Did Yields Peak?

Bond investors have had a rough year. However, there is hope on the horizon. Despite inflation at 40-year highs, aggressive rate hikes, and falling food, energy, and real estate prices, provide us with growing optimism that we have seen yields peak for this cycle. More evidence of a peak is found in the rapidly flattening yield curve. The 2yr/10yr yield curve now sits at -20bps, the lowest level since 2000. Recessions almost always follow yield curve inversions, and bond yields often peak and fall sharply before recessions.

Technical analysis also argues a peak in yields is becoming more likely. As we see below, the price of the 30-year Treasury bond future is forming a relatively symmetrical inverse head and shoulders pattern. A break above 143 would signal the possibility of a run to the mid-150s. It would also put the price solidly above its 200-day moving average. While the setup is optimistic, we offer caution. A Fed "pivot" or "stall" could lead bond investors to sell as concerns for another surge in inflation could resurface.

What To Watch Today

Economy

- 8:30 a.m. ET: **Chicago Fed national activity index**, June (0.01 prior)
- 8:30 a.m. ET: **Dallas Fed manufacturing business index**, July (17.7 prior)
-

Earnings

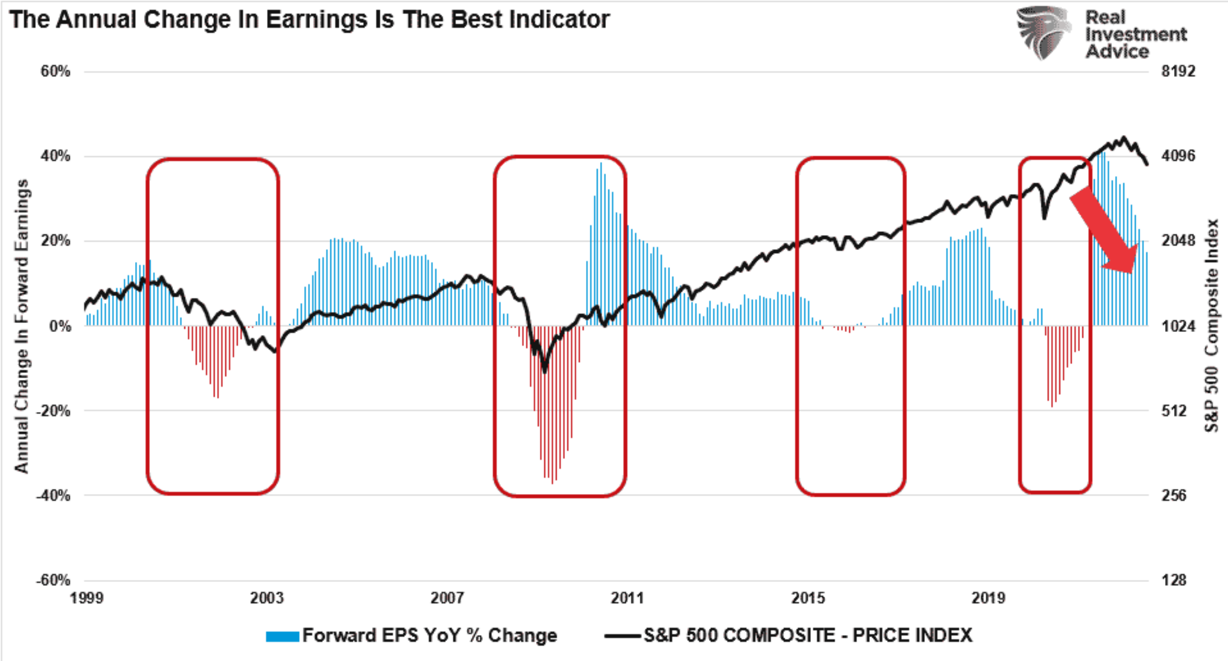
Whirlpool (WHR), **Squarespace** (SQSP), **TrueBlue** (TBI), **F5** (FFIV), **Alexandria Real Estate Equities** (ARE), **Ryanair** (RYAAY), **NXP Semiconductor** (NXPI), **Newmont Corporation** (NEM)

Market Trading Update - A Healthy Pullback?

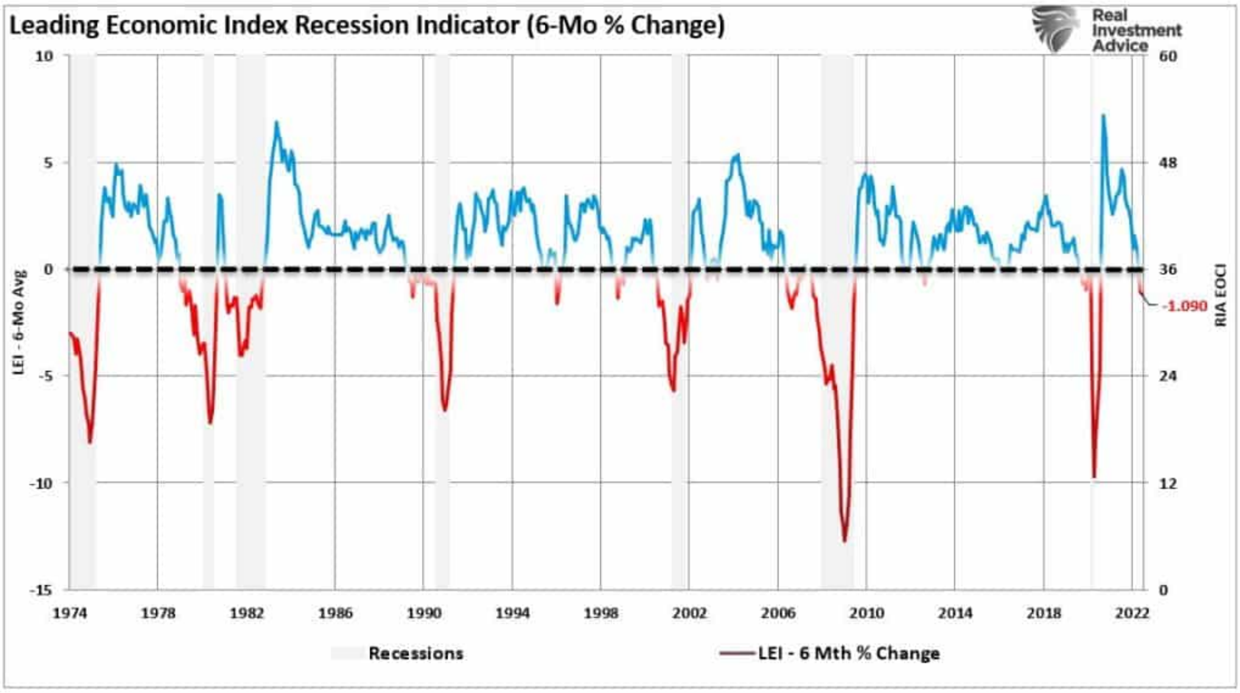
Over the last week, the market finally gained a decent rally. The break above the 50-dma and the declining trend channel gave the bulls the signal to jump back into stocks. While much of the rally was short-covering, the market did push into the upper resistance of the longer-term downtrend channel.

The sell-off on Friday was not surprising and could be bullish for the markets in the short term. With the markets very short-term overbought, a pullback to the 50-dma which holds would turn that previous resistance level into key support. If such occurs, without triggering a MACD sell signal, such could provide the setup for the bulls to rally the market a bit further.

As we proceed through earnings season, which will pick go into high gear next week, the big issue short term is whether estimates and stock prices have fallen enough to account for slower growth. As shown below, forward estimates have fallen but remain at a positive growth rate. Historically, if the economy is indeed slowing, the growth rate tends to go negative.



As far as a recession is concerned, the single best recession indicator is the Leading Economic Index's 6-month annual rate of change.



Whether or not a recession is imminent, the market tends to bottom before the economy. As such, could longer-term analysis be signaling a turning point is coming?

The Week Ahead

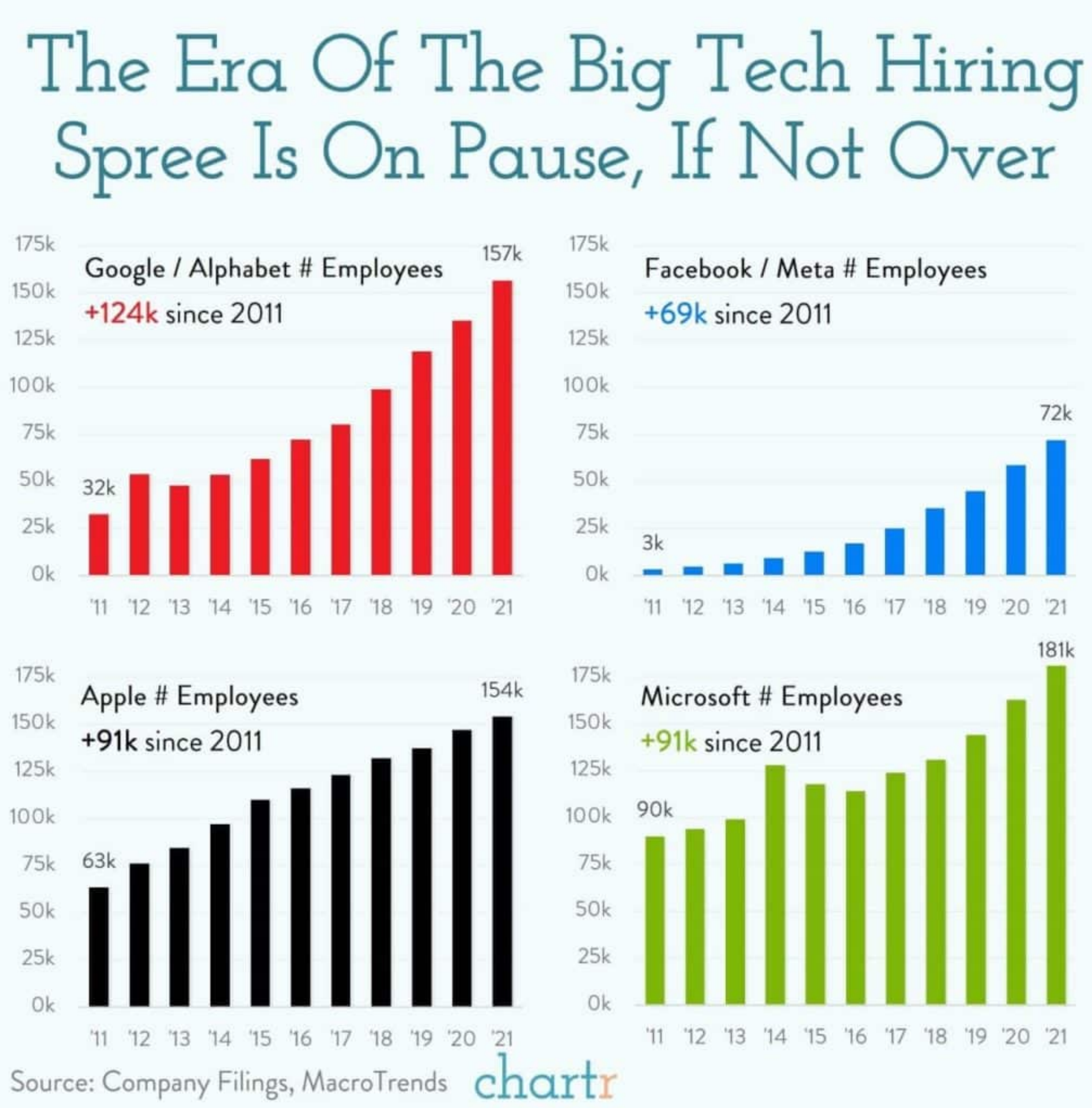
This is a big week for economic data, corporate earnings, and the Fed. On the economic data front, we will see a slew of regional manufacturing surveys. Following last week's sub-50 contractionary reading in the PMI flash survey, investors will look for confirmation in the regional reports. New orders, inflation, and forward-looking sentiment will be the sub-components garnering the most attention. New and pending home sales come out on Tuesday and Wednesday, respectively. Both are expected to drop as higher mortgage rates drag on the housing market. While the data is old, GDP on Thursday will be interesting. Another negative reading would put the economy in a technical recession. Current expectations are for a slight increase.

The Fed meets on Wednesday. Expectations are for continued hawkish sentiment and a 75bps rate hike. The potential surprise in the statement or Powell's press conference will be if they start talking about stalling rate hikes due to the economy. In this vein, we will also pay attention to see their level of concern for the recent weakening in the labor markets.

As if the Fed and economic data were not enough, the corporate earnings calendar will be busy. Apple, Microsoft, Amazon, Google, Exxon, and UPS all report this week.

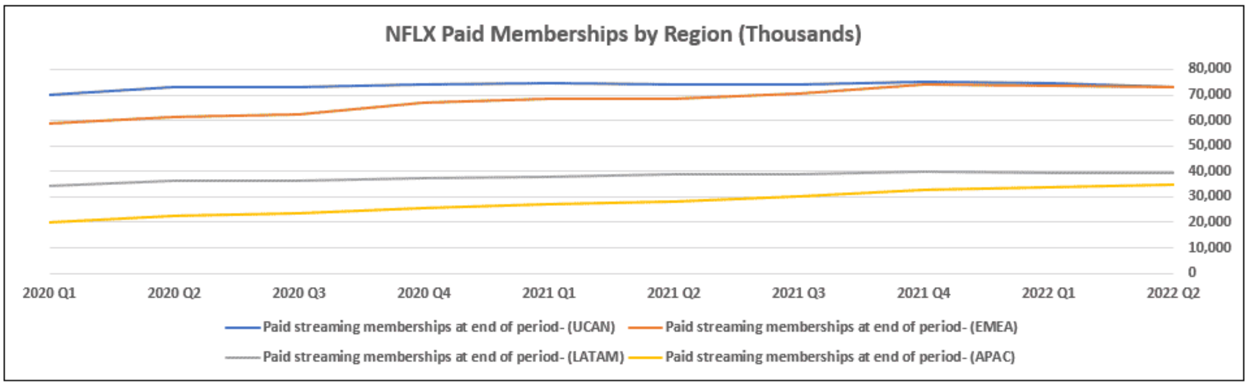
Hiring Freeze

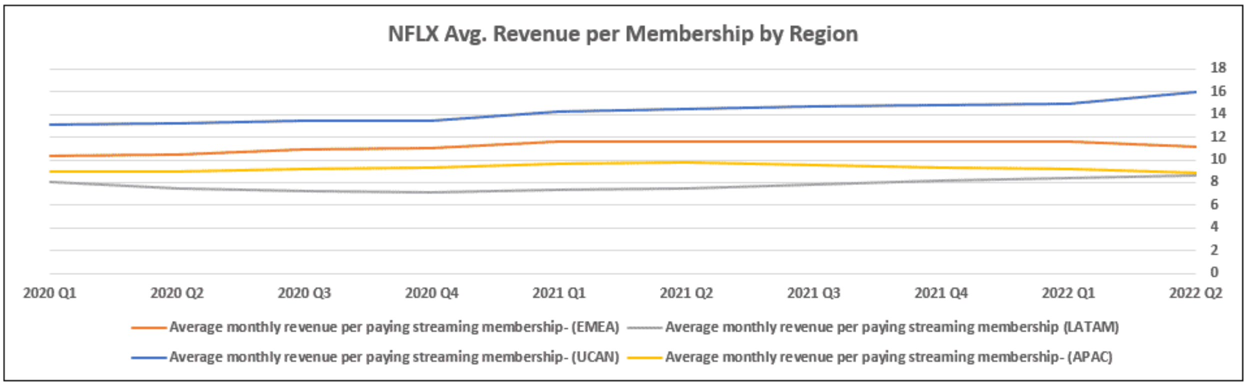
> "*Last week,* ***Google*** *announced a hiring freeze, with the search engine giant* ***putting a pause on all hiring for 2 weeks as the company reviews its*** *"headcount needs."*
>
> *Even if only short-lived, the announcements end a decade of almost non-stop hiring for much of big tech. A decade ago* ***Google*** *employed just* ***32,000*** *people. Today its parent company has more than* ***156,000****. In the same time frame* ***Facebook*** *went from* ***3,200*** *employees to more than* ***71,000 Metamates****, while* ***Apple*** *and* ***Microsoft*** *both added more than* ***90,000****. How long it takes to thaw out the freeze is likely to depend on if ? or perhaps when ? the US economy falls into a recession." - Chartr*



Digging Into NetFlix's Earnings

Netflix (NFLX) is up over 25% this week, primarily due to a positive reaction to its earnings. The headline that drove the gains was that subscriber losses in the 2nd quarter were less than expected. The positive surprise was driven by a strong net addition of subscribers in the Asia/Pacific region. Looking under the surface, however, the surprise isn?t as positive as one would think by looking at Netflix's stock price. Investors are overlooking that the average revenue per membership is much lower in areas where NFLX gained subscribers versus the regions where subscribers were lost. Furthermore, the largest drop in subscribers came from the region with the highest revenue per membership. The net additions bode well for its subscriber numbers but not for its revenue. This will be an important trend to follow in upcoming earnings reports.





Real Investment Advice

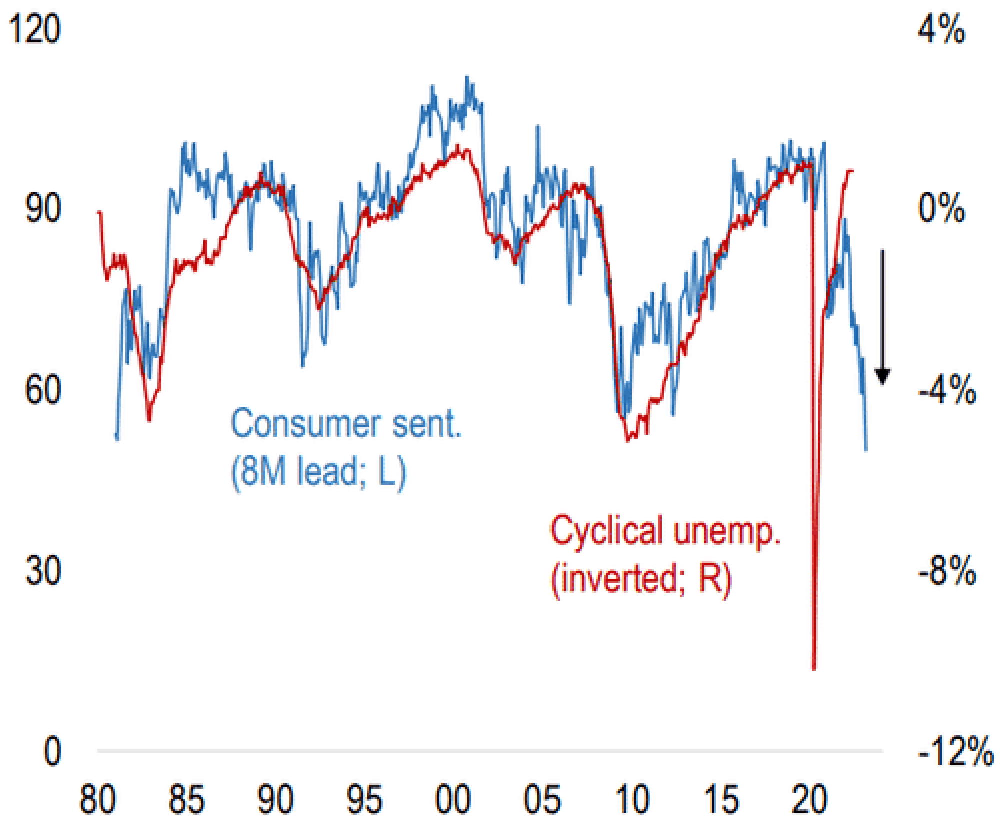
Jobless Claims Are Drifting Higher, Opposite of Sentiment

Initial jobless claims rose to 251k last Thursday. While still a relatively low number, it has been steadily rising for four months. Often, as recession approaches, hours get cut, temporary workers are laid off, and hiring for new positions is put on hold. Firing employees is not only costly but builds ill will toward the employer from those remaining employees. As such, jobless claims and the broad BLS employment data tend to lag economic weakness. Accordingly, we must rely on other data to help us assess how the labor markets will react to slower economic activity.

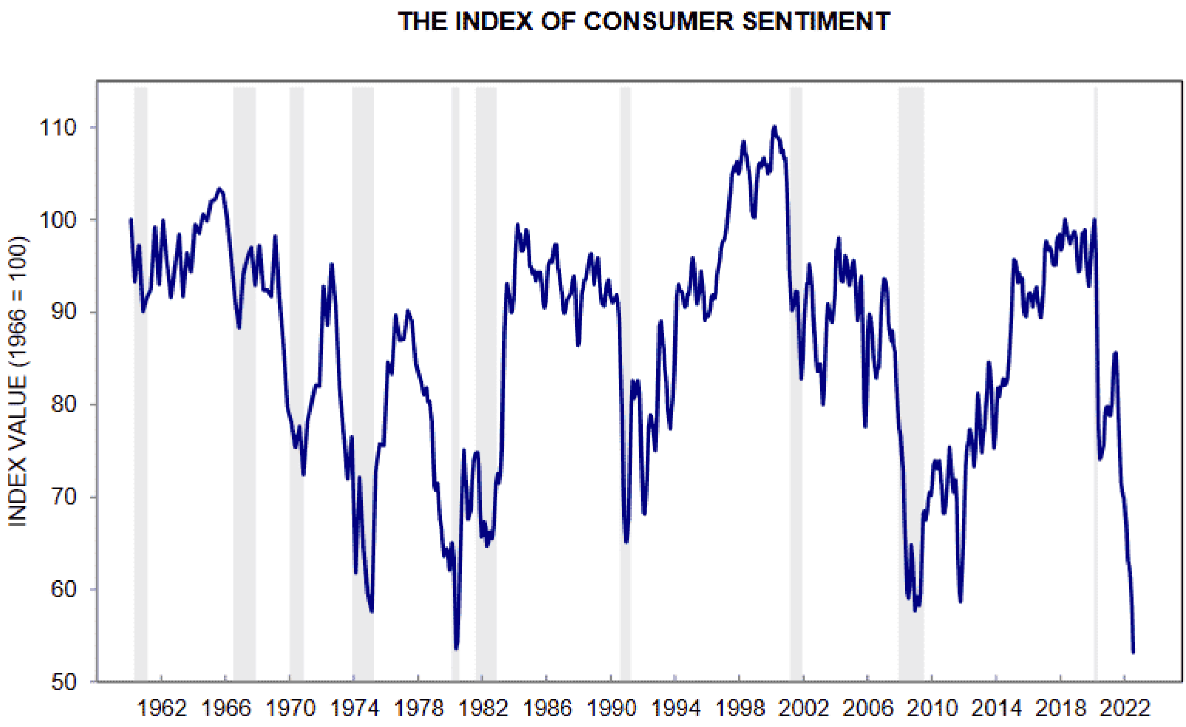
The first graph below shows a strong correlation between employment and consumer sentiment. Not surprisingly, as consumers account for two-thirds of GDP, consumer sentiment correlates well with economic activity. The University of Michigan Sentiment index (second graph) peaked in April 2021 but started falling rapidly in late 2021. It now matches the late 1970s at the lowest levels since 1960. The first graph indicates that sentiment tends to lead employment by eight months. Assuming the correlation holds, expect employment to deteriorate much quicker than in the first half of the year.

US cyclical unemployment vs. consumer sentiment

Unemployment rate – NAIRU and diffusion index



Source: University of Michigan, CBO; Numera calculations



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