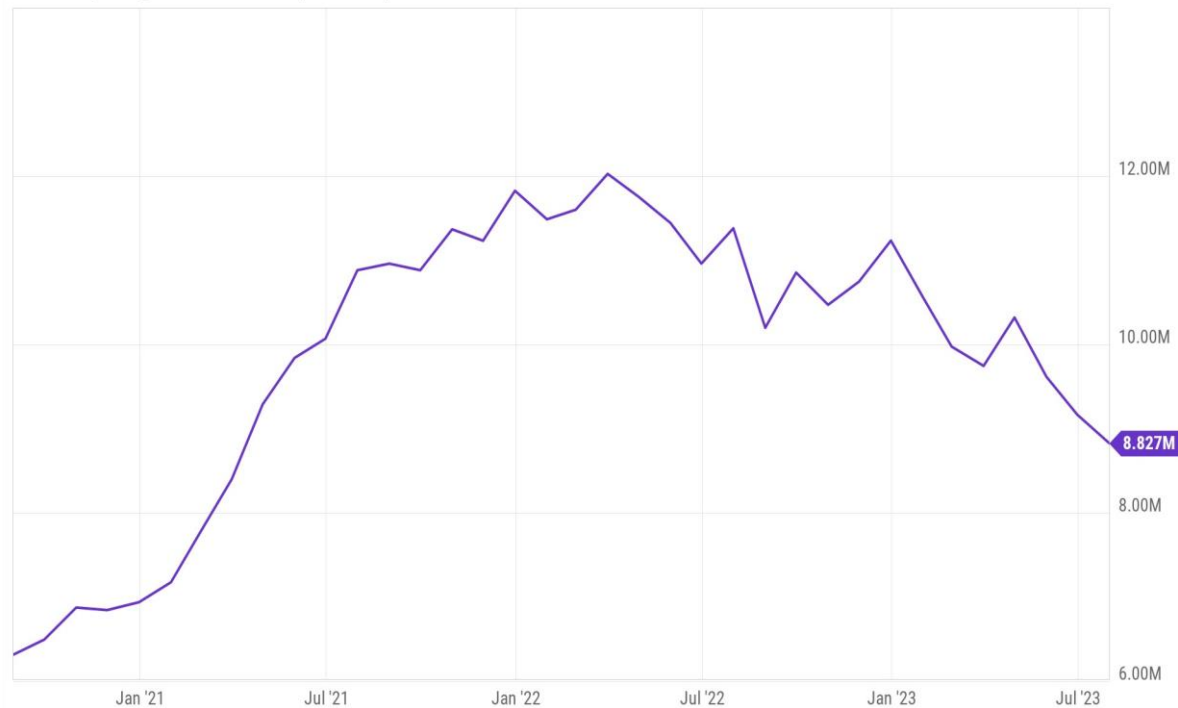


# Labor Market (Continued)

But, while the most followed labor market statistics are still showing a strong jobs market, there are some indicators that imply there's some softening.

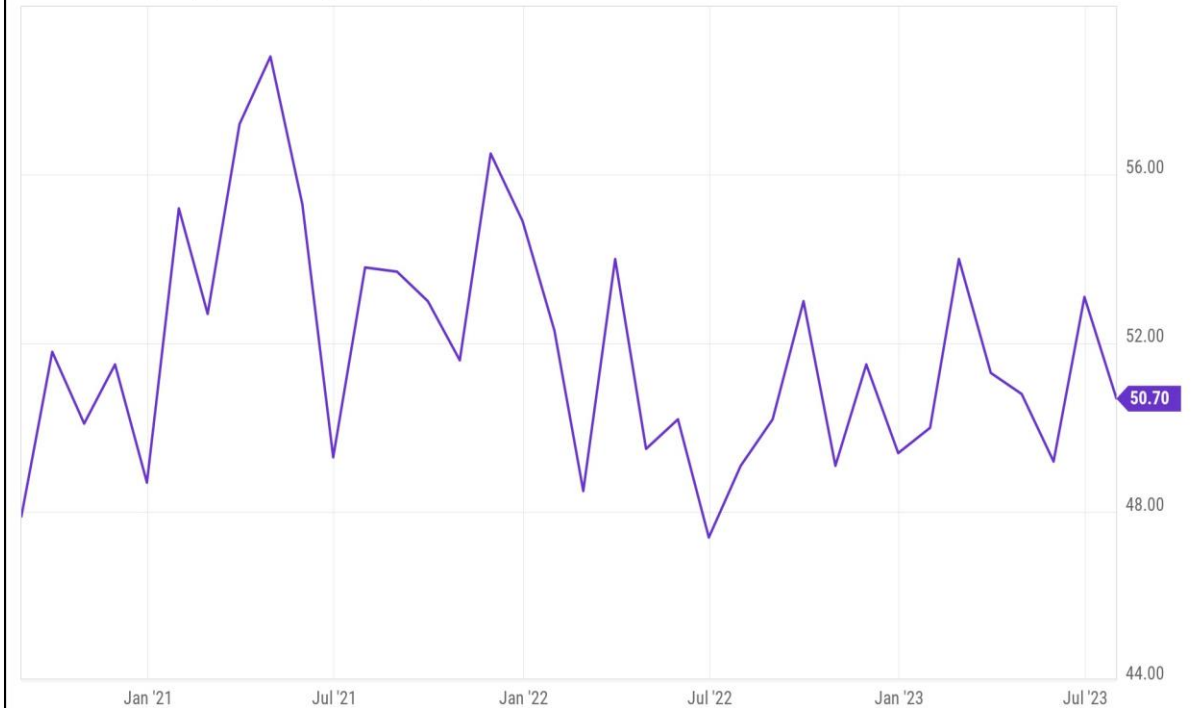
Whether these anecdotal readings of the jobs market begin to impact the more widely followed labor market metrics will be important for markets in the fourth quarter.

US Job Openings: Total Nonfarm (I:USJOTN)



Aug 30 2023, 1:25PM EDT. Powered by **YCHARTS**

US ISM Services Employment Index (I:ISMNMEI)

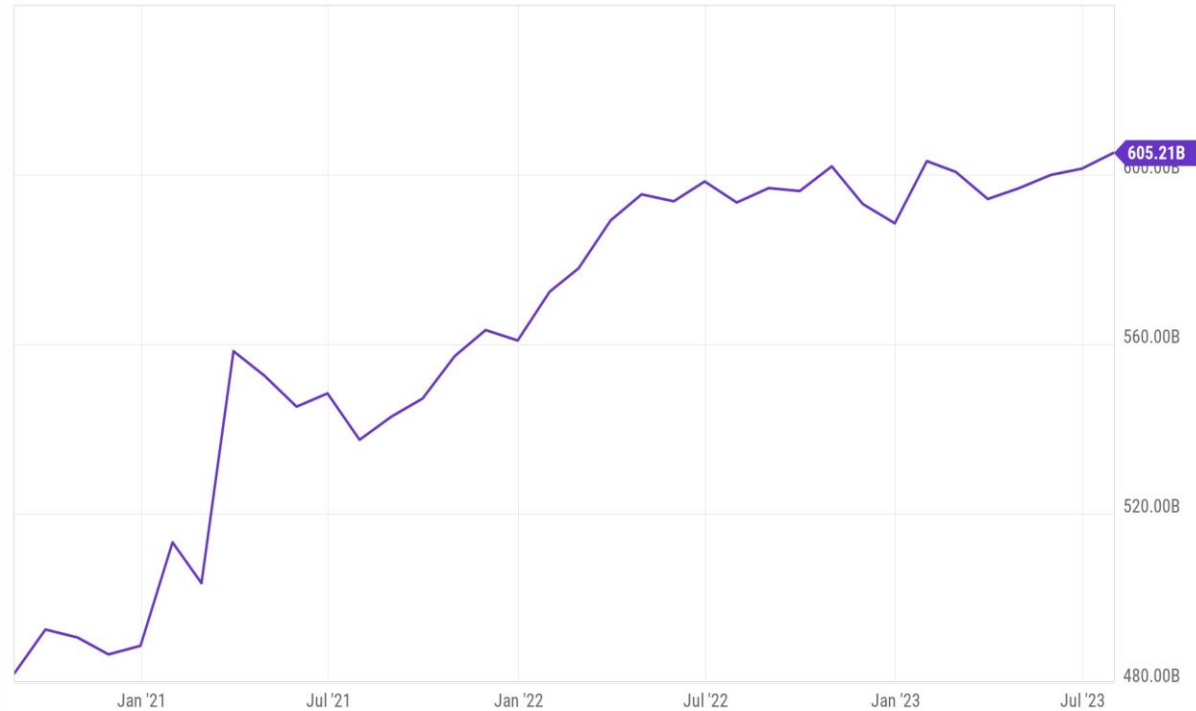


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# Growth

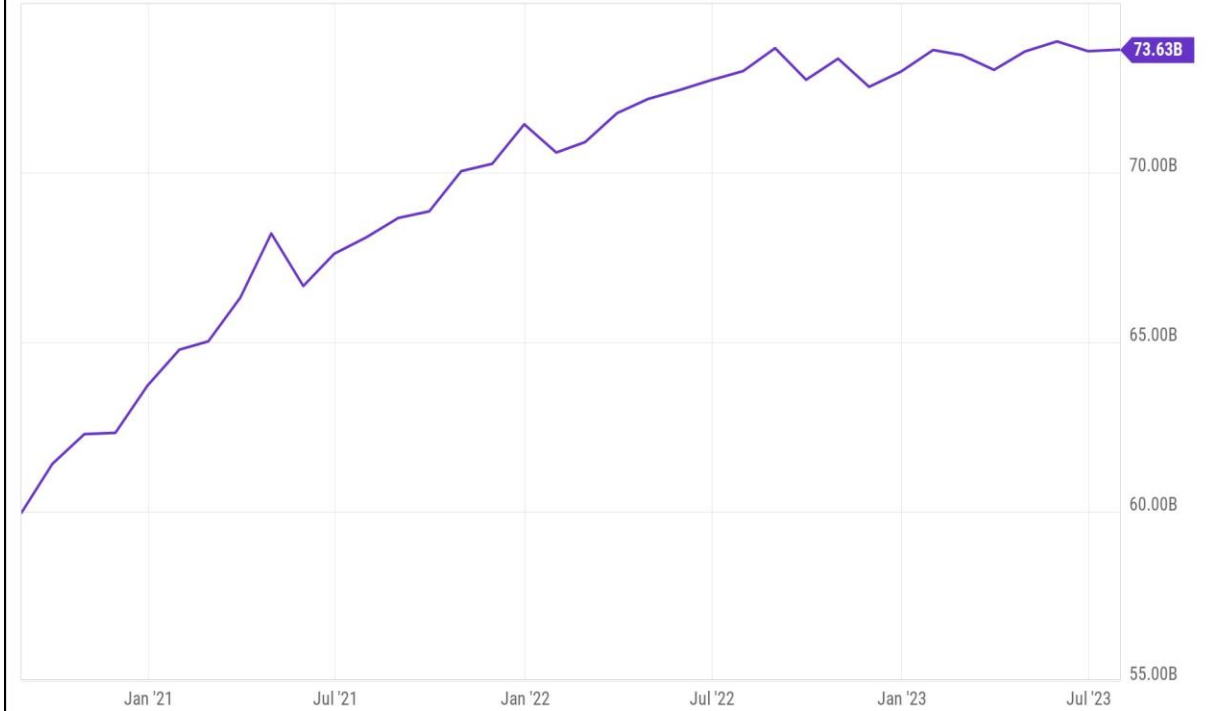
Like the labor market, major measures of economic growth remain “fine” and there’s no hard data to hint a soft landing is less likely than before.

US Retail Sales (I:USRS)



Aug 30 2023, 1:28PM EDT. Powered by **YCHARTS**

US Nondefense Capital Goods Excluding Aircraft New Orders (I:USNCFJOH)



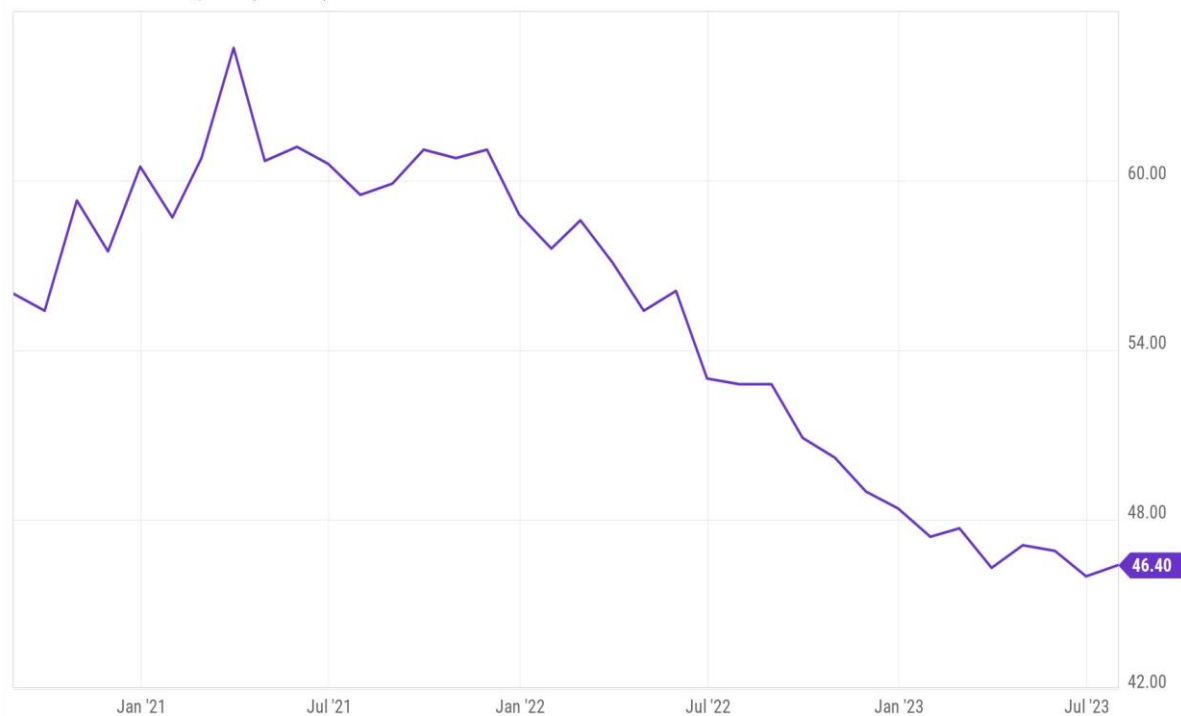
Aug 30 2023, 1:29PM EDT. Powered by **YCHARTS**

# Growth (Continued)

However, “soft” measures of the economy are more mixed. Manufacturing has been under pressure for most of this year, as manufacturing is more sensitive than services to rising interest rates.

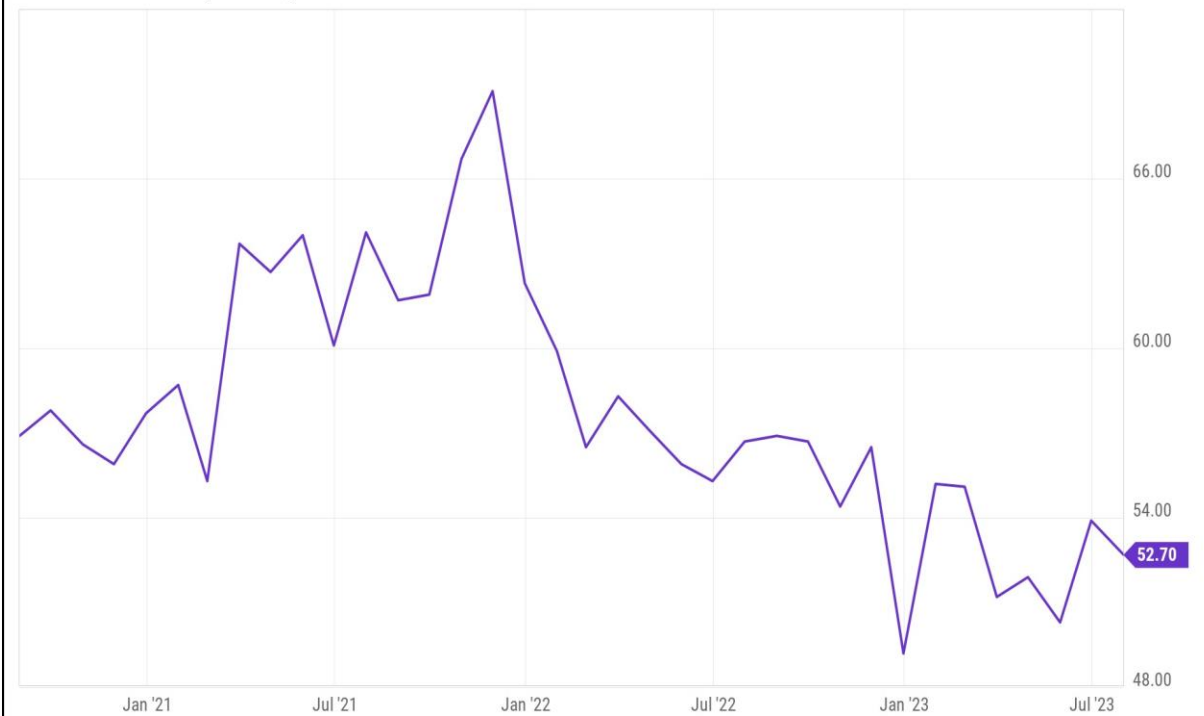
Lately the services PMI has also threatened to drop below 50, and if this happens consistently (so for 2-3 months) that will absolutely increase hard landing worries.

US ISM Manufacturing PMI (I:USPMI)



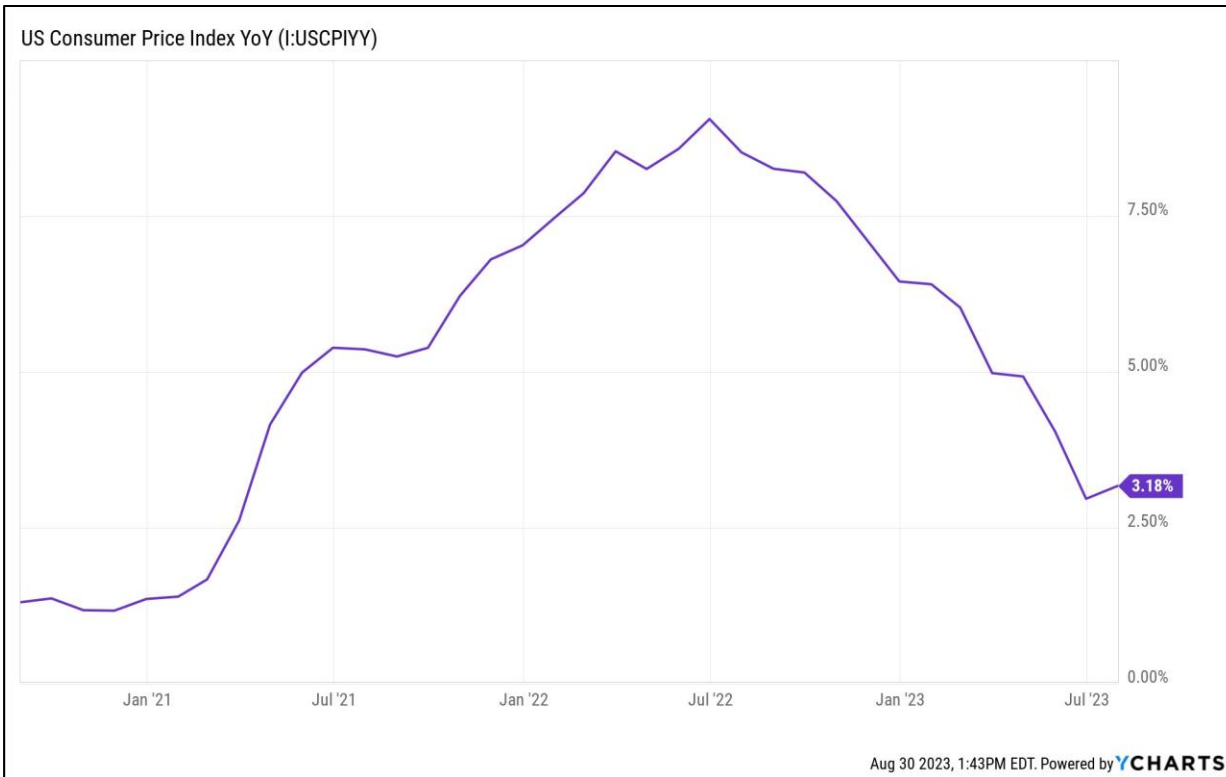
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US ISM Services PMI (I:ISMNMI)



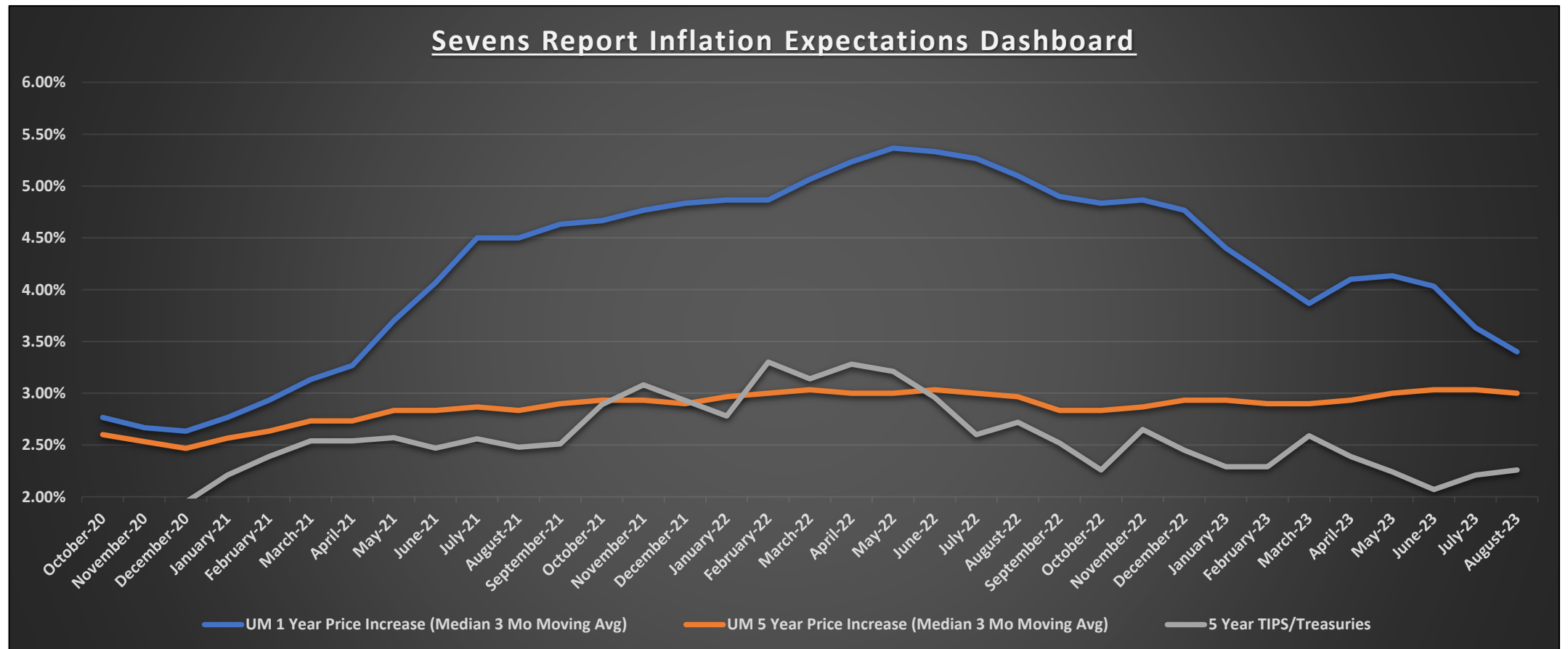
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## Inflation



- Inflation metrics have declined considerably and while there is some worry that inflation measures will bounce back now that easy “base effects” are working out of the readings, the bottom line is that most inflation metrics are pointing towards continued declines.

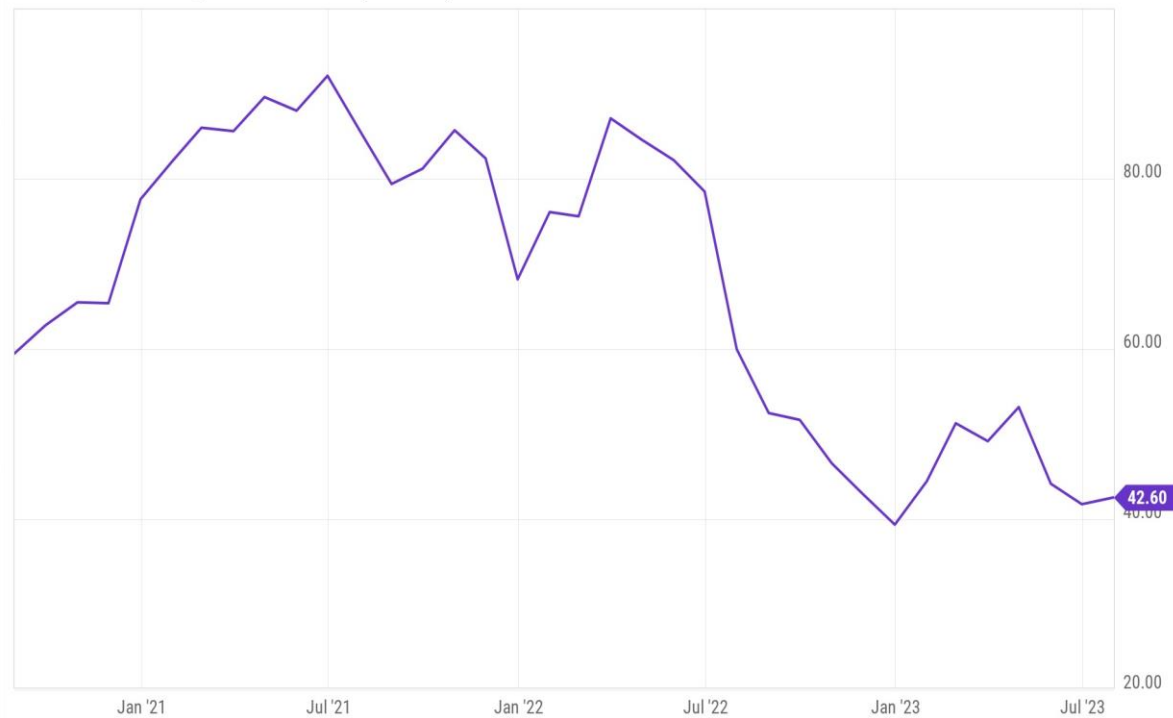
# Inflation (Continued)





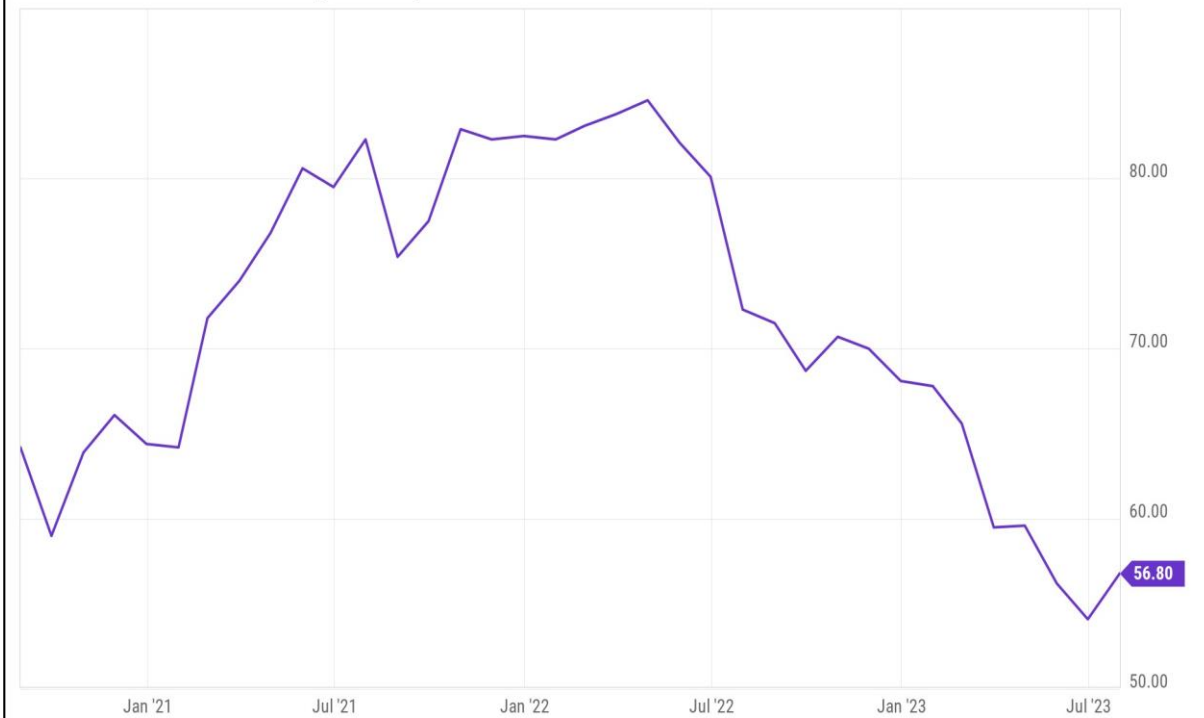
# Inflation (Continued)

US ISM Manufacturing Prices Paid Index (I:ISMMPPI)



Aug 30 2023, 1:39PM EDT. Powered by **YCHARTS**

US ISM Services Prices Paid Index (I:ISMNMPI)



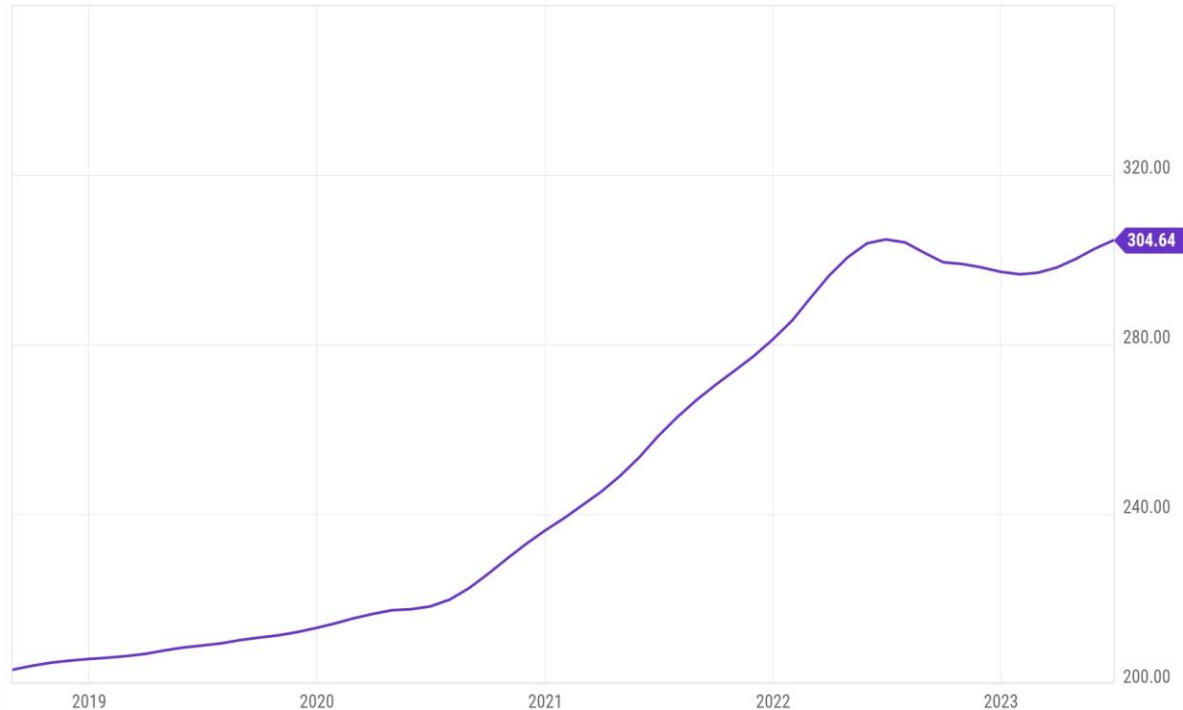
Aug 30 2023, 1:40PM EDT. Powered by **YCHARTS**

# Inflation (Continued)

The moderation of housing prices and rental increases should continue to gradually push inflation lower.

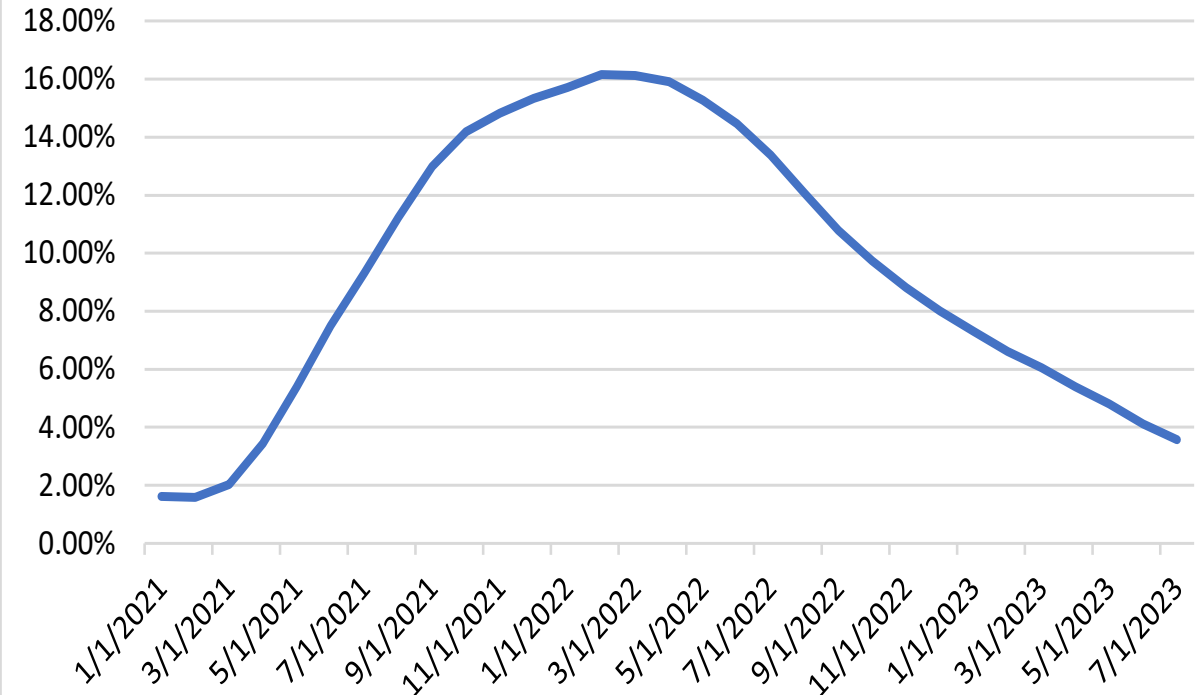
However, if we see a sustainable and significant rebound in home prices/rents, that would make an uptick in CPI more likely.

Case-Shiller Home Price Index: National (I:CSHPIN)



Aug 30 2023, 1:37PM EDT. Powered by YCHARTS

Zillow Observable Rent Index, Y/Y Change



## Answers to Those Questions

- Is an economic soft-landing still likely?
  - Based on facts, **yes it is.** There is not much in any observable economic data to imply a hard landing/recession is more likely than it was a few weeks or months ago.
  - Hard landing warning signs to watch for:
    - Hard Landing Warning Sign #1: The ISM Manufacturing and Service PMIs both fall below 50.
    - Hard Landing Warning Sign #2: Monthly retail sales suddenly turn lower and the rolling three-month average turns negative (we'll monitor this for you in the Economic Breaker Panel).
    - Jobless claims begin to rise, quickly, and the four-week moving average of claims rises above 260k.

## Answers to Those Questions

- Will inflation stay higher for longer?
  - Based on facts, **no it won't**. Most major inflation metrics are still solidly declining, including housing, which should exert downward pressure on CPI and other inflation metrics in the coming months.
  - Inflation bounce back signs to watch for:
    - Inflation Rebound Warning Sign #1: Prices in the ISM Manufacturing and Service surveys begin to sustainably rebound.
    - Inflation Rebound Warning Sign #2: Inflation expectations begin to rise (we'll monitor this internally in the Sevens Report Inflation Expectations Monitor).
    - Inflation Rebound Warning Sign #3: Housing and rent metrics begin to rebound solidly.

## Bottom Line

- The rally of 2023 has been driven (mostly) by more resilient than expected economic data and declining inflation (plus some AI enthusiasm).
- It's extremely prudent and reasonable to continue to watch trends in growth and inflation going forward, because if we see growth reverse lower and inflation stop declining, that will absolutely result in a correction in stocks and giving back all of the YTD gains is not unrealistic if a hard landing becomes more likely.
- But, based on facts, there is simply no reason to think that a hard landing is more likely than it's been in months, nor that inflation is about to reverse these recent declines.
- As such, while the pullback in stocks isn't over, there's no factual reason to believe we're about to see a full-blown correction.