WEEKLY MARKET COMMENTS – SEPTEMBER 21, 2021

Last week saw the major indices continue their weakening trend this month as the S&P and Nasdaq finished down for the second straight week while the Dow ended lower for the third straight week. And the reasons for this included the fact that the list of risks to the market have finally become too big to ignore, such as ongoing delta variant covid concerns, potential higher taxes, persistent inflation worries, slowing down of profit growth and anxiety about raising the debt ceiling by the end of September, all during the month that is the weakest of all historically.

And then events over the weekend did not help either as on Sunday, Democratic Senator Joe Manchin (West Virginia) said that he would support an infrastructure spending package of about $1.5 trillion, far below the $3.5 trillion proposed by more progressive members of Congress. Manchin, whose vote will be crucial to the bill's passage, also said he believes congressional leaders should take their time instead of pushing the issue. To fund the new package, Democrats want to raise the corporate tax rate from the current 21% to 26.5%, while also raising the top capital gains tax rate from 20% to 25%, which are smaller increases than previously sought.

Then of course we had the historic collapse to start the new week yesterday, the details of which are discussed in yesterday's Daily Market Notes.

Other events from last week include that retail sales increased slightly in August, highlighting an uneven pace for the economic recovery as spending behavior swings month over month.

The 0.7 percent climb in sales last month came after a 1.8 percent decline in July and gains earlier in the summer. The gains in August, which were better than what economists expected, were prompted by a rise in spending on clothing, electronics, and furniture and home goods. But sales at bars and restaurants fell, after a rise in July. That drop is partly tied to the end of summer, but it is also tied to fear of the virus when going into a bar.

Sales of sporting goods and musical instruments and at bookstores rose as students prepared to go back to school. Sales at non-store retailers, which include e-commerce businesses, rose about 6 percent in August after falling in July as the resurgence of the virus resulted in households switching their buying options to hands-free transactions.

Sales of cars and auto parts were down 4.5% percent in August as the auto industry has been hit by a shortage of computer chips, causing TM to announce plans to slash production by about 40 percent.

Through August, the NRF(National Retail Federation) estimates that sales are 15% higher than the comparable year-ago quarter, putting 2021's retail sales on track to grow by double-digits from 2020, to at least $4.4 trillion. That is unequivocal good news for an economy that is two-thirds powered by consumer spending.

According to the NRF, "the consumer remains rock solid despite the trifecta of macroeconomic headwinds we've seen this year, including tapering off of government stimulus, elevated COVID-19 infections and ongoing supply chain challenges in the form of shortages of labor and goods." Even in the face of "disjointed" return to schools, the data "pave the way for sturdy consumer spending and a strong economy in the fourth quarter," they added.

Indeed, there's at least another reason Americans appear poised to continue opening their wallets. Although restaurants and bars are certainly feeling the chill of soaring COVID-19 infections, the jobs market continues to defy gravity.

Last week's jobless claims report ticked slightly higher up to 332,000, primarily due to the aftershocks of Hurricane Ida, but remain within range of pandemic-era lows. And investors are becoming more convinced that the end of generous unemployment assistance will bolster job creation even more, especially as children return to school.

In a rare show of bipartisan unity, not a single U.S. governor has opted to extend supplemental jobless benefits, despite the Biden administration's request to do so.

The end of unemployment assistance could represents a large boost to jobs growth through year's end to the tune of 1.3 million, and a drop in the unemployment rate to 4.2%. This suggests that, regardless of lingering fears that some are holding out in fear of contracting COVID-19, countless workers will start venturing out to fill some of the 11 million vacant positions that currently exist. And more workers returning to the labor market almost assuredly translates into higher consumer spending, which should mean stronger growth.

Switching gears now, inflation cooled slightly in August but remained strong, as a surge in Covid-19 infections slowed economic growth and pandemic-related shortages of labor and supplies continued to drive up prices.

The Labor Department said last month's consumer-price index increased by a seasonally adjusted 0.3% in August from July, slower than the 0.5% one-month increase in July, and down markedly from June's 0.9% pace. Prices eased for autos, with used vehicle prices dropping sharply, and hotel rates and airline fares declined in August from July.

The C.P.I. measures what consumers pay for goods and services, including groceries, clothes, restaurant meals, recreation and vehicles. On an annual basis, price pressures eased slightly with a rise of 5.3% in August from a year earlier, down from the 5.4% pace in June and July, on an unadjusted basis.

The so-called core price index, which excludes the often volatile categories of food and energy, climbed 4% from a year before, compared with 4.3% in July.

Price growth driven by used vehicles eased in August. The recovery of travel-related prices also reversed as the spread of the Delta variant of the Covid-19 virus depressed demand, particularly for travel, as airline fare prices declined 9.1% from July, while rental cars and trucks dropped 8.5%. Gasoline prices picked up 2.8% in August from July, a faster pace than the prior month. Restaurant prices rose 0.4%, while grocery prices climbed 0.4%, both categories rising at a slightly slower monthly pace than in July.

Inflation has heated up this year for several reasons. U.S. gross domestic product rose at a rapid 6.6% seasonally adjusted annual rate in the second quarter, fueled by a gush of consumer demand. Spending jumped at an 11.9% pace in the second quarter as more people received vaccinations, businesses reopened and trillions of dollars in federal aid coursed through the economy.

Prices for services hit hardest by the Covid-19 pandemic are still recovering to pre-pandemic levels, including for air travel, accommodation, entertainment and recreation. The outbreak of the Delta variant of the Covid-19 virus likely weakened that rebound, taking some stress off overall price pressures in August but at the same time, Delta-driven disruptions due to shutdowns and absenteeism could also worsen supply bottlenecks and shortages.

Many companies are passing on higher labor and material costs to consumers. The sharp uptick in restaurant prices in the past few months suggests that this pass-through is showing up in the inflation data. From June through August, fast-food prices rose at an annual rate of 9.7% according to Labor Department data.

The U.S. inflation rate reached a 13-year high recently, triggering a debate about whether the country is entering an inflationary period similar to the 1970s.

Peak pandemic pressures have likely passed, but significant pressures remain and one prime example is the shortage of semiconductors that has crimped auto production, which had caused, causing new and used car prices to soar, which in turn drove up overall C.P.I. throughout the late spring and summer. However, supply of new autos remains limited, due to the chip shortage and a resurgence of Covid-19 infections in Asia that led to shutdowns of factories and ports. While the jump in used-car prices is now easing, prices for new vehicles are still rising. More broadly, hopes are fading that supply-chain disruptions would pass after a few months.

Economists anticipate that broader, longer-lasting inflationary pressures will emerge in coming quarters. For example, many expect an increase in rents to keep the C.P.I. elevated in the months ahead. Combined, the Labor Department’s various measures of rent make up about one-third of the prices for the CPI’s hypothetical basket of goods and services and could therefore buoy the overall inflation measure.

Federal Reserve officials are closely watching many inflation measures to gauge whether the recent jump in prices will prove temporary or lasting. Persistent high inflation could compel them to tighten their easy-money policies sooner than expected, or to react more aggressively later, in order to achieve their 2% average inflation goal.

One factor they watch is consumer expectations of future inflation, which can prove self-fulfilling. Consumers' median inflation expectation for three years from now jumped to 4% in August, from 3.7% a month earlier, according to a survey by the New York Fed. This reading was the highest since the survey began in 2013.

Fed Chairman Jerome Powell in late August continued with his view that inflation is likely to cool over time, as supply-chain bottlenecks and other effects related to the economy's re-opening subside. So far, there is little evidence that inflation is rising beyond a "relatively narrow group of goods and services that have been directly affected by the pandemic and the reopening of the economy," he said.

The easing of price growth in August on the surface supports Fed analysis that says inflationary pressures could be largely temporary. However, an alternative measure of inflation tracked by the Cleveland Fed suggests a broadening of price pressures.

The latest C.P.I. report suggests that peak inflationary pressure is easing, but it is not disappearing. Most experts still expect inflation to decline, but to settle at a higher level than in the last cycle. In addition, labor shortages and supply constraints will begin to ease, but more slowly than we would like. Last week's University of Michigan consumer confidence survey showed a slight improvement from the previous reading, but also a deterioration in reported buying conditions for homes, cars, and durable goods, suggesting that high prices are likely to have a dampening effect on large purchases.

The peaking of inflation rates should provide some relief to the Fed, allowing for a gradual withdrawal of monetary stimulus, starting with the expectation that bond purchases will be reduced later this year. A look at previous economic cycles since 1990 shows that when inflation rates peaked in the upswing, the following year saw solid stock market advances.

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