Industry Snapshots

Arrow denotes 12-month moving total/average direction.

RETAIL SALES	Mild Rise
WHOLESALE TRADE	Mild Rise
AUTO PRODUCTION	Mild Rise
MANUFACTURING	Mild Rise
ROTARY RIG	Mild Rise
CAPITAL GOODS	Mild Rise
NONRESIDENTIAL CONSTRUCTION	Mild Rise
RESIDENTIAL CONSTRUCTION	Mild Rise

Steep Rise *Mild Rise* *Flat* *Mild Decline* *Steep Decline*

Macroeconomic Outlook

Rates of inflation are beginning to ease across the economy. US Consumer Prices, while up 8.3% from the year-ago level as of August, are in a tentative disinflation trend, with the rate of rise down from the June peak of 9.1%. US Producer Prices are in a similar trend, though the rates-of-change are noticeably higher (currently at 12.7%, down from 18.3%). We do not expect overall deflation, especially for consumers, though there are currently pockets of decline in some commodities – such as lumber, steel, oil, and copper – and there may be other such incidences ahead.

Inflation is coming down in part due to normal supply chain improvement, changes in demand, and the Federal Reserve's hawkish actions such as rate hikes and quantitative tightening. The Fed has raised its benchmark federal funds rate by more than 2 percentage points this year, with further increases expected. This rate rise and quantitative tightening has rippled through bond markets – lifting rates for short-term Treasury securities and corporate bond yields – and on to mortgage rates.

Thus far, US Single-Unit Housing Starts have borne the brunt of the rise in interest rates. Mortgage rates have more than doubled in the past year, surpassing 6% in the week prior to this writing, according to Freddie Mac. However, mortgage rates are not the sole reason for the weak Starts results; housing affordability has declined as rising home prices have outpaced incomes.

The housing market comprises a sizeable portion of the US economy, but not the whole of it. While we anticipate contraction in Single-Unit Housing Starts, we do not expect contraction for US Industrial Production. Rather, we anticipate a soft landing for Production in the latter half of 2023, with slowing growth giving way to accelerating growth.

> *"Additionally, Real Personal Income – excluding current transfer receipts such as stimulus payments – is rising."*

Evidence is wide ranging for a soft landing for Industrial Production. We are seeing signs of supply chain improvements, which will allow manufacturers to work through their expanded backlogs. Additionally, Real Personal Income – excluding current transfer receipts such as stimulus payments – is rising. This suggests that even when inflation is taken into account, consumers are well-positioned to drive the economy forward. Given that roughly two thirds of US Gross Domestic Product (GDP) is attributable to the consumer, this consumer strength is a key indication of the strength of the US economy.

Make Your Move

The labor shortage will remain a pain point in the coming years. Ensure your wages and benefits are competitive in your industry and geographic region and look for creative strategies to improve your retention of existing talent.

Investor Update

We are seeing a fundamental shift in the market, with convincing signs that inflationary pressures are easing in the overall defensive and high-inflation environment. What does this mean for you, the investor? Defensive, high-but-waning inflation periods are rare, but the relatively few precedents we have suggest balancing a more defensive-minded portfolio with diversification.

ITR Economics Long-Term View

2022	2023	2024
SLOWING GROWTH	SLOWING GROWTH	GROWTH

Leading Indicator Snapshot

	4Q2022	1Q2023	2Q2023
ITR Leading Indicator™	🔴	🔴	⚪
ITR Retail Sales Leading Indicator™	🟢	🔴	🔴
US OECD Leading Indicator	🔴	🔴	⚪
US ISM PMI (Purchasing Managers Index)	🔴	🔴	🔴
US Total Industry Capacity Utilization Rate	🔴	🔴	⚪

🟢 *Denotes that the indicator signals cyclical rise for the economy in the given quarter.*

🔴 *Denotes that the indicator signals cyclical decline for the economy in the given quarter.*

⚪ *N/A*

KEY TAKEAWAYS

- As of the most recent month of data, the US Total Industry Capacity Utilization Rate signals that US Industrial Production will be on the back side of the business cycle through the first quarter of 2023, corroborating what other leading indicators have signaled.
- The US ISM PMI (Purchasing Managers Index), which looks a little further out, signals growth-rate decline in Industrial Production will persist through the second quarter of next year.
- The ITR Retail Sales Leading Indicator™ is declining. While the timing relationship has been altered this cycle due to the unprecedented fiscal stimulus issued during the pandemic, decline in the Indicator aligns with our expectation for growth-rate decline in US Total Retail Sales. The Indicator suggests Retail Sales will be on the back side of the business cycle into at least the second half of 2023.

Industry Analysis

RETAIL SALES

- Annual US Total Retail Sales in August were 12.2% above the year-ago level
- Consumers are pulling back on some discretionary spending amid the heightened inflationary environment
- Slowing growth in consumer spending is likely to persist into 2023

WHOLESALE TRADE

- Annual US Total Wholesale Trade was at $7.9 trillion in July, 21.5% above the year-ago level
- Many markets are undergoing slowing growth on the back side of the business cycle, and some are even declining
- Annual Wholesale Trade will generally rise into at least 2023, though some rise will be attributable to elevated prices

AUTO PRODUCTION

- While still below year-ago levels, annual North America Light Vehicle Production is rising as supply chain pressures ease
- Backlogs and robust demand from consumers will drive growth in Production
- Annual Production will rise in the coming quarters

MANUFACTURING

- US Total Manufacturing Production in the 12 months through August was 4.1% above the same period one year ago
- We are seeing normalization in markets that expanded rapidly during the pandemic
- The overall US industrial sector is poised for a soft landing in 2023

ROTARY RIG

- In the three months through August, the US Rotary Rig Count averaged 753 units, 55.9% above the same period one year ago
- The US Rotary Rig Count will likely remain well-below the pre-pandemic peak in the coming quarters
- World Oil Supply is outpacing World Oil Demand, which will impact demand for exploration activity

CAPITAL GOODS NEW ORDERS

- Annual US Nondefense Capital Goods New Orders (excluding aircraft) in July were 11% above the year-ago level
- Cancellations are more likely on the back side of the business cycle – keep this in mind when planning inventories
- Disinflation and even deflation in some commodity prices will ease upside pressure on dollar-denominated New Orders, contributing to the slowing growth trend

TOTAL NONRESIDENTIAL CONSTRUCTION

- Annual US Total Nonresidential Construction transitioned to an accelerating growth trend in July, coming in 0.2% above the year-ago level
- Private Nonresidential Construction has been above year-ago levels since early 2022, while Public Nonresidential Construction, though recovering, remains below year-ago levels
- Labor shortages will persist as a pain point in this expanding market

TOTAL RESIDENTIAL CONSTRUCTION

- US Total Residential Construction in the 12 months through July was 20.7% above the year-ago level
- On a volume basis, single-family housing starts are declining amid affordability constraints; however, we do not anticipate this will be a long-term problem
- In the near term, multi-family construction will be an area of opportunity given the tight market and weakness in the single-family market

A Closer Look: The US Economy

What Turbulent Financial Markets Do (and Don't) Mean to You

BY: ERIC POST

What you need to know: Portfolios should anticipate quickly evolving conditions; some businesses will post soft landings while others undergo recession

For many investors, 2022 has been an exercise in frustration. Consider the following year-to-date performances (as of the morning of September 19):

• -14%: iShares 7-10 Year Treasury Bond ETF
• -18%: iShares iBoxx $ Investment Grade Corporate Bond ETF
• -19%: SPDR S&P 500 ETF
• -28%: Invesco QQQ ETF (tracks the NASDAQ)

WHAT HAS HAPPENED AND WHY

What has happened is a sharp move toward asset classes that benefit from inflationary trends and/or hold up better when economic growth prospects weaken. Even in inflationary times, people have to fill up the tanks in their cars and homes, pay their electric bills, insure their assets, put food on the table, and go to the doctor. Contrast the above year-to-date performances with the following:

• +35%: Energy Sector SPDR ETF
• +5%: Utilities Sector SPDR ETF
• +2%: iShares Insurance ETF (insurers are part of the finance sector)
• -2%: Invesco Dynamic Food & Beverage ETF (food and beverage is largely part of the consumer staples sector)
• -7%: iShares Healthcare Providers ETF (healthcare providers are part of the healthcare sector)

This is consistent with how the economic and financial data we track at ITR Economics has developed. Specifically, our system of leading indicators has foreshadowed an economy weakening into 2023 (as we have long been forecasting) and building inflationary pressures. The ITR Equity Optimizer™ portfolio is down a comparatively mild 6% year to date thanks to its heavy exposure to the utilities, consumer staples, and healthcare sectors thus far this year, as well as its modest exposure to energy and financials.

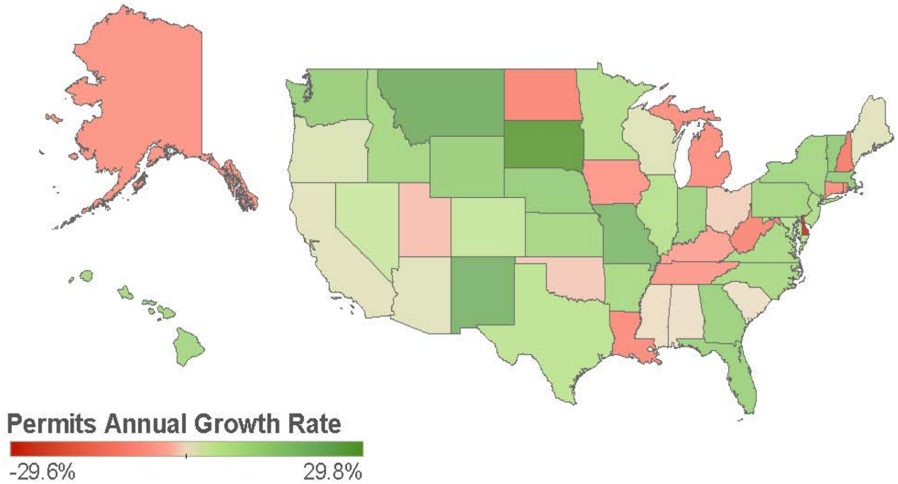
WHERE WE ARE HEADED AND THE ATTENDANT IMPLICATIONS FOR INVESTORS AND BUSINESS OWNERS

Keep in mind two things: (1) we are **NOT** investment advisors, and (2) past performance does not guarantee future results. Regarding the second point, not only does past performance not *guarantee* future results, the economic data suggests we should also not *expect* future results to mirror that of the year thus far. Why? Unlike most of the year thus far, inflation is now starting to ease, the supply chain is normalizing, and we are starting to see some green shoots develop within our system of leading indicators.

What does this mean for investors? Make sure your portfolio takes into account the ever-evolving economic and financial conditions. Complacency and looking in the rear-view mirror are the enemy: Federal Reserve actions, economic growth and recession probabilities, etc., evolve quickly, and as the year-to-date performance numbers show, even "safe" investments like long-term Treasury bonds are not immune in such an environment. Talk with your investment advisor, or, if you wish to learn more about the ITR Optimizer process, send ITR Economics President Alan Beaulieu an email (alan@itreconomics.com).

Finally, what does this all mean for business owners? The data shows that stock market performance is not the best indication of where the economy is headed. Instead, look to our forecasts, which are informed by the most predictive leading indicators. Those forecasts suggest that some segments of the US economy – particularly those on the services side or those that are less discretionary in nature – will undergo "soft landings," while segments that benefited greatly from the 2020−21 stimulus or that skew discretionary in nature are more likely to endure recession this cycle as they normalize.

State-by-State: Permits



- US Housing Permits in the 12 months through July came in 5.7% above the year-ago level, but activity has been waning in recent months. On a monthly basis, July Permits came in 3.4% below the July 2021 level; consumers are contending with rising mortgage rates and affordability issues.
- Annual permits for 16 states and the District of Columbia came in below year-ago levels in July, while permits posted double-digit rates of rise for 19 states.
- States with favorable population growth trends are affirming the old adage that it is all about "location, location, location" – permits exhibited strong growth in Florida, Georgia, New Mexico, Montana, and Wyoming.
- On the national level, Permits are likely to contract in the near term, but regional trends will vary.

Reader's Forum

I keep reading that inflation was unexpectedly high this past month. Should I be worried?

Caroline Dunsby, Economist at ITR Economics™, answers:

What most of the headlines are referring to is consumer inflation, which is a comparison between the Consumer Price Index (CPI) reading for the latest month and the CPI reading from the same month a year prior. Consumer inflation in August was at 8.3%, down from a tentative June peak of 9.1%. If the June peak holds, it will indicate that Consumer Prices are exhibiting disinflation – still rising, but at a slowing pace.

The results through August are not outside our expectations. Consumer Prices are elevated, and we expect they will continue to rise through at least 2023, but this is not cause for worry, so long as the appropriate actions are taken.

If your business is consumer facing, make plans to address this reality of heightened prices. Does your product mix include offerings for the more price-conscious customer? Are you seeing some consumer pullback in discretionary products? If so, incorporate this into your inventory plans. Inflation is a pain point, but, with the right plan of action, it does not have to be detrimental to your business.

Please send questions to: questions@itreconomics.com