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Economic Indicators November 2021
By Kim W. Suchy

When I wrote you last month, the Dow closed September with its worst one-day sell off of the year closing down 586.80 points. A confluence of weak sentiments surrounded the financial markets and political landscape. Surging retail prices, rising oil prices, rising interest rates, low job formation, and rising debt limit concerns leading to a potential national credit default, inflation climbing and the Evergrande real estate bubble.

Once again, the markets proved how resilient they can be as the markets roared back in October. What changed?

Fundamentally nothing has changed, but time gave us the benefit to receive hard data for Q3:21 earnings from the corporate sector. The data reported thru mid-week last week has confirmed that we are in the midst of economic recovery. FactSet has reported that the growth rate of actual earnings, over estimates, continues to be stronger on a quarter over quarter for the first three quarters of this recovery year!

Looking at the earnings reports we see that growth transcends a broad swath of corporate names and an extensive range of economic sectors. Q3 reveals strong performance across the health care, energy, financials, and consumer discretionary sectors as leading performers of the economy. This last sector, consumer discretionary, is an interesting finding since it shows companies are able to sustain their operating margins despite rising wages and limited supply of qualified labor. The consumer remains alive and well thus providing the octane for the economic recovery.

So, as I write this, here comes a curveball from the two behemoths in the tech sector. Amazon and Apple released earnings which, coupled with their guidance, were disappointing. Amazon reported weaker-than-expected results for Q3 and issued downbeat sales guidance for the Q4. Amazon cited that it will incur additional costs in their business due to labor supply shortages, higher wage costs and supply issues.

Apple reported earnings that were in line with expectations but guidance was soft. On its conference call after the report, management said supply constraints had a $6B revenue impact in the last quarter and warned it expects continuing chip shortages will cause an even bigger hit looking forward. Concerns over Amazon's supply chain issues and Apple's chip shortage enhanced tech sector volatility on the last day of trading in October.

We have all heard of the term, supply chain disruption, yet its resolution is very complicated as there are often multiple kinks in the chain. I thought it would be useful to identify the scope of the issue which will shed light on what hurdles face the global economy.

Economist, Ed Yardeni, summarizes the depth and breadth of the supply chain issue as follows:

(1) Global factories shutdown. When the virus outbreak occurred, mass quarantines forced factories to shut down around the globe. Since reopening, they've struggled to keep up with new orders.

(2) Lopsided demand. Consumers on lockdown in early 2020 quickly shifted their demand from services to goods. Stuck at home, many consumers renovated them or moved to bigger ones in the suburbs. Consumers also upgraded their stay-at-home entertainment and workout routines. Demand exceeded supply.

(3) Containers stuck. Finished products are piling up in manufacturing warehouses waiting to be shipped to their destined port. But shipping containers have been hard to come by. Many have been stuck in parts of the world where they are usually not found. Shippers are refusing to send boxes inland to pick up their cargo because they are trying to get empty containers back to factories in Asia as quickly as possible to take advantage of historically high shipping prices for exports from the continent.

(4) Congested docks. Dozens of loaded container ships are floating in the waters near Los Angeles and Savannah waiting for up to two weeks to be unloaded.

(5) Chain gangs wanted. Retirees, quitters, and labor unions are tightening the labor market for essential logistics workers from longshoremen to truckers and rail workers alike.

(6) Component problem. The imbalance between booming consumer demand for goods and strained manufacturing capacity inevitably has generated supply shortages for key raw materials and parts. For example, shortages for chemicals like resin and polymers have reduced production by paint suppliers. Semiconductor shortages have severely impacted inventories from cars and computers to appliances and toothbrushes.

(7) Hoarding for the holidays. Manufacturers and retailers are panic-ordering extra inventory just in time for the Christmas and holiday season—which has worsened the situation, noted an October 20 CNBC article. "Because the problems are well known, orders for raw materials, component parts, and finished goods are now being placed earlier than normal, which is lengthening the queue.

(8) Factories gone cold. The latest energy crises in mainland China and Europe are further disrupting global supply chains. China's power supply shortages have interrupted the operation of many factories. Europe is in the same boat.

As you can see the supply chain issue is quite complex as it may contain multiple kinks depending on the product or commodity. You may have seen some empty shelves in your favorite stores and the situation may become worse before it gets better. In any event, I've heard Santa will have his elves working overtime to ensure Johnny and Suzie have their list at least partially satisfied.

Here is your look at developments in the global marketplace.

Positive Developments:

- The consumer is alive and well. The Census Bureau reports that retail sales continued to show strength in September and rose 0.7% for the month. The sales gains were broad, with 11 of 13 major categories up in September, led by general merchandise stores (back-to-school shopping) and at gas stations (more miles driven and consumers paying more at the pump). *Note, gas prices are up a whopping 43% ytd!* Overall sales are up a robust 13.9% from a year ago.

    - Consumer confidence unexpectedly drifted higher in Oct. after showing 3 consecutive mos. of declines led by elevated prices and rising delta variant case counts. The upbeat in consumer activity was mainly supported by increased optimism in housing despite the surge in home prices.

- Through October 26th, roughly 1/3 of the SP500 companies have reported Q3 earnings. Of these companies, 84% have beat EPS estimates which is above the 5-yr. avg. of 76% according to FactSet. If 84% is the final percentage for Q3, it will be one of the highest levels since 2008. In aggregate, companies are reporting earnings that are 13.4% above estimates, which is also above the 5-yr. avg. of 8.4%. In terms of revenues, 75% of S&P 500 companies have reported actual revenues above estimates, which is above the 5-yr. avg. of 67%. In aggregate, companies are reporting revenues that are 2.2% above the estimates, which is also above the 5-yr. avg. of 1.4%.

- R&D is very strong. Over the past 2 qtrs., R&D spending has grown at nearly an 8% a/r, more than twice the pace over the last 20 years as reported by Renaissance Macro. R&D is an important source of productivity growth within firms and necessary for product innovation. Although it takes time to flow to the bottom line, it is an inflationary buffer.

Neutral Developments:

- Housing starts declined 1.6% in September to a 1.6M a/r. Starts are up 7.4% yoy. Note, First Trust Economics reminds us that the US needs roughly 1.5M housing starts per year based on population growth and scrappage (voluntary knockdowns, natural disasters, etc.). However, we haven't built that many new homes in any calendar year since 2006.

With plenty of future building activity in the pipeline and builders looking to boost the inventory of homes and meet consumer demand, and as more millennials finally enter the housing market, it looks very likely construction in 2021 will exceed the 1.5M benchmark this year and then move higher in 2022.

- *Existing* home sales increased 7.0% in September to a 6.3M a/r. Sales are down 2.3% yoy. The number of listed, but unsold, existing homes was 1.3M in September, the lowest number for any September on record (dating back to 1999). The combination of strong demand and waning supply has pushed median prices up 13.3% in the past year, but the good news is that price gains have been decelerating rapidly since hitting a year-to-year gain of 23.6% in May. Sales in 2021 are on track to be the highest for any calendar year since 2006.
- Durable goods orders pulled back slightly in Sept., but it was entirely due to the typically volatile transportation sector that can, and does swing wildly from month to month. Strip out transportation, and orders rose 0.4%. Orders are up 15.3% yoy, while orders excluding transportation are up 14.6% according to the Census Bureau.
- A survey by the National Association of Business Economists (NABE) found 36% of companies are experiencing labor shortages and expect them to end at some point in 2022. 14% expect them to extend into 2023 at least. A third of companies are experiencing cost increases they characterize as permanent. These include labor costs. Another 21% say they are experiencing temporary cost increases.

Negative Developments:

- On 10/20, The Fed Beige Book revealed slower growth in most of the 12 Fed districts. Much of the slowdown is due to mounting inflationary pressures and shortages. Every sector in every district reported difficulty sourcing goods, materials, and employees. That includes retail, construction, manufacturing, and real estate segments of the economy.
- Dollar-bond defaults from Chinese property developers are surging as China's housing market slumps, and the problem could worsen as a wave of debt from the weak industry comes due in the coming months. As I reported to you last month, real-estate developers dominate China's international high-yield bond market, making up about 80% of its total $197B billion of debt outstanding, according to Goldman Sachs. Selloffs are at the highest level in a decade. The market has already endured massive selloffs after Evergrande Group skipped some interest payments to dollar bondholders in late September, and smaller rival Fantasia Holdings Group Co. shocked investors by defaulting on debt that matured in early October.
- The Labor Department reported that the Producer Price Index (PPI) logged its highest 12 mo. surge since 1981. Producer prices rose 0.5% in September, are up 8.6% in the past year, and up at an even faster 9.8% a/r in the past 6 mos. Supply-chain issues continue to place significant upward pressure on prices. Further, each step in the distribution process

is disrupted. With goods sitting on idle ships off the coast of California, limited drivers to move loads out of the ports, shortage of trains available to move product across the country, and limited staff available to unload once at the destination warehouses. Collectively, these steps face difficulties in trying to satisfy demand thus driving up PPI.

- Consumer Price Index (CPI), which rose to a 30-yr. high of 4.5% yoy in June, eased to 4.3% in July and to 4% in August and September. Finally, the core Personal Consumption Expenditure (PCE) index, the Fed's preferred measure of inflation, hit a 30-year high at 3.6% yoy in June, July and August, well above the its 2% target. Note, with sustainable inflation rising at a pace well above what the Fed has expected, it may announce plans for tapering its $120B/mo. bond purchases in early November and the taper program could conclude in June 2022, which would then set the table for the liftoff in interest rates in late 2022.

- The transition to green energy is going to be difficult. The price of Brent crude oil futures is up 64% ytd, the price of natural gas futures has risen 100% over the same period, and there has even been a 114% ytd jump in the price of coal through mid-October. *I hope you have a reasonable stock of warm sweaters.*

- The Fed reported that industrial production dropped 1.3%, with manufacturing down 0.7% in September. The Fed blamed 0.3% of the drop on Hurricane Ida, which forced some producers to idle operations. The rest is attributable to bottlenecks, including the semiconductor shortage. Motor vehicle production fell 7.2%. US light auto assemblies dropped to a 7.5M unit rate last mo. They were lower during the lockdowns last spring and during the global financial crisis, but before that, the last time they were this week was in the 1980s!

- U.S. GDP growth decelerated to a 2% a/r in Q3, down from a 6.7% rate in Q2, according to the Commerce Department. This is the slowest growth rate since the 2020 recession. Consumer spending rose a modest 1.6% in Q3, well below the 12% rate in Q2. Households shifted spending to services, which rose 7.9% while spending on durable goods fell 9.2% in Q3 as new cars were scarce due to the microchip shortage.

The Markets:

The U.S. equity markets recouped their September pullbacks and then some. The SP500 closed October at 4610 up 6.99%. Again, solid earnings results trumped inflationary and interest rate concerns. Looking forward, sticky inflation in the short and intermediate term and a Fed beginning the process of winding down quantitative easing will not be a death knell for equity markets. But in the absence of easy financial conditions, earnings rather than multiples should continue to drive markets. This suggests less of a reliance on rates and more on corporate earnings, cash flow and sustainable margins as inflationary pressures mount. This has been the case this past month as market upticks were viewed through the prism of earnings despite the haunting of higher rates.

Energy, consumer discretionary and real estate sectors led the market las month while industrials, consumer staples and communication services were laggards.

U.S. Index	Last Month (% return)	YTD (%)
S&P500	7.0	22.7
Dow	5.9	17.1
NASDAQ Comp	8.0	23.9
Russell 2000	4.2	16.3

On the international front, the European markets had a solid month and kept pace with their U.S. counterparts. Asian markets were generally lower as supply chain issues and energy shortages continue to nag their economic vitality. Crude oil continues to surge logging a 10.8% increase and is now up 71.4% YTD. Get some sweaters folks, we are in for a costly winter!

International Index	Last Month (% return)	YTD (%)
Euro Stoxx 50	5.2	19.8
Hang Seng	3.3	-6.8
Germany	2.9	14.5
Nikkei	-1.9	5.3
FTSE-U.K.	2.3	12.2
China Shanghai Comp.	-0.6	2.1
Crude oil	10.8	71.4

The year 2021 began with the 10-year Treasury Note yield at 0.90%. The 10-year closed October at 1.56%, 5bps higher than the September 2021 close. The 2-year Treasury closed October yielding .49%, 20 bps higher than September's close. Although rates were higher across the curve, the 10/2 spread compressed a bit to 107bps or 15bps tighter than last month.

News You Can Use:

On Sunday, October 24th, Tom Brady of the Tampa Bay Buccaneers threw his 600th career touchdown pass, which no player in NFL history has accomplished. Unknowing of the accomplishment, Mike Evans who took in the reception handed the ball off to a fan after the touchdown. After minutes of negotiation between the fan and Buccaneers officials to get the ball back, the fan gave the ball back in exchange for two Brady-signed jerseys, a signed helmet, a signed Evans jersey plus his game cleats, a $1,000 store credit at the Buccaneers team store, and season tickets for two years. In addition, the following day Brady sent the fan 1 bitcoin. Adding it all up, the fan would have made out more by keeping the ball and selling it, but he wishes to receive no additional compensation, but rather a round of golf with Brady.

https://www.marketwatch.com/story/tom-brady-gives-a-fan-one-bitcoin-in-exchange-for-his-600th-touchdown-ball-11635267126

Millennials (those born from 1980 to 1995) currently represent 22% of the US population or 72.8 million Americans. According to studies done by the Education Data Initiative, millennials in their 20’s have on average $22,953 in student loan debt, while those in their 30’s have only $874, and those in their early 40’s have mostly paid off their debt. Millennials received more than $380 million in federal stimulus starting in March 2020, and of this stimulus, 49% went to money for goods and services, 33% for paying down debt, and 18% for savings and investments, which includes home ownership. The number of households for ages 30-44 years jumped by 1.3 million during the pandemic. Married couples between 31-40 were more likely than any other age group to buy a home. The largest group of unmarried couples to buy a home were ages 22 and 30.

https://educationdata.org/average-student-loan-debt-by-year

https://www.nar.realtor/sites/default/files/documents/2021-home-buyers-and-sellers-generational-trends-03-16-2021.pdf

On Tuesday, October 12th, the Chicago White Sox were defeated by the Houston Astros three games to one in the American League Division Series. It was the end of a disappointing season for the Sox, considering their prospects heading into the season. Prior to the season, the White Sox hired well renowned manager Tony La Russa, who is 76 years old and who hadn’t managed baseball since 2011. The decision has come under a lot of scrutiny considering a worse win percentage in 2021 compared to 2020 and another lackluster playoff performance.

https://www.cbssports.com/mlb/news/astros-vs-white-sox-score-houston-takes-out-chicago-moves-to-fifth-consecutive-alcs-to-face-red-sox/live/

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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