Yardeni Research

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Morning Briefing

Another Candidate For Fed Chair

Check out the accompanying chart collection.

Executive Summary: Dr Ed is sticking to his guns: He has contended since early last year that the US economy is too resilient and inflation is not close enough to 2.0% for Fed officials to muck around with easing. The widespread expectation that they will ease anyway in September is lifting stocks, and the actual event may cause a stock market meltup. The bond market's reaction to unwarranted easing is tougher to gauge. If it causes the Bond Vigilantes to drive up yields, the Fed's reputation as inflation fighters could be shot. Recent inflation data suggest inflation could use some fighting, as Trump's tariffs may be keeping it elevated above the Fed's target 2.0% and services inflation remains hot. ... Also: Dr Ed reviews "The Gilded Age" (+ +).

YRI Weekly Webcast. Join Dr Ed's live webcast with Q&A on Mondays at 11 a.m., EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

The Fed I: The Short List. I am disappointed: I am not on the list of candidates being considered to replace Fed Chair Jerome Powell when his term ends as Fed chair in May of next year. I have often in the past offered to do the job for half the current cost of operating the entire organization. For starters, I would halt construction on the Fed's $2.5 billion headquarters renovation. I would continue to work from my home office on Long Island. Yardeni Research has been virtual since the start of our business in 2007. I would maintain that business model at the Fed. So the Fed's headquarters can be reconfigured as luxury condos to be sold to the public. President Donald Trump should like that idea.

However, I clearly have disqualified myself from the race by arguing consistently since the start of last year that the economy is resilient and doesn't need the Fed to cut the federal funds rate (FFR). But the Federal Open Market Committee (FOMC) didn't take my advice: From September 19 through December 19 of last year, they lowered the FFR by 100 basis points to 4.25%-4.50% (*Fig. 1*). They were reacting to weaker economic indicators last summer than had been expected, as evidenced by negative readings in the Citigroup

Economic Surprise Index (CESI). But just as they started to ease, the CESI turned positive at the end of the year. Real GDP rose 3.1% and 2.4% during Q3-2024 and Q4-2024.

I also warned that bond yields were likely to rise because of the Fed's unwarranted easing in 2024. Sure enough, the 10-year Treasury bond yield rose from a low of 3.63% on September 16, 2024 to peak at 4.79% on January 13, 2024 (*Fig. 2*). It has been hovering right around the FFR since then, in a range between 4.00% and 4.80%.

The Trump administration has been pushing for another round of Fed rate cuts as soon as possible. One of the goals is to lower mortgage rates to revive housing activity. Last year when the Fed eased, the 30-year mortgage rate rose from 6.08% at the end of September to peak at 6.95% during early February 2025 (*Fig. 3*). It hasn't helped the mortgage market that the Fed has been paring its holdings of mortgage-backed securities (MBS) since early 2022 (*Fig. 4*). That has widened the spread between the mortgage rate and the 10-year Treasury yield (*Fig. 5*). Most Fed officials would like to reduce the current $2.1 trillion of the Fed's MBS holdings to zero over time.

Another goal of the Trump administration is to reduce the net interest outlays of the US Treasury that must be paid on the rapidly rising US government debt. Lowering the FFR undoubtedly would reduce the yield on Treasury bills and even on two-year Treasury notes. However, bond yields might remain at their current levels or move higher, especially if the economic indicators confirm the economy's resilience while the inflation indicators remain hot, at least relative to the Fed's 2.0% inflation target.

Suppose the FOMC members ignore my advice again, as seems likely, and vote to lower the FFR at the September 16-17 meeting of the committee. In that case, they risk a hit to their credibility as inflation fighters since inflation remains closer to 3.0% than to their 2.0% inflation target. It will be easy to gauge whether bond investors have lost faith in the Fed's ability to corral inflation: The Bond Vigilantes would conclude that it is up to them to maintain law and order in the credit markets now that the sheriff isn't doing so. They would do so by keeping bond yields elevated, as they did late last year. That would frustrate the President's goals of lowering bond yields and mortgage rates.

Notwithstanding my current disqualifying stance on Fed policy, I would like to nominate myself for Fed chair. At the beginning of my career, from July 1976 to December 1977, I worked at the Federal Reserve Bank of New York as an economist in the research department. Paul Volcker was the bank's president at the time. I started my Wall Street career at EF Hutton in January 1978. I've been a "Fed watcher" ever since then. In 2020, I published my book titled “Fed Watching for Fun & Profit: A Primer for Investors.” I focused on the influence of the Fed chairs on monetary policymaking. You can download a pdf copy of the book *here*. It is also available on Amazon.

On second thought, I like my current job. The job of Fed chair is a tough one, especially if Trump administration officials don’t like your decisions. They’ve been known to heckle and to threaten the Fed chair when they disagree with Fed policy. Then again, Wall Street economists aren’t off limits: Trump recently called on Goldman Sachs to fire its economists. Thankfully, I own my firm. If he called on me to fire me, I’d respectfully decline.

The Fed II: Exercising Fed Put Would Fuel Stock Market Meltup. Stock investors have been joyously discounting a Fed rate cut in September following the release of July’s weaker-than-expected employment report. The S&P 500 rose to yet another record high on Thursday. It is up 3.4% since the close on August 1—the day of the disappointing jobs report—through Friday’s close. There hasn’t been a similar party in the bond market since then, as the 10-year Treasury yield has risen 10 basis points over the same period (*Fig. 6*).

Notwithstanding my concerns about an adverse bond market reaction to a Fed rate cut in September, I am not as sure about what the bond yield will do as I am about what stock prices will do. Stocks will rise on expectations of another rate cut before the end of the year. What could be a better development for the stock market than another Fed Put when the economy doesn’t need the Fed’s help?!

In this scenario, the Fed could very well fuel a wild meltup in the stock market. Valuation multiples would get even more stretched than they are already. On a weekly basis, the Buffett Ratio rose to a record 3.1 during the August 14 week using the forward price-to-sales ratio of the S&P 500 (*Fig. 7*). That same week, the forward P/E of the index rose to 22.5 (*Fig. 8*). It would need to rise only another 11% to match its record high of 25.0, hit just before the Tech Wreck of 2000.

For stock investors, the only problem with meltups is that they are followed by meltdowns. The classic example that many of us experienced was the Tech Bubble of the late 1990s, which was followed by the Tech Wreck bear market of the early 2000s. Meltdowns aren’t always severe enough to qualify as bear markets. Last year’s meltup was led by technology stocks, especially the ones related to AI. That meltup was followed by a bear market in the S&P 500 Information Technology sector, but just a correction in the overall S&P 500. The sector dropped 25.9% from February 19 through April 8, while the S&P 500 fell 18.9%. Since then, the sector is up 50.7% and the S&P 500 is up 28.2% through Friday’s close.

For the Fed, a stock market meltup increases the likelihood of financial instability. The Fed's legal mandate is to keep both unemployment and inflation rates low. To do so requires financial stability. That should be the Fed's third mandate since the Fed originally was created to avert financial crises.

The Fed III: Latest Data Don't Warrant Easing. If the Fed eases in September, it will be because of July's weak employment report. It included a shocker: downward revisions in May and June payroll gains of only 19,000 and 14,000. Compared to those two, July's increase of 73,000 is a hopeful sign of a recovery following a couple of months when Trump's Tariff Turmoil (TTT) might have depressed employers' hiring. If TTT was the cause of the payroll weakness, then August's employment report should show a gain of closer to 100,000.

In the past, the Fed usually lowered the FFR aggressively when initial unemployment claims soared (*Fig. 9*). That happened during recessions. This time, there is no recession, and layoffs remain subdued along with initial claims. The main problem in the labor market is that the duration of unemployment is increasing. It is taking longer for the unemployed to find jobs (*Fig. 10*). That might be increasingly attributable to automation, especially in services such as restaurants. AI may also be starting to reduce the demand for labor.

Meanwhile, Friday's release of July's retail sales data showed an increase of 0.5% m/m and an upward revision in June's sales increase from 0.6% to 0.9% (*Fig. 11*). The Atlanta Fed's *GDPNow* model showed that real GDP is tracking at 2.5% (saar), while real consumer spending is growing at 2.2% (saar) (*Fig. 12*). There is no significant sign of consumer distress in either the unemployment claims or retail sales data that warrants a Fed rate cut in September.

On the inflation front, July's CPI and PPI confirm our view that while Trump's tariffs aren't pushing inflation higher (so far), they may have caused inflation to stall around 3.0% y/y rather than falling to the Fed's 2.0% target. The tariffs may have a transitory impact on goods inflation, but meanwhile services inflation seems to be heating up a bit. Consider the following:

(1) *CPI.* Trump's tariffs undoubtedly have boosted the CPI durable goods inflation rate from last year's low of -4.2% y/y in August 2024 to 1.2% in July (*Fig. 13*). Similarly, the core CPI goods inflation rate rose from -1.6% y/y to 1.2% over this same period (*Fig. 14*).

The core CPI services inflation rate stalled at 3.6% y/y during July (*Fig. 15*). The CPI services inflation rate excluding rent of shelter edged up to 4.0%. Several components of the CPI services inflation rate remain elevated (especially compared to the Fed's 2.0% overall inflation target): other personal services (4.5%), medical & care services (4.3%), recreation services (3.9%), rent of shelter (3.6%), transportation services (3.5%), and education & communication services (1.1%) (*Fig. 16*).

(2) *PPI*. The core PPI final demand personal consumption increased 3.6% y/y in July, boosted by a 5.8% m/m jump in portfolio management fees (*Fig. 17*). July's core CPI inflation rate was 3.0% y/y. We conclude that the core PCED inflation rate likely rose from 2.8% in June to 3.0% in July (*Fig. 18*).

The latest inflation data along with the latest economic indicators don't justify Fed rate cutting in September. If saying that disqualifies me from being considered as a candidate to be the next Fed chair, so be it. I'll just keep plugging away at my day job and watch the Fed from afar.

Movie. "The Gilded Age" (+ +) is an American television drama series set in the period from about *the late 1870s to the late 1890s*, which occurred between the Reconstruction Era and the Progressive Era. It was created and written by Julian Fellowes, who was also behind the British hit series, "Downton Abbey." Both series were inspired by the British "Upstairs, Downstairs" series that aired from 1971 to 1975. The latest series draws heavily on the Vanderbilt family for inspiration, particularly the characters of the Russells. While the Russells are a fictional family, their story arc, especially Bertha Russell's, mirrors the real-life rise of Alva Vanderbilt and her family within New York society during the Gilded Age. It's all very interesting and fun to watch. (See our movie reviews *archive*.)

Calendars

US: Mon: NAHB Housing Market Index 33; **Tues:** Housing Starts & Building Permits 1.29mu & 1.39mu; Atlanta GDPNow 2.5%; Bowman. (Source: FX Street)

Global: Mon: Buba Monthly Report; Canada Housing Starts 270k. **Tues:** Canada CPI 2.7%y/y; Japan Core Machinery Orders -1.0%m/m,5.0%y/y; PBoC Loan Prime Rate 3.90%. (Source: FX Street)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index rose 0.9% during the August 15 week and closed 0.3% below its August 13 record high. That was behind the 1.9% gain to a new record high for the AC World ex-US. The AC World ex-US had been hitting new record highs since May 14 for the first time since June 15, 2021. Despite its strength in recent weeks, the US MSCI only outperformed the AC World ex-US in 10 of the past 29 weeks. EAFE was the best performing region last week, with a gain of 2.3%, followed by EMU (2.1%) and the AC World ex-US. EMEA was the worst regional performer, albeit with a gain of 0.2%, followed by EM Latin America (0.7), EM (1.5), EM Asia (1.8), and Europe (1.8). The Japan MSCI index, with a gain of 4.0%, performed the best among country indexes, ahead of Spain (3.8), China (3.0), France (2.8), and South Africa (2.0). The Mexico MSCI index was the worst performer w/w, with a decline of 0.4%, followed by Canada (-0.1), Taiwan (0.4), Germany (0.7), and Brazil (1.0). In terms of ytd performance rankings, the US MSCI index is up 9.7% ytd, but ranks as the second worst country performer and trails the 20.0% gain for the AC World ex-US. Among the regional indexes outperforming the AC World ex-US ytd, EMU leads with a gain of 29.1%, followed by EM Latin America (26.4), Europe (23.0), EAFE (21.2), and the AC World ex-US. EM Asia is the worst ytd performer, albeit with a gain of 17.5%, followed by EM (18.3) and EMEA (19.2). Looking at the major selected country markets that we follow, Spain is the best ytd performer, with a gain of 55.6%, followed by Korea (43.7), South Africa (38.6), Germany (33.4), and Mexico (30.6). The worst performing countries ytd: India (-0.5), the US (9.7), Australia (13.5), Taiwan (17.0), and Canada (17.0).

US Stock Indexes (*link*): Forty-seven of the 48 major US stock indexes that we follow rose during the week ended August 15, up from 45 rising a week earlier and a big turnround from 47 indexes falling the week before that. The S&P 600 SmallCap Pure Value index was the best performer for the week, rising 4.4%, ahead of S&P 600 SmallCap Value (3.8%), S&P 600 SmallCap Equal Weighted (3.5), Russell 2000 Value (3.4), and S&P 600 SmallCap (3.1). The Dow Jones 15 Utilities index was the worst performer, with a decline of 0.9%, followed by Nasdaq 100 (0.4), S&P 400 MidCap Pure Growth (0.5), S&P 500 Growth (0.6), and Russell 1000 Growth (0.7). Forty-four of the 48 indexes are now higher so far in 2025, up from 37 a week earlier and down from a ytd peak of 47 in mid-February. With a gain of 13.3%, the S&P 500 LargeCap Growth index is in the top spot as the best performer so far in 2025 with a gain of 13.7%, ahead of Nasdaq 100 (12.8), Dow Jones 15 Utilities (12.3), S&P 500 LargeCap Pure Growth (12.1), and Nasdaq Composite (12.0). The worst performing major US stock indexes ytd: S&P 600 SmallCap Value (-2.8), S&P 600

SmallCap Equal Weighted (-1.8), Dow Jones 20 Transports (-1.5), S&P 600 SmallCap (-1.0), and S&P 600 SmallCap Pure Value (0.8).

S&P 500 Sectors Performance (*link*): Seven of the 11 S&P 500 sectors rose during the week ended August 15, and five were ahead of the S&P 500's 0.9% gain. That compares to just nine S&P 500 sectors rising a week earlier, when only three were ahead of the S&P 500's 2.4% gain. The outperformers last week: Health Care (46%), Consumer Discretionary (2.5), Communication Services (2.1), Materials (1.8), and Financials (1.2). The underperformers last week: Utilities (-0.8), Consumer Staples (-0.8), Industrials (-0.3), Information Technology (-0.1), Real Estate (0.2), and Energy (0.5). The S&P 500 is now up 9.7% ytd, with nine of the 11 sectors positive ytd and four ahead of the index. During the June 20 week, Consumer Discretionary and Health Care were trailing so far behind ytd that they were the only sectors trailing the index. Communication Services now wears the crown as the best ytd performer with a gain of 17.4%, followed by Information Technology (15.5), Industrials (14.0), and Utilities (12.6). These seven sectors are lagging the S&P 500 so far in 2025: Health Care (-1.2), Energy (-0.5), Consumer Discretionary (0.8), Real Estate (1.3), Consumer Staples (5.4), Materials (8.0), and Financials (8.3).

US Economic Indicators

Retail Sales (*link*): *Headline retail sales* rose for the second successive month, by 0.5% in July, in line with the consensus estimate, following June's upwardly revised increase of 0.9%—first reported up 0.6%. These back-to-back increases followed back-to-back declines. Auto sales climbed an impressive 1.6% in July. *Excluding autos*, sales were up 0.3%. *Retail sales* for the *control group*—which excludes autos, gasoline, building materials, and food services, used in calculating GDP—also rose a solid 0.5% in July. Of the 13 nominal retail sales categories, nine increased in July, while four declined. *July sales performance versus that of a year ago*: motor vehicles & parts (1.6% m/m & 4.7% y/y), furniture & home furnishings (1.4 & 5.1), nonstore retailers (0.8 & 8.0), sporting goods & hobby stores (0.8 & 2.3), clothing & accessories stores (0.7 & 5.0), gasoline stations (0.7 & -2.9), food & beverage stores (0.5 & 2.5), health & personal care stores (0.4 & 5.6), general merchandise stores (0.4 & 2.3), food services & drinking places (-0.4 & 5.6), electronics & appliance stores (-0.6 & -2.3), miscellaneous store retailers (-1.7% & 10.6), and building materials & garden equipment (-1.0 & -2.6).

Consumer Sentiment Index (*link*): *Consumer sentiment* fell for the first time in four months in mid-August, sliding to 58.6, after climbing from 50.8 in May to 61.7 in July, triggered by inflation concerns. *Expectations* fell from 58.1 in June to 57.2 in mid-August, while the *current conditions* component dropped from 68.0 in July to 60.9 this month. The report notes that buying conditions for durables plunged 14%, to its lowest reading in a year, reflecting higher prices. *Year-ahead* inflation expectations climbed from 4.5% in July to 4.9% this month—with the increase seen across multiple demographic groups and all three political affiliations. *Long-run* inflation expectation also rose, increasing from 3.4% in July to 3.9% in August. This month ended two consecutive months of receding short-run expectations and three straight months for long-run expectations. However, both readings remain well below the highs seen briefly in April and May of this year.

Industrial Production (*link*): *Headline industrial production* slipped 0.1% in July after a 0.4% increase in June, which followed weak readings in May (0.1%), April (0.0), and March (-0.2%). By *industry group*, manufacturing output was flat during the month, as a 0.3% increase in durable goods production offset a 0.4% decrease in nondurable goods output. Meanwhile, mining production fell 0.4% in July, while utilities output fell 0.2%. *Versus a year ago*, manufacturing (1.4% y/y), mining (1.9), and utilities (0.8) output were all above year-ago levels. *By market group*, *consumer goods* production ticked up 0.1%, with both *durable goods* and *nondurable goods* production ticking up 0.1%. Within *durable goods*, production of home electronics (2.4%) and automotive products (0.7) rose during the month, while production of appliances, furniture, and carpeting (-1.5) declined. Output of *consumer nondurable goods* production recorded declines in clothing (-1.4%), paper products (-0.6), and food & tobacco (-0.2), while output of chemical products (0.3) and energy (0.4) rose. Meanwhile, *business equipment* output climbed 0.5%, led by gains in output in transit equipment (1.8), defense & space equipment (0.6), and industrial equipment (0.3); production of information processing equipment declined -0.5%.

Capacity Utilization (*link*): The *headline* capacity utilization rate ticked down to 77.5% in July from 77.7% in June, hovering between 77.5% and 77.7% the past five months. July's rate was 2.1ppts below its long-run (1972-2024) average. The *manufacturing* utilization rate slipped to 76.8% in July, after climbing from 76.7% in May to 76.9% in June, and was 1.4ppts below its long-run average. The utilization rate for mining slipped for the second month from 91.2% in May to 90.3% in July. July's rate was 3.8ppts above its long-run average. The utilities rate ticked down from 70.4% to 70.0% in July—remaining substantially below its long-run average.

Empire State M-PMI (*link*): The New York Fed, the first regional Fed bank to report on manufacturing activity for August, showed activity grew modestly this month, with general business conditions climbing from 5.5 in July to 11.9 in August—to its highest level since

November 2024. New orders (to 15.4 from 2.0) accelerated this month, while shipments (12.2 from 11.5) continued to expand at a solid pace. Meanwhile, delivery times (17.4 from 8.3) lengthened significantly, and supply availability (-5.5 from -11.0) worsened a bit. *Turning to the labor market*, *employment* (4.4 from 9.2) climbed slightly higher, while the average workweek (0.2 from 4.2) held steady. *As for pricing*, the *prices-paid* (54.1 from 56.0) measure was little changed this month but remained elevated, while prices-received (22.9 from 25.7) showed moderate selling prices. *Looking ahead*, future general business conditions dropped eight points to 16.0, suggesting business conditions will increase in coming months, but firms turned less optimistic. The report notes that two-thirds of respondents expect input prices to pick up over the next six months and capital spending plans to be soft.

PPI (*link*): The headline PPI blew past forecasts in July, posting its largest monthly gain since June 2022, suggesting tariffs are starting to boost the cost of imported goods. The *headline PPI* rose 0.9% in July, considerably above the 0.2% consensus guesstimate, while *core prices*—excluding food, energy, and trade—rose 0.6%, triple the consensus estimate of 0.2% and the largest monthly gain since March 2022. July's headline rate rose 3.3% y/y, the largest 12-month gain since February's 3.4%, while the core rate climbed to 2.8% in July after slowing from 3.6% in February to 2.5% by June. The PPI for *personal consumption* shot up to 3.2% y/y in July after slowing four of the prior five months from 3.9% in January to 2.4% in June, while the yearly rate for *personal consumption excluding food and energy* accelerated 2.8% y/y in July after easing from 3.6% in February to 2.5% in June.

Global Economic Indicators

Eurozone Industrial Production (*link*): *Headline production* fell for the second time in three months, by 1.3% in June and 2.7% over the period. Energy output increased for the second successive month, by 2.9% in June and 6.5% over the period. It had declined 3.3% during the two months ending April. June's report was a sea of red, with output of consumer nondurable goods (-4.7%), capital goods (-2.2), consumer durable goods (-0.6), and intermediate goods (-0.2) all contracting during the month. *Compared to a year ago*, production edged up 0.2%, slowing from May's 3.1% gain, with only consumer nondurable goods (5.8) and energy (4.6) output above year-ago levels. Output of consumer durable goods (-4.0) was the weakest component, followed by capital (-2.1) and intermediate (-1.8) goods. Looking at the *largest Eurozone economies*, data are available for the top four and show production rose on a monthly and year-over-year basis in both France (3.8% m/m &

1.9% y/y) and Spain (1.1 & 2.5), while Germany (-2.3 & -3.8) output contracted over both periods. Italy (0.2 & -0.9) was little changed during June but fell versus a year ago.

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