

A Flurry of Unexpected Weakness Drags Bond Yields Lower

It's a data-packed, holiday-shortened week capped by Friday's critical release of the June labor market report, but the majority of releases so far have signaled surprising softness during the first month of summer.

This morning, the ISM services survey showed unexpected *contraction* in the most dominant sector of the U.S. economy. The ISM Services Index slipped from 53.8 into *contraction territory* (sub-50) at 48.8 in June. This was well below the 52.7 median forecast and *the lowest composite service reading since May 2020*. The employment index (already signaling contraction) fell further from 47.1 to 46.1, while the forward-looking new orders index dropped from 54.1 to 47.3. The prices paid index continued to indicate more service managers were experiencing higher prices in June, but the percentage has fallen in the last two surveys.

The morning began with a rally as early data releases were also soft, but the surprise ISM weakness extended and amplified the rally, dragging yields lower.

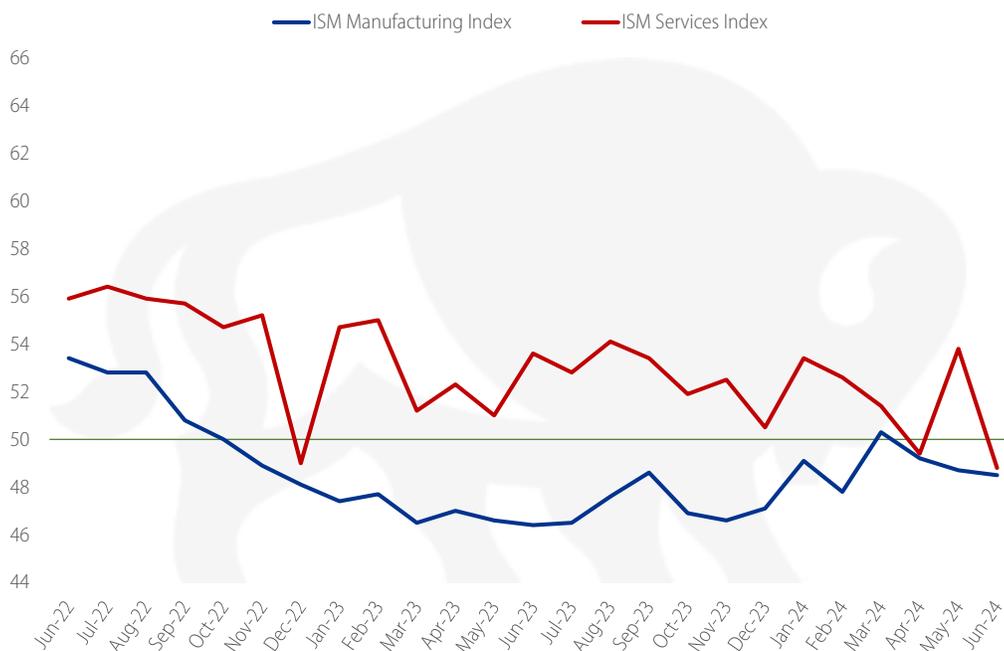
In other news from this morning, initial jobless claims (first time filings for unemployment benefits) came in at 238k for the final week of June. Average weekly claims for the month were also 238k. For the first five months of the year claims averaged 213k. Although unemployment filings are still quite low on a historical basis, it appears as though employers have increased the pace of layoffs, which is consistent with an economy slowing down. Another supporting indication of softness is continuing or ongoing claims, which rose to a 16-week high. This indicates it's taking unemployed Americans longer to find work.

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2012
greg.warner@hilltopsecurities.com

The ISM Services Index slipped from 53.8 into contraction territory (sub-50) at 48.8 in June. This was well below the 52.7 median forecast and the lowest composite service reading since May 2020.

ISM Purchasing Managers Index



Although unemployment filings are still quite low on a historical basis, it appears as though employers have increased the pace of layoffs, which is consistent with an economy slowing down.

Source: Institute for Supply Management
Please see disclosure starting on page 3

Also this morning, the monthly ADP employment report showed U.S. companies added just +150k workers in June after a revised +157k tally in May. Last year at this time, ADP had reported +543k new hires. This is a volatile data series, but you don't have to squint to see a more cautious pace of hiring. The ADP miss hints at a lower payroll count in Friday's BLS employment report.

Yesterday, June vehicle sales fell well short of forecast at a 15.3 million seasonally adjusted annualized pace, down from 15.9 million in May. It's possible that the widely reported cyber attack on U.S. auto dealerships last month impacted sales, but the bottom line is *weakening sales on big ticket purchases.*

Also on Tuesday, the Job Openings and Labor Turnover Survey (JOLTS) showed an unexpected increase in the number of available job postings for May. The previous survey had indicated the lowest number of job openings in three years at a revised 7.92 million but May rebounded to 8.14 million. The bond market still rallied, but presumably due to Powell's somewhat dovish comments at the European Central Bank policy forum rather than the unexpected increase in job availability.

On Monday, the ISM manufacturing survey showed U.S. factory managers are becoming less optimistic. The composite manufacturing index remained in contraction territory (sub-50) in June, slipping further from 48.7 to 48.5. The employment sub-index fell from 51.1 to 49.3 indicating fewer factory managers are hiring new workers. The prices paid index fell from 57 to 52.1, as a lesser number of factory managers reported higher prices.

The inflation battle is still priority one for Fed officials, but demand has to fall in order for prices to retreat. *It looks like that may be happening.* Yields are lower in early trading as weaker economic growth (if it continues) would allow Fed officials to ease rates sooner.

The minutes to the June FOMC meeting are scheduled for a quiet release this afternoon, while the June employment report will drive the markets on Friday morning.

This is a volatile data series, but you don't have to squint to see a more cautious pace of hiring. The ADP miss hints at a lower payroll count in Friday's BLS employment report.

The inflation battle is still priority one for Fed officials, but demand has to fall in order for prices to retreat. It looks like that may be happening.

Market Indications as of 9:43 A.M. Central Time

DOW	Down -45 to 39,287 (HIGH: 40,004)
NASDAQ	Up 39 to 18,067 (NEW HIGH)
S&P 500	Up 4 to 5,513 (NEW HIGH)
1-Yr T-bill	current yield 5.05%; opening yield 5.08%
2-Yr T-note	current yield 4.68%; opening yield 4.74%
3-Yr T-note	current yield 4.47%; opening yield 4.54%
5-Yr T-note	current yield 4.31%; opening yield 4.39%
10-Yr T-note	current yield 4.35%; opening yield 4.42%
30-Yr T-bond	current yield 4.53%; opening yield 4.60%

The paper/commentary was prepared by Hilltop Securities Asset Management (HSAM). It is intended for informational purposes only and does not constitute legal or investment advice, nor is it an offer or a solicitation of an offer to buy or sell any investment or other specific product. Information provided in this paper was obtained from sources that are believed to be reliable; however, it is not guaranteed to be correct, complete, or current, and is not intended to imply or establish standards of care applicable to any attorney or advisor in any particular circumstances. The statements within constitute the views of HTS and/or HSAM as of the date of the document and may differ from the views of other divisions/departments of affiliates Hilltop Securities Inc. In addition, the views are subject to change without notice. This paper represents historical information only and is not an indication of future performance. Sources available upon request.

Hilltop Securities Asset Management is an SEC-registered investment advisor. Hilltop Securities Inc. is a registered broker-dealer, registered investment adviser and municipal advisor firm that does not provide tax or legal advice. HTS and HSAM are wholly owned subsidiaries of Hilltop Holdings, Inc. (NYSE: HTH) located at 717 N. Harwood St., Suite 3400, Dallas, Texas 75201, (214) 859-1800, 833-4HILLTOP.