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Economic Indicators July 2021

By Kim W. Suchy

For most of Q2, stock and bond indexes have grinded to new highs, with the SP500 generally trading in a tight range as investors seem to be waiting for signals to move on from the "steady-as-she-goes Goldilocks market" that has cemented valuations at relatively stable levels. Now that the Fed has hammered us with its conviction that inflationary levels are merely transitory, the wall of worry remains laced with all sorts of labor market data that, quite frankly, reads like a Steven King novel.

Assuming we can backburner inflation reports for a few months, we must still deal with the lumpy and volatile labor market reports that are being released throughout the reopening phase of our economy. Depending on the report data and prognosis, markets have been attempting to put a stamp on whether growth or value stocks will take charge. You have probably noticed industrials and banks surging or falling one day while tech and other growth related names take the opposite tact. This pattern may transcend the next few quarters emphasizing the importance of maintaining exposure to both growth and value oriented stocks.

Labor markets aside, we all thought the market would commence a decent rally and give a boost to cyclicals when a $600B bipartisan infrastructure package was agreed to. This would fund transportation, power grid, water infrastructure, broadband, roads and bridge projects. The huge plus was that this was to be financed <u>without</u> tax increases and by unused spending authorizations, enhanced IRS enforcement, and selling some of the Strategic Petroleum Reserve. This news certainly lifted the markets; particularly industrials as they are the benefactor of the projects. In fact, the SP500 and Dow rallied 0.8% and 1% respectively on the news.

However, just as the market was salivating over the physical infrastructure plans, Biden released an outline of his "human infrastructure" childcare initiative which would be pursued as a second package in the Senate using the budget reconciliation process. Biden wants both the physical and

Human infrastructure packages on his desk at the same time. Whoa, that was a buzzkill…markets got heartburn. With infrastructure programs now waiting in the wings, it looks as though we will need definitive inflation and labor market patterns to help chart the next leg in the market's course.

Here is your look at developments in the global marketplace.

Positive Developments:

- The Census Bureau reported that durable goods rose 2.3% in May after a 0.8% drop, revised from -1.3% in April. The level of new orders for durable goods is at its 2nd highest since 2014, showing businesses are continuing to invest to keep up with strong demand. New orders are still exceeding the level of shipments as producers adjust capacity.

- The 3rd report on Q1 real GDP was unrevised from last month's read, showing a 6.4% annualized surge in growth due to the rollout of vaccines, opening businesses, and massive government stimulus. The details reveal that there were small upward revisions to business fixed investment, inventories, and personal consumption but were offset by downward revisions to net exports. Consumer spending was the biggest driver of growth in Q1, with spending on durable goods rising at a 49.2% a/r, and purchases of motor vehicles and parts up at a 65.1% rate despite continued supply-chain and semiconductor issues.

- Bloomberg's Financial Conditions Index, today is about as high as it has ever been. This all but rules out a near-term recession or even a growth pause. Liquidity is abundant, credit quality is excellent, business confidence is rising and pandemic concerns are easing.

- Consumer confidence surged in June to the highest level since onset of C19 in March of 2020 according to the Conference Board. The confidence index has risen for six straight months as households are spending plenty of money and businesses are investing heavily to cement their place in a post C19 world.

    - *As C19 fears dissipate and mobility normalizes, spending habits will be an important catalyst to further the shift in spending from goods to services and broaden the expansion of GDP.*

- The BLS reports that *initial* jobless claims fell 7K in the 3rd week of June to 411K. Further, *continuing* claims declined 144K to 3.4M. There is a growing list of states that have announced an early cut-off of expanded unemployment benefits that have served as a headwind to hiring across the U.S. despite job openings standing at the highest level in history. Expect claims to fall dramatically after the summer months and into Q4.

- Rapid economic and C19 recoveries in both China and the US have shocked supply chains drained from last year's closures. Commodities are currently rallying in an effort to keep up with surging demand. The impact is broad-based, affecting industrial metals, agricultural, lumber and semiconductors. Over the intermediate term, increased global capital spending, a strong US housing market, a weaker US dollar and rising overall inflation suggest the asset class will remain quite strong.

Neutral Developments:

- It's hard to believe, but today the 10-yr Treasury yield is roughly 1.4%, which is well below the current rate of inflation. Much less. In fact, the entire Treasury curve is well below the last inflation print which means that Treasuries are generating losses in real terms. Uncle Sam doesn't mind, though, since Sam is the world's biggest debtor. The debt holder's loss is the debt issuer's gain…..*and not so good news to fixed income investors.*

- Fed Chair Powell said in testimony before Congress that the economy is growing but faces continued threats from C19 and the new delta variant which is doubling at a rapid pace. He also noted that inflation has spiked but he expects to lessen over time. He also pledged continued support from policies the Fed put into place in the early days of the C19 threat (asset purchases and near zero rates).
  - *Fed Chairman Jerome Powell continued to give a very patient tune in congressional testimony this past week, saying that one needs to be very humble about drawing signals for the economy from "such an unusual setting of reopening the economy" and maintained the belief that inflation pressures are transitory.*

- *New* home sales continued to disappoint in May, falling for the 2nd month in a row and coming in below even the most pessimistic forecast by any economics group surveyed according to First Trust. Sales have generally been decelerating since January of this year however, the good news is that builders have plenty of projects in the pipeline to meet demand and keep construction activity running on all cylinders for the foreseeable future.

- Personal income declined by 2.0% in May. The pullback in stimulus payments accounted for the decline. .With the pullback in income, the personal saving rate edged down from 14.5% in April to 12.4%. This rate remains historically high…consumers have lots of dry powder for rainy days especially since many consumers paid down debt and/or refinanced homes to improve their cash flow.

Negative Developments:

- Sales of previously owned (existing) U.S. homes fell for a 4th straight month in May as higher home prices and lean inventories weighed on home buying according to the National Assn. of Realtors. Existing-home sales account for about 90% of U.S. housing and are calculated when a contract closes. New-home sales, which make up the remainder, are based on contract signings.

- The Producer Price Index for final demand increased 0.8% in May as reported by the Bureau of Labor Statistics (BLS). On an unadjusted basis, the final demand index advanced 6.6% for the 12 mos. ended in May, the largest increase since 12-mo. data were first calculated in November 2010.

- The Consumer Price Index (CPI) increased 0.6% in May on a seasonally adjusted basis after rising 0.8% in April, the BLS reported. Over the last 12 mos., the index increased 5.0% which was the largest 12-mo. increase since a 5.4-percent increase for the period ending August 2008.

  - *Inflation continues to raise eyebrows. The, the CPI and PPI increases in May were expected given the low base effect (virtually no inflation at onset of C19) and transitory factors associated with a fast reopening of the economy. Still, the Fed's estimate for core inflation in 2022 and 2023 remains just 0.1% above 2%. Until the Fed has more proof of inflation's persistence it is unlikely to signal it will tap on the brakes.*

- There is an odd development in the labor market. Millions of people have returned to work, yet there are millions not returning to work or can't find work. The number of job openings has surged because employers are unable to find workers who want to work. The apparent blame is the emergency unemployment benefits which has create an attractive incentive for people to remain unemployed until these benefits expire in early September. While this is mostly a temporary problem, it is stalling the recovery and continuing to balloon the deficit. Fed Chair Powell noted that as many as 15M people will lose the extended benefits by September which should send many back to workforce.

- TD Economics reports that the share of firms with unfilled job openings increased by 4 pts. to a new record high of 48%. At the same time, the share of firms planning to increase employment rose a sharp 6 pts. to a new record high of 27%. Several other indicators pointed to difficulty in hiring workers. The share of firms with few or no qualified applicants rose 3 pts. to 57%, matching an all-time high set in mid-2019. Meanwhile, 'quality of labor' concerns remained top of mind, with the sub-indicator rising two points to 26%. Given these difficulties, the pace of hiring fell into shallow negative territory in May.

The Markets:

Domestic stocks were generally higher last month as technology and health care related stocks sent the SP500 and NASDAQ higher. As noted in my introduction, the market continues to seek a catalyst to send us to the next level but found tech and health care to be decent "go to's" as they are less sensitive to the current economic data hiccups. Energy stocks were also providing a boost as oil prices drifted higher. Financials (banks), materials and utilities were all laggards in June.

U.S. Index	Last Month (% return)	YTD (%)
S&P500	2.3	14.5
Dow	-0.1	12.7
NASDAQ Comp	5.5	12.5
Russell 2000	2.2	16.8

On the international front, the European markets were relatively flat while Asian markets were weak and closed in negative territory last month. Gold retreated last month after the Fed continues to postulate that inflation remains transitory – thus demand for gold as an inflationary hedge waned a bit.

International Index	Last Month (% return)	YTD (%)
Euro Stoxx 50	0.6	14.4
Hang Seng	-1.2	5.8
Germany	0.7	13.2
Nikkei	-0.2	4.9
FTSE-U.K.	0.2	8.9
China Shanghai Comp.	-0.7	3.4
Gold	-7.4	-7.2

Bond yields continue to vacillate in a tight range shrugging off volatile swings in economic data, spikes in PPI and CPI, and uncertainty about the direction of fiscal and monetary policies. Quite frankly, bond yields at current levels aren't consistent with the prospect of strong economic growth, and budding inflationary pressures. Even if economic growth and inflation return to pre-C19 levels, yields still appear low. Yields back then drifted into negative territory when adjusted for inflation and, in fact, are deeper into negative territory at today's rate and inflation levels. We may be able to assume that demand for Treasury paper remains robust particularly due to mandated pension fund rebalancing as equities continue their trek higher. However, this will wane at some point and considering the unprecedented fiscal stimulus and the Feds willingness to tolerate higher inflation, bond yields should move higher over time. Shorter term interest rates should remain anchored near zero due to Fed policy, but expect 10-year Treasury yields to rise giving the curve some steepness which would benefit banks and other lending institutions that borrow at the short end and lend (make money) at the intermediate and longer end.

The year 2021 began with the 10-year Treasury Note yield at 0.90%. The 10-year closed June at 1.45%, 18bps lower than May 2020 close. The 2-year Treasury closed June yielding .25%, 10bps higher than May's close. The curve flattened quite a bit last month as the 10/2 spread is at 120bps or 28bps lower than last month. The flattening explains why bank stocks suffered so badly in June.

News You Can Use:

- Crowdstrike, a global leader in cybersecurity that offers cloud-delivered solutions and cyber protection, states in their Q1 Falcon Overwatch Report that the number of interactive intrusion campaigns have been on the rise over the last two years, as COVID has created a ripe environment for social engineering attacks. Interactive intrusion campaigns are defined as threats involving a threat actor using hands-on-keyboard techniques to carry out their campaign. Q1 intrusion count was the second highest in over two years of reporting and distribution by threat type included 26% targeted intrusions (state-sponsored adversaries whose motive is geopolitical or financial gain through disruption, data theft or information manipulation) and 74% eCrime (criminal adversaries whose motive is financial gain through fraud, data theft, or extortion).

To familiarize and explore the adversary universe / threats to our security and to download Crowdstrike's threat report visit: APTs & Adversary Groups List - Malware & Ransomware | Crowdstrike Adversary Universe.

- According to the American Automobile Association (AAA), more than 47.7M Americans are expected to travel this Independence Day (July 1-July 5), which represents a near recovery to pre-pandemic levels. It also represents a 40% increase compared to last year, where the total number of Americans that traveled were 34.2M. 43.6M Americans are expected to drive to their destinations, while 3.5 million are expected to fly. Drivers should expect delays on the road as AAA estimates traffic volumes will increase about 15% over normal, with more significant delays around major metro areas. Travelers should also expect higher prices as mid-range hotel rates have increased 35% since last year and daily car rental rates have increased 86%. In addition, average gas prices remain above $3.

https://newsroom.aaa.com/2021/06/aaa-more-than-47m-americans-to-celebrate-with-an-independence-day-getaway/

- According to Amazon shopping patterns, sales of toothpaste, whiteners, and mouthwash were up 66% in April 2021 compared to January 2020. In addition, sales of skirts, dresses, dress shirts, suits and tuxedos have more than tripled in the past year. Curling irons are up 30% year over year, while skin-care products increased by more than 38%. It seems we are in search of better breath, whiter teeth, nice clothes, designer hair, and better skin.

https://www.marketwatch.com/story/10-fascinating-things-people-are-buying-way-more-of-on-amazon-right-now-01624843363?mod=mw_latestnews

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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