

Good morning,

What's in this week's Report:

- What the Bad Jobs Report Means for Markets
- Weekly Market Preview: Do Stagflation Fears Keep Rising?
- Weekly Economic Cheat Sheet: ISM Services the Key Report This Week (Needs to Stay Above 50)
- What the Fed Decision Means for Markets
- How to Navigate an "AI Bubble" (If One Exists)

Futures are seeing a moderate bounce following Friday's declines and after a mostly quiet weekend of news.

On trade, there was potentially positive news over the weekend as Swiss officials implied a trade deal with the U.S. was close, which would reduce tariffs.

There were no notable economic reports overnight.

Today, there are no economic reports, so focus will remain on trade, and any announcement of trade deals that reduce tariffs will be a mild tailwind on the markets.

Finally, earnings season has mostly wrapped up, but some remaining notable companies are reporting, including: BRK.B (\$5.24), W (\$0.27), ON (\$0.54), TSN (\$0.72), PLTR (\$0.08), MELI (\$12.01), AXON (\$0.08).

Market	Level	Change	% Change
S&P 500 Futures	6,298.00	33.50	0.53%
U.S. Dollar (DXY)	98.71	-0.43	-0.43%
Gold	3,420.55	20.75	0.61%
WTI	65.98	-1.35	-2.01%
10 Year	4.217%	-0.013	-0.31%

Stocks

Last Week (Needed Context as We Start a New Week)

Stocks rallied to record highs through the first half of last week thanks to strong mega-cap tech earnings and a mostly as-expected Fed decision. However, an uptick in June inflation and a slightly stagflationary July jobs report sparked significant volatility late in the week. The S&P 500 fell 2.34% on the week.

Equity markets rallied initially last Monday on the U.S./EU trade deal, although it met current market expectations, so the rally faded, and the S&P 500 finished flat.

On Tuesday, stocks were lower in quiet trade as economic data was mostly in line, as investors looked ahead to the Fed decision. The S&P 500 slipped 0.3%.

A typical sense of Fed paralysis left markets sideways and little changed in morning trade Wednesday, even after GDP and the ADP Employment report both came in stronger than expected. Unusual comments from Treasury Secretary Bessent, “discouraging panic” surrounding the Aug. 1 tariff deadline, prompted modest risk-off money flows; however, the market steadied into the Fed decision. The initial reaction was slightly dovish and saw stocks hit session highs in mid-afternoon trade. Then, Powell pushed back on September rate-cut prospects, which prompted a selloff and saw the S&P 500 end the day down a modest 0.12%.

A glimpse of risk-on money flows on the heels of solid earnings and guidance from Mag 7 members MSFT and META saw stocks recover to record highs at the open Thursday. However, strong jobless claims data paired with a warmer-than-expected Core PCE inflation print dampened optimism for a September Fed rate cut, in turn weighing on the S&P 500, which ended down 0.37%.

Stocks opened Friday’s session down ~1%, and for the second day in a row, the day’s first print in the S&P 500 proved to be the session high, to the tick. Tariffs going into effect, paired with a relatively soft BLS employment report for July (especially June revisions), were the two primary negative catalysts for stocks, which ultimately saw the S&P 500 close down 1.60%.

Putting Friday’s Jobs Report In Proper Context

I noted that the most significant near-term risk to this market was excessive complacency towards tariffs and their potential impact on the economy. That turned out to be good timing as Friday’s jobs report implied that the labor market is slowing more than expected. At the same time, the tariff declarations reminded investors that tariff rates will settle near-100-year highs (and that will impact the economy and inflation). But while Friday’s jobs report was a jolt, I do want to make sure you understand it in the proper context.

First, the jobs report was a major disappointment, but job adds are still positive, so it’s not signaling any recession or slowdown. Second, of all the economic reports, the jobs report is the most “inaccurate.” It’s prone to massive revisions (as we’ve seen). It can offer diverging signals between the Establishment and Household surveys and has extreme seasonal volatility (usually in August/September, so right on cue). Importantly, no other labor market indicators are flashing a warning sign (no claims or JOLTS), and other economic metrics are stable, so the jobs report is not warning of a slowdown.

Regarding Friday’s tariff announcements, they were mainly in line with expectations. The only countries that saw “worse” tariff rates than expected were Canada and Switzerland, and negotiations are ongoing. Point being, the negative decline wasn’t due to actual new negatives, just more a case of the headlines causing a more poignant reaction. The bottom line here is that neither the jobs report nor the tariff announcements should lead us to think anything is worse than we thought it was on Thursday.

The problem, however, is that at 6,350, the S&P 500 gave zero room for disappointment, even if it’s just on the surface. That’s why stocks dropped on Friday: not because the news was much worse than we expected, but instead because it reminded the markets that it is possible that tariffs and policy volatility damage economic growth.

Looking forward, the next key number is Tuesday's ISM Services PMI. If it's much weaker than expected and drops below 50, look for economic anxiety to rise and stocks to fall further. If it's stable above 50, economic concerns will ease. Beyond that, we all need to continue to watch economic data very closely because if investors get nervous about growth, this market will drop further (possibly much further if recession fears rise).

Economic Data (What You Need to Know in Plain English)

Last Week

Primarily due to Friday's weak jobs report, economic data last week revived the "tariff stagflation" narrative. And while that's not the most likely outcome, the data last week reminded investors that the risk of it happening in the future is not zero (as the S&P 500 near 6,400 implied).

The key report last week was the jobs report, and while the headline was modestly weaker than expected (74k vs. (E) 106k), it was the revisions that made the report very weak. The May jobs report was revised sharply lower from 144k to just 19k, while the June report was cut from 147k to 14k! Here's what that means: The three-month run rate of job adds went from 141k before the revisions to just 35k after the revisions!

Other details of the jobs report were generally "fine" as the unemployment rate rose 0.1% to 4.2%, while the wage data increased to 3.9% y/y vs. (E) 3.8% y/y, but the weak job adds more than offset any concerns about upward wage pressures.

Stepping back, the soft jobs report and big revisions did serve as a "wake-up call" to investors about economic risks from tariffs and new economic policy. The fact that this jobs report came on the day new reciprocal tariffs were announced only further highlighted that fact. But while the jobs report in total (including the revisions) was very weak, it's not being confirmed by other metrics. As such, it's going to be looked at with a bit of skepticism (the jobs report is always mercurial, and the dramatic revisions will only further that opinion). Point being, jobless claims remain low, JOLTS are generally "fine," and the employment indices in the ISM PMIs aren't flashing a warning sign. So, while the jobs report is undoubtedly a signal we need to continue to closely monitor for any signs of weakness (because if they show up, it's a problem for stocks), the jobs report isn't, by itself, a complete indictment of the labor market. It needs to be taken with a grain of salt.

Looking at growth metrics outside of the jobs report, the ISM Manufacturing PMI echoed the weak jobs report. The headline fell to 48.0 vs. (E) 49.5, while New Orders, the leading indicator in the report, rose to 47.1 vs. (E) 48.7, underscoring the weakness.

Turning to the Fed, the FOMC decision provided a mixed bag as the statement downgraded the current pace of economic growth and saw two dissents in favor of a more dovish stance. At the same time, Fed Chair Powell reiterated that the FOMC is still in a "wait-and-see" mode and could cut rates in September, but only if the data pointed towards it. That slightly mixed message caused stocks to slip on Wednesday, but overall, the FOMC decision didn't change the outlook for a September rate cut.

Thursday's Core PCE Price Index did, however. The Core PCE Price Index rose 2.8% y/y vs. (E) 2.7% y/y. Combined with low jobless claims and solid Q2 GDP, this pushed back modestly on the expectations for a September rate cut, which weighed on stocks. To be clear, the Core PCE Price Index doesn't mean inflation is re-accelerating (if the market thought that stocks would be much lower). To that point, there were offsets to the hot Core PCE Price Index (most notably a lower-than-expected increase in home prices), which could more than offset any tariff-related goods increases in CPI

and the Core PCE Price Index in the future. But the slightly hot Core PCE Price Index does keep alive concerns that tariffs are now, finally, starting to flow through and increase prices.

Thursday's Core PCE Price Index and Friday's jobs report and ISM Manufacturing PMI reminded investors that tariffs can negatively impact growth and boost inflation, so while last week's data didn't dramatically increase slowdown risks, it did remind investors that the chances of stagflation are not zero, and stocks reacted accordingly.

Important Economic Data This Week

The week after the jobs report is usually a quiet week of data, and that's the case this week, as the most notable economic report is Tuesday's ISM Services PMI. Following Friday's soft data, it's fair to say this report is taking on greater significance. As has been the case, the key for this report remains staying above 50, as it's not common that both the ISM and Services PMIs drop below 50 for several months in a row. If that does happen, it's a very reliable negative economic signal and will shake the confidence in investors that we're headed towards a soft landing. Bottom line, the service sector is the majority of the economy, and as long as it is in expansion, then a material slowing of economic growth remains unlikely.

The other notable reports this week come on Thursday via jobless claims and Unit Labor Costs. Starting with claims, they are the most high-frequency labor market indicator, and they remain near historic lows, implying a stable labor market. Continued low readings will keep confidence high that the economy is stable. While there aren't many reports this week, the ones we do get are important for reinforcing the current bullish ideas of 1) Stable economic growth and 2) Benign inflation, as those ideas have massively contributed to the four-plus-month rally.

Special Reports and Editorial

What the Fed Decision Means for Markets

The FOMC decision was slightly dovish, but the market declined following the release, and that validates a point that we and others have made about this market: a lot of good news is already priced in, so for stocks to move higher, we need great news, not just good news.

The Fed was a case in point. The decision was slightly dovish, and it reinforced current expectations for a September rate cut. But neither the FOMC statement nor Powell's press conference made a September rate cut dramatically more likely, which is why stocks declined despite the slightly dovish decision.

The market's disappointment in the Fed just reinforcing current expectations is the second instance of "what's expected" being "not good enough" to spur a rally, as this week, numerous earnings reports that have beaten estimates have seen relatively muted rallies. In contrast, slightly underwhelming reports have been met with heavy selling.

Bottom line, I'm not ready to say this is a market priced for perfection because there is room to move higher over the coming months if growth data is good, inflation is tame, tariffs are stable, and the Fed cuts. But it's going to take some great news on economic data, inflation, tariffs, or the Fed to send this market higher near term, not just news that reinforces the assumptions that took us to 23X current year's earnings and nearly 22X next year's earnings.

Candidates for great news include very positive inflation reports and strong economic data (that destroy the tariff stagflation narrative), geopolitical progress (Russia/Ukraine ceasefire), or more AI-driven positive news.

Absent that, we should be prepared for data that points to a soft landing, buoyant inflation that's not a problem, a probable (but not guaranteed) September rate cut, and dramatic earnings growth to merely support stocks at these levels, not send them dramatically higher.

How to Navigate an "AI Bubble" (If One Exists)

A recent question provoked some serious thought and a round of deep-dive analysis regarding the topic.

Paraphrasing his words, he asked: "Is the stock market in a bubble, and if so, what indicators or market signals would you be monitoring?"

When assessing whether or not we are in another stock market bubble, one initial thought stood out among the rest: Every bubble in modern market history has been based on a narrative, whether it be the internet or real estate.

Critically, that given narrative is widely perceived by the investment world to be a source of unlimited earnings growth across most market sectors. Today, that potentially bubble-inflating theme is unquestionably AI technology. Knowing what the narrative is, we can lean on hindsight and look back at prior bubbles to see where early warning signs could be found; canaries in each respective bubble's proverbial coal mine, if you will.

So, if an AI bubble does exist, what indicators will offer early warning signs *prior* to it "popping?" In 2006 and 2007, a steady rise in mortgage delinquencies and property foreclosures was one of many key warning signs. Leading into the 2000 market peak, retail trader participation as a percentage of daily volume and reckless levels of margin trading activity proved to be an anecdotal warning signal (with the benefit of hindsight, of course).

This time around, with a focus on the emerging but already booming AI industry, we should logically look to chip-makers in our search for a leading indicator that should warn of a potential market peak being established in the broader stock market.

With that in mind, NVDA could be, and widely is already, viewed as a good proxy for the health of the "AI trade," and logically so, as NVDA is the unchallenged leader among mega-cap global semiconductor producers. So, if we were to look to NVDA shares alone as our preferred proxy for the health of the AI trade, then the dream is alive and well, and stocks should be set to continue higher as the stock just hit another all-time high yesterday.

However, there are a lot of various factors that can impact a single stock, including a "cult following" like we saw with TSLA and its loyal investor base for years after the company went public in 2010, a dynamic that has appeared to have emerged with NVDA as well, which presents a risk to the effectiveness of looking at NVDA alone as a broader "AI bubble indicator." Instead, in our view, it would be much more prudent to keep tabs on the broader-based semiconductor index, SOX, as it includes NVDA, but also other major players in the AI-chipmaking game, including AMD, QCOM, MU, AVGO and MRVL.

So, for those who challenge the idea of looking only to NVDA for direction regarding the broader AI narrative and underlying stock market rally, and instead accept the idea that the SOX index is a better "signaling indicator" as to the state of a potential stock market bubble. This bull market in equities has a serious problem. The reason is that the SOX index hasn't hit new record highs since last July (*yes, July 2024*), while the S&P 500 has continued to power to record high after record high, up ~13% since last July's highs.

The takeaway here is that if AI remains the primary source of bullish optimism for a continued rally in the broader stock market in the months and quarters ahead, this market is in trouble and at risk of rolling over sooner than later as the SOX should still be leading the market higher like it was in 2024, not lagging considerably over the last 12 months. That divergence in index performance is meaningful, and if we see the SOX roll over in the weeks or months ahead, and start selling off materially, the S&P 500 will almost certainly not be far behind.

A lighthearted comparison of the SOX vs. S&P 500 performance gap over the last 12 months can be made to one of the many classic cartoon scenes in which *Road Runner* (the SOX) stops abruptly short at the edge of a cliff as *Wile E. Coyote* (the S&P 500) goes screeching off the end, unable to stop in time, and ultimately left to face the effect of the one-way law of gravity—a downward force that the broader stock market could very well be on the brink of facing in the near term.

To be clear, we're not saying the rally is over, but if the SOX index is indeed acting as a leading indicator for AI optimism, then there is a significant sense of complacency in equity markets right now with risks of a downturn both underappreciated and, more importantly, underpriced in these early stages of H2'25.

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