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Economic Indicators August 2021
By Kim W. Suchy

Bond investors and individuals relying on interest income keep scratching their heads over the behavior of interest rates. Further, the stock market can't make up its mind if it wants high yields or low yields? Conventional wisdom suggests that when inflation is rising, interest rates should rise in tandem to preserve the purchasing power of the dollar. However, inflation numbers are surging, interest rates keep falling and the stock market edges higher.

The 10-year Treasury fell 27 basis points in Q2 and does not foot with an economy that is growing at its fastest pace in 40 years and with a core inflation number that's rising the most in a decade. Couple this with a backdrop of massive quantitative easing (QE) and a fiscal policy that's racking up record trillion-dollar-plus deficits….with potentially more to come. Rising tax obligations due to heightened fiscal spending, inflationary spikes and surging debt are not the right recipe for lower rates.

Interest rates are low because of all the liquidity in the financial system. The fact that we have the most extreme intervention in the history of financial markets, in Japan, the euro-zone, and the U.S., some of the QE money from the ECB and the Bank of Japan ends up in the U.S. Treasury market, in addition to the Fed's own QE money, pushing yields lower, as inflation rises. With respect to Fed QE, the Fed is purchasing $120B of Treasuries and mortgage backed securities per month to support prices and keep interest rates (yields) low.

Despite the historically low rates, a vibrant market exists for Treasuries. Having benefited from record stock prices, pensions and endowments are rebalancing into bonds as they are mandated to hold a certain percentage of their portfolios in U.S. bonds. Consider that a 20%+ percent move higher in stocks creates quite an under allocation to bonds thus, bonds must be purchased. In addition, interest rates abroad are much lower. In fact, many are in negative territory (yes, you have to pay someone to hold your money and get less back in return). Thus, the foreign buyers of Treasuries have, and will continue to be, key purchasers of U.S. debt as long as our rates remain

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higher than theirs inclusive of transaction costs and currency adjustments. With the Dollar trading in a narrow and stable range relative to other currencies we should not experience much dislocation in trading.

At some point, Fed Chair Powell will have satisfied one or both of the Fed's Congressional mandates; maximum employment and price stability. Achieving price stability in the 2% range (currently well above this but Powell considers this transitory) or attain maximum employment may not require an immediate adjustment in the Fed Funds rate but would certainly trigger a reduction in their bond purchases. It would be at this time that bond yields will move higher as liquidity wanes despite the continued support from pension, endowment and foreign buyers.

Here is your look at developments in the global marketplace.

Positive Developments:

- The Census Bureau reported that retail sales for June shows sales increased at a .6% rate vs. May and an 18% increase on a yoy basis. Total retail sales for June equaled $621B. Non store sales totaled $88B while brick and mortar sales totaling $533.4B.

    - On a yoy basis clothing store sales are up 47.1%, auto sales are up 21%, electronics and appliances up 37.3% and home furnishings up 17.1%.These increases show the strength of the consumer and their effort to satisfy pent-up demand.

- The Conference Board reported that its Consumer Confidence Index was little changed at a reading of 129.1 this mo. the highest level since February 2020, just before the World Health Organization officially declared the start of the pandemic on March 11. Further, they reported that their gauge of current conditions rose to 160.3, a fresh pandemic high. The share of consumers who said jobs were "plentiful" increased to a 21-year high of 54.9%. The percentage saying "jobs are hard to get" plunged to 10.5% suggesting that the unemployment rate could drop like a rock over the rest of this year….great news!

- The Conference Board Leading Economic Index continued to rise in June. Most of its underlying components made positive contributions, except for building permits and average weekly manufacturing hours. The leading economic index increased 5.0% during the first half of 2021, slower than the growth of 6.6% during the second half of 2020. In addition, the strengths among the leading indicators remained widespread which helps support a broader-based recovery.

- *Existing* home sales increased 1.4% last month to 5.86M million in June of 2021, the first rise in 5 mos. according to the National Association of Realtors. Supply has modestly improved in recent months due to more housing starts and existing homeowners listing their homes, all of which has resulted in an uptick in sales. Home sales continue to run at a pace above the rate seen before the pandemic. Total housing inventory amounted to 1.25M, up 3.3% from May's inventory and down 18.8% from one year ago (1.54M). The median existing-home price for all housing types was $363,300, up 23.4% from June 2020. The surge/flight from cities to suburban has fueled this increase. Of additional note, there are significant demographic tailwinds coming together for home sales for the foreseeable future. Census Bureau population projections show that the key home buying population of those 30-49 years old is set to grow significantly through 2039.

Neutral Developments:

- Buyback announcements this year have hit $431B, exceeding 2020's $307B total, according to J.P. Morgan data. This number should continue to grow, and it could top the previous record of $1T on a rolling 12-mo. basis at some point in the future. Historically, tech companies and banks that do the bulk of the repurchases, and Apple and Bank of America, with $90B and $25B in announced buybacks, respectively, will keep the story alive. However, Google's recent announcement of a $50B buyback means communication services will also join the party.
    - Note, with corporate bond interest rates resting about 1% above Treasuries, companies are taking advantage of issuing debt and repurchasing shares. The after tax cost of capital for companies is too attractive to pass up repurchases.
- Retail sales rose 0.6% in June and are up 18% yoy according to the Census Bureau. Nine of 13 major categories rose in June, with restaurants & bars leading the way as people have become more comfortable venturing out. Looking forward, the path of retail sales will a tug of war between several factors. Rising wages, jobs and inflation will all be tailwinds for sales, while the temporary and artificial boost from stimulus checks waning, along with the termination of generous jobless benefits being headwinds.
- The Commerce Department announced that housing starts rose 6.3% to an annual pace of 1.6M in June. May's housing starts were revised down to an annual 1.55M pace in May, down from a previously reported 1.57M pace. Note, building permits declined 5.1% to an a/r of 1.6M in June. Lumber prices have also declined 70% since June, after surging 125.3% in the first 5 mos. of 2021, so oscillating lumber prices may have adversely impacted building permits and permits could surge as homebuyer appetite grows.
- Morningstar reports that YTD through 6/30/21, the five growth categories (domestic and foreign) has experienced a combined $38.5B in liquidations while the five value categories (domestic and foreign) took in a combined $70.8B. It appears that a rotation into value is underway at the expense of growth which has had substantial outperformance for several years. Flows include ETF's and mutual funds.
- GDP rose 6.5% in Q2, below the 8.4% consensus, but putting the level above its pre-pandemic peak in Q4 2019. Notably, inventories shaved 1.13 percentage points off GDP growth, not as much as the 2.62 detraction in Q1, but still significant. Firms are depleting

inventories as they keep struggling to meet demand. Residential investment fell 9.8%, held back by increasing expenses from shortages of labor and other construction materials.

Negative Developments:

- Concerns about inflation continue to gnaw at the markets. The Consumer Price Index (CPI) inflation jumped to a new high of 5.4% yoy in June. This comes after a 5.0% rise in May and a 4.2% rise in April. The Fed maintains its transitory posture and many point out that there are really only two outliers driving prices: used car prices and gasoline prices were both up 45% y/y in June. They are outliers; but people do have to drive and new cars are hard to find these days, so these outliers hurt. A deeper look at CPI drivers we see that these two outliers have some serious competition. Consider transportation services were up 10%, car insurance 11%, apparel 5%, commodities other than food and energy close to 9%, and food away from home over 4%. Note, once these price increases begin to mount in the service related sectors, they usually stick and don't come back down thus hurting the transitory argument.

- The National Federation of Independent Businesses (NFIB) conducted a broad national survey in June and discovered that about half of firms are planning on raising prices, with 60% having problems hiring – meaning wages may not go down any time soon.

- *New* single-family home sales fell 6.6% in June and are down 19.4% yoy according to the U.S. Census Bureau. The median price of new homes sold was $362K in June, up 6.1% from a year ago. The average price of new homes sold was $429K, up 12.2% versus last year. The sales decline in June was the 3rd consecutive monthly decline. New homes were sold at a torrid pace in the second half of 2020 into very early this year but have since declined substantially. Why have sales dropped? We think for two main intertwined reasons: a lack of supply of completed (existing) homes plus rapid price appreciation versus pre-COVID levels. Look for builders to ramp up construction in the year ahead, particularly once excess jobless benefits are finished and, as a result, prices should stabilize.

- Weekly data from the U.S. Census Bureau show 15% of people in renter-occupied housing units are behind on rent payments. That's 2x pre-pandemic levels, according to National Equity Atlas. Further, Barron's reports that when the federal moratorium on evictions expires this month, nearly 8M households are at risk of being evicted. Rent inflation was running at a 3.4% clip pre-pandemic. With home prices rising and wages rising, this could create a perfect storm for rising rents….deepening the problems for those in eviction risk mode.

The Markets:

Domestic stocks were modestly higher last month with the exception of small caps as the Russell 2000 was off 4.5%. U.S. stocks faded as the month came to an end on the news that the C19 Delta variant was spreading rapidly and may induce business interruptions.

Over the past month health care, technology and consumer discretionary sectors performed very well while financials (banks), energy and real estate sectors lagged the broader market.

U.S. Index	Last Month (% return)	YTD (%)
S&P500	1.8	17.0
Dow	0.9	14.1
NASDAQ Comp	2.8	16.1
Russell 2000	-4.5	12.6

On the international front, the European markets were relatively flat while Asian markets were weak and closed in negative territory for the second consecutive month. Gold rebounded last month as the risk off trade prevailed along with concerns that inflationary pressures could begin to mount.

International Index	Last Month (% return)	YTD (%)
Euro Stoxx 50	0.3	15.2
Hang Seng	-8.5	-4.9
Germany	-0.4	13.3
Nikkei	-5.0	-0.6
FTSE-U.K.	-1.4	8.8
China Shanghai Comp.	-5.3	-2.2
Gold	2.1	-4.4

The year 2021 began with the 10-year Treasury Note yield at 0.90%. The 10-year closed July at 1.625%, 18bps higher than June 202 close. The 2-year Treasury closed July yielding .125%, 12bps lower than June's close. The curve widened quite a bit last month as the 10/2 spread is at 150bps or 30bps higher than last month. Despite the widening, bank stocks did not fare well last month.

News You Can Use:

Maggie Steffens of the USA women's water polo team broke the Olympic record with an astounding 49 career Olympic goals and counting as of 7/30/2021. The USA women's water polo team will play in the quarterfinals on Tuesday, August 3rd for Maggie to further add to her Olympic record tally. Maggie is 28 years old and has been playing since Monday with a broken nose, hurt during their match with China. Steffens is a two-time gold medalist, playing in her third Olympic games.

https://www.si.com/olympics/2021/07/30/maggie-steffens-breaks-water-polo-scoring-record-tokyo-olympics

Lollapalooza, one of the largest music festivals in the USA, is estimated to attract hundreds of thousands of attendees in Grant Park, Chicago from July 29 – August 1. This four-day event, in recent history, has drawn 100,000 attendees each day. This festival comes just one day after Chicago Mayor Lori Lightfoot warns to reimpose mask mandates and other COVID-19 restrictions if daily virus cases top 200.

https://time.com/6085927/lollapalooza-covid-19/

https://www.msn.com/en-us/news/us/mask-mandate-in-chicago-possible-if-daily-virus-cases-top-200-lightfoot-warns/ar-AAMAGCFOn July 7, 2021, former President Donald Trump announced class-action lawsuits against Big Tech Giants Facebook, Twitter, and YouTube, along with their respective CEOs Mark Zuckerberg, Jack Dorsey, and Sundar Pichai, for censorship and content moderation after being banned from social media platforms after the Capitol Hill riots on January 6, 2021. Facebook has banned the former President until at least January 2023, Twitter has permanently banned him, and YouTube (owned by Google) has indefinitely banned him.

https://www.washingtontimes.com/news/2021/jul/12/trumps-lawsuit-against-big-tech-has-legal-merit/

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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