

OBSERVATIONS: *S&P 500 modestly higher, European PMIs still weak, and housing data mixed.*

- The S&P 500 closed last week +0.8% higher, while small cap stocks (Russell 2000) declined -0.3% on the week. The 10-Year US Treasury yield reached a fresh multi year and 2023 high of 4.34% before retreating and ending the week at 4.24%.¹
- Eurozone Purchasing Manager (PMI) data show the Eurozone economies continue to be hampered by high interest rates and stubbornly high inflation. The composite PMI (services + manufacturing) fell to a 33-month low of 47.0, below expectations of 48.5 (readings below 50 indicate economic contraction).¹
- China (re)enters a bear market in August as the major indices dropped and foreign investors pulled nearly \$11 billion over the past two weeks—see One More Thought.²
- Existing home sales came in below expectations declining -2.2% month-over-month (MoM) in July to 4.07 million (annualized rate) and down -16.6% compared to July-2022.¹
- Meanwhile new home sales came in slightly above expectations reaching 714,000 (annualized rate) in July which is a +4.4% MoM increase—the number of new homes under construction is at near record levels.¹
- Mortgage rates have risen above 7.3% in August and approached 7.5% last week. Weekly new mortgage (home) purchase applications dropped to their lowest levels since 1995 as limited inventory has kept housing prices elevated and high mortgage rates have eroded affordability.³
- Durable goods orders dropped -5.2% in July (thanks mostly to variability in commercial aircraft orders). Excluding transportation durable goods orders rose +0.5% MoM, better than expectations of +0.2% and marking the third straight month of positive durable goods ex transports orders.¹

EXPECTATIONS: *Powell's hawkish speech, and S&P downgrades select banks.*

- Fed Chair Powell delivered a hawkish message at last week's Jackson Hole Economic Symposium acknowledging progress has been made with respect to inflation but noting that "it remains too high." Following the speech, markets increased the odds of a +25bps rate hike by the November Fed meeting to over 60%—nearly double the probability assumed by markets in the week prior.^{1,4}
- S&P followed Moody's recent downgrades of ten banks with ratings cuts of its own. S&P's focus was on regional banks more exposed to higher interest rates and funding risks (deposit outflows), and constrained profitability. Regional banks (KBW Regional Bank Index) have declined nearly -11% this month, though are about +19% higher than the lows set in mid-May this year.¹

ONE MORE THOUGHT: *China's stock prices reflect consumer and business pessimism.¹*

We wrote last week about the economic challenges facing China this year as Chinese developers are forced to deleverage, and Chinese consumers are choosing to save more and spend less amid heightened uncertainty about the trajectory of the Chinese real estate sector. This pessimism among Chinese consumers and businesses has taken its toll on Chinese stock prices. The MSCI China Index—a large cap index of China's largest firms that are primarily traded on the Hong Kong Exchange—lost more than -11.2% so far in August and is now down -20.0% since its year-to-date high which occurred at the end of January 2023. Meanwhile, the CSI 300 index—the 300 largest firms that are traded on either the Shanghai or Shenzhen Exchanges (so called "A-Share" market)—is down -18.2% over the same period. The MSCI China Index is full of some of China's most well-known global firms—Alibaba, Tencent, and China Mobile—while the A-Share is largely comprised of lesser-known firms that are largely only

¹ Bloomberg LP

² Bloomberg "Global Funds Abandon China Blue Chips in \$11 Billion Selloff" 8/22/2023

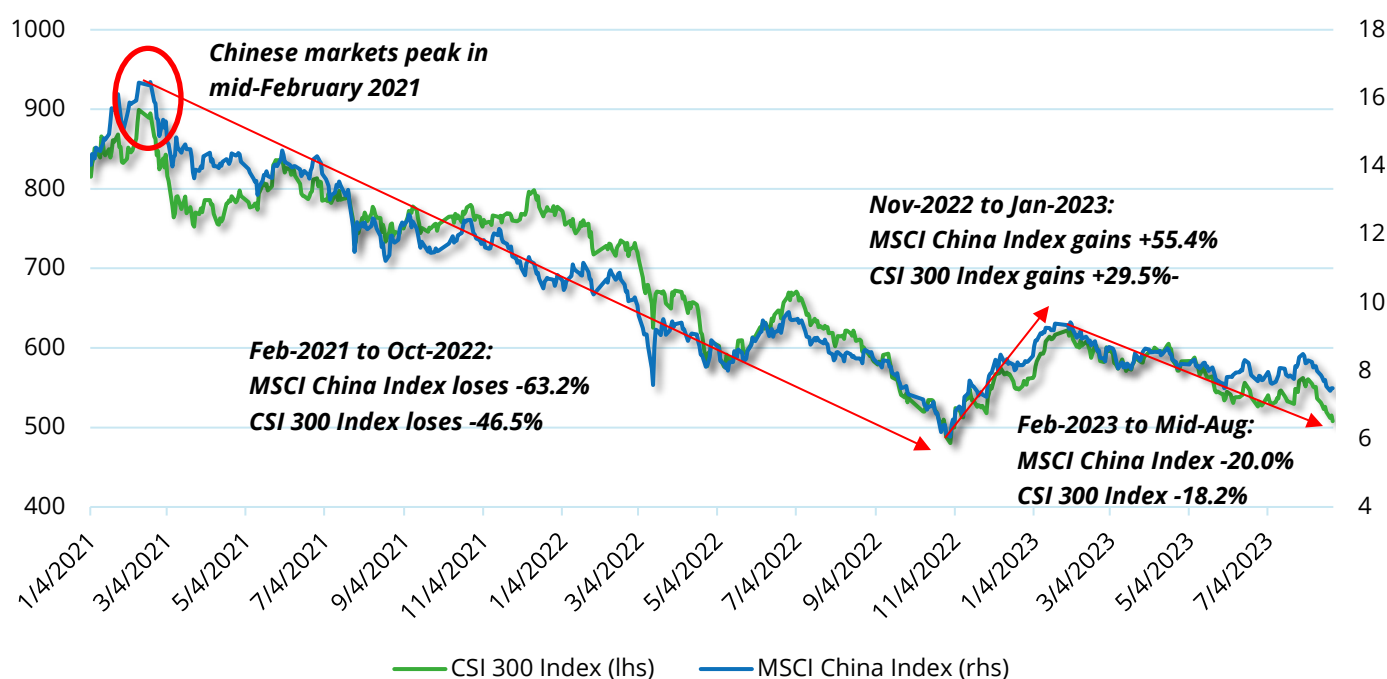
³ <https://www.mba.org/news-and-research/newsroom>; <https://www.mortgagenewsdaily.com/>

⁴ <https://www.federalreserve.gov/newsevents/speech/powell20230825a.htm>

recognizable to Chinese consumers. Regardless of the index, both have seen steep losses this year. As the Chinese economy sputtered this summer and geo-political tensions between the US and China festered, international investors have been pulling money out of China. Bloomberg Intelligence shows that most emerging market fund managers increased their underweight to China during Q2-2023 and global investors sold Chinese shares at a record clip in August. Meanwhile, local Chinese investors have not stepped-up to stem the tide of selling. Both the MSCI China Index and the CSI 300 are getting close to retesting their multi-year lows set in October 2022—see Chart of the Week. Against this backdrop, one might expect Beijing to announce additional stimulus measures and policy support for the economy, which in the past were often coupled with informal directives from Beijing to the financial sector to buy stocks and put a floor under the market. Time will tell if Beijing goes back to this familiar playbook.

CHART OF THE WEEK

Chinese Stocks Re-Enter Bear Market



Source: Clearstead, Bloomberg 8/23/2023

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