Summary

Economic data for the week included a surprise higher for consumer inflation, with the strongest monthly report in decades, along with strong readings for producer price inflation and import prices. Industrial production also came in positively, while retail sales and consumer sentiment fell back a bit from a stronger prior months.

Equity markets experienced higher volatility last week as early fears of inflation were eventually replaced by optimism over the CDC's looser recommendations about mask-wearing. Bonds fell back as higher long-term rates again pulled prices lower. Commodities were mixed, with gains in energy and declines in industrial metals and agriculture.

Economic Notes

(-) Following a strong rise in March, **retail sales** stagnated in April, coming in unchanged, underperforming the median forecast of 1.0% expected. However, March's results were revised upward by 0.7%, assisted by government stimulus spending. On a core/control basis, removing the more volatile sectors, retail sales actually declined -1.5%, which was a further drop than the -0.2% decline expected. The report was mixed by component, driven by declines of about -5% each for clothing, general merchandise, and sporting goods. On the other hand, sales of cars and restaurant meals rose by several percent each. The more dramatic end of the report is that retail sales overall are up 40% from a year ago on both a headline and core basis, with restaurants/bars being a major factor in holding back results from even stronger growth.

(0/+) **Industrial production** in April rose by 0.7%, a deceleration from March when an upward revision was included, but just two-tenths below the consensus market forecast. Manufacturing production rose nearly a half-percent, which was held back by a -6% in autos due to semiconductor supply bottlenecks. Gains, however, were seen in business equipment, utilities, and mining (including oil extraction). **Capacity utilization** rose by 0.5% to a rate of 74.9%. This release is an example of the back-and-forth between the economy getting back online, but hampered a bit by logistical supply constraints that have elevated price inflation for certain goods. Regardless, over the past year, auto production has rebounded by several hundred percent, while other groups are 17% higher, as shutdown base effects from March 2020 were obviously dramatic to the downside.

(-) The **consumer price index** in April rose a sharp 0.8% on a headline basis, and 0.9% on a core level—higher than consensus expectations. The headline number was the largest since mid-2009, coupled with energy price volatility, while the core CPI number was the highest single month reading since 1981. As has been the case many times over the past year, the index has been driven somewhat by Covid-affected groups and 'one-offs,' such as higher prices for non-energy commodities (such as metals and grain) as well as used cars (up 10% in the month alone, contributing a third of the core figure, and over 20% for the past year). Energy commodity prices actually fell back by over a percent in April. The year-over-year inflation numbers accelerated to 4.2% and 3.0% for headline, and core respectively.

This release was clear indication of the price increases markets have been expecting (and fearing, in some circles). However, it's important to note the wide dispersion of the various sub-categories, with energy commodities up nearly 50% year-over-year (as crude oil plummeted and then sharply rebounded), followed by a 21% gain in used car prices (related to lack of new car manufacturing during early Covid lockdowns, as well as shortages in the semiconductor space). Other areas such as shelter, medical care services, apparel, and food gained only around 2% for the trailing 12 months—near average. The consensus view among economists echoes that of the Fed, in that the recent spike in inflation is 'transitory,' reflecting low base effects from Spring 2020 and a recent reacceleration in the economy. The next several quarters will provide more color on this theory one way or the other, with the immense amount of fiscal stimulus injected into the economy a potential catalyst for higher prices, while longer-term demographic and productivity trends fall on the side of less robust economic growth and inflation in coming years.

In recent corporate earnings call comments, it appears the consensus is mixed, with some firms electing to pass on pricing pressure to customers in the form of higher prices, while others are taking a 'wait and see' approach, assuming the higher costs will be transitory. This has been particularly noteworthy in the areas of industrial raw materials, which relate to higher commodity costs in recent months.

(-) Similarly, the April **producer price index** increased by 0.6%, which exceeded expectations calling for 0.3%. PPI ex-food and energy rose an even stronger 0.7%, which reflected an over-2% increase in food prices that offset a decline in the price of energy. Other areas of strength included sectors of Covid recovery, including air transport and car rentals, which rose in the mid-single digits for the month. Year-over-year, headline final demand PPI increased by 6.2%, which includes an extreme decline in April 2020 that heightened the 'base effect' of the recovery, although the annualized rate for the past six months exceeded 7%. Core PPI is up an also solid 4.1% on a year-over-year basis.

(-) **Import prices** rose 0.7% in April, in keeping with other inflation indicators. The index was driven by a 1% gain in petroleum prices, and 2% each for food and industrial supplies. Lesser gains were seen in cars and capital goods, while remaining consumer goods saw no change—bringing down the overall index.

(-) The preliminary **Univ. of Michigan index of consumer sentiment** for May fell by -5.5 points to 82.8, in the opposite direction of the median forecast calling for improvement to 90.0. Consumer assessments of both current conditions and future expectations fell to a similar degree (perhaps related to inflation fears). Inflation expectations for the coming year rose sharply, by 1.2% to 4.6%, while those for the next 5-10 years rose by 0.4% to 3.1%—the highest expectation in a decade.

(+) The **JOLTs** government job openings report showed a strong increase of 597k (about 8%) to 8.123 mil. in March, in addition to upward revisions in February; this outperformed the 7.500 mil. expected. By segment, leisure jobs represented 45% of those added, while manufacturing, construction, and government jobs also rose sharply. The job openings rate rose by 0.3% to 5.3%, along with a 0.2% gain in the hiring rate to 4.2%. Quits were unchanged at a rate of 2.4% (better than pre-Covid levels), while layoffs fell -0.2% to 1.0%. These point to increased employer demand for workers, seen in other releases, and seasonal/timing issues.

Theories continue to bounce around the economic community about the April jobs report, since rarely do estimates come in as off the mark as that one did. The discussion has largely revolved around seasonal effects, incentives to stay home because of generous unemployment benefits, and a mismatch between employer needs and worker skills. Others have proposed that continued school closures have affected the ability to re-enter the workforce—particularly for women, who have been hit especially hard in the labor market during the pandemic.

(+) **Initial jobless claims** for the May 8 ending week fell by -34k to 473k, below the 490k expected by consensus. **Continuing claims** for the May 1 week also fell, by -45k, to 3.655 mil., but just above the 3.600 mil. expected. The initial claims figure was led by sharp decline in MI, while several other states were mixed—either up or down by +/- around 5k. It continues to appear that improvement is occurring, albeit slowly. However, the broader measure of claims, which includes emergency programs and other assistance, saw an increase of several hundred thousand for week ending Apr. 24—a lag on current data.

Market Notes

Period ending 5/14/2021	1 Week (%)	YTD (%)
DJIA	-1.08	13.09
S&P 500	-1.35	11.73
NASDAQ	-2.32	4.46
Russell 2000	-2.04	13.01
MSCI-EAFE	-1.29	7.94
MSCI-EM	-3.00	1.79
BBgBarc U.S. Aggregate	-0.37	-2.70

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
5/7/2021	0.02	0.14	0.77	1.60	2.28
5/14/2021	0.01	0.16	0.82	1.63	2.35

A back-and-forth week for equities ended with net returns ending up negative. Wednesday saw markets down 2-3%, the worst single day in month, as the morning's CPI report came in high, spooking some investors. The year-over year, as noted above, wasn't that far from expectations. However, Thursday and Friday featured sharp rebounds, seemingly powered by new CDC guidelines allowing for masks to be put away for vaccinated individuals. Although not a tangible economic event, the surprise action seemed to improve the overall mood and potentially further accelerate reopening activity. A restart of the Colonial Pipeline helped as well, easing extreme gasoline supply pressures in the East and Southeast, with hopes of stronger government prioritization of cyber threats.

Sector results were led by financials and consumer staples outperforming with minor gains, while consumer discretionary stocks fell by nearly -4%. The latter was mostly due to a pullback in Tesla, now the second-largest member of the sector (behind Amazon), as it was announced that the firm would no longer accept Bitcoin for payment, despite earlier announced large corporate holdings in the currency. Technology and communications stocks each fell over a percent as well. Real estate also suffered negative returns, pressured by higher interest rates in the past week; this is despite a stronger long-term positive relationship between real property and inflation.

The performance differential between the S&P 500 and Nasdaq had become far more apparent in recent weeks, as the latter was down -2.5% early in the week as the more expensive tech names fell back. Over the past month, the Nasdaq 'growth' group is nearly in correction territory, with investor preferences moving to more cyclical 'value' names, particularly in financials and energy/materials, with post-Covid reopening themes continuing. Earnings estimates for 2021 continue to be revised upwards, which seems to be letting stocks 'grow into' their relatively multiples a bit—not an uncommon tendency in recoveries.

Foreign stocks were mixed compared to the U.S. last week, with minimal losses on net for Europe and the U.K., while Japan and the emerging markets each declined by several percent last week. A stronger British pound resulted from status quo election results, as well as better-than-expected economic growth being reported. Overall, continued pandemic concerns appear more pervasive abroad, with largely lower vaccination rates so far, and fears that higher U.S. inflation will carry globally.

U.S. bonds declined on the week as longer-term interest rates ticked higher upon investors' broadening inflation fears after the week's surprisingly strong CPI report. Floating rate bank loans fared better than traditional debt, benefitting from higher yields. Despite a little-changed U.S. dollar, developed market government bonds fell sharply as rates ticked higher overseas as well.

Commodities generally lost ground on net, with major declines in agriculture and a modest drop in industrial metals offsetting small gains in energy and precious metals. Corn and wheat contracts in particular fell sharply, as speculators pared back positions upon news of logistical issues in grain markets. The price of crude oil bounced around for several days before ending almost a percent higher, over $65/barrel. Over the prior weekend, the Colonial Pipeline, serving the east coast, suffered a ransomware attack, shutting down operations and requiring contingency plans for fuel delivery, but not enough to stem shortages. This may be used as additional reason to beef up America's hard infrastructure, which has increasingly been seen as vulnerable to such attacks.

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.

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