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# Economic Indicators May 2021

**By Kim W. Suchy**

As I often allude to, investors always need something to be worried about; something which tempers market enthusiasm. Well, this past month there were plenty of tax salvos and buzz kills that would warrant market headwinds and at least a stall in the market. This did not happen.

Consider late April alone, there was a proposal of DC Statehood, packing the Supreme Court, another $2T spending package, a Green New Deal, and a doubling of capital gains tax rates. Surprisingly, these did not stall the market but served more like speed bumps through a residential neighborhood.

What are the catalysts for the market setting new highs? I see three main sparks. First, heightened vaccinations and lower C19 cases in the U.S. Second, a Fed with its foot on the gas and third, a consumer with plenty of money to spend and to support a market on any pullback.

We all understand the mechanics of the first two sparks but let's take a deeper dive into the role of the consumer. The government has issued a massive amount of stimulus money as checks were issued to nearly 250M Americans. Many did not need the funds but certainly willing to accept them. In fact, most of that money (about 75%) is being saved or used to pay down debt, according to The Federal Reserve Bank of New York. This applies to the January $600 stimulus as well as the March $1,400 check.

This suggests that each check recipient has plenty of spending power to fuel the stock market, as well as more retail sales, in addition to the record $7.4T (a/r) spent this past March. That's up 28% year over year vs. the $5.8T rate last March at the start of the economic slowdown. The Commerce Department reported that retail sales were up 9.8% last month as consumers came out of C19 hibernation purchasing sporting goods, clothing, food and beverage…and there is more to come.

In addition to consumption, there is still plenty of liquidity sloshing around. The Federal Reserve Bank of St. Louis reports that the broad measure of money supply (M2) is up by $4.2T (year over year) through February. According to Reuters, personal savings totaled a record $3.1T in the last three months and that's before accounting for the latest $1,400 relief checks. They further report that Americans now have $16.3T in bank accounts! With so much money on the sidelines, market correction seems unlikely as any normal correction would be met by buying support as investors gravitate to bargains.

Some of these savings excesses may wane over the next few months as money works its way into the consumer marketplace. If the past month or so is any indication, we may see another robust GDP print in Q2 which will undoubtedly give the market a respectable floor if not a decent leg higher.

Here is your look at developments in the global marketplace.

**Positive Developments:**

- Housing construction soared in March following the large, but temporary, disruption from February's severe winter weather. The Census Bureau reports that the 19.4% gain in housing starts puts these at the highest level since 2006 and the gains were broad-based, with every region outside the West and both single-family and multi-family construction posting increases. Starts are up 37% yoy.
    - Building permits for future construction remain near the highest level since 2006. Moreover, permits have now outpaced new construction for 8 consecutive months. This bodes well for consumer discretionary expenditures in the months ahead as homes will need refrigerators, TV’s and other amenities which help fuel the velocity of money hence, GDP growth.
- *New* home sales surged at a seasonally-adjusted a/r of 1.02M in March according to the U.S. Census Bureau. Sales represented the fastest pace of new home sales since 2006. Month-over-month, sales rose 20.7%, and compared with March 2020 sales had more than doubled. Additionally, the Census Bureau revised the sales figure for February up to a rate of 846,000, from the originally reported rate of 775,000. The report bodes well for homebuilding stocks. Note, the median forecast of economists polled by Market Watch was 888K.
- There are several factors explaining why the stock market continues to press higher. Technology and communication facilitated personal and professional adjustments to shutdowns, big box stores stayed open, the government allotted literally trillions of borrowed dollars, a vaccine was invented and dispensed in less than a year, the money supply ballooned, and the Fed cut short-term interest rates to near zero and has committed to keeping rates low for at least two more years. Because of all this, the market has been given high octane fuel to move higher.
- The S&P/Experian Consumer Credit Default Composite Index stood at 0.56% in March 2021, down from 0.99% in March 2020 and well below its 1.75% avg. since inception (7/31/04), according to S&P Dow Jones Indices. The default rate on first mortgages stood

at 0.37%, down from 0.77% a year ago. The bank card default rate stood at 3.15%, down from 3.94% a year ago. The auto loans default rate stood at 0.48%, down from 0.81% a year ago.

- In the first 2 mos. of 2021, sales of passenger plug-in electric cars totaled 593K, which was double the amount sold in the same period a year ago, according to InsideEVs.com. EV sales have accounted for roughly 4.6% of total global car sales so far this year. Data from Canalys indicates that EV sales increased by 39% yoy to 3.1M units in 2020. It predicts that EV sales will reach 30M globally by 2028 and believes that EVs will represent nearly half of all passenger car sales by 2030. Note, both Volvo and Cadillac have announced that they will cease production of combustion vehicles by 2030 and focus on EV production.

- The Conference Board reported that consumer confidence surged in April to a 14-mo. high as rising vaccinations, falling C19 cases and a hiring surge eased pandemic-related anxieties. The Index climbed to 121.7 this mo. from a revised 109 in March… that's the highest level since February 2020. Note, Economists polled had forecast a 113 reading so the April post was significant.

**Neutral Developments:**

- Durable goods rebounded slightly in March yet well less than expected as shortages of key supplies, particularly computer chips, are still slowing manufacturers as they attempt to keep up escalating consumer demand. The Census Bureau reported that orders for durable goods rose 0.5%. vs. an expected 2.2% increase. These are products such as electronics, appliances, machines, cars and other transportation equipment meant to last at least 3 years. Sans key computer chips for an <u>extended period</u> of time is certainly inflationary. Recall, Fed Chair Powell suggests, overall inflation is transitory at this time. *I believe this shortage could force a more permanently embedded inflationary adjustment if not rectified in short order as chips have become a more integral component in product development.*
- Gold prices alone have given up over half of their post-pandemic gain. This is attributable to two key factors (interest rates and the Dollar) have moved such that they have kept a lid on precious metal prices. Gold prices fell after interest rates have moved higher. Rising yields reduce demand for metals because investors can park their cash in bonds and collect a coupon for a stream of payments. But it's not just the level of interest rates that matter. Rates adjusted for inflation, or real yields, are key for precious metals. Metals are known for their role as an inflation hedge, and inflation has certainly arrived! So, expect gold prices to regain some of their luster. Further, most precious metals, are priced and traded around the world using the Dollar. When the Dollar weakens, commodities become cheaper. That tends to boost commodity prices. And vice versa when the Dollar is rising. Of late, the Dollar has been rising as *nominal* interest rates have risen. However, the Dollar is expected to weaken for 2 primary reasons: 1) falling *real* interest yields become more

pronounced and; 2) inflation and prospects for higher corporate and capital gains taxes are perceived to slow economic growth in the U.S. Both reasons are fuel for higher gold prices.

- The Fed remains very accommodative as they elected to hold rates near zero and will continue to purchase Treasuries at a pace of $80B/mo., and mortgage-back securities at a pace of $40B/mo. This suggests faster economic growth and tailwinds for stocks however, the risk down the road is "too loose for too long." Unwinding will be a tough Fed decision.

**Negative Developments:**

- The Biden Administration has proposed taxing cap gains at the same rate as ordinary income for people earning more than $1M per year. The net effect would roughly double the rate on cap gains for those high earners to 43.4% from the current 23.8% (including the Obamacare tax levy on investment income). While this appears awful at face value, a UBS study suggest that only 25% of U.S. equities are owned by U.S *taxable* investors, with the remaining 75% held by pension plans, retirement accounts, endowments and foreign investors which are not subject to capital gains levies. Further, the study suggests that the non-taxed cap gain participants will buy at market dips thus giving equities some ballast. Still, the headline read of a cap gain tax boost does not fare well to investors.

- The National Association of Realtors reported that U.S. home sales fell to a 7 mo. low in March, pulled down by a sizable shortage of properties, which is boosting prices and making owning a house more expensive for some first-time buyers. Existing home sales dropped 3.7% to a seasonally adjusted a/r of 6M units last mo., the lowest level since August 2020.

- The Fed has longed for inflation for some time and now we are seeing it. The Bureau of Labor Statistics reported that The Producer Price Index (PPI) rose 1.0% in March and is up 4.2% yoy. Energy prices rose 5.9% in March, while food prices increased 0.5%. PPI ex food and energy rose 0.7% in March and are up 3.1% yoy.

    - Prices have been accelerating at a quicker pace over the pace few months. Expect more of this in the near future as extensive supply-chain issues are affecting the economy and leading to higher prices. The shortage in semiconductors for example is leading to delays in cars, trucks and appliances and is forcing prices higher. *Note, it is this temporary supply chain disruption that Fed Chair Powell believes that inflation at this time is transitory*.

- Proctor & Gamble and Kimberly Clark will be raising prices on many household staple products, especially those that are pulp-based i.e. diapers and all paper products. Surging pulp prices can no longer be absorbed (*pun intended*) thus companies will be passing along these costs via higher prices.

- Further, the Wall Street Journal (4/21) reported that Southern pine growers are getting paid not to cut their timber until next year. Companies want to offset their carbon emissions and are paying timber owners to wait until next year to cut trees. They want the trees to sponge more carbon from the atmosphere before becoming 2 by 4's and telephone poles.

- Lumber prices have soared. Although the import tariff on lumber from Canada has declined from 20% to 9%, the National Association of Home Builders reports that the increase in lumber prices has added over $24K to the price of an average, new single-family home since April of 2020. Still, demand for new housing continues to climb higher and when coupled with labor shortages in the construction space is driving home prices higher. The saving grace is that interest rates remain relatively slow from a historic perspective so housing remains affordable all things considered.

**The Markets:**

| U.S. Index | Last Month (% return) | YTD (%) |
|---|---|---|
| S&P500 | 5.2 | 11.3 |
| Dow | 2.7 | 10.6 |
| NASDAQ Comp | 5.8 | 7.5 |
| Russell 2000 | 1.8 | 14.6 |

On the international front, both European and Asian markets were mixed. Asian markets were generally in flat to modestly lower across the board. Europe, despite continued setbacks with C19, managed to post higher returns. Gold popped higher this month as inflationary seeds are cropping up across many commodities, labor and of course, anything chip related.

| International Index | Last Month (% return) | YTD (%) |
|---|---|---|
| Euro Stoxx 50 | 1.1 | 11.5 |
| Hang Seng | 1.2 | 5.5 |
| Germany | 0.7 | 10.1 |
| Nikkei | -1.3 | 5.0 |
| FTSE-U.K. | 3.1 | 7.7 |
| China Shanghai Comp. | 0.1 | -0.8 |
| Gold | 3.5 | -6.8 |

The year 2021 began with the 10-year Treasury Note yield at 0.90%. That rate has come off last month's high of 1.73% to close April at 1.63%. The 2-year Treasury closed April yielding .16%, which is where it closed last month. The curve has narrowed slightly given that the 10/2 spread is at 146bps or 11bps lower than last month.

**News You Can Use:**

- An analysis in April 2021 from Key Data, a market data company for the short-term rental industry, shows that occupancy rates for vacation homes are increasing across nearly every U.S. region and are on track to outpace 2019 by upwards of 13%. Various rental sites state the current average price of a U.S. vacation rental is $141 per night (hotel) and $171 per night (Airbnb), which are forecasted to rise. This means a five-night stay at your destination of choice could easily cost an estimated $705 - $855 for lodging alone.
  - https://blog.keydatadashboard.com/pandemic-shift-how-covid-19-has-affected-u.s.-vacation-rental-regions
  - https://www.alltherooms.com/analytics/average-airbnb-prices-by-city/
  - https://www.valuepenguin.com/average-cost-vacation

- One of the unforeseen results of the lockdowns was that new pet adoptions soared around the world. In 2020, total pet-industry expenditures in the United States reached $103.6B and the world's citizens spent an estimated $6.9B purchasing pet insurance in hopes of being able to afford unexpected veterinary bills. Two out of every three American homes includes a pet, and 393.3M pets live in the United States.
  - http://www.econotimes.com/Top-5-Pet-Industry-Trends-in-2021-1607299
  - https://spots.com/pet-ownership-statistics/

- Carlos Rodón of the Chicago White Sox threw a no hitter on April 14th, coming within one ninth-inning hit-by-pitch of a perfect game in the White Sox 8-0 win over the Indians. Prior to the outing, Rodón had a 4.10 career ERA in 98 career games (93 starts), with no shutouts and only one complete game -- which came back in his rookie year (2015). This was the 20th White Sox no-hitter, the most of any American League team.
  - https://www.mlb.com/news/carlos-rodon-no-hitter-stats-facts

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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