Yardeni Research

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Morning Briefing

The Chair Has Spoken

Check out the accompanying chart collection.

Executive Summary: Fed Chair Powell's eagerly awaited speech at the Fed's Jackson Hole Symposium on Friday fanned stock investors' hope that the FOMC would lower the federal funds rate in September—despite Powell's hedges and the fact that upcoming data releases will figure into the decision. Notably absent in his speech was mention of the Fed's need to maintain financial system stability if it is to achieve either goal of its dual mandate. Easing in September could test that stability, test the Fed's commitment to its 2.0% inflation target, and test the Bond Vigilantes' patience. But it would be good for the stock market. We're maintaining our targets for the S&P 500 price index of 6600 by year-end 2025 and 7700 by year-end 2026. ... Also: Dr Ed reviews "Grizzly Man" (+ + +).

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: Markets Hear Powell Cooing. We expected Fed Chair Jerome Powell to sound neither dovish nor hawkish *when he spoke* at the Fed's Jackson Hole Symposium on Friday. We expected him to be owlish, expressing the need to wait and watch for further data before committing to another round of monetary policy easing. The financial markets expected that he would be dovish, and they were right, sort of. Investors have believed that a Fed rate cut is likely in September ever since the weaker-than-expected July employment report. We've been pushing against this scenario. Powell did not push against it. He did not try to reset expectations. So that made the markets even more convinced that a rate cut is coming.

In previous discussions of monetary policy this year, Powell repeatedly said that the Fed is in no hurry to lower interest rates. He didn't say that on Friday. The sentence in Powell's speech that fueled Friday's big stock market rally was the following: "Nonetheless, with policy in restrictive territory, the baseline outlook and the shifting balance of risks may warrant adjusting our policy stance." In other words, the FOMC might cut the federal funds rate at the September meeting.

Needless to say, Powell included lots of hedge clauses in his speech. Immediately after he threw more gasoline on the stock market's meltup, he noted: "Monetary policy is not on a preset course. FOMC members will make these decisions based solely on their assessment of the data and its implications for the economic outlook and the balance of risks. We will never deviate from that approach." Those were his concluding remarks on the near-term outlook for monetary policy, which remains data dependent.

Powell did not mention that before the next FOMC meeting in September, there will be two important inflation indicators and another employment report. Presumably, the FOMC's decision in September will depend on these data points. We continue to think they could confirm that inflation remains stuck around 3.0%—a full percentage point above the Fed's 2.0% inflation target. We are also anticipating that payroll employment rose 100,000 in August. That would be an increase from 73,000 in July (which likely will be revised) and confirm our view that the weakness in payroll gains during May and June was attributable to Trump's Tariff Turmoil, which has abated since then.

Powell did discuss the current employment and inflation situations:

(1) *Employment*. On the employment front, Powell noted that payroll jobs growth slowed to an average pace of only 35,000 per month over the past three months, down from 168,000 per month during 2024 (*Fig. 1*). But he also observed that the slowdown in jobs growth hasn't "opened up a large margin of slack in the labor market" (*Fig. 2*). The unemployment rate, he noted, has been historically low and broadly stable over the past year (*Fig. 3*). "Other indicators of labor market conditions are also little changed or have softened only modestly, including quits, layoffs, the ratio of vacancies to unemployment, and nominal wage growth" (*Fig. 4*).

Most importantly, in our opinion, Powell stated that "[l]abor supply has softened in line with demand, sharply lowering the 'breakeven' rate of job creation needed to hold the unemployment rate constant. Indeed, labor force growth has slowed considerably this year with the sharp falloff in immigration, and the labor force participation rate has edged down in recent months" (*Fig. 5* and *Fig. 6*). In other words, slower monthly payroll employment growth is not an obvious trigger for Fed easing.

Yet oddly, Powell concluded that "while the labor market appears in balance," it "suggests that downside risks to employment are rising. And if those risks materialize, they can do so quickly in the form of sharply higher layoffs and rising unemployment." In our opinion, that's an odd conclusion.

(2) *Inflation*. On the inflation front, Powell noted that the current estimate for July's core PCED inflation rate shows an increase of 2.9% y/y. He said that "is based on the latest available data." It was 2.8% in June (*Fig. 7*). He estimated that core prices of goods increased 1.1%, "a notable shift from the modest decline seen over the course of 2024" (*Fig. 8*). He noted that housing services inflation is falling, while nonhousing services inflation is "a bit above what has been historically consistent with 2 percent inflation" (*Fig. 9*).

He clearly and convincingly implied that the increase in core goods inflation is mainly attributable to tariffs. He reckons that will be a transitory phenomenon: "A reasonable base case is that the effects will be relatively short-lived—a one-time shift in the price level." He acknowledged that the tariff situations are evolving, which "prolong[s] the adjustment process." For example, Trump is now considering imposing tariffs on furniture imports. Powell also recognized that the tariffs could cause a more persistent inflation problem if they trigger a wage-price spiral.

Powell briefly mentioned inflationary expectations and concluded that they are not worrisome: "Measures of longer-term inflation expectations, however, as reflected in market- and survey-based measures, appear to remain well anchored and consistent with our longer-run inflation objective of 2 percent" (*Fig. 10*).

All eyes will be on July's PCED inflation rate, which will be released on August 29. The core rate could be a bit hotter than Powell is expecting. The Cleveland Fed's *Inflation Nowcasting* is tracking it at 3.0% y/y. August's CPI will be released on September 11. Its core inflation rate is tracking at 3.1%.

If the FOMC eases on September 17 following such numbers, Powell will have to explain that the committee has judged that tariffs are having a transitory impact on keeping inflation around 3.0%, but it should soon be falling to 2.0%. The Bond Vigilantes might not be persuaded.

August's employment report will be released on September 5. Naturally, all eyes will be on the month's payroll employment gain (or loss). Just as important may be the revisions in the June and July numbers. Again, we are expecting a gain of about 100,000, which should be close to Powell's breakeven monthly pace.

The Fed II: Fueling a Meltup. In his speech, Powell mentioned the word "stability" 11 times in the context of monetary policy's dual mandate, which is to maintain low and stable unemployment and inflation rates. He did not mention that these can't be achieved without financial stability.

A week ago, in our *Morning Briefing*, we wrote: "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."

Friday's wild rallies in the S&P 500 and the Nasdaq confirmed our assessment. So did the broadening of the stock market rally to riskier risk-on assets such as the Russell 2000 and "story stocks" that have a good narrative but no earnings to show.

We concluded our analysis a week ago as follows: "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."

Powell did not mention that lowering interest rates might weaken financial stability. The notion was barely mentioned in the minutes of the July 29-30 meeting of the FOMC: "In their discussion of financial stability, participants who commented noted vulnerabilities to the financial system that they assessed warranted monitoring. Several participants noted concerns about elevated asset valuation pressures." That's all, folks!

Expectations for a quarter-point rate cut in September surged following Powell's speech, according to the CME Group's *FedWatch* tool. Friday's powerful and broad stock market rally in response to Powell's comments suggests that investors are delighted with the prospect of another Fed Put, especially if the economy doesn't really need it. Highly elevated valuation multiples were even more elevated after Powell's speech, which hinted that the Fed is now ready to consider cutting rates again.

We are sticking with our targets for the S&P 500 of 6600 by year-end 2025 and 7700 at the end of next year. That's our base-case scenario with a subjective probability of 55%. We currently assign a 25% subjective probability to a meltup that lifts the S&P 500 to 7000 by year-end 2025 and 20% odds to a correction in the index by the end of this year (*Fig. 11*).

The Fed III: Reframing the Monetary Policy Framework. In his speech, Powell also reviewed the recent changes made by the FOMC in its *Statement on Longer-Run Goals and Monetary Policy Strategy*. The original statement was adopted effective January 24, 2012. The latest amendments to it were made on August 22. He explained that it "describes how we pursue our dual-mandate goals. It is designed to give the public a clear sense of how we think about monetary policy, and that understanding is important both for transparency and accountability, and for making monetary policy more effective." The previous update occurred in 2020.

Powell acknowledged that the 2020 playbook for monetary policy became irrelevant quickly. The assumption was that structural factors were weighing on global economic growth, which explained why inflation remained below the Fed's 2.0% inflation target for so long. To solve that problem, the Fed adopted "flexible average inflation targeting" (or FAIT). It was a "makeup" strategy. Following periods when inflation had been running persistently below 2.0% y/y, appropriate monetary policy would aim to achieve inflation moderately above 2.0% for some time.

FAIT was supposed to overcome the "effective lower bound" (or ELB) problem. The federal funds rate couldn't be cut below zero, so the Fed had to come up with a new trick to boost inflationary expectations. Quantitative easing since 2009 certainly hadn't done the trick. Fortunately, the FOMC didn't follow the Bank of Japan and the European Central Bank into negative interest-rate policy (a.k.a. NIRP).

In any event, inflation soared in 2022 and 2023, forcing central banks to raise their official interest rates significantly. The Fed raised the federal funds rate by 5.25ppts over 16 months (*Fig. 12*). Powell noted: "That action, combined with the unwinding of pandemic supply disruptions, contributed to inflation moving much closer to our target without the painful rise in unemployment that has accompanied previous efforts to counter high inflation."

So the latest amended statement demoted the ELB concept as follows: "The Committee is prepared to use its full range of tools to achieve its maximum employment and price stability goals, particularly if the federal funds rate is constrained by its effective lower bound." The "makeup" strategy of FIAT was dropped.

The big contradiction in Powell's Friday speech is that he started off sounding more dovish by saying that monetary policy is still slightly restrictive, inflation will soon moderate, and the labor market can use some monetary easing. Yet in his discussion of the updated framework, he stated that anchoring inflationary expectations seems to be a higher priority now. He implied that the framework also seems to give more weight to the inflation mandate over the employment mandate by stating that "price stability is essential for a sound and stable economy and supports the well-being of all Americans."

Finally, Powell said, the Fed remains committed to its 2.0% inflation target. That commitment may be about to be tested.

Movie. "Grizzly Man" (+ + +) is a 2005 documentary by Werner Herzog about the life and tragic death of Timothy Treadwell. He was a grizzly bear activist who spent his summers in Alaska communing with these dangerous animals. He filmed them and his interactions with them and showed his videos during presentations at schools focused on the need to protect the bears from civilization. His obsession led to his death. (See our movie reviews *archive*.)

Calendars

US: **Mon:** New Home Sales 630k; Dallas Fed Manufacturing Index; Williams; Logan. **Tues:** Consumer Confidence 96.3; Headline & Core Durable Goods Orders -4.0%, 3.0%; Richmond Fed Manufacturing Index -17; Atlanta Fed GDPNow 2.3%; S&P/CS HPI 2.9%y/y; Barkin. (Source: FX Street)

Global: **Mon:** Ifo Business Climate Index 88.3, RBA Meeting Minutes. **Tues:** France Consumer Confidence 90; Japan Core CPI 2.4%y/y; Mann; Macklem. (Source: FX Street)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index rose 0.3% during the August 22 week and closed a hair below its August 13 record high. That was behind the 0.5% gain to a new record high for the AC World ex-US index. The AC World ex-US has 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 30 weeks. Europe and EM Latin America were the best performing regions last week, with gains of 1.4%, followed by EMU (0.8%), EAFE (0.8), and the AC World ex-US. EM Asia was the worst regional performer, with a decline of 0.7%, followed by EM (-0.5) and EMEA (0.0). The Mexico MSCI index, with a gain of 2.2%, performed the best among country indexes, ahead of Switzerland (2.1), the UK (1.8), China (1.6), and India (1.5). The Taiwan MSCI index was the worst performer w/w, with a decline of 4.9%, followed by Korea (-2.7), Japan (-0.6), Australia (-0.3), and Hong Kong (0.1). In terms of ytd performance rankings, the US MSCI index is up 10.0% ytd, but ranks as the second worst country performer and trails the 20.6% gain for the AC World ex-US. Among the regional indexes outperforming the AC World ex-US ytd, EMU leads with a gain of 30.1%, followed by EM Latin America (28.2), Europe (24.8), EAFE (22.2), and the AC World ex-US. EM Asia is the worst ytd performer, albeit with a gain of 16.7%, followed by EM (17.8) and EMEA (19.2). Looking at the major selected country markets that we follow, Spain is the best ytd performer, with a gain of 56.9%, followed by South Africa (40.0), Korea (39.7), Germany (33.7), and Mexico (33.5). The worst performing countries ytd: India (1.0), the US (10.0), Taiwan (11.2), Australia (13.2), and Japan (17.6).

US Stock Indexes (*link*): Forty of the 48 major US stock indexes that we follow rose during the week ended August 22, down from 47 rising a week earlier. The S&P 600 SmallCap Pure Value index was the best performer for the week, rising 4.4%, ahead of Russell 2000 Value (4.1%), S&P 400 MidCap Pure Value (4.1), S&P 600 SmallCap Value (3.8), S&P 600 SmallCap Equal Weighted (3.8), and S&P 600 SmallCap (3.5). The Nasdaq 100 and Russell 1000 Growth indexes were the worst performers, with declines of 0.9%, followed by Russell 3000 Growth (-0.7), Nasdaq Composite (-0.6), and S&P 500 LargeCap Growth (-0.4). All 48 indexes are now higher so far in 2025, up from 44 a week earlier. With a gain of 13.3%, the S&P 500 LargeCap Pure Growth index is in the top spot as the best performer so far in 2025, ahead of S&P 500 LargeCap Growth (13.1), Dow Jones 15 Utilities (12.9), Nasdaq 100 (11.8), and Nasdaq Composite (11.3). The worst performing major US stock indexes ytd: S&P 600 SmallCap Value (0.9), Dow Jones 20 Transports (1.3), S&P 600 SmallCap Equal Weighted (1.9), S&P 600 SmallCap (2.5), and S&P 400 MidCap Growth (4.2).

S&P 500 Sectors Performance (*link*): Nine of the 11 S&P 500 sectors rose during the week ended August 22, and the same nine were ahead of the S&P 500's 0.3% gain. That compares to seven S&P 500 sectors rising a week earlier, when five were ahead of the S&P 500's 0.9% gain. The outperformers last week: Energy (2.8%), Real Estate (2.4), Financials (2.1), Materials (2.1), Industrials (1.8), Health Care (1.4), Consumer Discretionary (1.3), Utilities (0.4), and Consumer Staples (0.3). The underperformers last week: Information Technology (-1.6) and Communication Services (-0.9). The S&P 500 is now up 10.0% ytd, with all 11 sectors positive ytd and six 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 still wears the crown as the best ytd performer with a gain of 16.4%, followed by Industrials (16.0), Information Technology (13.6), Utilities (13.1), Financials (10.6), and Materials (10.3). These five sectors are lagging the S&P 500 so far in 2025: Health Care (0.2), Consumer Discretionary (2.1), Energy (2.3), Real Estate (3.8), and Consumer Staples (5.7).

US Economic Indicators

Leading Indicators (*link*): The leading indicators index hasn't posted a gain since last November. *Leading Economic Indicators* (LEI) fell 0.1% in July, in line with expectations, following a 0.3% decline in June and no change in May. The LEI has plunged 17.9% since December 2021's record high. The LEI's six-month growth rate fell 2.7% over the six months ending July, faster than the 1.0% decline over the six months ending January, triggering the recession signal again last month. Still, the Conference Board is not currently projecting a recession, though expects the economy to weaken during the second half of this year, "as the negative impacts from tariffs become more visible." In July, six of the 10 components contributed positively, though three just barely, while three contributed negatively, with average weekly hours in manufacturing unchanged. *Six components contributed positively*—stock prices (+0.18), initial claims (+0.13), the leading credit index (+0.09), the interest rate spread (+0.01), new orders for consumer goods (+0.01), and nondefense capital goods ex aircraft (+0.01)—although the last three barely budged. The drags on July's LEI were consumer expectations for business conditions (-0.19pts), followed by ISM new orders index (-0.18) and building permits (-0.09).

Coincident Indicators (*link*): The Coincident Economic Indicators (CEI) index climbed to another new record high in July, advancing 0.2% last month after no change in June and a 0.1% downtick in May. Three of four components of July's CEI improved in July—personal income less transfer payments, manufacturing & trade sales, and payroll employment—while industrial production declined. The CEI climbed 0.9% over the six months through July, up from 0.6% over the previous six-month period.

Regional M-PMIs (*link*): Two regional Fed banks so far have reported on manufacturing activity for August, New York and Philadelphia. The New York region showed general business conditions climbing, while activity in the Philadelphia region weakened. *New York's headline general business activity index* rose 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. 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. The *Philadelphia survey's general business activity* (-0.3 from 15.9) measure was at a standstill in August. New orders (to -1.9 from 18.4) dipped into negative territory, while shipments (4.5 from 23.7) slowed considerably, though remained in positive territory. Employment (5.9 from 10.3) continued to register job gains, though at a slower pace, while the average work week (4.7 from 0.4) rose during the month. Turning to pricing, both measures remain elevated, though Philadelphia's price-paid (66.8 from 58.8) measure accelerated sharply—posting its highest reading since May 2022. Prices-received (36.1 from 34.8) accelerated, though was more subdued. Most firms (64%) reported no change in prices and 36% reported an increase in prices.

Existing Home Sales (*link*): "The ever-so-slight improvement in housing affordability is inching up home sales," noted Lawrence Yun, chief economist of NAR. "Wage growth is now comfortably outpacing home price growth, and buyers have more choices. Homebuyers are in the best position in more than five years to find the right home and negotiate for a better price. Current inventory is at its highest since May 2020, during the COVID lockdown." *Existing home sales* increased 2.0% in July to 4.01mu (saar)—above consensus estimates of 3.93mu and 0.8% above a year ago. *Single-family* home sales rose 2.0% in July to 3.64mu (saar), while *condominium and co-op* sales were climbed 2.8% to 370,000 units. The former rose 1.1% versus a year ago, while the latter was 2.6% below last July sales. *Regionally*, existing home sales were a mixed bag: Sales in the *Northeast* (8.7% m/m & 2.0% y/y) and *South* (2.2 & 2.2) rose on both a monthly and yearly basis. Meanwhile, while sales in the *Midwest* (-1.1 & 1.1) fell in July, though were above year-ago levels, while sales in the *West* (1.4 & -4.0) climbed in July, though were below July 2024's sales pace. The *inventory of unsold existing homes* at the end of July was at 1.55 million units, up 0.6% from June, and 15.7% above a year ago. Unsold inventory is at a 4.6 months' supply at the current sales pace, a tick below June's 4.7 months and above July's 2024's 4.0 months.

Global Economic Indicators

US PMI Flash Estimates (*link*): "Growth and hiring accelerate in August, while selling price inflation hits three-year high" was the headline of this month's report. August's *C-PMI* (to 55.4 from 55.1) climbed to an eight-month high and has shown growth continually for the past 31 months—with the latest two months recording the strongest back-to-back growth since the spring of 2022. The *M-PMI* (53.3 from 49.8) and *M-PMI* Output (55.2 from 51.3) measures both reached 39-month highs this month, according to the flash estimates, while the NM-PMI (55.4 from 55.7) ticked down to a two-month low, though remains robust—around July's year-to-date high. The report notes that *hiring* picked up this month, as "job creation reached one of the highest rates seen over the past three years as companies reported the largest build-up in uncompleted work since May 2022." *Business confidence* improved a bit, though remained much weaker than at the start of the year as "companies reported ongoing concerns over the impact of government policies, especially in relation to tariffs." Tariffs are linked to sharply higher costs, which triggered the steepest increase in *average selling prices* over the past three years.

Eurozone PMI Flash Estimates (*link*): Activity in the Eurozone picked up a bit in August, led by manufacturing. The *Eurozone C-PMI* (to 51.1 from 50.9) reached a 15-month high this month, according to flash estimates, with the M-PMI (50.5 from 49.8) moving out of contraction, and the M-PMI Output (52.3 from 50.6) measure moving further above the breakeven point of 50.0. The former is at a 38-month high, and the latter at a 41-month high. Meanwhile, the NM-PMI (50.7 from 51.0) dipped to a two-month low. Turning to the *Eurozone's two largest economies*, *Germany* saw its C-PMI (to 50.9 from 50.6) edge up to a five-month high, with the M-PMI Output (52.6 from 50.6) climbing to a 41-month high, while the M-PMI (49.9 from 49.1) was at a 38-month high—just short of the breakeven point of 50.0. Meanwhile, the NM-PMI (50.1 from 50.6) edged down to a two-month low. Economic activity in *France* moved close to stabilization in August, with all measures climbing closer to the 50.0: France's C-PMI (to 49.8 from 48.6) and NM-PMI (49.7 from 48.5) climbed to 12-month highs, while the M-PMI (49.9 from 48.2) hit a 31-month high, with the M-PMI Output (49.8 from 48.6) measure the highest in three months. The report noted that the *rest of the Eurozone* continued to register increasing output, albeit with the pace of growth easing slightly from July.

Japan PMI Flash Estimates (*link*): "Overall business activity expands at quickest pace in six months," according to the report. The C-PMI (to 51.9 from 51.6) moved further above 50.0, with the M-PMI Output (50.5 from 47.6) measure moving above 50.0, while the M-PMI (49.4 from 48.9) moved closer to expansion. The NM-PMI (52.6 from 53.6) held fairly steady above the breakeven point of 50.0. The report notes that Japanese companies were generally upbeat in August, with the level of optimism strong and slightly above that seen in July, though the reading remained below the survey's long-run average.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-241-6502
Melissa Tagg, Senior Global Investment Strategist, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
William Pesek, Contributing Editor, 516-277-2432
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102