Summary

Economic data for the week included positive surprises in retail sales and industrial production, while housing results were mixed for the past month—although the recovery trend remains in place.

Global equity markets were mixed to lower globally, with the U.K. as the best performer. Bonds pulled back globally, as interest rates again nudged higher due to fears of stimulus leading to eventual inflation. Commodities gained ground, led by strength in industrial metals and natural gas.

Economic Notes

(+) **Retail sales** for January rose by 5.3%, far exceeding forecasts calling for a 1.1% increase, and reversing a decline from the prior month, along with several mixed revisions for prior months. Every category in the index experienced a gain, while removing autos from the headline result boosted the sales increase to 5.9%, with the core/control measure came in at 6.0%. By individual segment, department stores, electronics, furniture, and non-store/online retail all gained in the double digits for the month, which was likely aided by stimulus payments overall. The year-over-year increase of 7.4% represents the strongest result in years for that trailing time period—again an example of the strong economic rebound experienced, especially in areas such as online retail.

(0) The **producer price index** for January experienced an increase of 1.3% on a headline level, and 1.2% on a core basis, subtracting food and energy. This surpassed estimates slightly, as the largest single-month increase in over a decade. The month was largely driven by a 5% rise in energy prices, while food prices rose a mere 0.2% on the headline side. An increase of a percent in retail margins was responsible for the bulk of the core PPI increase, although prices of crude commodities also rose substantially in line with spot prices. Year-over-year, headline and core PPI are up 1.7% and 2.0%, respectively; although PPI is up over an annualized rate of 5% since the April trough. Signs of reflation in the economy are occurring, as shutdowns have reversed and caused pent-up demand to be released—the degree of this remains to be determined.

(+) **Industrial production** in January rose by 0.9%, exceeding expectations calling for 0.4%. For the single month, manufacturing production rose by a percent to drive the increase, not helped by auto manufacturing, which experienced a decline for the month, while production of business equipment rose. Utilities production fell by over a percent, due to weather, and likely to reverse as winter turns to spring; mining/oil production also rose by a few percent along with stronger prices that incented higher activity. **Capacity utilization** in January rose by 0.7% to 75.6%. Although production fell short of the pace of last month's gain (even with some downward revision), the multi-month rebound remains solidly in recovery. In fact, the measure has closed nearly 90% of the gap created by the pandemic.

(+) The **Empire manufacturing index** rose 8.6 points in February to 12.1, beating expectations calling for a more tempered rise to 6.0, and representing solid expansion. New orders, employment, and prices paid each rose to more expansionary levels, in keeping with the index, while shipments dropped—but remained in expansion. Expected business conditions for the next six months rose by 3 points to a solid reading just under 35. This continues to point to a strong manufacturing recovery.

(0) The **Philadelphia Fed manufacturing index**, on the other hand, fell by -3.4 points to 23.1 in February, but fared better than the larger expected decline to 20.0. New orders and shipments each fell by several points but remained solidly in expansion, while the employment and prices paid indexes rose further into expansion. Expected six-month ahead business conditions fell by over -13 points for the month, but remained solidly expansionary.

(+) **Existing home sales** in January rose by 0.6% to a seasonally-adjusted annualized rate of 6.69 mil. units, surpassing the median forecast expectation calling for a drop of -2.4%. Single-family units rose slightly, by two-tenths of a percent, while condos/co-ops gained 4% for the month. Regionally, the South and Midwest experienced low single-digit gains, which offset declines of a similar magnitude in the West and Northeast. Interestingly, inventory declined by another -20k to new record low levels (at 1.9 months sales), which has been driven by the oft-discussed trends to suburban moving, low financing rates, and low (up until recently) building activity.

(-/0) **Housing starts** in January fell by -6.0% to a seasonally-adjusted annualized rate of 1.580 mil. units, exceeding the expected drop of -0.5%. However, the prior month was revised higher, pushing the year-over-year gain over 17%. Single- family starts were the primary culprit, falling -12%, with multi-family gaining 17% to provide a partial offset. Regionally, starts in the Northeast gained slightly, but were countered by double-digit drops in the West and Midwest. **Building permits**, on the other hand, rose by 10.4% to 1.881 mil. for the month, contrary to an expected decline of -1.4%. Here, single-family permits were 4% higher, and multi-family rose by 27%. While permits in the Midwest fell slightly, sharp gains were generated from the Northeast, followed by the West and South. There appears to be substantial pickup taking place, with the annualized pace of building nearing the best levels in a decade.

(+) The **NAHB housing market index** rose by 1 point in February to 84, beating expectations for no change at 83. The current sales metric was unchanged, while future sales and prospective buyer traffic each rose by several points. Regionally, the Northeast index increased dramatically (by 30%), while the other three regions were little changed.

(-/0) **Initial jobless claims** for the Feb. 13 ending week rose by 13k to 861k, far exceeding the expected drop to 773k. **Continuing claims** for the Feb. 6 week fell by -64k to 4.494 mil., but still elevated compared to the expected 4.425 mil. Initial claims numbers were again high in OH, but also contained rises in CA and IL; on the other hand, TX saw double-digit declines. There have likely been some weather effects in recent weeks, due to frigid conditions around the country, which have included power outages. This is in addition to the continuing claims numbers still being elevated by extended benefit programs.

(0) The **FOMC meeting minutes** from January continued to show support by the committee for keeping rates low and asset purchases intact until 'substantial progress' has been made toward employment and inflation goals. In their words, this will likely take 'some time.' (The 'some time' component helped temper the rise in interest rates somewhat during the week, although for others, it raises worries about keeping policy stimulative for too long and creating conditions for asset bubbles.) At the same time, there was an acknowledgment that the overall economic outlook has improved, especially with the fiscal stimulus from late 2020, and more expected in coming weeks. The Fed has committed itself to keeping interest rates at the lower bound for the foreseeable future, in order to ensure the economic output gap has been re-filled and unemployment levels move back toward their pre-Covid strength. However, there is some growing private sector concern over signs of inflation in recent months morphing into an environment that would back the Fed into a corner, and necessitating rate hikes sooner than expected. This has been an ongoing fear over the past decade, though, with the Fed learning one lesson about the importance of communication—to avoid a repeat of 2013's 'taper tantrum.'

There was some member attention brought to higher asset valuations, which have been a modern byproduct of low interest rates and tight credit spreads, as well as the dislocation of hoarded savings by higher-income folks during the pandemic. Despite the Fed frequently being questioned about financial market valuations during strong equity bull markets, restraint of prices is largely out of their purview, other than obvious excesses that can threaten their mandate of 'financial stability.' Hiking rates historically has been a tool that can sharply correct frothy valuations, if done for economic and monetary reasons, but is rarely a popular or subtle tool.

Market Notes

Period ending 2/19/2021	1 Week (%)	YTD (%)
DJIA	0.16	3.17
S&P 500	-0.68	4.23
NASDAQ	-1.54	7.75
Russell 2000	-0.98	14.88
MSCI-EAFE	0.27	4.07
MSCI-EM	0.09	10.88
BBgBarc U.S. Aggregate	-0.57	-1.80

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
2/12/2021	0.04	0.11	0.50	1.20	2.01
2/19/2021	0.04	0.11	0.59	1.34	2.14

U.S. stocks were mixed to lower for the week as higher interest rates began to rain on the bullish parade, likely not helped by severe weather nationwide that put a damper on activity. Overall, however, sentiment has remained positive due to continued hope for a Congressional fiscal stimulus package, strong corporate earnings relative to expectations, and continued improvement in getting Covid vaccines distributed. At the same time, some concern remains about specific new Administration policies, such as the timing and magnitude of a minimum wage increase.

By sector, conditions were mixed, with energy and financials leading with gains of several percent each—the former due to commodity price strength and latter from higher interest rates that improve net interest margins. Laggards with negative returns included growth stocks, such as technology, as well as defensive areas health care, consumer staples, and utilities. Real estate also lost some ground along with moves higher in rates.

Foreign stocks behaved similarly to those in the U.S., along with sentiment around Covid, and economic recovery hopes. European earnings have fared better as well, which has put pressure on interest rates—causing these to become 'less negative.' Strength in the U.K. appeared related to an upcoming easing of lockdowns, as virus cases have fallen. Emerging markets were down also last week, with the exception of Turkey, which kept rates steady (at a policy level of 17%), due to some stabilization in currency and inflation metrics.

U.S. bonds fell back as interest rates continued to rise, notably on the long end of the curve. Treasuries outperformed corporates on the investment-grade side, while high yield and senior loans outperformed other groups. The dollar was little changed on the week, but developed market and emerging market bonds lost significant ground.

Commodities rose on the week, with industrial metals gaining sharply, followed by agriculture and energy, while precious metals pulled back. The price of crude oil rose a few dollars mid-week before falling back to just over $59/barrel, resulting in a net decline. The rise in energy prices were partially related to severe weather issues in Texas, whose energy grid is separated from the rest of the nation. Petroleum refiners there are not 'hardened' to extreme cold weather as they are in, say, Alberta, Canada, so the shutdowns over the past week have caused unleaded gas prices to spike. Sources of possible disruptions on the processing, storage, and distribution side often go unappreciated until there's a crisis.

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.