Weekly Market Insights

November 1, 2021

Another record closing, mixed indicators and growth in Europe

Equity Markets

U.S. and European equity markets closed both the week and month at record levels. They did this in the face of mixed economic signals and disappointing earnings from some market favorites. However, earnings have been very good overall. Another important reason for investor enthusiasm is the increasing likelihood that there will be an agreement reached in Washington, and both the social spending and bipartisan infrastructure bills will be passed.

The month's rally was not restricted to U.S. stocks, as European markets also benefitted from investor enthusiasm. European investors were encouraged that their economic growth outpaced both the U.S. and China. Not all countries benefitted equally, with France and Italy being winners while Spain and Germany failed to meet expectations.

The Economy

Economic signals are confusing at best. This will be evident from Ryan Schutte's discussion of economic indicators. We believe the unusual nature of both the recession and recovery has caused anomalies in the sequence of indicators. The unusualness being the rapid descent of growth rates due to COVID and the strong recovery. If this is the case, economic models might not be as accurate as normal. We agree with this assessment. The press often reports economic growth as a competition between countries. In other words, winners and losers. This does not have to be the case. Global growth can and should be positive for all countries. The bigger the pie, the better for all. This positive view of global growth has been the opinion of most all economists, from David Hume and Adam Smith to John Maynard Keynes and Milton Freedman. We agree and see positive signs for continued growth.

Both the *Wall Street Journal* and the *Washington Post* report that Asian economies are beginning to strengthen. Therefore, it is possible that supply chain developments will improve. There appears to be a breakthrough in the negotiations concerning both the social spending and infrastructure bills. The passing of these bills should add a significant boost to economic growth and investor confidence.

Of course, all the news is not encouraging. Global transportation of goods remains spotty and economic growth in China is slowing, although it is not clear by how much. The Chinese economy is very difficult to analyze because the reported information is not always accurate.

Next week, in the absence of a more dramatic event, we will spend more time on China and the marriage of technology and innovation.

October Economic Update

Economic indicators were mixed this past month. The spread of the Delta variant and heightened inflation concerns caused some data points to turn lower; however, more timely releases capturing periods when COVID trends were better offered a more optimistic picture. As we have mentioned in the past, the pandemic has resulted in more volatile economic data, often complicating its interpretation. Nevertheless, there are important takeaways from October's releases.

While no longer recording record highs, inflation measures remain elevated relative to historical norms and the Federal Reserve's flexible 2% inflation target. The Consumer Price Index increased at a faster rate in September than in the prior month and rose 5.4% year-over-year. The core measure, which excludes the volatile components of food and energy, increased at a more reasonable 4% year-over-year pace. Despite declining from the peak inflation levels reported a few months ago, a turn higher in some of the more durable components like shelter may be indicating a "stickier" inflation than previously thought. Additionally, labor shortages have resulted in firms offering higher wages, further increasing inflationary pressures. Conversely, recent NFIB data indicates that the number of firms planning to raise prices and the number reporting inflation as the most important problem are both declining. As we alluded to in the introduction, the ever-changing nature of pandemic has resulted in volatile and sometimes contradictory economic data. Inflation data falls in that camp.

The advanced estimate of 3rd quarter GDP growth was reported at an underwhelming 2% real annualized rate with the deceleration in growth largely driven by a quarter-over-quarter decline in personal consumption expenditures. Nonetheless, spending and a build-up of inventories contributed the most to growth. Spending on services outpaced spending on goods, a reversal in what we have seen since the pandemic began. To this point, government transfer payments and elevated savings have encouraged consumers to spend more on big ticket items like houses, cars, and appliances. Pandemic-related restrictions, capacity limitations, and closures within the service industry further influenced the shift. However, continued vaccinations and improved COVID trends may have renewed consumers' willingness to participate in in-person activities and spending. Supply chain disruptions also contributed to the mix shift with the decline in expenditures on goods driven by decreased spending on motor vehicles. Looking forward, growth is expected to rebound, albeit at a more moderate pace, as supply chain disruptions ease and consumer demand remains strong.

Labor market releases are another example of contradictory economic data. The payroll number disappointed to the downside for a second consecutive month with 194,000 jobs added. Nevertheless, the unemployment rate declined to 4.8% and unemployment claims continued to make pandemic lows. Despite a U.S. labor force with around 4.3 million less workers than in February 2020, many signs point to a tight labor market. JOLTS data reported over 10 million job openings, and firms are struggling to fill positions. So, why are jobs going unfilled? COVID fears, childcare, and unemployment benefits are frequently cited reasons; however, accelerated retirements could be another significant factor. With the boost in asset prices that followed the March 2020 decline and the significant rise in housing prices, household wealth has increased, allowing more people to retire. It is also worth noting that nonessential jobs in the leisure and hospitality sector are still far below pre-COVID levels. A possible reason for this is that potential workers do not want to rejoin the workforce only to be let go if another COVID wave and set of lockdowns occur. It is also possible that former leisure and hospitality sector workers are holding out for higher wages or have been lured into higher paying jobs in different industries. We would like to see improvements in payroll additions and the labor force participation rate; however, a lower supply of labor than before the pandemic may be here to stay.

As we reminded readers last month, it is important to acknowledge that many economic indicators are backward looking and reflect a period when COVID cases were on the rise from the Delta variant. This, along with the unpredictable nature of the pandemic, often result in volatile economic data releases making their interpretation more difficult. New cases have declined and supply chain issues look to be improving, so we hope to see more positive reports in the months ahead.

Weekly Market Insights (cont'd)

Conclusion

Investors are faced with an interesting array of economic data. This is often the case, but because of all the unusual circumstances covered earlier, the current situation appears to present more confusion than normal.

We remain positive on U.S. equity markets for a number of reasons. The apparent slowdown of the Delta strain in the U.S., steady U.S. growth, accelerating economic growth in Europe, positive signs from Washington, and continued global liquidity–all positive economic signs that indicate higher markers.

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