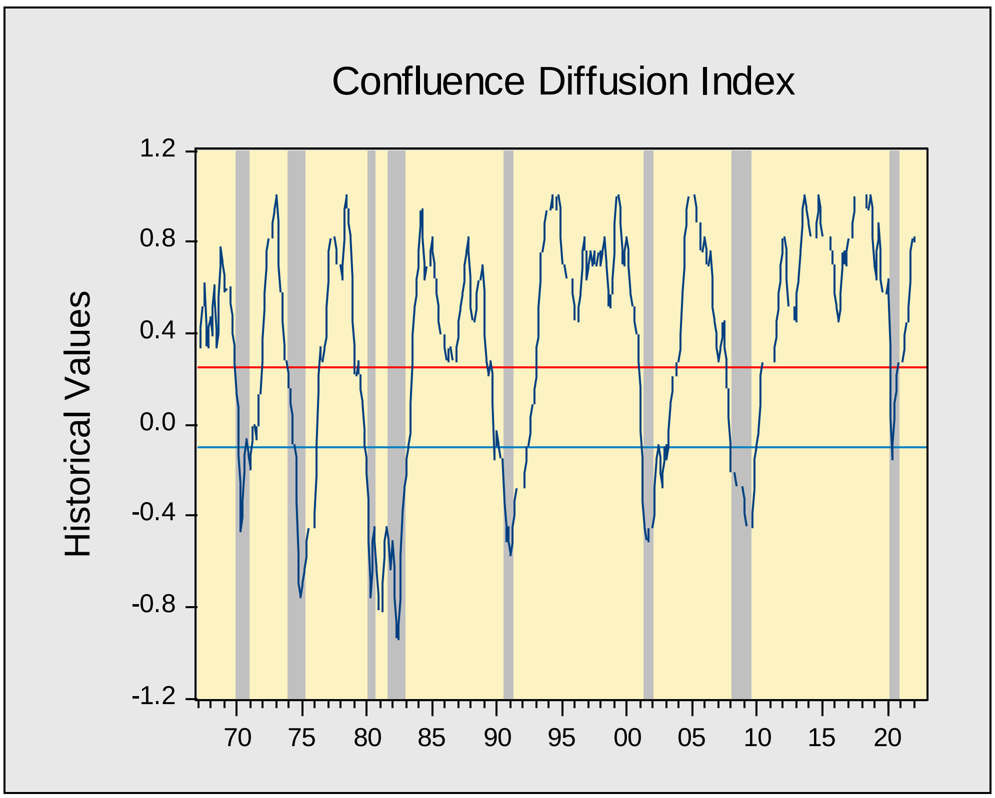
# Business Cycle Report

*By Thomas Wash*

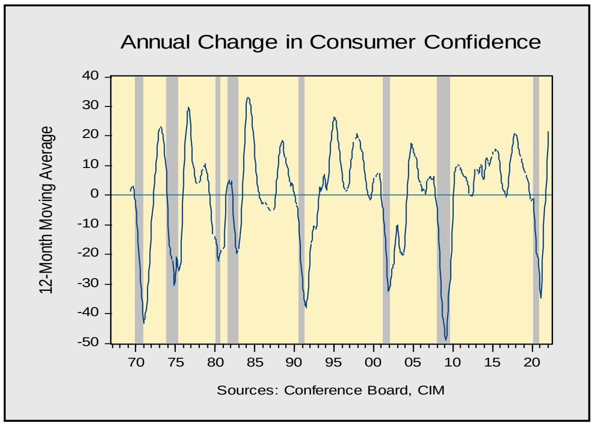
*The business cycle has a major impact on financial markets; recessions usually accompany bear markets in equities. The intention of this report is to keep our readers apprised of the potential for recession, updated on a monthly basis. Although it isn't the final word on our views about recession, it is part of our process in signaling the potential for a downturn.*

In March, the diffusion index rose further above the recession indicator, signaling that the economy remains in expansion. Higher yields on Treasuries and the Russian invasion have weighed heavily on equities. Meanwhile, manufacturing data suggests that supply chains are improving. Lastly, the labor market appears strong, with initial weekly claims falling to near historic lows. The latest report showed that all 11 indicators are in expansion territory. The diffusion index rose from +0.8182 to +0.8789, remaining well above the recession signal of +0.2500.



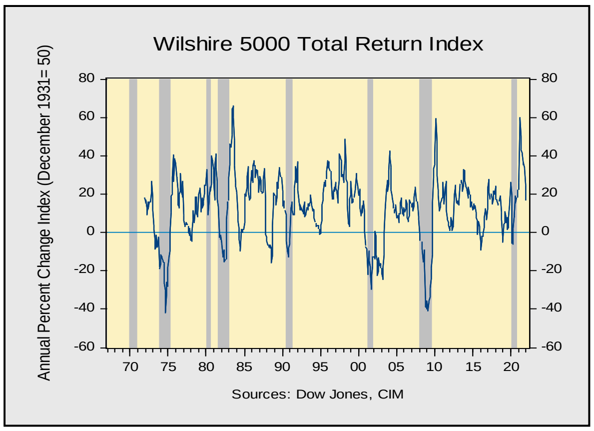

The chart above shows the Confluence Diffusion Index. It uses a three-month moving average of 11 leading indicators to track the state of the business cycle. The red line signals when the business cycle is headed toward a contraction, while the blue line signals when the business cycle is in recovery. The diffusion index currently provides about six months of lead time for a contraction and five months of lead time for recovery. Continue reading for an in-depth understanding of how the indicators are performing. At the end of the report, the *Glossary of Charts* describes each chart and its measures. In addition, a chart title listed in red indicates that the indicator is signaling recession.

**Consumer Confidence**



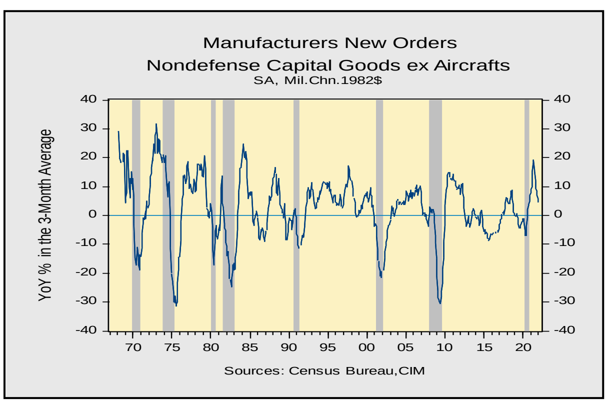

Last month, the rise in the Present Situation Index outweighed the decline in the Consumer Expectations Index, therefore leading to an overall improvement in the Consumer Confidence Index. The readings suggest that although consumers are relatively satisfied with the economy, they are concerned that the expansion will last. A strong labor market appears to be supporting present-day optimism. However, rising inflation has likely dampened consumer expectations about the future. Consequently, the latest reading for the Consumer Confidence Index stands at 107.2, up from 105.7 in the previous month and well below last year's level of 114.9. The 12-month moving average of the annual change in the index fell from +21.67 to +20.95. As a result, the Present Situation Index rose from 143.0 to 153.0. Meanwhile, the consumers' six-month outlook index fell from 80.8 to 76.6.

**Wilshire 5000 Index**



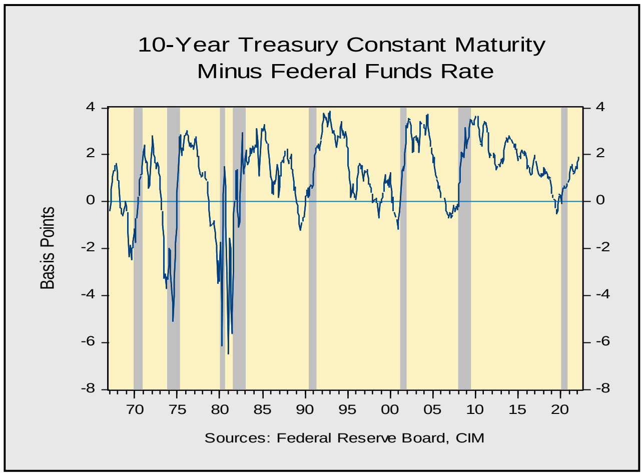

The annual change in the Wilshire 5000 Total Return Index fell for the fourth consecutive month in March. Last month, the index average was 212.54, down 1.2% from the prior month. Annually, the index recorded in February slowed from 10.8% to 8.4%. The deceleration in the year-over-year change can be attributed to expectations that the Federal Reserve will raise rates and the Russian invasion will cause supply shocks. Last month, Fed officials raised rates for the first time since 2019. Meanwhile, the Russian invasion has led to disruptions in trade and higher energy prices.

**Three-Month Average Manufacturers New Orders**
**Nondefense Capital Goods excluding Aircraft**



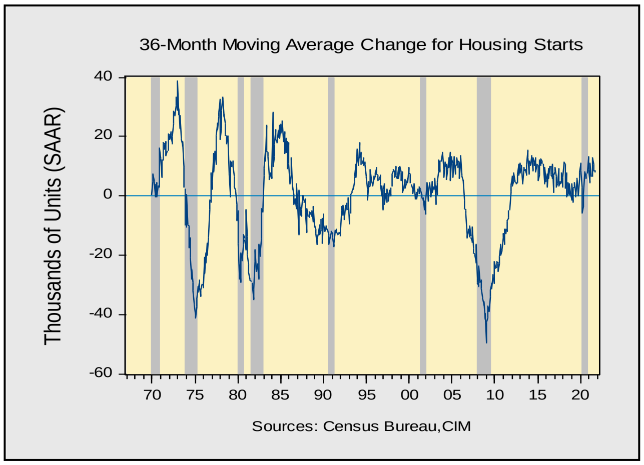

According to the Conference Board LEI, new orders for durable goods, a proxy for business investment, decelerated in March. The report showed that the value for new orders of durable goods adjusted for inflation rose 2.3% from the previous year, down from the last month's rise of 2.8%. The slowdown in orders suggests investments may be slowing. As a result, new orders for nondefense capital goods came in at $41.232B in 1982-chained dollars, 0.4% higher than the previous month's revised reading of $40.901B. The three-month moving average came in at $41.179B, up from the last year's value of $41.203B. The indicator, which tracks the annual change in the three-month moving average for new orders, slowed to 2.87B from 3.43B.

**10-Year Treasury Constant Maturity Minus Federal Funds Rate**



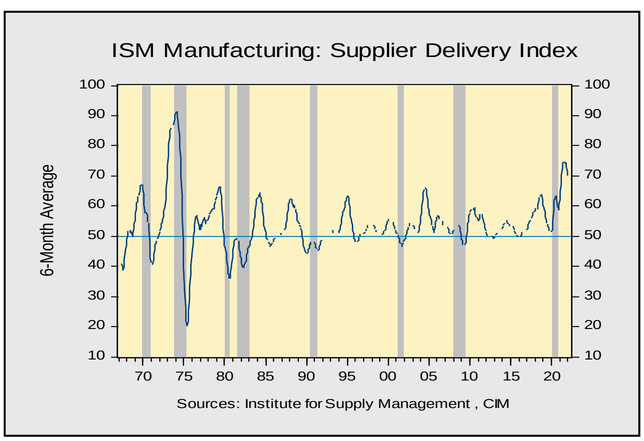

The financial spread widened in March due to the rise in the 10-year Treasury yield. The spread widened from +1.85 to +1.93, above the recession indicator of 0. The increase in longer duration yields is likely the result of growing speculation that the Fed is becoming more hawkish. As a result, the 10-year Treasury rate surged from 1.85% to 1.93%, while the fed funds rate rose 12 bps from 0.08% to 0.20%. With the Fed moving to raise rates, this spread will likely narrow in the coming months.

**36-Month Moving Average Change for Housing Starts**



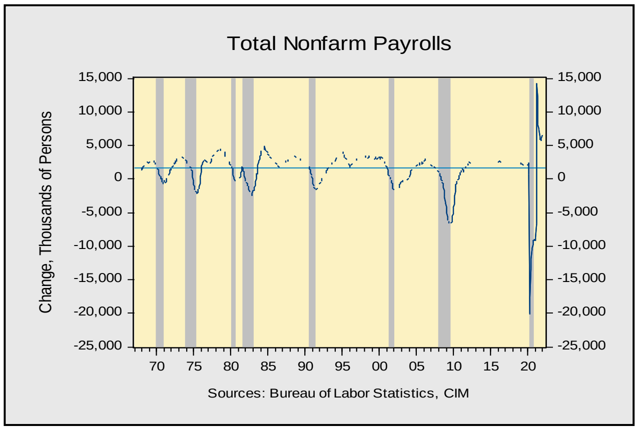

In March, residential construction expanded at the fastest pace since 2006. Housing starts rose last month at an annualized rate of 1,793K, higher than the previous month's report of 1,788K. Last month's increase in construction may have been driven by strong demand for homes and relatively tight supply. The latest NAHB Market Index for single-family home sales over the next six months increased from 70 to 73 points in March. In light of the recent surge, there are growing signs that housing starts could slow again this year. Homebuilders are reporting difficulties receiving materials and finding workers. Meanwhile, potential homebuyers complain that higher mortgage rates and rising residential prices are making homes unobtainable. We suspect if demand falls and input prices continue to increase, homebuilders may start to take on fewer construction projects.

**ISM Manufacturing: Supplier Delivery Index**



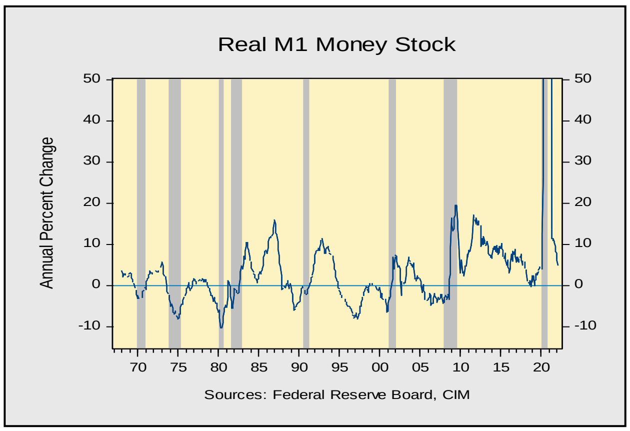

The latest ISM report showed that manufacturers had improved the pace of supplier deliveries. In March, the ISM Supplier Delivery Index declined to 65.4; the previous month's reading was 66.1. The drop in the index contributed negatively to the six-month moving average, which fell from 69.5 to 68.1. The dip is related to firms finding it easier to attract workers and supply chains showing more flexibility. In general, the index assumes that slower deliveries reflect strengthening demand. As a result, finding labor and supply chain improvements are not viewed favorably because the indicator ignores supply shocks. Therefore, a decline in this index should be seen as a positive.

**Total Nonfarm Payrolls**



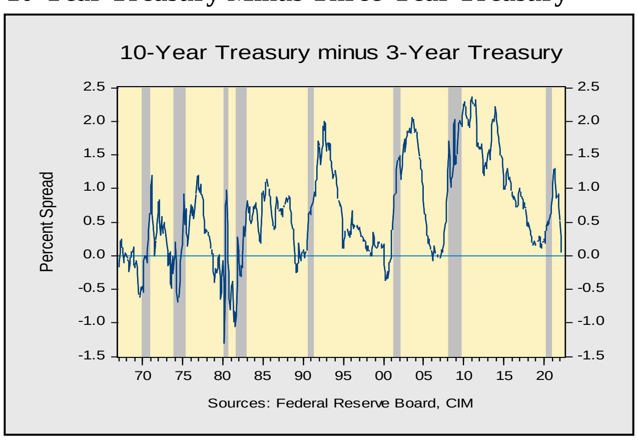

In March, the country gained 431K jobs for a 12-month moving sum of 6.494MM. Most of the jobs added came from the private services-providing sector, primarily in *Leisure & Hospitality* and *Professional and Business Services*, which added 112K and 102K, respectively. In total, the services-providing sector accounted for 366K new jobs. The government sector added 5K, while the goods-producing sector added 60K. Currently, the indicator is significantly above the recession signal of 1.600MM.

**Real M1 Money Stock**



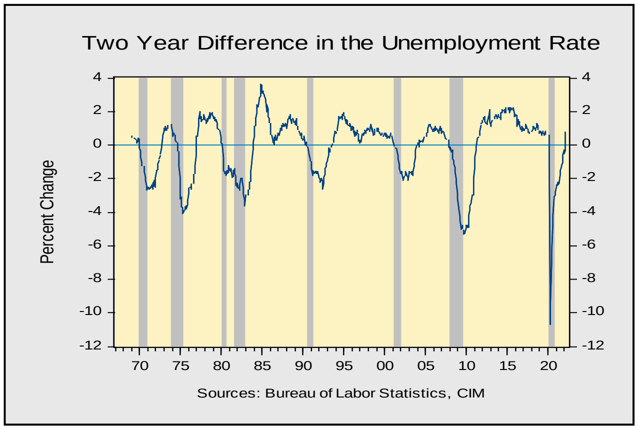

The rise in Real M1 money stock slowed in March. Real M1—M1 minus CPI—rose 2.60% from the prior year, down from the previous month's reading of 4.62%. The decline in the Real M1 reflects the Fed's decision to end its balance sheet expansion amidst rising inflation. The deceleration in real M1 signals that higher inflation is starting to weigh on economic activity.

**10-Year Treasury Minus Three-Year Treasury**



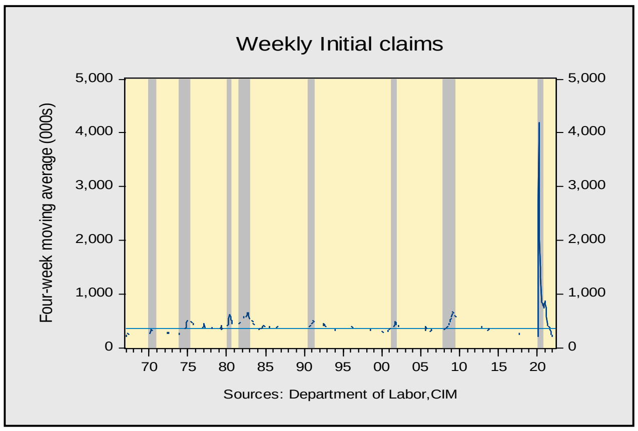

The yield spread between the 10-year and 3-year Treasury nearly inverted in March. The Russian invasion and a hawkish Fed led to a rise in both long and short-duration bonds. However, the increase in the 3-year yield surpassed the 10-year yield, 44 bps vs. 20 bps. The sharp rise in the 3-year Treasury almost led to an inversion. The slight miss could mean that the economy may not be headed toward a slowdown.

**Two-Year Difference in the Unemployment Rate**




The two-year spread in the unemployment rate returned to positive territory for the first time since the pandemic. Last month, the unemployment rate fell from 3.8% to 3.6%, below its level of 4.4% two years prior. The drop in the unemployment rate was primarily due to more workers finding work. The number of workers employed rose 0.47% from the prior month, while the civilian labor force grew by 0.25%, and the number of unemployed workers fell by 5.07% from the previous month.

**Weekly Initial Claims**




Weekly initial claims sank to their lowest level since the report began publication in 1948. Last month, new jobless claims fell by 20K from the prior month to 175K. The decline is due to an overall improvement in the labor market conditions.

Thomas Wash
April 28, 2022

## *Glossary of Charts*

**Consumer Confidence:** The Consumer Confidence Index is an economic indicator that measures the level of consumer optimism about the overall state of the economy and consumers' personal financial situations. This chart shows the 12-month moving average of the annual change of the index.

**Wilshire 5000 Index:** This chart shows the annual change in the Wilshire 5000 Total Return Index, which is the broadest U.S. equity index. The index contains 3,500 stocks and is designed to track overall performance of the U.S. stock market. It is an important indicator because steep equity pullbacks have often coincided with economic contractions.

**Three-Month Average Manufacturers New Orders Nondefense Capital Goods excluding Aircrafts:** This chart shows the annual change in the value of core capital goods orders. This indicator gives insight into the amount of business investment spending. A positive report suggests that manufacturers are optimistic about future demand.

**10-Year Treasury Constant Maturity Minus Federal Funds Rate:** This chart shows the spread between the 10-year maturity and the fed funds rate. It reflects market sentiment of the future state of the economy. Generally speaking, a negative spread suggests a contraction is likely to occur within 24 months.

**36-Month Moving Average Change for Housing Starts:** This chart shows the 36-month moving average of the annual change in housing starts. This is an important indicator because it provides a gauge of future construction activity. If housing starts are strong it implies that builders are optimistic about future demand.

**ISM Manufacturing (Six-Month Average):** The ISM Manufacturing Index is a report that monitors employment, production, inventories, new orders, and supplier deliveries. This index specifically focuses on the six-month moving average of supplier deliveries section in ISM, which we believe is a good gauge of future levels of manufacturing activity. A reading above 50 signals that manufacturing activity is expected to expand, while a reading below 50 signals that manufacturing activity is expected to contract.

**Total Nonfarm Payrolls:** This chart shows the 12-month moving sum of total nonfarm payrolls. This report represents the total number of workers added to the workforce excluding proprietors, private household employees, unpaid volunteers, farm employees and incorporated self-employed. It is a significant indicator of the strength of the labor market. A moving sum that exceeds 1,600 suggests the demand for labor is strong.

**Real M1 Money Stock:** The Real M1 Money Stock report measures the annual change in the money supply minus inflation. M1 is the measure of currency in circulation and represents the amount of money being held for transaction purposes, therefore it can act as a proxy for economic activity.

**10-Year Treasury Minus Three-Year Treasury:** This chart shows the spread between the 10-year and three-year Treasury, a gauge of investor sentiment. A widening spread suggests investors are optimistic about the state of the economy, whereas a negative spread suggests pessimism. This indicator is less sensitive than the financial spread as it is less affected by the Fed's decisions.

**Two-Year Difference in the Unemployment Rate:** The two-year difference in the unemployment rate measures the amount of slack in the labor market. When the difference of the two-year unemployment rate falls below zero it indicates the labor market is becoming less tight.

**Weekly Initial Claims:** This chart shows the four-week moving average of initial jobless claims. A rising initial claims number means the demand for labor is weakening, likely due to a worsening business environment. If the four-week moving average rises above 350K, it signals the economy may be headed toward a contraction.