Summary

Economic data for the week included strong consumer and producer inflation readings, as well as improvements in retail sales and industrial production. Jobless claims also continued to fall, while consumer confidence waned a bit.

Stocks were mixed globally last week—the U.S. and developed foreign markets lost ground, while emerging markets gained. Bonds fared positively as yields on the treasury curve continued to fall. Commodities were mixed, with crude oil prices pulling back by a few percent, partially offset by ag prices.

Economic Notes

(+) **Retail sales** rose 0.6% in June, surpassing the median forecast calling for a -0.3% pullback. However, the prior month's number was revised down by over a half-percent to a deeper decline, tempering the June improvement somewhat. Removing the more volatile components of autos, gasoline, and building materials, the core/control retail sales measure rose a stronger 1.1%, which was nearly three times the forecasted increase. In the underlying categories, department stores, 'miscellaneous,' electronics, and restaurants all gained several percent during the quarter as consumers continued to pick up activity. On the other hand, furniture, autos/auto parts, and sporting goods fell back by a few percent. With the exception of autos themselves, the declining categories had been the ones that fared well during the pandemic, so a 'normalization' downward isn't be too surprising. Overall, retail sales are up 18% from a year ago, which represents a substantial increase albeit from a very low (or practically zero in some categories) base level.

(+/0) **Industrial production** for June rose by 0.4%, which fell short of the median forecast calling for 0.6%. Manufacturing as a sub-component fell by a tenth, mostly as auto/auto parts production fell by nearly -7% for the month, in addition to business equipment falling over a half-percent. Utilities production, however, rose by nearly 3%, along with hot weather in the U.S. raising air conditioning needs. **Capacity utilization** ticked up by three-tenths of a percent to 75.4%.

(0/-) The **Philadelphia Fed manufacturing index** fell by -8.8 points to a still-strong 21.9, falling short of the 28.0 expected. Under the hood, new orders, shipments, and employment all fell by a few points each, but remained solidly in expansion. This was also true of prices paid, which fell back by 14%, and business conditions six months ahead by a third—although both stayed solidly expansionary.

(+) The **Empire manufacturing index**, on the other hand, shot up by 25.6 points to 43.0, exceeding the 18.0 anticipated by consensus. In contrast to the Philly index, shipments, new orders, and employment all gained solidly—further into expansion. Prices paid, on the other hand, fell back by a few points, but remained positive. Business conditions six months out fell by -8 points, but remained quite expansionary as well. For these regional indexes, any reading over zero represents expansion, as opposed to contraction, with both readings remaining quite high.

(0/-) **Import prices** rose 1.0% in June, which was just a tenth below forecast, and a slower pace than the increase of the prior month. For the single month, petroleum, industrial supplies, and food all gained by several percent to lead the overall index, while capital goods and autos were little changed. When present, import price inflation represents the 'bad' inflation, as it isn't generated as a byproduct of domestic economic growth—merely raising prices for businesses and consumers. For the past year, import prices are up 11% (although, on the other hand, export prices are up 17%, which has been more beneficial for U.S. corporations).

(0) The **producer price index** rose 1.0% in June on both a headline and core level, exceeding expectations of about a half-percent for each (similar to the surprise seen in CPI). Interestingly, the goods and services sub-components came in somewhat similarly (goods at 1.2% and services at 0.8%), in contrast to the goods price

dominance of the past year. This pushed the year-over-year change in PPI to 7.3% for headline and 5.6% for core—both of which are modern records for this series. Core finished goods PPI rose at a more tempered 3.6%, although it's only hit that level two times over the past 30 years. Supply constraints and strong demand recovery continue to drive the underlying data, with crude material prices (ex-food and energy) up 45% from pre-Covid levels.

(-) The **consumer price index** for June rose by 0.9% on both a headline and core level—the fastest pace since the 2008 recovery and twice the monthly rate expected. In fact, the annualized three-month rate is just under 10%, which has caused much of the consternation about inflation 'going out of control' as of late. The monthly strength was led by sharp gains in hotels, airfares, car rentals, and used car prices (all of which were up 3-10% on a single month basis). The anomaly is that used car prices accounted for half of the June core CPI increase (even though its weighting is less than 5% of overall core CPI), although recent week car auction prices appear to have fallen back, as was eventually expected.

Year-over-year, headline and core CPI are up 5.4% and 4.5%, respectively. The underlying components, however, remain quite mixed. Energy commodities are up nearly 45% over the trailing year, due to a recovery in crude oil prices from negative levels up beyond $75/barrel, with commodities 'less food and energy' are up a still-high 9%. Used cars are up an equally-dramatic 45%, followed by airline fares up 25%. These prices are naturally skewed by the off-on dynamic of the starting and ending points of the past pandemic year. On the other hand, food prices are up only 2%, and shelter up 3%. Medical costs are also lower, due to a postponement of consumer procedures and treatments over the Covid lockdown period.

The consensus views of more and more economists is that recent inflation is indeed 'transitory,' with supply bottlenecks and demand disruptions/rebounds to abate in the coming quarters. However, there are economists that disagree, with a view that higher secular inflation is more deeply entrenched, as in what the U.S. faced in the 1960's following massive Federal spending in LBJ's Great Society programs and the Vietnam War. Of course, this was eventually coupled with the geopolitical event of the oil embargo of the early 1970s. How long the current inflation situation takes to unwind is debatable, with the demand portion still dependent a bit on how much of accumulated consumer savings is spent on goods/services as opposed to being hoarded.

(-) The preliminary July **Univ. of Michigan index of consumer sentiment** fell by -4.7 points to 80.8, compared to a slight increase to 86.5 expected by consensus. Consumer assessments of current economic conditions as well as future expectations both declined by similar degrees, with the latter falling a bit more. Median inflation expectations for the coming year rose by 0.6% to 4.8% (basically on par with current CPI readings, but the highest in 13 years), while those for the next 5-10 years ticked only a tenth higher to 2.9%. Long-term inflation expectations remain relatively contained compared to current readings, but do remain a percent or so higher than the Federal Reserve target. This has been largely in line with tendencies over the past decade.

(+) **Initial jobless claims** for the Jul. 10 ending week fell by -26k to 360k, but remained higher than the 350k level expected by consensus. **Continuing claims** for the Jul. 3 week fell by -126k to 3.241 mil., below the 3.300 mil. expected. Initial claims fell by the largest amounts in MI and NY, but the array of gains and losses were mixed by state, and relatively minor. The total rolls, including emergency government benefits and extensions, saw further estimated decrease of -300k to just over 8 mil. in the period ending late June. These figures continue to show steady but strong improvement.

Market Notes

Period ending 7/16/2021	1 Week (%)	YTD (%)
DJIA	-0.52	14.45
S&P 500	-0.96	16.12
NASDAQ	-1.87	12.33
Russell 2000	-5.11	10.07
MSCI-EAFE	-0.46	8.76
MSCI-EM	1.72	4.99
BBgBarc U.S. Aggregate	0.24	-0.94

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
7/9/2021	0.06	0.23	0.79	1.37	1.99
7/16/2021	0.05	0.25	0.79	1.31	1.93

U.S. stocks fell back on the week, with broader markets down a percent, but small caps down over -5%, with investor movements away from risk. On the positive side, earnings results for Q2, primarily for the initial bank group last week have been exceeding expectations. However, concerns about increasing Covid Delta variant infections may be weighing on the recently benign sentiment. By sector, defensive utilities and consumer staples fared best, with positive returns. On the other hand, energy stocks fell back by over -7%. Real estate fared positively, led by the more defensive apartment and health care sectors.

Interestingly, stronger stock prices on Friday experienced a minor reversal, following the positive retail sales report. We mention this as another example of the 'good news is bad news' theme that has started to increasingly surface lately—it stems from a concern that too many good numbers will cause the Fed to take their taper talk more seriously sooner than expected (before year-end).

Fed chair Powell testified before Congress, and markets were closely listening to his comments regarding inflation. He continued to stay the course on the theme of inflation being 'transitory,' as well as ongoing repair still needed in the labor market. This type of accommodative language pleases markets, which hope for the simple answer of low interest rates forever (if possible). Of course, this has started to generate more criticism from some economists who believe that while extreme measures were necessary during the pandemic, the inevitable normalization to a higher-rate reality could keep current inflation (for asset prices as much as goods prices) going at an unsustainable pace. In hindsight, the Greenspan Fed of the 1990s is seen as prioritizing asset prices in this way, which led to some of the excesses of the late decade prior to the 2001 bear market. Also, it could be argued as being a byproduct of very large fiscal spending packages (leading to large M2 bank balances), with investors seeking returns anywhere but 0.01% returns in cash—translating to increasingly negative real returns on a compounded basis.

Foreign stocks fared better than U.S. in local terms, but a stronger dollar brought them largely in line. In Europe, Covid recovery conditions were split between wide reopenings in the U.K., while France and the Netherlands imposed further restrictions as Delta variant cases continue to spread. Emerging markets bucked developed market trends with positive returns, particularly in Brazil, China, and India.

U.S. bonds gained last week, as interest rates continued to tick down across the yield curve. Treasuries and investment-grade credit performed similarly, both beating out high yield and floating rate bank loans. Due to the headwind of a weaker dollar, foreign bonds in both developed and emerging markets were little changed, offsetting slightly lower yields.

Commodities were flattish on the week with falling energy prices were offset by strength in agriculture (primarily in wheat, due to crop shortages). Crude oil prices fell back by over -3% to close just above $71.50, representing the worst week since March, as expectations of additional supply weigh on the global market following an OPEC+ deal between Saudi Arabia and UAE.

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.