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Economic Indicators April 2021

By Kim W. Suchy

Investors always have something to worry about. Over the last year, Covid (C19) and its global ramifications stood at the forefront. Recall that a year ago (mid-March 2020) the Dow cratered 3000 points, roughly 13%, on economic concerns. Fast forward 12 months and there is light at the end of the health crisis tunnel. Investors are becoming increasingly confident that C19 will soon be behind us, massive stimulus will provide supply side benefits to consumers, markets will recover, supply chains will get back into balance, international trade will regentrify and yes, inflation shoots will emerge.

Over the past few years we have had little concern about inflation as productivity enhancements have held labor costs in check and globalization has provided access to efficient productive resources (i.e lower cost goods and services). Now, the $4.2T increase in money supply over the past year, driven by extraordinary fiscal and monetary aid, is reason enough for investors to become concerned. The Fed knows this and has been extremely busy this past month talking down inflation. In fact, Fed Chair Powell testified before Congress that, "We might see some upward pressure on prices. Our best view is that the effect on inflation will be neither particularly large nor persistent." The Fed certainly does not want inflation concerns to spook the markets (via lower stock prices and surging bond yields) and will do everything to facilitate the goals of Treasury fiscal policy and preserve the unemployment and price level mandates of Fed monetary policy.

With regard to inflationary shoots, here is why some investors are concerned. There is evidence that even some temporary price increases are affecting corporate profits…note the spread between wholesale and consumer prices. Recently, The Department of Labor reported that the producer-price index is outpacing the consumer-price index. While this trend is short-lived the shift reflects increased pricing pressures that many businesses face. Currently, companies are absorbing these costs (energy, input prices stemming from supply chain disruption) instead of passing them on to their customers. Absorbing these margins, as opposed to passing along increases, eats into profit margins and can keep a lid on stock prices.

While we remain hopeful that the Fed observation of the aforementioned costs are transitory, we turn our attention to the gorilla in the room, wages. We will monitor wage inflation closely. Labor, is most companies' biggest cost, and, like production cost inflation, wage inflation has been

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missing for many years. With several million people remaining in the ranks of the unemployed, wage inflation should be subdued for some time. However, there is an active push towards hiking the minimum wage and unionizing employees at companies that have historically been nonunion. A successful drive to these ends will certainly eat at corporate margins forcing inflationary price increases as these costs become permanent unless swift productivity enhancements offset the labor cost increase.

The Fed certainly has its hands full of dynamics to monitor. The markets will be watching attentively as the Fed cannot afford to be behind the curve on inflation control or too early which could impede on employment growth.

Here is your look at developments in the global marketplace.

Positive Developments:

- The Bureau of Labor Statistics reports that the most recent weekly initial jobless claims came in at a level of 684K well below many forecasts and well below the prior week's upwardly revised 781K level. The 4 week moving average declined by 13K to 736K, and *continuing* claims for the week fell by 264K to 3.87M, south of estimates of 4M. The 4 week moving average of *continuing* claims decreased by 137K to 4.1M. The improving job data suggests the economy is on the mend which will ultimately fuel additional boosts to GDP growth.

- Consumer confidence jumped 19.3 points in March, thanks to the passage of a generous stimulus, full reopening of several state economies, and recognition of the success of the vaccine rollout. It was the biggest one-month increase since March, 2003 according to Conference Board records.

- The U.S. economy expanded in Q4 at a revised 4.3% a/r….a touch higher than previous reported according to the Bureau of Economic Analysis. GDP was raised from the previous reading of 4.1% mostly because of somewhat higher business investment. The economy gaining momentum after slowing toward the end of the 2020 following a record C19 outbreak. The biggest change in the Q4 GDP was in business investment. Investment in inventories, intellectual property and residential housing were all a bit higher than previously reported. GDP is expected to accelerate given improvements in the labor market (noted above) the broad distribution of C19 vaccines, unprecedented stimulus and an accommodative Fed content with zero rates.

- The Fed recently stated that temporary limits on dividend payments and share buybacks will end for most banks after June 30, following the completion of their annual stress tests to determine their resilience various economic shocks. The Fed initially placed restrictions on bank payouts during the midst of C19, citing the need to conserve capital during the downturn. It barred buybacks and capped dividends so that they would not exceed a bank's

recent profits. The relaxed policy should, coupled with the steepening yieold curve, give bank stocks a boost.

- An interesting trend is developing when looking at stock insider sales and purchase transaction volume. Vickers' Weekly Insider reveals that NYSE sales transactions are down 14% and purchase transactions are up by 4%. Nasdaq sales transactions are down 1% and purchase transactions are up 5%. While this is a short term observation, it suggests that corporate insiders are becoming more confident in their company stock price movement in future periods.

- According to FactSet, near the close of Q1, 94 S&P 500 companies have issued EPS guidance for the qtr. which is below the 5 yr. avg. of 101. Of these 94 companies, 34 have issued negative EPS guidance and 60 have issued positive EPS guidance. The number of companies issuing negative EPS guidance is well below the 5 yr. avg. of 66, while the number of companies issuing positive EPS guidance is well above the 5 yr. avg. of 35. Further, 86 S&P 500 companies have issued revenue guidance for Q1. This number is above the 5 yr. avg. of 77. Of these 86 companies, 17 have issued negative revenue guidance and 69 have issued positive revenue guidance. The number of companies issuing negative revenue guidance is well below the 5 yr. avg. of 39, while the number of companies issuing positive revenue guidance is well above the 5 yr. avg. of 38. *Note, the reason the number of companies issuing both earnings and revenue guidance is smaller is due to the fact that many company officers decided not to release guidance to the uncertainties associated with sales, production, supply chain disruptions, timing of government stimulus and speed of vaccination. Companies issuing guidance is expected to return to normal levels soon.*

- Where is all this stimulus money going? We know savings rates are climbing as consumer's feather their nests making sure C19 is waning. However, expect these monies to be spent in more traditional ways once lockdowns ease. Vaccine penetration and herd immunity will go a long way toward unlocking this pent-up consumption. The average U.S. household has saved more than $22K during the pandemic, equaling more than 31% of realized average income, according to data from the Bureau of Economic Analysis, as of the end of 2020, which is an unprecedented (and likely unsustainable) savings rate. This will be a significant positive for future consumption, hence GDP.

Neutral Developments:

- Consumer prices rose 0.4% in February. Although they are up a modest 1.7% yoy and about to move much higher. Recall that prices dropped at a steep 4.4% a/r in March thru May last year as C19 and various restrictions hit the US economy. Since then, they've grown at a 3.8% a/r, the fastest pace of price gains in many years.

- Ed Yardeni cites Fed Chair Powell's view on "transient inflation": "Over the next few months, 12-month measures of inflation will move up as the very low readings from March and April of last year fall out of the calculation," Powell said. "Beyond these base effects, we could also see upward pressure on prices if spending rebounds quickly as the economy continues to reopen, particularly if supply bottlenecks limit how quickly production can respond in the near term. However, these one-time increases in prices are likely to have only transient effects on inflation," he added. *Note, there is a fair amount of concern that is these are not transient, we could see the Fed starting to consider rate hikes even before the labor market recovers.*
- Fed Chair Powell has stated in the past that the Fed wants inflation to trend above the 2% target for a prolonged period. However, the labor market – the other side of the Fed's dual mandate – has a long way to go in order to heal. As the economy opens further, more and more companies will absorb idle labor and eventually trigger some wage inflation. So, whatever inflation is in the pipeline now, will certainly move higher over time. A growing economy coupled with a growing labor force will certainly create price increases.

- Gold is down from last summer's record $2,000+ level and is at levels pre-C19 (March 2020. However, with deficit spending surging, the fundamentals for gold have become very attractive although gold is $300/oz. off the peak. All of the other precious metals, silver, platinum and palladium, have been outperforming gold of late, because their uses are primarily industrial in nature, and industrial metals are climbing in anticipation of the global reopening.
- *New* home sales slid in February, posting the largest monthly decline since 2013 However, sales are still up a healthy 8.2% yoy and that number is set to soar in the months ahead as the comparison months from 2020 begin to include the huge drop in sales early in the pandemic, according to Brian Wesbury of First Trust. Note, sales of *new* homes are counted when the contracts are signed rather than being counted at closing like *existing* home sales. This means they are a timelier indicator of the housing market, so it's not surprising that last month's polar vortex had a larger impact on February's new home sales report (-18.2%) than it did on existing home sales (-6.6%). We should see a rebound in new home sales in March while existing home sales continue to show weakness. In addition to it wasn't all just severe winter weather that impacted new home sales in February as the 30-year fixed mortgage rate has surged 40bps in February alone.
  - *Interesting note, on March 22, the Wall Street Journal reported that there are more real estate agents than homes for sale! With this dynamic, if agents could negotiate their own commissions, transaction costs would plummet.*
  - *New sales may be somewhat muted due to lumber shortages and surging lumber prices. Lumber is higher in large part due to C19 creating chaos throughout markets. New numbers from the National Association of Home Builders shows that*

since mid-April of 2020, lumber prices have risen by 130%, and those increased costs have increased the cost of single-family homes more than $16K on average.

- Stocks have been volatile in March as investors grapple with the jump in interest rates, increased inflation concerns and optimism of an expected helathy economic recovery in 2021. It is becoming increasingly evident that there is a rotation away from certain growth-oriented stocks (i.e. information technology software) and into value and cyclically-oriented issues, (i.e. financials and energy).
- Since interest rates began rising last fall, tech stocks have been most caught within the he market's crosswinds. Certain tech stocks were among the biggest winners at the onset of C19 as they benefitted from the stay/work from home practices earlier in the pandemic, but now their high stock prices and long runways of profit growth have made them susceptible to weakness when interest rates have been on the rise.
- Personal income fell as the stimulus payments passed in December reached consumers in January and then fell back toward "normal" in February. Despite the surge in January and the February normalization, personal income is still up 2.3% versus December, and up 4.3% yoy. We should see volatile again as $240B of new checks have been paid out of the new $1.9T stimulus. Note, private sector wages and salaries were flat in February but are up 0.5% in the past year. Based on limited income timelines for private and public sectors, it appears that private wages are running behind public wages yoy.

Negative Developments:

- Mortgage rates have jumped to their highest level since last summer as interest rates are reflecting optimism about the state of the economy which is not very good news for some home buyers. The 30-year fixed-rate mortgage averaged 3.17% for the week ending March 25th, up 8 bps from the previous week while the 15-year fixed-rate mortgage, rose 5 bps to an average of 2.45%. The 5-year Treasury-indexed adjustable-rate mortgage averaged 2.84%, up 5 bps from the previous week. New home buyers are now faced with a limited supply of homes for sale and rising rates. The rush to buy before rates continue their ascent is keeping upward price pressure on housing prices.

- Trade volume declined in February, as exports declined 3.8% to $130.1B, and imports declined 1.4% to $216.9B as February's big freeze disrupted port operations in Houston, which reported a 22% annual decline in container volume due to the freeze and electricity outages.

- Supply chain issues are widespread. Back in February, an earthquake halted production in a major Japanese chip factory complex, reducing the supply of chips. Now, the automotive semi-conductor shortage became much more acute after a fire at one of the world's leading chip manufacturers in Japan. A factory owned by Renesas Electronics noted that it will be at least a month before they can restart operations at their semi-

conductor plant. As a result, Japanese auto manufacturers all sold off, since they will now likely have to further curtail production. Further complicating the global supply chain, one of the world's largest container ships got stuck sideways in the 120-mile Suez Canal, blocking one of most important shipping channels in the world, where 50 supertankers with billions of dollars of cargo per day usually pass. While the vessel has been freed, it will take time to get cargo backlog to end users.

- The federal budget deficit hit an all-time record high of $3.1T last year. With the passage of the recent stimulus bill, it's set to be even higher in 2021. Now we may see an infrastructure bill, which could run as much as an additional $4T over the next 10 yrs. Higher spending, unless offset with future spending cuts, is going to lead to higher taxes. The Biden Administration is already looking at tax rebalancing which is most likely a code for higher taxes.

- The pace of C19 vaccinations is helping U.S. economic growth resurge. Unfortunately, a glitch surfaced this past week as the Center of Disease Control (CDC) informed the cruise ship industry that its "no sail" order would remain in place until November 1st.

The Markets:

U.S. Index	Last Month (% return)	YTD (%)
S&P500	2.0	5.9
Dow	4.8	7.9
NASDAQ Comp	-1.3	1.7
Russell 2000	0.3	13.1

On the international front, both European and Asian markets were mixed. Asian markets were generally in negative territory across the board. Europe, despite setbacks with C19, logged higher returns. Gold was lower once again this month yet many believe gold will recover with inflationary shoots beginning to surface.

International Index	Last Month (% return)	YTD (%)
Euro Stoxx 50	6.0	10.6
Hang Seng	-3.7	4.2
Germany	7.4	9.7
Nikkei	-1.6	6.3
FTSE-U.K.	2.3	4.3
China Shanghai Comp.	-6.6	-2.8
Gold	-1.0	-9.9

The year 2021 began with the 10-year Treasury Note yield at 0.90%. That rate has now almost doubled to 1.73% at the close of the month. Because investors have been so well rewarded in a

low-growth, low-rate, low-inflation economy for so long, the notion of this paradigm undergoing such a major shift in such a short period of time has caught much of the investing world flat-footed. This helps explain why certain growth stocks tick lower as rates edge higher. The 2-year Treasury closed March yielding .16%, which is 6bps higher last month's close. The curve has widened a bit given that the 10/2 spread is at 157bps or 27bps higher than last month.

In closing, several of my readers have asked about the rotation in the market away from growth and into value stocks. While most of our portfolios have a growth/value blend, I believe it is important to for investors to understand that many growth stocks have been categorized by having strong top-line growth, but no earnings to speak of. Many tech companies fall into this category but not all technology oriented firms should be pigeon holed as pure growth. High-tech companies that are crucial suppliers to cyclical companies stand to benefit from the economic rebound, perhaps even more so than the companies they supply.

For example, the semiconductor sector has a broad application in all sectors of the market. Technology, healthcare, utilities, consumer staples, communications, materials, industrials, transportation, real estate, energy and finance – depend heavily on semiconductors being at the core of the platforms they operate on, as well as the products and services they deliver.

The takeaway is that regardless of the ongoing growth versus value debate, the chip and chip equipment sector could be considered to be both value and growth. They perform well in deflationary environments, when most of the economically sensitive industries are out of favor, and they should perform just as well and maybe even more so as the economy emerges from the depths caused by C19.

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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