

## *Summary*

Economic data for the week included slightly weaker results for manufacturing, but a stronger report for services. The employment situation report for January was disappointing, but other labor reports featured a few bright spots.

Global equity markets bounced back sharply last week, with U.S. outperforming foreign by a bit. However, higher-quality bonds fell back in keeping with rising interest rates. Commodity prices rose due to spikes in the prices for crude oil and natural gas.

## *Economic Notes*

(-/0) The **ISM manufacturing index** fell by 1.8 points in January to a level of 58.7, just below the 60.0 expected. Regardless, the index remains in solid expansion. The underlying components included declines in production and new orders, although they each remained in expansion. On the other hand, employment, supplier deliveries, and inventories rose more solidly into further expansion from last month's data. Overall, while some manufacturing activity appears to have been held back by still-persistent virus counts, the recovery is still well underway. One item of note is that inventories have become increasingly tight, due to demand exceeding production supplied, and causing the prices paid component to reach the highest level in nearly a decade.

(+) The **ISM non-manufacturing index** for January rose 1.0 points to 58.7, identical to the manufacturing survey. This was the highest level for the index in two years, and beat expectations calling for 56.7. The underlying components showed strength in new orders and employment, each rising further into expansion. Expected business activity ticked down a bit, as did supplier deliveries, but still remained solidly in expansion.

(+/-) **Construction spending** rose 1.0% in December, beating expectations calling for 0.9%, and included upward revisions for several prior months. Private residential spending rose 3%, in addition to a smaller gain for public residential. Nonresidential was mixed, with a rise in public spending and decline of a few percent on the private side.

(0/+) The **Federal Reserve Senior Loan Officer Opinion Survey** for Q4 of 2020 showed a reduction in tighter lending standards generally. The number of banks reporting tighter standards on commercial/industrial loans fell in Q4, from higher levels mid-year in the depths of the early pandemic (banks that did so largely acted due to uncertainty about the broader economy, or a particular sector involved). Demand for C&I loans was also weaker for the period.

In general lending was looser for all three sizes of borrowers—large, mid, and small—with little changes in loan spreads or credit line maximums from the prior quarter. Bank standards for commercial real estate loans were looser than in Q3, including riskier construction/development loans, while demand for such loans also fell. Residential real estate standards were little changed from the prior two quarters, when conditions had tightened. Consumer installment loan availability rose slightly in the quarter, in keeping with credit card standards loosening. Demand for such loans were little changed, with those for auto loans pulling back somewhat. Overall, along with an expected recovery in economic conditions broadly, banks appear increasingly willing to lend (a steeper yield curve also helps in this effort).

(0/+) **Initial jobless claims** for the Jan. 30 ending week fell by -33k to 779k, below the median forecast calling for 830k. **Continuing claims** for the Jan. 23 week fell by -193k to 4.592 mil., below the expected level of 4.700 mil. Initial claims numbers saw a sharp rise in CA, along with less severe increases in FL and NY, while claims fell dramatically in IL. Moving in fits and starts, claims results are showing gradual improvement, along with other labor measures, despite being distorted by benefit extensions and processing times.

(+) The **ADP employment report** of private sector employment showed an increase of 174k jobs in January, far surpassing the consensus forecast calling for only 70k. This also included a substantial upward revision for the prior month, which reduced the net loss reported. Services jobs rose by 156k, a third of which were in health care. Goods producing jobs, a far smaller percentage of the workforce, rose by 19k, almost all of which were in the construction industry. While progress has been achieved more recently, over -9.5 mil. jobs were lost in the past year, which was 50% more than those lost during the financial crisis—obviously far different events from a variety of standpoints.

(-/0) The January employment situation report came in mixed, but generally weaker than expected, as the nation continued to battle the pandemic. While labor markets have recovered sharply since the peaks of difficulty last April, levels of unemployment remain elevated compared to levels just before the pandemic. Financial markets appeared to handle the news, though, as the odds of larger stimulus increase as the labor market weakens.

**Nonfarm payrolls** rose by only 49k, which fell short of the tempered 105k expectation, in addition to sizable downward revisions for both November and December. Employment growth was weak across the board, with professional/business services (+97k, mostly in temporary accounting jobs), in addition to local and state government education. Jobs in leisure/hospitality fell by -61k, continuing difficulty in that segment due to the pandemic and mandated closures; health care jobs also declined sharply, particularly in nursing care facilities. This report continues to show the continued challenges for the lower-wage segment of the workforce.

The **unemployment rate** declined by -0.4% to 6.3%. The U-6 underemployment rate fell by -0.6% to a rate of 11.1%. The household survey component of this showed an increase of 539k jobs, which was a positive. Additional good news is that the number of persons considered on 'temporary layoff' fell to 2.7 mil. While far higher than the pre-Covid Feb. 2020 level of 0.7 mil. persons, it's far below the Apr. 2020 peak of 18 mil. The newly jobless also continued to decelerate.

**Average weekly earnings** rose by 0.2% for the month, a tenth below forecast; the year-over-year change was unchanged at a pace of 5.4%. The **average workweek** rose by 0.3 hour to 35.0 hours.

Earlier in the week, **nonfarm productivity** for Q4 declined at a rate of -4.8%, reversing a similar gain the prior quarter, and falling nearly two percentage points below expectations. On the other hand, **unit labor costs** rose 6.8% in Q4, beating the median forecast of 4.0%, and reversing a decline of similar magnitude in Q3. This raised the year-over-year labor cost change by over a percent to 5.2%. These figures are obviously more extreme than normal, with labor dislocations from Covid causing the more extreme readings.

## Market Notes

Period ending 2/5/2021	1 Week (%)	YTD (%)
DJIA	3.90	1.87
S&P 500	4.67	3.61
NASDAQ	6.04	7.57
Russell 2000	7.72	13.14
MSCI-EAFE	2.75	1.66
MSCI-EM	4.96	8.18
BBgBarc U.S. Aggregate	-0.39	-1.11

U.S. Treasury Yields	3 Mo.	2 Yr.	5 Yr.	10 Yr.	30 Yr.
12/31/2020	0.09	0.13	0.36	0.93	1.65
1/29/2021	0.06	0.11	0.45	1.11	1.87
2/5/2021	0.03	0.09	0.47	1.19	1.97

U.S. stocks recovered from the weakness of the prior week, as positive economic data and odds of a fiscal stimulus rose—with several key indexes again reaching record highs. As across-the-aisle talks seemed to break down, it appears that Congress may use the budget reconciliation process (requiring only a simple majority in the Senate) to get a full-sized \$1.9 tril. fiscal aid package through.

Every sector ended in the positive last week, led by cyclical energy, consumer discretionary, and financials, while communications was also up sharply. Defensive healthcare gained less than a percent, due to a more defensive nature and ongoing concerns surrounding the group about potential pricing reforms from a Biden administration. Small caps continue to lead in 2021, along with the cyclical recovery expected as the pandemic comes to a hoped-for end.

Earnings results continue to roll in, with over half of S&P companies reporting final results—80% of which surprised on the upside for both revenue and earnings, per FactSet. The blended year-over-year growth rate for Q4 is a positive 1.7%, which includes both the extreme decline of early Covid and subsequent partial bounceback, and a sharp improvement on the initial expectation of -9% at year end. The strongest contribution to earnings recovery originated with financials and materials, although growth sector technology was not far behind in third place—all with 15% gains. In last place were energy and industrials, showing extreme earnings declines over the past year.

Foreign stocks gained as well, to a lesser degree due to the stronger U.S. dollar. Vaccination rates have grown, which has elevated sentiment. In Italy, concerns over another collapsed government were helped by attempts from former ECB President Mario Draghi to form a new coalition. Emerging markets earned the strongest returns, with continued hopes for vaccine distribution translating to economic growth—in addition to more attractive valuations. Emerging markets have tended to be more cyclical by nature, so have fared well, similar to how U.S. small caps have.

U.S. bonds fell back last week, as interest rates continued to tick higher. This is due to a combination of general economic repair, and higher growth expectations for 2021-22, as well as the large size of the Congressional stimulus package. The latter has raised concerns over the size of the monetary base and potential long-term inflation, in addition to generally higher U.S. deficit and debt levels, which erode the U.S.' credit standing. While investment-grade bonds earned negative returns, high yield and floating rate bank loans gained along with general positive sentiment for stocks. A stronger dollar, though, weighted significantly on foreign developed market debt, which lost nearly a percent. Emerging market bonds earned positive returns along with other risk assets.

Commodities rallied along with risk assets last week, despite a stronger dollar. The strongest energy week in several months, coupled with smaller gains in industrial metals offset flat to down results for agriculture and precious metals. The price of crude oil rose by almost \$5/barrel (9%) to just under \$57/barrel—due to a continuing combination of expected rising demand along with economic recovery coupled with more recent tighter U.S. supplies. Natural gas prices also spiked by over 10% with frigid temperatures expected in several U.S. regions, raising heating demand. Interestingly, there appears to be more bullishness on the commodity complex than has been seen in some time, with massive stimulus and an expected bounceback in industrial and consumer demand for products (needing raw material inputs).

Have a good week.

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Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Associated Press, Barclays Capital, Bloomberg, Citigroup, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

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Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.