Summary

Economic data for the week included strength in industrial production and housing starts, but offset by weaker retail sales results. Initial jobless claims rose slightly, although the overall rolls continue to improve. The U.S. Federal Reserve kept interest rates on hold (at zero), as expected, but several committee members assumed some tightening by 2022-23.

U.S. equity markets declined last week along with slightly more 'hawkish' Federal Reserve language about future interest rate policy—acknowledging a steady return to normal. Foreign stocks fared a little better in local terms, but were held back by a stronger dollar. Bonds were flattish in the U.S. on net, despite some rate volatility during the week, and outperforming foreign debt. Commodities were down across the board sharply, aside from higher prices for crude oil.

Economic Notes

(-) **Retail sales** for May declined by -1.3% which was deeper than the -0.8% consensus expectation. Removing the more volatile components improved the core/control sales slightly, to -0.7%. In May, declines were focused on the more cyclical groups of building materials, vehicles, and 'miscellaneous,' each of which lost up to -5%; while sales of clothing, restaurants, and health/personal care saw gains. On the other hand, growth for several prior months was revised up by a percent each, which tempered the negative current report. Overall, sales are up 28% on a year-over-year basis (and nearly 20% from pre-Covid levels), which reflects the extremes of widespread closures and reopenings since, as well as the positive influence of economic stimulus. It would be fair to expect this fast pace to eventually taper off somewhat.

(+) **Industrial production** in May rose by 0.8%, surpassing the median forecast by a tenth of a percent, although this was offset by a downward revision for a prior month. As a sub-component, manufacturing production rose 0.9%, led by a 7% rise in autos/parts and 1% in business equipment. However, it appeared that auto gains continued to be held back somewhat by shortages in semiconductor chips. Mining production, which includes petroleum extraction, rose over a percent as well. **Capacity utilization** increased by 0.6% to 75.2% for the month. These indicators also continue to show broader improvement in economic functioning, although hampered in some areas by supply chain disruptions and shortages in goods such as semiconductors (which seems to be improving).

(0/-) The **Empire manufacturing index** for June fell back by -6.9 points to a still-expansionary 17.4, falling short of the expected 22.7. The various components declined in line with the headline number, with new orders, shipments, prices paid, and employment all decelerating from the prior month; however, all continued to expand at a decent pace. Expectations for business conditions six months out improved by over 11 points to an even more expansionary level.

(+) The **Philadelphia Fed manufacturing index** fell by a smaller -0.8 of a point to a still-very expansionary 30.7 reading for June, but just short of the 31.0 expected. The measurements of shipments, employment, and prices paid all increased sizably, further into expansion; on the other hand, new orders fell by -10 points, but continued to expand. Expected business conditions 6-months out rose by 16 points to the highest level in 30 years. Overall, despite some supply-related bumps in a few areas, overall manufacturing sentiment hasn't been better in decades (if measured by manufacturing ISM, literally since late 1983).

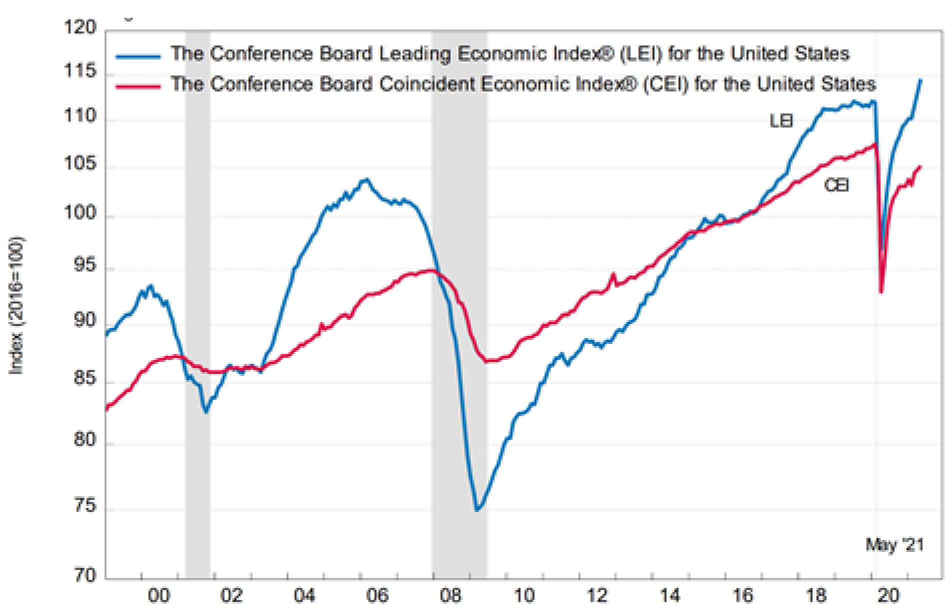
(0/-) The **producer price index** in May increased by another 0.8% on a headline level, and 0.7% for core, removing food and energy. These each exceeded consensus expectations by a few tenths. Both energy and food prices rose 2-3% during the single month. Over the past 12 months, the rate of increase is far more dramatic, up 6.6%—the sharpest rate of increase in at least a decade—while core PPI rose 4.8%. Even more so than CPI, PPI has borne the brunt of supply chain disruptions and raw materials cost increases, which has resulted in the higher annual figure. (Goods PPI is up nearly 11% over the past year.) Any persistent or changing 'transitory' nature of inflation, as expected by the Fed, will likely be seen in PPI first.

(0/-) **Housing starts** in May rose 3.6% to a seasonally-adjusted level of 1.572 mil. units. While it reversed the sharp drop of April, it fell short of the 3.9% increase expected by consensus. Single-family starts gained 4%, while multi-family rose over 2%. Starts rose in the Midwest by 30%, followed by low single-digit gains in the South and Midwest, while those in the Northeast fell by -22%. **Building permits** fell -3.0% for May, which fell far short of the -0.2% expectation. Here, both single-family and multi-family experienced declines, as did every U.S. region, with the Northeast faring worst, down over -7%.

(-) The **NAHB housing market index** for June fell by -2 points to 81, below expectations calling for no change. All three components, present sales, future expectations, and prospective buyer traffic all fell in line with headline. All four regions were negative for the month, led by the Northeast and West.

(+) The Conference Board's Index of **Leading Economic Indicators** rose by 1.3% in May, continuing a string of similar results in recent months. The monthly number was led by positive results for most components, such as jobless claims notably, while building permits and some capital goods were the only negative influences. Over the past six months, the index rose at an annualized 9.9% rate, which fell short of the 19.7% annualized rate of the prior six months (unsurprisingly). The coincident index rose by 0.4% for the month, while the lagging index fell by -2.2% in May.

The leading index has reflected the broader economic recovery over the past year. While the pace of growth has tempered from base effects last spring, overall results point to continued growth ahead with low recession risks.



Source: The Conference Board. Shaded areas indicate recessions, as defined by the NBER.

(-/0) **Initial jobless claims** for the Jun. 12 ending week unexpectedly rose by 37k to 412k, surpassing the assumed consensus decline to 360k. **Continuing claims** for the Jun. 5 week moved 1k higher to 3.518 mil., as opposed to the lower 3.425 mil. reading expected. While changes were minor, initial claims rose in PA, CA, and KY, while MI saw the largest declines. Looking at pandemic emergency programs as well, it appeared that long-term benefits numbers continued to fall by several hundred thousand in late May—pointing to broader business repair.

Market Notes

Period ending 6/18/2021	1 Week (%)	YTD (%)
DJIA	-3.40	9.79
S&P 500	-1.87	11.71
NASDAQ	-0.26	9.21
Russell 2000	-4.17	13.78
MSCI-EAFE	-2.40	8.92
MSCI-EM	-1.45	6.25
BBgBarc U.S. Aggregate	0.11	-1.60

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
6/11/2021	0.03	0.16	0.76	1.47	2.15
6/18/2021	0.05	0.26	0.89	1.45	2.01

U.S. stocks fell back along with the disappointment over the Federal Reserve's 'hawkish' tone mid-week. This was exacerbated by a Fed President later adding that a hike could in fact happen as soon as late 2020. By sector, the 'value' group took the brunt of the damage last week, with financials, materials, and energy all down over -5%. Technology fared best, ending flat, followed by health care and consumer discretionary stocks, which suffered minor declines. Higher-beta small cap stocks were hit far harder than large caps.

How 'hawkish' was the Fed's tone? Only if it were to describe common sense. The FOMC indicated that tapering and eventual rate hikes have a greater likelihood of occurring in 2022 and 2023. Should investors be worried? The tapering of large bond purchases starting in perhaps late 2021/early 2022, along with rate hikes a year later appears perfectly reasonable given the quick recession and recovery of the past year. Markets merely don't want the party to end (a few years from now), although it would be unreasonable for it not to. Thought of this way, if conditions were bad enough a few years from now that a rate hike wasn't advised, we'd likely have more to be concerned about in the economy than a slight tightening of monetary policy (which ironically could result in stress-induced bond-buying and again-lower rates). Bringing rates down to zero has been an emergency measure, used twice in the last 15 years, but should not be thought of as normal operating procedure. The accompanying negative real interest rates don't make economic sense long-term. Eventual higher rates are the 'punishment' for underlying fundamental improvement. (Savers may disagree.)

Foreign stocks behaved slightly better than U.S. markets in local currency terms, with sentiment focused on local Covid recovery conditions and Federal Reserve accommodation, but ended in line with domestic stocks due to a stronger U.S. dollar. (The dollar has tended to fare well when prospects for stronger growth conditions and/or higher interest rates are expected.) The mood was somewhat helped by dovish ECB policy language, in light of continued Covid struggles on the continent. The U.K., in particular, was forced to delay a broader reopening for a few weeks due to the dramatic rise in cases from the new 'Delta' variant, which appears to be more contagious and dangerous. However, inflation in the U.K. rose a bit to 2.1%, above target, but showing that the recovery abroad continues to lag that of the U.S. Emerging markets fared better than developed markets, as minimal declines in China and Brazil outweighed deeper declines in more cyclically-sensitive nations.

U.S. bonds experienced minimal change last week on net, despite an equity drawdown and rate volatility mid-week upon a Fed meeting later described as 'hawkish' toward future policy. The move away from risk favored long-term treasuries, pulling yields down by over 10 bp on the 30-year, which offset the otherwise negative-for-bonds Fed news. Despite more dovish language on monetary policy in Europe to offset the less accommodative language in the U.S., a stronger dollar pushed foreign bond returns negative in both developed and emerging markets.

Commodities generally fell across the board last week, with a stronger dollar being the primary driver. Energy represented the only gaining group, while agriculture and metals declined by over -5% each. The price of crude oil ticked up by a fraction of a percent to above $71/barrel, as expectations for demand continued to tick upward along with increased economic activity.

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, Quandl, 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.

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