Summary

Economic data for the week included declines but still-strong readings for key regional manufacturing indexes, and a pullback in home sales and starts, while jobless claims improved and the index of leading economic indicators continue to show strength.

U.S. equity markets declined last week, and underperformed gains in foreign markets along with improved sentiment for the future. Bonds were little changed, along with minimal change in the yield curve. Commodities were mixed, with most falling into the negative, including lower oil and metals prices.

Economic Notes

(+/0) The **Empire manufacturing index** for May fell by -2.0 points to a still-expansionary 24.3, but still exceeded consensus estimates calling for 23.9. Under the hood, fundamentals remained robust, with the important shipments and new orders components improving to an even faster pace during the month, while employment fell back slightly (but remained well in expansion). Prices paid rose almost 10 points to a new all-time high, reflecting recent supply constraints and associated industrial input cost pressures.

(0) The **Philadelphia Fed manufacturing index** also fell in May, by -18.7 points, but remained at an expansionary level of 31.5 (but short of the 41.5 reading expected). By sub-component, shipments, new orders, and employment all fell to lesser degrees than the headline index, and stayed solidly in expansion. Prices paid continued to expand to an even further degree—to the highest level in 40 years. Expectations for business conditions over the next six months fell by nearly -15 points, but remained solidly expansionary, pointing to overall continued optimism.

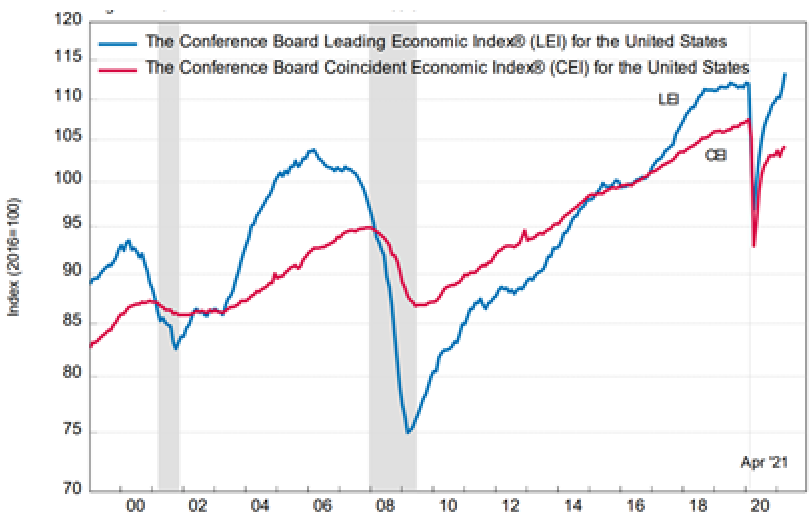
(-) **Existing home sales** for April fell by -2.7% to a seasonally-adjusted level of 5.85 mil. units, which fell below the 1.0% increase expected. This was driven by a -3% drop in single-family units, as condos/co-ops rose by 1% for the month. Regionally, the Midwest saw a small gain of just under a percent for the month, while the other three regions saw declines of between -3% and -4%. The median existing home sales price is up nearly 20% from a year ago to $341,600. Per comments from the NAR, it continues to be fairly obvious that a lack of inventory of available homes has contributed to weaker-than-expected sales numbers, considering the high demand that's been pushing up prices. This is evidenced by the months' supply figure remaining at an extremely low number of 2.4 (although a few tenths higher than in March).

(-) **Housing starts** fell by -9.5% in April to a seasonally-adjusted rate of 1.569 mil., further than a lesser drop of -2.0% expected by consensus. By segment, multi-family starts rose by 1%, but was overwhelmed by the single-family group down -13%. Regionally, the West and Northeast saw increases in the 5-10% range for the month, while the Midwest and South suffered double-digit declines. **Building permits**, on the other hand, rose 0.3% for the month, but this was a much slower pace than the prior month, and only half the 0.6% growth expected. Multi-family fared better here as well, up 9%, which offset a -4% drop in single-family. By region, the Northeast and South gained, while the Midwest and West experienced declines in permits. Overall, starts are not rising fast enough to keep up with housing demand, especially with labor and materials bottlenecks, but are up 20% over the pre-Covid period.

(0/+) The **NAHB housing market index** was flat in May, but remained at a high level of 83, as expected. The current sales measure was unchanged, future sales gained a point, while prospective buyer traffic fell by a point. Regionally, the South saw a gain of a few points, while both the Northeast and Midwest declined by several points for the month. Interestingly, it appears that some builders have purposefully tamped down building and sales activity due to supply shortages and far stronger prices over the past year (over 10% for some materials).

(+) The Confidence Board's Index of **Leading Economic Indicators** for April increased by 1.6%, surpassing the pace of March's 1.3% rise and surpassing the index's prior peak before the pandemic. The monthly numbers were led by positive contributions from most areas—mostly jobless claims, stock prices, and ISM new orders, although manufacturing hours and manufacturing non-defense non-aircraft new orders were unchanged.

The coincident index rose by 0.3%, while the lagging index gained 1.8%. Over the past six months, the leading economic indicator increased at a 9.6% annualized rate, which lagged the dramatic 24.9% annualized gain of the prior six months, which was heavily affected by base effects beginning in April 2020 at the depth of shutdowns. From the chart below, the most notable takeaway appears to be the rapid 'V-shaped' bounceback from the lows in early 2020. Naturally, the return to former levels is a double-edged sword, as future growth beyond this point could be more muted.



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

(0) **Initial jobless claims** for the May 15 ending week fell by -34k to 444k, below the 450k expected and their lowest level in the pandemic recovery so far. **Continuing claims** for the May 8 week, however, rose by 111k to 3.751 mil., exceeding the drop to 3.620 mil. forecast by consensus. It appeared that initial claims fell the greatest in the South (GA/KY/TX), while NJ saw the largest rise in claims. Looking at the wider measure of longer-term pandemic emergency benefits, it appears that levels have continued to decrease in early May, at an increasingly faster pace as the economy reopens.

(0) The **FOMC minutes** from the April meeting noted that a number of committee participants felt that preliminary 'taper' discussions could be appropriate at upcoming meetings. This would include the beginning of a wind-down in Treasury and agency mortgage bond purchases. However, as the meeting took place before the disappointing April jobs report, that could have been premature. The group's assessments of the economy generally improved a bit, although the supply bottlenecks in some sectors were noted as a risk to the recovery's pace and breadth. The Fed's attitude toward tolerating higher inflation for a time (and expectations that it really is 'transitory') also appeared to be discussed in light of risks of an overshoot to 'unwelcome' levels. Increased investor risk-taking was also described as 'elevated' (notably in housing, business debt, hedge funds/leveraged investors, as well as a reaching for yield in financial markets), although they didn't appear overly concerned presently.

As always, markets seem to desire some inflation (but not too much, just the slightly elevated kind that accompanies strong growth), repairing labor markets as that helps consumer buying power (but not too strong, as that would tell the Fed it's time to taper). Inflation breakevens, which represent the broader market's view on forward-looking inflation, have continued to rise over the past year from the Fed's 2% official target up to the 2.5-3.0% range. Despite the intense watching of these numbers, the differential is still small from a historical perspective.

Market Notes

Period ending 5/21/2021	1 Week (%)	YTD (%)
DJIA	-0.43	12.61
S&P 500	-0.39	11.29
NASDAQ	0.33	4.81
Russell 2000	-0.41	12.55
MSCI-EAFE	1.06	9.08
MSCI-EM	1.74	3.56
BBgBarc U.S. Aggregate	0.07	-2.63

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
5/14/2021	0.01	0.16	0.82	1.63	2.35
5/21/2021	0.01	0.17	0.84	1.63	2.33

U.S. stocks were down on net, with concerns over inflation mixing in with positive news about stronger economic data and vaccine-fueled reopenings. Early in the week, Treasury Secretary Yellen's comments in favor of higher taxes and unions seemed to not please market sentiment, nor did Fed minutes discussing the idea of a 'taper,' while a pared-back infrastructure bill revision may have helped. The defensive group of utilities, health care, and consumer staples were the only sectors in the positive, in addition to a strong week for real estate. Energy, materials, and industrials fared worst, with declines well over a percent.

We're reluctant to mention bitcoin, but the price has fallen over -50% from an April high of $65,000, before rebounding 40% within hours. The unfolding of this could have added to equity market volatility, and again shows the unique nature of cryptocurrency markets (a volatile store of value of there was one). Other than Elon Musk's comments, the announcement about the Chinese government further restricting its use as a payment mechanism, as well as additional official reviews from other governments, have put a damper on the excitement as the outcomes become more bimodal.

Aside from ongoing fears of persistence in inflation, another market worry that appears to be taking up space is the growing possibility of corporate tax hikes. The 21% rate cut from 2017 is under threat, with consensus new rate of the 25-28% range (assuming that initial Democratic targets are lowered to garner broader support). While a net negative, it would still be far below the 35% top rate from pre-2017 period. And, as is the case of personal income tax rates, the top rate is just that—the average tax rate paid is far lower. Nevertheless, such legislation would trim earnings expectations for 2022 and beyond.

Foreign stocks gained mostly across the board, aside from the U.K., with Japan in the lead, followed by emerging markets. In Europe and other areas, slowing infection rates and an increased pace of reopenings continued to lead investor sentiment. This was evidenced by strong PMI figures in Europe and Japan, showing improved expansion in conditions. While emerging markets are still with large challenges from Covid infections and being far behind in vaccinations, compelling valuations a stronger cyclical tilt when conditions do improve remain in positive points in favor of non-U.S. equities.

U.S. bonds were little changed to slightly higher by a few basis points, as interest rates were steady across the yield curve. So, therefore, very little to report in terms of price change. A slightly weaker dollar helped developed market foreign bonds, which gained almost a half-percent for the week, while emerging market bonds fell back slightly.

Commodities lost ground on net, despite the normally positive influence of a weaker dollar. Declines in energy, agriculture, and industrial metals of up to several percent were offset by a rise in precious metals of nearly 2%. The price of crude oil declined by nearly -3% to around $63.50/barrel, as some supply concerns abated—mostly due to apparent progress on a renewed U.S.-Iran nuclear deal, which would bring more future oil supply to market.

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.