Cornerstone
ASSET MANAGEMENT GROUP, LLC

5411 Commonwealth Ave | Western Springs, IL 60558 | 312-485-6847 | Kim.Suchy@csamg.com

Economic Indicators March 2021

By Kim W. Suchy

Recovery and growth certainly have their consequences. During this earnings season, reports were generally robust across the board. Revenue growth, earnings stability, earnings surprises, sales growth, margin expansion, cash flow and return on equity results were phenomenal and Analyst upward earnings revisions have turned considerably higher year to date.

These health earnings results and upward revisions have been a major driver of stocks, which has some investors believing that the market is due for a pause or at least the "growthy" segment of the market is due for some consolidation. This past week, we witnessed a rapid consolidation in the growth oriented NASDAQ as well as the FAANG stocks (five tech companies Facebook, Amazon, Apple, Netflix and Google). As we know, the stock market likes to climb a "wall of worry," which now includes fear of rising interest rates and inflation. With strong economic reports in retail sales and durable goods, investors seem to have surmised that the economy is going to run hot and inflation will push beyond the Fed comfort zone and rates will have to step higher.

As the week's stock pullback unfolded, Treasury yields surged as bonds sold off. Bonds sell off when investors believe higher rates will be available down the road so they sell those bonds with lower yields and eventually buy the higher yielding instruments. However, the problem with the surge in yields was that the newly minted Treasury yield used as the discount factor on stock cash flows escalated. When this happens, future valuations of stocks falls. Thus, the pullback. The 10-year Treasury bond yield is now trading over 1.45%, which is also spooking interest rate-sensitive stocks (i.e. those with significant debt requirements like electric utilities). Furthermore, the federal government is expected to run a $2.3T deficit (10.6% of GDP) this year, so it will be interesting to see if the Fed and their quantitative easing plans can accommodate the massive Treasury auctions now anticipated.

The truth of the matter is that the stock market has been over-bought for over a month, so it was perhaps time for Wall Street to consolidate its recent gains. In a brewing inflationary environment, growth stocks have traditionally been a great inflation hedge, so the current consolidation could just be the "pause that refreshes" before the next surge as we await the first-quarter earnings announcement season, beginning mid-April. As noted above, with earnings revisions in uptick mode, the surge could be significant. In the meantime, the market will leave some excellent short term opportunities by providing investors with high quality stocks at a discount.

Here is your look at developments in the global marketplace.

Positive Developments:

- Retail sales soared 5.3% in January and are now up 7.4% from a year ago (pre-C19). All major categories of sales rose in January, suggesting that the stimulus spending approved in late December coupled with less onerous lockdowns of business are taking hold.

- Industrial production increased 0.9% in January and was revised up for prior months. What is key is that the gain in industrial production was led by manufacturing *excluding* the auto sector, which is essentially "core" industrial production – it increased 1.1% in January. That measure of production has now increased for 9 consecutive mos.

- The housing market remains strong as the S&P Case Shiller 20-city house prices rose 10.1% over the course of 2020. The biggest increases were in Phoenix (14.4%), Seattle (13.6%), and San Diego (13.0%). The smallest increases were in Chicago (7.7%), Las Vegas (7.9%), and Dallas (8.4%).

    - These price increases have been driven by demand flight to sub-urban work from anywhere environments due to C19 and relatively low inventory. The Census Bureau reports that new single-family home sales jumped 4.3% in January and 10.0% during the 2 mos. through January, to 923K units. January's level is within 5.7% of last July's high of 979K units. Regionally, home sales in the South (40.4% y/y) and Midwest (10.3) posted double-digit gains versus a year ago, while the Northeast (-8.8) and West (-6.4) showed declines. A fair amount of this regional bifurcation can be attributable to relocation away from high tax states to tax friendly states. Texas, Tennessee, Florida have been beneficiaries while New York, New Jersey and California have seen pullbacks in sales.

- Real GDP growth in Q4 was revised up to a 4.1% a/r from a prior estimate of 4.0. Upward revisions to home building and inventories were slightly larger than a downward revision to consumer spending. The largest positive contributions to the real GDP growth rate in Q4 were consumer spending, home building, business investment in equipment, and inventories. The weakest component, by far, was net exports.

- The Conference Board's consumer confidence index rose from 88.9 to 91.3. This is a rather substantial monthly uptick. This time, the present situation index accounted for the increase, a sign the economy is thawing as C19 numbers drop and an increasing number people are getting vaccinated. Note, the present situation index is an indicator of consumer sentiment about *current* business and job market conditions. Combined with the Expectations Index, the Present Situation Index makes up the monthly Consumer Confidence Index. This Index often serves to help gauge near-term consumer demand. Further note that savings rates remain at elevated levels which should give demand an additional boost at some point in the near future.

- *First-time* jobless claims fell by 111K in the week ended Feb. 20 to 730,000, the Labor Department said Thursday. The previous week's level was revised lower by 20K to 841K. The 4 week moving average, which smooths out volatility, was 807K, a decrease from a downwardly revised 828K the week prior. *Continuing claims* for the week ended Feb. 13 fell by 101K to 4.4M. The 4 week moving average of continuing claims was 4.5M, down 91K from the prior week's report.

- Durable goods orders rose 3.4% in January. Nondefense capital goods ex-air orders rose 0.5%, a touch less than expected, but any disappointment here was more than offset by a significant upward revision from 0.7% to 1.5% in December. This underscores the big boost to growth already evident from last December's stimulus. Momentum on the next stimulus bill may generate extremely strong results in the months ahead especially if jobless claims continue fall.

- Personal income surged 10.0% in January. Personal consumption rose 2.4% in January Personal income is up 13.1% in the past year, while spending has declined 0.4%.

Neutral Developments:

- The Census Bureau reported that housing starts declined in January and fell short of consensus expectations. However, these figures are volatile from month to month, and a better measure of how much residential construction is happening every month is the total number of homes under construction, which increased 0.6%. We may see a weak February housing start report due to the widespread polar vortex that basically brought many industries to a halt.

- The Center for Disease Control reports that at the current pace of vaccinations, 50% of the population in the US could have the vaccine by late June and 70% by the start of September. Of course, the daily pace of vaccines may accelerate further as logistics improve and additional vaccines get FDA approval. Further, Bloomberg reports that so far, 82M vaccine doses have been distributed with 65M having been administered, and 44.5M people having received at least one dose. That means 13.4% of the US population has some form of antibodies to C19 through vaccination. Vaccine production is ramping up. At the current delivery pace of 10 to 15M doses per week is set to rise to 20M next month, 25M in April and May, and more than 30M a week in June. We could move from 1.5 M shots administrated per day to levels two to three times higher.

- FactSet reports that through 2/17, 83% of the companies in the SP500 have reported actual results for Q4 2020. Of these companies, 79% have reported actual EPS above estimates, which is above the 5 yr. avg. of 74%. If 79% is the final percentage for Q4, it will mark the 3rd highest percentage of SP500 companies reporting a positive EPS surprise since FactSet began tracking this metric in 2008. In aggregate, companies are reporting earnings that are 14.6% above the estimates, which is well above the 5 yr. avg. of 6.3%. If 14.6% is the final percentage for Q4, it will mark the 4th largest earnings surprise percentage reported by the index since FactSet began tracking this metric in 2008. Due to these positive EPS surprises, the index is now reporting yoy growth in earnings of 3.2%. Companies that have reported positive earnings surprises for Q4 2020 *have seen a decline in price* of -0.1% on average 2 days before the earnings release through 2 days after the earnings release. This percentage decrease is well below the 5 yr. avg. price increase of +0.9% during this same window for companies reporting positive earnings surprises.

Negative Developments:

- Consumer prices started 2021 where they finished last year, continuing the trend higher that began back in June. The Bureau of Labor Statistics reported that The Consumer Price Index (CPI) rose 0.3% in January and is up 1.4% from a year ago. With all the money printing, extra spending and pent up demand from accentuated savings rates, traditional economic theory suggests this is inflationary. The Fed has preemptively suggested that it will let inflation run past its 2% target in order not to stifle a fragile recovery. Inflation and higher bond yields will be the price we all pay to climb our way out of the pandemic setbacks.

- At the close of 2020, about 18% of US renters (10M tenants) were behind on their rent payments, according to a report by Moody's Analytics and the Urban Institute. Roughly 1 in 4 tenants still has the same income sources they used before the pandemic to pay rent and other expenses. Biden extended the eviction moratorium for renters through the end of March. Further, the Mortgage Bankers Association reports that the number of home mortgages in forbearance has declined for the third week in a row to 5.22% (week ending 2/14) or roughly 2.6M mortgages. Last year's CARES allowed borrowers to postpone mortgage payments until March 31, 2021. Now they are able to postpone payments until June 30, 2021. In addition, forbearance on federal student loans was extended through the end of September 2021. *As noted above, savings rates and retail sales have been moving higher, the key question is how much of this is driven by eviction moratoriums, postponement of mortgage loans and student loan forbearance. We will find out who has their shorts on when the tide rolls out.*

- Bonds prices/yields have reacted as expected given the expectation of a $1.9T stimulus package. Prices have dipped and yields have risen on expectations of elevated inflation in the months and years ahead.

- In a 2/10 webcast Fed Chair Jerome Powell presented a speech titled "Getting Back to a Strong Labor Market." He painted a grim picture of the current labor market. While the official unemployment rate is currently down to 6.3%, Powell observed: "Fear of the virus and the disappearance of employment opportunities in the sectors most affected by it, such as restaurants, hotels, and entertainment venues, have led many to withdraw from the workforce. At the same time, virtual schooling has forced many parents to leave the work force to provide all-day care for their children. All told, nearly 5M people say the pandemic prevented them from looking for work in January. In addition, the Bureau of Labor Statistics reports that many unemployed individuals have been misclassified as employed.

The Markets:

U.S. Index	Last Month (% return)	YTD (%)
S&P500	1.5	1.3
Dow	2.1	0.9
NASDAQ Comp	-1.7	0.0
Russell 2000	4.3	11.3

On the international front, both European and Asian markets were mixed with Germany and Japan logging positive returns. Europe was up in February while China and Hong Kong posted negative returns. Gold bullion was lower last month and posted a -6.1% return and remains lower YTD yet remains one of the best performing asset classes over the last year.

International Index	Last Month (% return)	YTD (%)
Euro Stoxx 50	3.0	2.5
Hang Seng	-1.1	6.4
Germany	1.3	0.6
Nikkei	1.2	5.6
FTSE-U.K.	-1.3	0.3
China Shanghai Comp.	-1.6	3.2
Gold	-6.1	-8.7

Financials, particularly the banks, are benefitting from the rise in bond yields so far in 2021. The yield on the 10-year Treasury note has risen from 0.92% at the close on 12/31/20 to 1.45% on 2/28/21. That is a very significant increase over the last two months. With the 10-year yield is now trading at 1.45 %, this is 53bps higher than at the close of December and 39bps above January's close. The 2-year Treasury closed yielding .15%, which is 4 bps lower than where the 2-years closed last month. The curve has widened a bit given that the 10/2 spread is at 130bps or 35bps higher than last month.

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

Best regards,

Kim W. Suchy
CEO Cornerstone Asset Management Group

Email: Kim.Suchy@csamg.com
Website: www.csamg.com
LinkedIn: https://bit.ly/30Gr3XF