



## ARGUS ECONOMIC COMMENTARY

September 11, 2023

### **Two-Thirds Through: Our Monthly Survey of the Economy, Interest Rates, and Stocks**

The stock market stumbled in August, declining 1.8% on the S&P 500 and about twice that much on the Nasdaq Composite. Even the staid Dow Jones Industrial Average lost ground, as profit-taking was both widespread and sector-agnostic (although Energy gained slightly). A minor rally in August's final week helped mitigate some of the pain; at one point in mid-August, the S&P 500 was down more than 4% for the month.

The stock market is now two-thirds of the way through the trading year -- and even with the August stumble, year-to-date gains are robust. As of the eight-month mark, the S&P 500 was up 17.4%. The Nasdaq doubled that gain with a 34% advance. Weighed down by Financial Services and legacy Technology, the DJIA was up just 5% year-to-date at the eight-month mark.

At the end of July, the S&P 500 was within a few percentage points of its all-time high from very early January 2022. The "500" ended August 6.5% below that all-time high. For the other major indices, the DJIA ended August 6% below its peak, and the Nasdaq 13% below its all-time high.

#### **The Economy, Interest Rates, and Earnings**

The preliminary (second) report on second-quarter 2023 real GDP indicated growth of 2.1%, up from 2.0% growth in the first quarter, though down from the advance (first) estimate of 2.4%. Given first-half 2023 GDP growth in the 2% range and 2.1% GDP growth for all of 2022, the economy is expanding (albeit at a less-than-optimal pace).

For 2Q23, the increase in real GDP reflected growth in consumer spending, non-residential fixed investment, state and local government spending, private inventory investment, and federal government spending. These gains were offset by decreases in exports and residential fixed investment (housing).

Whereas 1Q23 featured a very strong consumer and a slightly positive business-spending environment, 2Q23 featured a more cautious consumer partly offset by strong trends in corporate investment. Private inventory investment, which subtracted sharply from 1Q23 GDP growth, remained slightly negative in 2Q23, after being reported as slightly positive in the advance report. We still believe that the broad drawdown in distributor and OEM inventories was winding down by mid-year.

Personal consumption expenditures (PCE) edged up 1.7%, less than half the 1Q23 rate of 4.2% (which was the highest quarterly growth since 2Q21). Consumer spending on goods increased just 0.7% in 2Q23, down from 6.0% in 1Q23. Durable goods spending, which surged by 16.3% in the first quarter, was down 0.3% in the second quarter. Non-durable goods spending grew 1.2%, better than in the advance report and rising from first-quarter levels. Services spending rose 2.2%, down from the first quarter's 3.2%.

Consumer spending on goods, which declined in every quarter of 2022, spurted higher in 1Q23 as consumers binged on vehicles and vacation. That behavior now looks like an anomaly, as consumers reckon with high rates. We expected to see this category moderate in a high-interest rate environment and as inflation drags through a second year.

Non-residential fixed investment, a proxy for corporate capital spending, increased 6.1% in 2Q23 -- better than the 2Q23 advance estimate of 4.9% and just 0.6% growth in the first quarter. Corporate capital spending rose in every quarter of 2022. Argus expects business spending to increase across the balance of 2023, but at a slower pace than overall GDP growth.

Within non-residential fixed investment, corporate spending on structures grew 11.2%, actually slowing after consecutive quarters of 15%-plus growth. Spending on equipment

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grew 7.7% after falling in high-single-digit percentages in the first quarter. Spending on intellectual property products grew by 2.2% in 2Q23.

Residential fixed investment declined at an annualized 3.6% rate in 2Q23, slightly better than the first-quarter's 4% drop. This housing-driven category declined at 10.6% for all of 2022. Argus sees the potential for flat/positive growth in residential fixed investment in the second half of 2023, which potentially means growth in this category for the first time since 1Q21.

Another aspect of the business economy, and one that can act as a swing factor in the broad economy, is the change in private inventories. Reduction in private inventories subtracted 214 basis points (bps) from 1Q23 growth. Private inventories were mildly negative in 2Q23, subtracting nine bps from overall GDP growth. The burning-off of distributor and OEM excess inventories is likely drawing to an end, but we do not see this category as a major growth driver in the second half of 2023.

For the past two years, one or more "outlier" data points have had an outsized impact on the total GDP report. In 2Q23, exports fell 10.7%, after rising 7.8% in 1Q23. Imports (which when rising are subtractive to GDP) fell 7.0%. Net exports-imports were thus negative for GDP growth.

Total government spending rose a (slightly) higher-than-normal 3.3%, down from a 5.0% rate in 1Q23. Federal spending was up 1.2% and federal non-defense spending growth down less than 1% for 2Q23, after 10.9% growth in the first quarter. State and local government spending extended first-quarter strength and was up 4.7%, after rising just 0.7% for all of 2022. Further cooling in government spending underpins our more-conservative GDP forecast in the second half of 2023.

Outside the GDP report, the jobs economy continues to moderate. Nonfarm payrolls grew by 187,000 in August 2023, less than the average monthly gain of 271,000 over the past 12 months; average monthly jobs growth was 399,000 for all of 2022. Argus looks for continued nonfarm payrolls growth in the sub-200K range in coming quarters -- but we have been saying that for months.

Unemployment jumped to 3.8% for August, from 3.5% in July. Annual wage growth ran at a 4.3% pace in August 2023, just below July PCE core inflation of 4.2% and well below the fed funds rate of 5.25%-5.5%. Argus believes higher unemployment and slowing wage growth will keep the Fed from further hiking the fed funds rate through the remainder of the year.

Indicators from the industrial economy suggest that most parts of the economy are growing at a subdued-but-steady level. Durable goods orders, after 4.7% month-over-month growth in June, fell 5.2% in July. But backing out the distorting timing of Boeing aircraft orders, the reading was up 0.5%. ISM's manufacturing PMI posted its tenth

straight reading in contraction territory (under 50). But the purchasing manager indicator reached a six-month high of 47.6% in July, up from 46.4% in June. The ISM's services PMI continues to signal expansion, rising to 56.7% in July from 53.9% in June and 50.3% in May.

Signals from the consumer economy remain mixed. Retail sales rose 0.7% month-over-month in July, up from a revised 0.3% for June. According to the BEA, personal incomes were up 0.2% in July, while personal consumption spending was up 0.8%.

The University of Michigan Consumer Sentiment survey for August 2023 came in at 69.5, down from 71.6 in July as inflation continued to drag on spending plans. Consumer confidence also fell, to 106.1 in August from 114.0 in July. Both of these series surged in May and June and have now moderated from that peak; consumer confidence was at the 100 level for most of 2023.

The housing economy remains constrained, as would-be sellers are in "mortgage handcuffs" (unwilling to give up a low-rate mortgage for a high-rate mortgage). With two-thirds of existing mortgages below 4%, inventory of existing homes is down in double-digits year-over-year. Recent new-home sales data has been more encouraging. July new-home sales expanded by 4.4% from June levels, to a seasonally adjusted annual rate (SAAR) of 714,000. The rate of supply of new homes continues to exceed that of existing homes.

For all of 2022, real GDP increased 2.1%, compared with an increase of 5.9% in 2021. Amid signs of mid-year recovery in certain consumer and business metrics, we are nudging up our GDP growth forecast for 2023 to 2.3%. A recent Atlanta Fed's GDPNow forecast called for 5.9% growth in 3Q23, which is much higher than the 2.3% consensus forecast. In line with the Atlanta Fed's positive outlook for 3Q23, Argus now expects 3Q23 to be the peak GDP quarter for the year. We look for 4.0% GDP growth in 3Q23 followed by just 1.5% growth in 4Q23.

Our GDP growth forecast for 2024 remains 2.2%; we expect this forecast number to be volatile. We continue to believe the U.S. economy can avoid recession in 2023 and 2024.

The FOMC paused its rate-hiking campaign in June and then hiked the fed funds rate by a quarter-point in July, bringing the fed funds rate central tendency to 5.25%-5.50%. Based on recent employment, inflation, and other economic data, Argus and the majority of investors now believe the Fed's 2022-23 rate-hiking campaign is over. But the timing of any reduction in rates during 2024 now seems more uncertain.

The CME's Fed Watch Tool shows over 90% of traders expected the Fed to hold off on additional rate hikes at the September FOMC meeting. However, around 30% of investors believe the Fed could hike rates at either its November or December meetings.

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The Fed did not conduct an FOMC meeting in August, but it did host its annual conclave in Jackson Hole, Wyoming. The Economic Symposium, held August 24-26, was meant to address “Structural Shifts in the Global Economy,” but that was not the top story. In his address, Fed Chairman Powell took a hawkish tone, noting that inflation was not yet at “an acceptable level” and that Fed officials will “do whatever it takes” to bring inflation down to the 2% target.

Consumer prices are moderating, but not fast enough. The July all-items CPI rose 0.2% month-over-month, flat with 0.2% in June, and was up 3.2% year-over-year, versus 3.3% annual growth a month earlier. The core CPI rose 0.2% month-over-month, unchanged, and 4.7% year-over-year, a tick better than consensus.

The all-items PPI showed a month-over-month increase of 0.3% for July, worsening from 0.1% for June. The annual change in all-items PPI was 0.8%, rising from 0.1% in June and 10 bps worse than the consensus. The core PPI -- which takes out food, energy, and trade services -- was up 2.7% year-over-year in July after rising 2.6% in June.

Although the CPI and PPI generally are trending in the right direction, the PCE price index, the Fed’s preferred inflation gauge, needs to mirror these trends before the Fed will relax its vigilance. The Core PCE price index was up 4.2% year-over-year in July, deteriorating slightly from up 4.1% in June. The decline in inflation is ongoing but has slowed, and the timeline to 2% inflation is uncertain.

Employment and the economy are still solid and not indicative of pending recession. That, along with past Fed rate hikes, has contributed to a rising-rate environment. Rates at the short end of the curve stabilized in July and in August (as investors anticipate the end of the Fed’s rate-hiking cycle) while continuing to move higher at the long end.

The two-year Treasury yield was 4.87% at the end of August, in line with end of July levels. The five-year yield moved to 4.29% at August-end from 4.18% at the end of July. The 10-year Treasury yield ended August at 4.18% after ending July at 3.96%.

The twos-10s spread was at 69 bps as of the end of August, the best level since May 2023. The twos-10s is still warning of recession, but has now been doing so for well over a year. Economists are divided as to whether yield-curve inversion predicts inflation with a long lag or a shorter lag, meaning it should have resulted in recession already if one were going to happen.

The bond market fulfilled our expectations that the entire yield curve would move higher across the 2022 year. With inflation showing signs of slowing and the Fed being more circumspect about future rate hikes, we expect to see a slower rise in rates going forward. At some point, more likely later in 2024 than early, interest rates may finally begin moving back down.

Second-quarter earnings declined 3%-4% year-over-year, better than preliminary expectations of a high-single-digit decline. For calendar 2Q23 earnings, just four-fifths of companies exceeded consensus expectations; and the average beat against expectations was above 7%. Over the preceding decade, about 75% of S&P 500 companies exceeded expectations and those companies, on average, topped consensus quarterly EPS estimates by about 6%.

During 2Q23 EPS season, about two-thirds of sectors exceeded pre-reporting expectations; that includes Technology, the largest sector. The most-positive sectors included Consumer Discretionary, Communication Services, and Industrial, all forecast to be up in double-digits year-over-year, generally against weak year-ago comps. The worst-performing sectors, as expected, were Healthcare, Materials, and Energy, all down in double-digits year-over-year. Although Energy represents only 4.0%-4.5% of S&P market capitalization, S&P 500 2Q23 earnings less Energy are about flat year-over-year.

Our final 2022 estimate of S&P 500 earnings from continuing operations was \$222. For 2023, our earnings estimate remains \$226, implying low-single-digit growth from 2022 levels. Following a low-single-digit EPS decline for 1Q23 and 2Q23 EPS, we look for growth in 3Q23 EPS, but less than 3%. And we are modeling 4Q23 continuing operations EPS to grow about 11% against a weak year-earlier comparison.

For 2024, our forecast of S&P 500 earnings from continuing operations is \$245. That estimate implied normal high-single-digit EPS growth in a market in which inflation is no longer the chief topic and interest rates are stable or possibly coming down.

After recovery in the S&P 500 through the first seven months of 2023, the S&P 500 two-year forward P/E on our 2023 and 2024 non-GAAP EPS forecasts is 19.2; that compares to the prior five-year (2018-22) average of 19.6. Reflecting higher inflation and current interest rates compared with the past five years, as well as other inputs, our adjusted earnings-yield model continues to signal overvaluation in stocks.

### Domestic and Global Markets

Nearly every major U.S. index and sector and most of the major global markets declined in August. We have talked about AI mania in 2023, and AI standard-bearer Nvidia continued its relentless climb in the month. But investors generally were content to take profits in August before heading out on vacation. The month did finish with strength in the final week, but the S&P 500 lost just under 2% in August.

Despite the one-month semi-correction, major index performance in 2023 remains bifurcated between growth-driven (Nasdaq), the broadest measure of the mar-

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## ECONOMIC & MARKET COMMENTARY (CONT.)

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ket (S&P 500), and the bluest of Blue Chips (the Dow Jones Industrial Average). As of end of August, the Nasdaq was out in front with a 34% gain. The S&P 500 was up 17%. The DJIA was up 5% in 2023 to date, deeply lagging the leaders after losing 300 bps of its annual gain in August.

How common is it for major indices to be so out of step? Over the previous six years (2017 to 2022), returns among the major indices were closely bunched in four years and widely dispersed in two years. When major index performance is widely dispersed, growth sectors will deeply lead or lag the markets, depending on whether growth indices are up or down.

Although the broad market (the S&P 500) is up strongly year-to-date, August showed that gains might not fully hold into year-end. A highly contentious presidential-election campaign season is underway – and that could tear the tender fabric of consumer confidence. At the same time, bearish investors will need to capitulate at some point, and the prevailing trend typically is amplified into year-end. Investors will also be broadly anticipating lower rates in 2024, and that may contribute to a stronger finish.

We are concerned that a handful of AI-driven companies are garnering outsized gains, even though the underlying industry (generative AI) will not be spared the usual bumpiness that accompanies true transformation. Any profit-taking among the individual stock-market leaders would be positive if it encourages rotation into underperforming Blue Chips.

Growth sectors soared on spiking AI interest in the May through July period, before stumbling somewhat in August. During the month, year-to-date gains fell in the three major growth sectors relative to the end of July: to 39% year-to-date for Technology, from 46% at the end of July; 40% for Communication Services, from 45%; and 30% for Consumer Discretionary, from 36%.

Within growth sectors, investment interest is concentrated in relatively few names. The market leaders in 2023 include Nvidia (up 235%-plus) and Meta (up 145%-plus), Broadcom and Amazon (60%-plus), and Alphabet (50%-plus). All those companies are tied to development and monetization of generative AI. Note, however, that all but Nvidia and Broadcom weakened in August. Concentration in perceived AI winners can contribute to fragility of sector gains should investors start taking profits in year-to-date winners.

Beyond the big three, the best sectors at the eight-month mark are Industrials (up 10%) and Basic Materials (up 6%). Every sector lost ground in August, with one exception: Energy gained about 2% from July-end. At August-end, three sectors are negative year-to-date: Utilities, Healthcare, and Consumer Staples. That is an improvement from the end of May, when five sectors were negative.

After a double-digit percentage decline for stocks in 2022, Argus is modeling better-than-normal returns in

2023, meaning S&P 500 appreciation in low-double-digit percentages. A normally advancing market usually is led by growth sectors. After 2022, investors have become used to buying cyclical, defensive, interest-rate-sensitive, and inflation-beneficiary stocks.

Many of last-year's winners have been left behind by AI mania. If the market sustains strength and builds on year-to-date gains, we would like to see a more broad-based advance from a sector perspective in the second half of 2023.

S&P Global Markets adjusted several sectors in March, sending Transactions and Payment Processing Services from Technology to Financial Services; and moving Broadline Retailers from Consumer Discretionary to Consumer Staples.

Despite these shifts, in a risk-on market both Technology and Consumer Discretionary added market weight in May through July, though not in August. AI fever has driven gains in growth sectors year-to-date. The declining market in August favored defensive sectors, with one notable exception.

Technology currently holds a 28.2% weighting within the S&P 500, up 100 bps year-over-year – though down 20 bps from one month earlier. Consumer Discretionary moderated to a 10.6% weighting at August-end from 10.7% at July-end, but remains below year-ago levels.

Financial Services, which peaked at a 13.1% weighting as of the end of March, was 12.5% as of end of July; this sector weight is up 160 bps year-over-year. Consumer Staples initially increased to a 7.4% weighting with the additions of discount retailers, but is now back to 6.6%. Healthcare lost ground in the COVID-19 transition, and is down to 13.2% of total S&P sector weight from 14.1% a year earlier.

Like the U.S. market, global stocks are doing better in 2023 than they did in 2022, but they were also subject to profit-taking in August. In fact, every global market in our survey declined month-over-month. On average, our composite of global bourses (which no longer includes Russia) is up 9% year-to-date, down from a 14% gain at end of July and currently lagging the S&P 500's 17% gain.

Themes for global leadership have undergone significant change from a year ago. In terms of our themes, mature economies lead with a 14% year-to-date gain. The Eurozone is up 15%, as EU central banks show signs of ending their rate-hiking cycles. Americas markets (including U.S., Brazil, Mexico, and Canada) are up 10% in 2023, led by gains in the U.S. and Mexico.

Asia is now up 8%, mainly reflecting strength in Japan. Resources economies are up 7%. BRICs-minus-Russia are up less than 2% in 2023, lagging the average due to a negative annual return in China.

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## ECONOMIC & MARKET COMMENTARY (CONT.)

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### Conclusion

The stock market has declined in just two of eight months in 2023: in February and in August. Since 1980, September has been the worst market month for the S&P 500, averaging a decline of 0.99%.

Nothing is given in the stock market. Even a big year-to-date gain can evaporate in an unfavorable environment. Year-to-date stock gains could prove particularly fragile if inflation were to stagnate in the 4% range (double the Fed's target); if inflation-weary consumers stop spending; and if waning consumer attitudes impact business spending.

On the other hand, economists and companies have stopped talking about recession. Companies are still hiring, wages are still growing, and consumer sentiment is miles

above where it was at the beginning of the year. As noted, gains can evaporate – but history suggests that they will not.

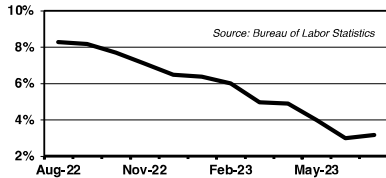
For all years since 1980, the S&P 500 has averaged a 10.0% gain. By out count, for 16 of those years, the S&P 500 has been up by at least 10% year-to-date as of the end of August. Also for those years, capital appreciation through the eight months has averaged 18.1%.

For almost all of those years, there was more to come in the final four months (1986 and 1987 are the notable outliers). On average, for years in which the S&P 500 has averaged capital appreciation exceeding 10% as of the end of August, full-year capital appreciation has averaged 23.3%. That's more than twice the 1980-2022 all-year average.

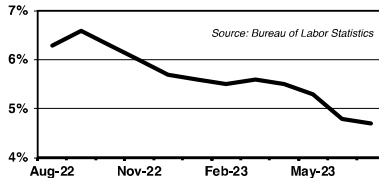
Jim Kelleher, CFA,  
Director of Research

# ECONOMIC TRADING CALENDAR

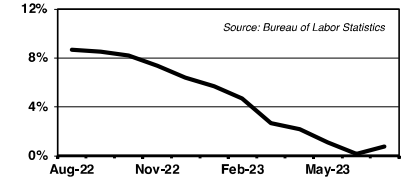
Release: **Consumer Price Index**  
 Date: 9/13/2023  
 Month: August  
 Previous Report: 3.2%  
 Argus Estimate: 3.4%  
 Street Estimate: 3.5%



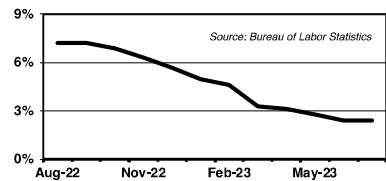
Release: **CPI ex-Food & Energy**  
 Date: 9/13/2023  
 Month: August  
 Previous Report: 4.7%  
 Argus Estimate: 4.3%  
 Street Estimate: 4.3%



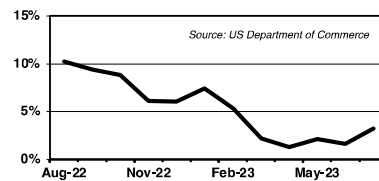
Release: **PPI Final Demand**  
 Date: 9/14/2023  
 Month: August  
 Previous Report: 0.8%  
 Argus Estimate: 0.7%  
 Street Estimate: NA



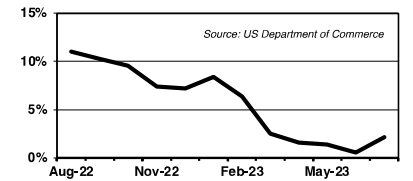
Release: **PPI ex-Food & Energy**  
 Date: 9/14/2023  
 Month: August  
 Previous Report: 2.4%  
 Argus Estimate: 2.2%  
 Street Estimate: NA



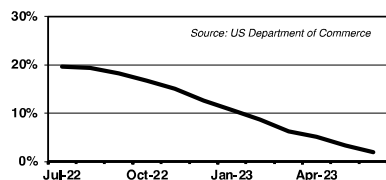
Release: **Retail Sales**  
 Date: 9/14/2023  
 Month: August  
 Previous Report: 3.2%  
 Argus Estimate: 2.9%  
 Street Estimate: NA



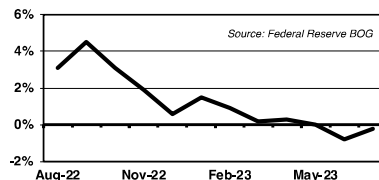
Release: **Retail Sales ex-autos**  
 Date: 9/14/2023  
 Month: August  
 Previous Report: 2.2%  
 Argus Estimate: 2.0%  
 Street Estimate: NA



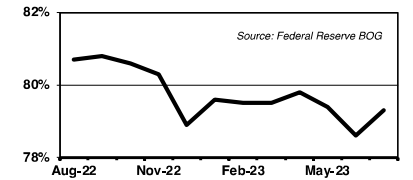
Release: **Business Inventories**  
 Date: 9/14/2023  
 Month: July  
 Previous Report: 2.0%  
 Argus Estimate: 1.5%  
 Street Estimate: NA



Release: **Industrial Production**  
 Date: 9/15/2023  
 Month: August  
 Previous Report: -0.2%  
 Argus Estimate: -0.2%  
 Street Estimate: NA

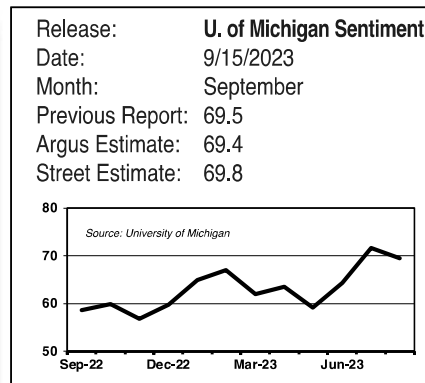
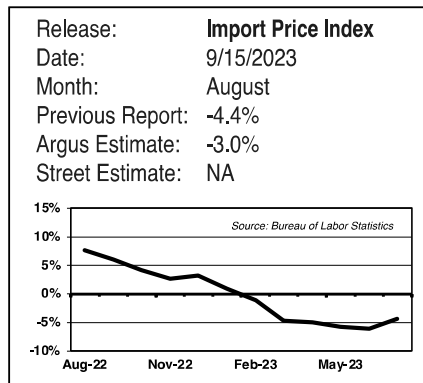


Release: **Capacity Utilization**  
 Date: 9/15/2023  
 Month: August  
 Previous Report: 79.3%  
 Argus Estimate: 79.0%  
 Street Estimate: 79.2%



*Previous Week's Releases and Next Week's Releases on next page.*

## ECONOMIC TRADING CALENDAR (CONT.)



### Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
5-Sep	Factory Orders	July	-0.2	-0.4	NA	NA
	Total Vehicle Sales	August	15.74 Mil.	15.40 Mil.	15.50 Mil.	NA
6-Sep	ISM Services Index	August	52.7	53.0	52.3	NA
	Trade Balance	July	-\$65.5 Bil.	-\$68.0 Bil.	-\$67.1 Bil.	NA
8-Sep	Wholesale Inventories	July	1.3%	0.0%	NA	NA

### Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
19-Sep	Housing Starts	August	1,452 K	NA	NA	NA
21-Sep	Existing Home Sales	August	4.07 Mln.	NA	NA	NA
	Leading Index	August	-0.4%	NA	NA	NA

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