Purchasing Managers Surveys Signal Improvement

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This morning, the ISM nonmanufacturing survey showed purchasing managers in the service sector are seeing improvement in a number of key areas. This suggests that the U.S. economy may be on stronger footing than the recent GDP report had indicated. It also reflects the recent shift in spending from goods to services, a trend that has been amplified by summer travel.

The headline composite index rose from 55.3 to 56.7 in July. In this series, a reading above 50 signals *expansion*, while below 50, *contraction*. The biggest contributors to the composite were the business activity index, which rose from 56.1 to a quite healthy 59.9, and the new orders index which also climbed from 55.6 to 59.9.

The supplier delivery index retreated from 61.9 to 57.8, but in this case the decline is a good thing as it reflects fewer delays. The prices paid index decreased for the third straight month, down from 80.1 to 72.3 on lower energy costs. The employment index, at 49.1, continued to reflect challenges in finding qualified and willing service workers.

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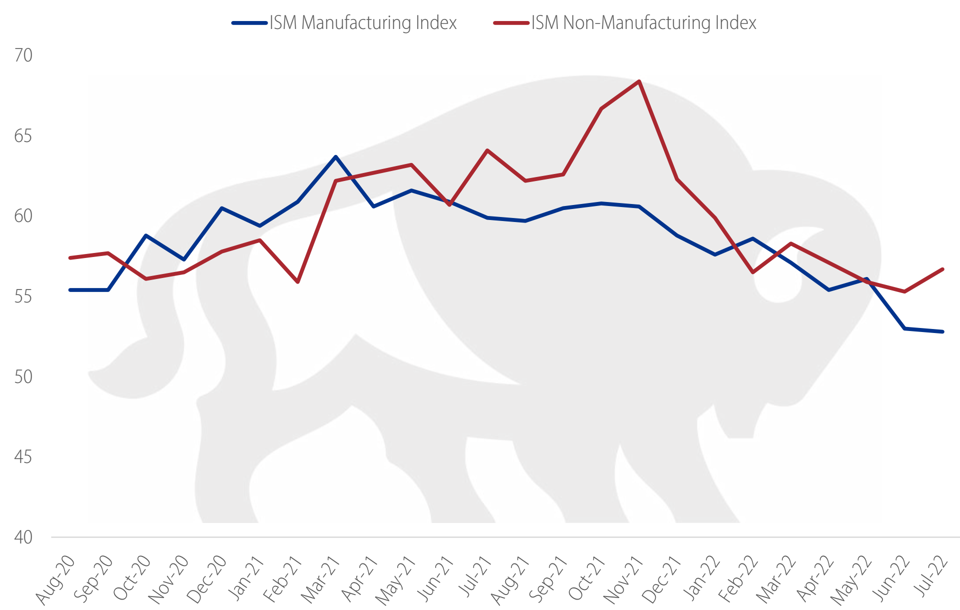
ISM Purchasing Managers Index



Source: Institute for Supply Management

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On Monday, the ISM manufacturing survey continued a weakening trend in the factory sector with the composite index slipping by 0.2 to 52.8 in July, a two-year low. Although some factory managers expressed concern over the softening economy, there were a number of positives, the most obvious being that index has now indicated expansion for the 26th straight month. Labor was a bright spot. Although the employment Index is still indicating mild contraction, it showed improvement, rising from 47.3 to 49.9. According to the survey participants, "companies continue to hire at strong rates, with few indications of layoffs, hiring freezes or headcount reduction through attrition." This suggests that hiring might be brisk if labor were more readily available.

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The orders backlog Index slipped from 53.2 to 51.3, while the supplier delivery index fell from 57.3 to 55.2. Both are now at two-year lows, suggesting progress in clearing supply chain snarls.

It's a little counterintuitive to believe a declining purchasing managers index is a positive, but amid signs of falling prices, and improving supply, a case can be made. It's also worth noting that as consumers increasingly shift purchases from goods to services, the goods producers are still indicating solid demand. As investors debate whether or not a recession is at hand, the third quarter is already showing improvement.

Yields are up this morning mostly on comments by St. Louis Fed President James Bullard, who told a CNBC audience late yesterday that he favors "front-loading" rate hikes and would like to see the overnight funds target at 3.75% to 4.0% this year. This implies another 150 bps over the next three meetings. Bullard also said the Fed might need to keep rates higher-for-longer in order to see a broad slowdown in price pressures, and agreed with Chairman Powell that the U.S. is *not currently in recession*, pointing to robust gains in company payrolls.

The more Fed officials emphasize labor strength as the primary economic pillar, the more important the employment numbers become – *the July labor report will be released on Friday morning.*

Market Indications as of 10:21 A.M. Central Time

DOW	Up 293 to 32,688 (HIGH: 36,800)
NASDAQ	Up 223 to 12,571 (HIGH: 16,057)
S&P 500	Up 38 to 4,129 (HIGH: 4,797)
1-Yr T-bill	current yield 3.14%; opening yield 3.03%
2-Yr T-note	current yield 3.15%; opening yield 3.06%
3-Yr T-note	current yield 3.10%; opening yield 3.01%
5-Yr T-note	current yield 2.92%; opening yield 2.85%
10-Yr T-note	current yield 2.80%; opening yield 2.75%
30-Yr T-bond	current yield 3.03%; opening yield 3.00%