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Economic Indicators October 2021

By Kim W. Suchy

As you know, I often talk about the walls of worry that face the U.S. markets. Well another wall has surfaced; the Chinese wall of worry. No, it's not related to C19, tariffs or technology theft, it's about Evergrande, one of the world's largest real estate developers located in China.

Evergrande is on the brink of default. Evergrande missed their last $83M coupon payment on U.S. dollar-denominated bonds with a face value of $2.03B. This is just a fraction of the company's $300B in debt obligations. The ramifications of additional missed payments have jolted markets across the globe as comparisons have been drawn to the U.S. crash in 2008, and to Japan's property bust in the 1980's where unreasonable speculation and leverage imploded and generated extended economic slowdowns.

Evergrande is running more than 1300 real estate projects in over 280 cities. Their success reaches beyond real estate as they have expanded horizontally, acquiring an electric vehicle company as well as the renown soccer club, Guangzhou F.C.. The company employs more than 123K employees alone, and that doesn't include the number of construction workers hired for each of their projects or employees of ancillary support businesses. Employees, financial institutions and suppliers rely heavily on Evergrande and a lot of companies could go bankrupt if they're not paid…this is essentially a domino effect of the entire Chinese market and the contagion could extend well beyond the borders of China.

China's economy is more vulnerable to a real estate crash than either America's or Japan's was at the time of their respective crashes. Real estate and related industries account for almost 30% of China's GDP, a much higher share than the U.S. at the height of its boom. Further, unlike Americans or the Japanese, Chinese citizens are extraordinarily dependent on real estate for their nest eggs. Bloomberg reports that the homeownership rate is 90%, and it's estimated that urban

Chinese people have more than 70% of their net worth in property. An Evergrande default would decimate the real estate market and ultimately the Chinese economy.

Because Evergrande has such a significant state-owned posture, investors may thinking that the Chinese government would intervene and provide ample backstop. Thus far, this has not taken place. This has the markets in China uneasy which has sent ripple effects throughout Asia, Europe and the U.S.. My hunch is that there will be some sort of intervention as President Xi knows that a long-lasting crash in real estate would lessen China's resiliency to macroeconomic shocks. China can ill afford a macroeconomic breakdown as China's post pandemic economic recovery is on wobbly legs. In addition, China hosts the Winter Olympics this year…Xi does not want a floundering economy as a backdrop while he has the world stage.

Here is your look at developments in the global marketplace.

Positive Developments:

- The Labor Department announced that the Consumer Price Index (CPI) rose 0.3% in August, a big drop from the most recent 0.5% and 0.9% increases in July and June, respectively. Further, the core CPI, ex food and energy, declined 0.1% in August as prices for used vehicles and transportation declined 1.5% and 2.3%, respectively. Good news for travel was the 9.1% plunge in airline fares and 2.9% decline in hotel prices. CPI has risen 5.3% yoy.

- The Commerce Department reported that retail sales rose 0.7% in August which was a surprise given economists' consensus expectation of a 0.8% decline. Grocery sales rose 2.1%, so it appears that higher food prices are helping to boost retail sales. It is becoming more evident that consumers are gaining confidence to spend (at least currently…. Consumer Confidence- see negative bullet below, suggests this may wane in longer term). When you consider that the personal savings rate is still quite high at 9.6%, compared with the historical norm of 5%, we are still sitting on some pent-up demand. This bodes well for future GDP growth and corporate earnings.

- Fed Chair Powell's tone in his conference following the Sept 22 FOMC meeting was measured, leaving the door open to a policy pivot if the Fed doesn't meet its targets (inflation control & full employment). The Fed's asset purchases are $120B/mo. If tapering means reducing purchases by, say, $15B/mo., that still leaves the markets with enormous liquidity in the system through mid-2022. Add to that the new infrastructure spending, and it's no surprise that the stock market is not rattled.

- The S&P/Experian Consumer Credit Default Composite Index measures the default rates across mortgages, bank cards and auto loans. The index registered a default rate of 0.39% in August 2021, a record low. And it sits well below its 1.72% avg. since inception (July 2004) and significantly below its all-time high of 5.51% set in May 2009. A low default rate is encouraging considering it has remained somewhat muted despite the economic fallout from C19. Extended govt. benefits helped keep defaults at reasonable levels.

- The Census Bureau reported that durable goods orders rose 1.8% in August, more than twice the 0.7% consensus and July orders were revised upward from -0.1% to 0.5%. The spread of the Delta variant did not slow business investment last month. Businesses are adding capacity to keep up with strong demand. There is still a wide gap between shipments and orders indicating strong business demand. The large increase in unfilled orders reflects supply chain bottlenecks throughout the economy.

- The US economy continues to grind forward even though the pandemic continues. The TSA travel numbers at US airports are back near pre-pandemic levels and railcar loadings excluding coal are back at pre-pandemic levels as well, and so are intermodal loadings according to a report by Atlantic Systems.

Neutral Developments:

- *Existing* home sales declined 2.0% in August to a 5.9M a/r after 2 mos. of gains. Sales are down 1.5% versus a year ago as buyers struggle with rising prices and limited supply. The median price of an existing home fell to $356.7K in August but is up 14.9% versus a year ago. Average prices are up 9.8% yoy.

- *New* single-family home sales increased 1.5% but sales are down 24.3% yoy. The median price of new homes sold was $391K in August, up 20.1% yoy. The average price of new homes sold was $443K, up 14.7% yoy. Sales are still well below the January peak of 993K…..Why? Two reasons: 1) a lack of supply of completed homes and, 2) rapid price appreciation versus pre-C19 levels. The Census Bureau reports that contractors are reporting and increase in permit demand. This, coupled with lower lumber prices, should bode well for the housing market and help reign in median and average home prices.

Negative Developments:

- Accenture recently released a report, Supply Chain Disruption that notes: 94% of Fortune 1000 companies are seeing supply chain disruptions from C19, 75% of companies have had negative or strongly negative impacts on their businesses and 55% of companies plan to downgrade their growth outlooks (or have already done so).

  - Note, supply chain disruption is partially driven by reduced employment, some related to C19 shutdowns or restrictions, as well as the inability of companies to fill open positions. One consequence of the inability to fill jobs is the development of constrained supply chain. Thus, demand is exceeding supply and pushing prices higher. This leads to higher inflation, which is occurring now, even if it is transitory. All of this can be a headwind to economic growth going forward.

- Oil and natural gas prices are rising. Under pressure from climate activists, major oil companies are limiting their spending on new oil and gas supplies. In a recent interview with Bloomberg News, Chevron's CEO Mike Wirth predicted that energy prices will remain high for the foreseeable future because oil and gas producers are hesitant to drill for more oil and gas. He didn't say it explicitly, but his remarks implied that climate change activists are forcing production constraints.
  - Gas prices are soaring in Europe, boosting inflation and depressing economic growth. European gas prices are up almost 500% in the year. Any sort of extended deep freeze this winter will cause major economic problems in Europe.
- Reuters reported on 9/24 that China's regulators intensified the country's crackdown on cryptocurrency with a blanket ban on <u>all</u> crypto transactions and crypto mining, hitting bitcoin and other major coins and pressuring crypto and blockchain-related stocks. Their aim is to root out illegal cryptocurrency activity and to go after rich people as the govt. doesn't want them to have any easy way to transfer their money overseas. Bitcoin slid on the news. Note, Turkey and India banned cryptos earlier this year for similar reasons.
- Competition for employees is fierce: The Bureau of Labor Statistics' Job Openings and Labor Turnover Survey (JOLTS) showed the number of job openings nationwide increased to a series high of 10.9M in July, versus 10.1M at the end of June.
- The Conference Board reports that concerns about the Delta variant continued to send consumer confidence south in Sept., falling to a 7 mo. with spending intentions for homes, autos, and major appliances retreating. Short-term inflation concerns eased a bit, but remained elevated. The Consumer Confidence Index (CCI) fell for the 3rd mo. in Sept. to a 7 mo. low of 109.3, after climbing steadily from 95.2 in Feb. to 128.9 by June.

The Markets:

The SP500 peaked at a record 4536.95 on September 2. It closed the month down 4.9% from that level on September 2nd. That's consistent with September's historical track record of being the worst month of the year to own stocks. It was particularly hard on growth stocks this month as rising bond yields and surging oil and natural gas prices boosted SP500 financials and energy at the expense of tech. Prior to this development, growth was outperforming value.

U.S. Index	Last Month (% return)	YTD (%)
S&P500	-4.5	15.0
Dow	-4.0	10.9
NASDAQ Comp	-5.4	14.4
Russell 2000	-2.2	12.8

On the international front, the European markets were generally lower with the Euro Stoxx 50 posting a -3.6% return in September. Asian markets were mixed with the Nikkei higher, Shanghai closed in positive territory but Hong Kong slid 5%. Crude oil continues to surge logging a 9.6% increase and is now up 54.7% YTD.

International Index	Last Month (% return)	YTD (%)
Euro Stoxx 50	-3.6	13.8
Hang Seng	-5.0	-9.8
Germany	-3.7	11.2
Nikkei	4.9	7.3
FTSE-U.K.	-0.6	9.5
China Shanghai Comp.	0.6	2.7
Crude oil	9.6	54.7

The year 2021 began with the 10-year Treasury Note yield at 0.90%. The 10-year closed September at 1.51%, 21bps higher than the August 2021 close. The 2-year Treasury closed September yielding .29%, 22 bps higher than August's close. Although rates were higher across the curve, the 10/2 spread remained relatively stable at 122bps or 1bp tighter than last month.

News You Can Use:

Last Sunday, Team USA ousted Europe in the 43rd Ryder Cup held at Whistling Straits. It was the youngest-ever American team to claim the Ryder Cup, and in addition, made history in scoring 19 points to Europe's nine. It's the most points scored by any team since the Americans began playing all of continental Europe in 1979. The U.S. won or tied all five sessions for the first time since 1967.

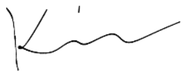
https://www.golfdigest.com/story/rydercup2021-us-defeats-europe-best-statistics

According to Bloomberg, 6.19 billion doses of the C19 vaccine have been administered globally, across 184 countries. In the U.S, 391 million doses have been given so far at a current run rate of 701,422 doses per day. Experts say that vaccinating 70-85% of the population would enable a return to normalcy. At the current vaccination rate, it will take another 6 months to cover 75% of the population globally.

https://www.bloomberg.com/graphics/covid-vaccine-tracker-global-distribution/

As always, if I can be of additional guidance, please feel free to call me at 312.485.6847.

Best regards,



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