1919 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

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Meme stocks remain volatile, S&P stable, what the indicators are telling us and some thoughts on trade

Equity Markets

Major U.S. equity markets remained stable this past week. The Wall Street Journal reported that Friday was the 10th consecutive day without a 1% move in the S&P 500, the longest streak since May. This should not unduly worry investors. Markets move in ebbs and flows as investors evaluate new information. On the other hand, the frantic movement of meme stocks[1] is something investors should be concerned about. A good example is AMC. AMC's gains for the year are over 2100%. This in the face of the firm warning investors, in a report to the SEC, "The current price reflects market dynamics unrelated to its business-investors should be prepared to risk losing all their money." Is this a signal that investors should think about leaving the market? We don't think so, but it is a sign that investors must be cautious and not get carried away.

The Economy

As readers will clearly see when reading Ryan Schutte's analysis of the most recent leading Indicators, the U.S. economy continues to move along in a positive fashion. We, like many others, believe the consumer is the driving force of the U.S. economy. After all, consumption is around 70% of the U.S. economy. Statistical analysis, along with common sense, tells us that consumer activity is highly correlated to employment. Strong employment growth leads to increases in consumer spending, and the rest of the economy follows.

On the international front, a piece of wisdom came from Europe. It seems likely that there will be a minimum tax that large corporations must pay. This may spread across the Atlantic with the United States joining. It may even catch on to the extent that there may be some form of equalization tax rate across States.

Economic Indicators

Following last month's surprisingly weak employment numbers, Friday's jobs release became a highly anticipated event for those attempting to gauge the pace of the labor market recovery. The unemployment rate declined to 5.8% and employers added 559,000 jobs to the economy—a strong number but below economists' expectations for a 650,000 increase. While uncertainty remains, this report, along with other employment-related releases over the month, have made a few things clear. One is that job openings are plentiful, as indicated by the latest JOLTS[2] survey showing a series-high 8.1 million open positions.

Another is that businesses are learning to do more with fewer employees. This month's NFIB monthly jobs report indicated that a record-high 48% of small businesses have unfilled job openings, and 93% reported that their attempts to hire have been met with no or few qualified candidates.[3] This has coincided with nationwide reopenings and a rapid return of consumer demand. For now, it seems businesses are managing their way through labor

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[1]A **meme stock** is any publicly traded company that is benefiting from the forces described above – a band of ordinary investors who are using social media to drive interest in the company's shares. GameStop and AMC are the two most notable examples.
[2]Job Openings and Labor Turnover.
[3]Dunkleberg, William C. 2021. "NFIB Small Business Jobs Report." National Federation of Independent Businesses. https://www.nfib.com/foundations/research-center/monthly-reports/jobs-report/.

shortages with longer workweeks and higher productivity from existing employees.

Lastly, overall employment numbers are trending in the right direction, just at a slower pace than many expected. For one, while the overall payroll additions have been disappointing, leisure and hospitality job gains have been impressive, with an increase of 620,000 over the last two months. Furthermore, unemployment claims have steadily decreased, consistently setting pandemic lows. The unemployment rate has also gradually declined, and businesses are looking to hire. Put simply, the demand for labor and supply of labor are both recovering but at different rates. Whether it be a mismatch of skills, a disincentivized labor force from enhanced unemployment benefits, childcare issues, or other reasons, the hope is that these frictions will pass, and the pace of the labor market recovery will improve.

Inflation has also remained at the forefront of the economic landscape, highlighted by May's 4.2% year-over-year CPI increase.[4] While the core measure came in at a tamer 3%, the monthly rise was the largest since 1981. The PCE[5] inflation index was also elevated, with a core reading of 3.1%. These large inflation numbers may have a shock factor and look worrisome at first, but the focus should instead be on the duration and composition of inflation rather than the headline number. Increases in items like airfares are an example of pricing simply returning to normal, while price jumps in other goods like used cars can be seen as transitory.[6] Instead, greater attention should be paid to the shelter and labor components of inflation. If we were to see sustained price increases in these areas, it may incentivize the Fed to act. Also, alternate measures of inflation like the Cleveland Fed's median CPI, the Dallas Fed's trimmed mean PCE price index, and the Atlanta Fed's Sticky Prices measure offer some reassurance. These indices are designed to be less volatile than traditional inflation gauges and are thought to incorporate future inflation expectations to a greater degree. With readings ranging from 2.1% to 2.4%, these measures offer a less worrisome inflation picture.

As we mentioned earlier, consumer demand has bounced back decisively as more Covid restrictions are removed and the nation continues to reopen. Despite indications of increased incomes and intentions to spend, positive momentum in both the Consumer Confidence and Consumer Sentiment measures has faltered, as it seems inflation concerns are weakening consumers' economic outlooks. Consumption expenditures increased for the second month in a row and real incomes (ex-government transfers) rose as well. Despite strong spending patterns and rising incomes, we may continue to see the consumer confidence measures falter unless further clarity is provided regarding the inflation and employment picture.

Overall, the U.S. economy continues to recover, but labor shortages and inflation fears present two potential headwinds. The overall employment situation is improving, and inflation measures designed to exclude more volatile components look less concerning than headline readings. Rising incomes and improving employment set the stage for a strong U.S. consumer and continued advances in the U.S. economy.

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[4]Consumer Price Index.
[5]Personal Consumption Expenditures.
[6]Ip, Greg. "Some, but Not All, of the Price Jump is Transitory." May 12, 2021. https://www.wsj.com/articles/some-but-not-all-of-the-price-jump-is-transitory-11620839990.

Weekly Market Insights (cont'd)

International Trade

International trade and globalization are often used interchangeably. That is not correct. Globalization is a much broader term, as it encompasses more than trade (i.e. emigration). Today we write about trade. We have written in the past about the benefits of trade and it being an important topic with a new administration. We still feel it wise to make some points even if we have written about them extensively in the past.

The United States, for much of the period following the post Second World War, ran significant trade surpluses. As we entered the twentieth century, things began to change. There were a number of reasons for the change. One driving force behind the trade surpluses was the aftermath of the Second World War. Europe was devastated, its industrial base destroyed, and it had neither the money nor the materials to rebuild. The United States had both, so it created the Marshall Plan. This was mutually beneficial, but, when Europe rebuilt, this dependency came to end, Europe became a legitimate competitor, and surpluses diminished and in some cases disappeared.

The same, of course, was true of Japan. The country had to rebuild. Then in the '70s, as global energy prices rose dramatically, the U.S. auto industry was very slow to adjust. Japan, who had specialized in small, energy-efficient cars, became one of the prime exporters to the United States, creating large trade imbalances.

In short, there are a number of reasons the United States neglected its infrastructure and corporate reinvestment slowed. For all of these reasons, the United States developed a chronic trade imbalance. Most economists don't find this particularly troubling. Next week we discuss why.

It is clear that there can be many causes for a trade deficit. Few of them are detrimental to the country running the deficit and most are self-correcting.

Readers will obviously ask where China fits in. China is clearly very important, but its significance transcends the trade deficit and lands in the middle of globalization. Again, a subject for another paper.

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