Summary

On a Memorial-Day shortened week, economic data included strong results for manufacturing and services indexes. Employment numbers were mixed, as jobless claims improved, as did the employment situation report number, although the latter fell short of market expectations.

Global equity markets earned positive returns last week, with stronger economic data coupled with eased worries about the duration of continued government policy support. U.S. bonds gained slightly as interest rates pulled back after a lackluster jobs data. Commodities continued to gain ground, largely due to higher oil and natural gas prices last week.

Economic Notes

(+) The **ISM manufacturing index** for May rose by another 0.5 of a point to 61.2, exceeding consensus forecasts calling for 61.0. Under the hood, new orders and supplier deliveries gained several points, while production and employment each fell by a few points—with all remaining solidly in expansion. Prices paid fell back by a few points, but remained near historic highs. Based on this metric, the trend of manufacturing strength upon economic reopenings continues.

(+) The **ISM non-manufacturing/services index** for May rose another 1.3 points to 64.0, beating expectations of 63.2. This continues to show accelerating growth, and was an all-time record for the series. Business activity and new orders both rose to even stronger expansionary levels, as did supplier deliveries and export orders. However, the employment metric fell by several points, but remained at an expansionary level of over 55. Prices paid also rose another 4 points to over 80—another 15-year high. This continues to show strong recovery on the services side as conditions steadily benefit from business reopenings, as well as increased leisure and travel activity.

(0) **Construction spending** in April rose 0.2%, which fell below the median forecast of 0.5%, in addition to an upward revision for the prior month. The details included a percent gain in private residential spending, in keeping with recent housing trends and demand, while private non-residential as well as all public construction spending declined for the month.

(+) The **ADP private employment report** saw a strong increase of 978k, which exceeded expectations calling for 650k. However, the April report was revised down by -88k (about 12% of the original figure). Services accounted for 850k of the new jobs, over half of which were in leisure/hospitality, as expected. Goods-producing jobs amounted to 128k, with about half of those originating from construction.

(+/0) **Initial jobless claims** for the May 29 ending week fell by another -20k to 385k, just below the median forecast calling for 387k. **Continuing claims** for the May 22 week, on the other hand, rose by 169k to 3.771 mil., above the consensus estimate calling for 3.614 mil. Initial claims results were mixed, with few large readings from individual states, but continue a downward trend as restrictions ease and reopenings progress. Looking at estimates of full claims programs, including emergency extensions, the rolls continue to fall but remain over 9 million. There appears to be a general political line at 70% or so of adult vaccinations for 'full' reopenings in many states, which could enhance capacity for establishments and ramp up workforce needs. Some states are closer to this goal than others.

(0) The employment situation report for May showed improvement from the poor April numbers, but again disappointed versus market expectations. The supply of available labor seemed to be a constraint for the time being, which should rectify with time. Markets were higher upon the lackluster numbers, presumably as the 'weakness' extends the rationale for the Fed keeping accommodative policy intact. This seems to be another period of 'bad' news is 'good' news, which we've seen before during periods of Fed policy transition.

Nonfarm payrolls rose by 559k, which disappointed compared to the 675k expected. By sector, leisure/hospitality jobs rose by 292k, two-thirds of which were in bars/restaurants, along with eased restrictions nationwide. While better, leisure sector remains down -15% from levels pre-pandemic in Feb. 2020 (this amounts to about 2.5 mil. jobs, according to the BLS). In other areas, education saw a boost in private/state/local employment by 144k, but also remains well short of pre-Covid levels. Other areas of improvement included healthcare, information, professional services, and manufacturing. Construction was one of the sole decliners for month, notably in specialty trades.

The **unemployment rate** fell by -0.3% to 5.8%, which was a tenth better than expectations, with the household employment survey showing a gain of 444k jobs. The U-6 measure of underemployment also fell, by -0.2% to 10.4%.

Average hourly earnings rose 0.5% in May, which surpassed the 0.2% expected. This brought the year-over-year change to 2.0%, although up over 6% compared to pre-Covid as the share of workers in certain industries has become scarcer. **Average weekly hours** were unchanged at 34.9.

Earlier in the week, nonfarm **productivity** for Q1 was unchanged at an annualized rate of 5.4%, largely as expected, with the year-over-year change coming in at also 4.1%. Unit labor costs were revised up sharply to 1.7% on an annualized quarter-over-quarter basis for Q1, bringing the annualized figure to 8.3%. These results are obviously still heavily affected by the March-to-March extreme base effect.

Question of the Week

What seems to be going on with labor market data, at least in terms of its underperformance compared to expectations?

Both private economists and public officials have shared a variety of opinions about remaining issues weighing on the jobs recovery. The arguments seem to be focused on a few key areas. Some are easier to rectify in the short term than others.

(1) Continued Covid-based concerns over either workplace environments or potential exposure to household members not yet vaccinated (like children) or are otherwise still vulnerable. These worries have seemed to wane as total vaccinations rise and mask/distancing/capacity requirements are unwound, but vaccine momentum has plateaued a bit.
(2) Caretaking responsibilities of elderly adults and/or children not yet having returned to physical school. (This has had a detrimental effect on women in the workforce, particularly those not able to work remotely.)
(3) Generous government unemployment benefit extensions that, in some cases, provide income larger than expected wages from work. This has led to about half of U.S. states to start cutting back those additional benefits as reopenings ramp up, with the broader extensions ending in Sept.
(4) Difficulty in employers finding the right workers for the right jobs. This is an extension of the long-standing 'skills mismatch,' which has especially affected higher-skill areas in construction and manufacturing. While partially related to Covid disruptions, there are other longer-term factors at play, including geographic mobility, and a demographic cliff of retirements occurring in skilled trades. Efforts to improve trade school enrollment and other job training programs are longer-term initiatives, but can't help a lot in the near-term. Politically, these gaps between labor demand and supply, as well as relative worker bargaining power, have translated to calls in some camps for higher minimum wages, paid community college, better healthcare/leave benefits, etc. The rebuttals to these policies are the high costs and uncertain end benefits to the economy.

Despite the speed of the Covid disruption and recovery cycle over the past year already, the depth of the recession has exposed a few already-existent gaps in the economy—particularly in jobs markets. With labor being one of the Federal Reserve's two mandates, and conditions still in transition, it appears it may be the key policy driver for the next several meetings at least.

Market Notes

Period ending 6/4/2021	1 Week (%)	YTD (%)
DJIA	0.69	14.55
S&P 500	0.64	13.55
NASDAQ	0.49	7.51
Russell 2000	0.78	16.20
MSCI-EAFE	0.73	11.22
MSCI-EM	1.59	7.72
BBgBarc U.S. Aggregate	0.12	-2.17

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
5/28/2021	0.01	0.14	0.79	1.58	2.26
6/4/2021	0.02	0.14	0.78	1.56	2.24

U.S. stocks gained in a lighter-volume holiday week. By sector, energy led all others by rising nearly 7%, in keeping with another weekly spike in crude oil prices. Real estate also fared well, gaining over 3% on the week, as interest rates continued to stay contained and ongoing removal of Covid restrictions gaining steam around the country—the latter boding well for the maligned retail and lodging sectors. Consumer discretionary and healthcare lagged last week, with declines of over a percent each; the former was due to negative results from several companies, primarily large index constituent Tesla.

Meme stocks have again been a focus of the headlines recently, with AMC Entertainment with a gain of 200% over the past week (and 3600% year-to-date). The company did make the somewhat savvy move of issuing additional shares at these recently-inflated prices, which ironically improved the company's capital position. In some embracing of its newer hip investor base, management rewarded its shareholders with special movie screenings and free popcorn.

Foreign stocks fared slightly better than domestic, with strength in Japan, while Europe fared similar to U.S. large cap markets. As in the U.S., gradually improving economic conditions are weighed against the timeframe and level of government monetary and fiscal stimulus. In the U.K., concerns over virus variants have put a cloud on upcoming further openings somewhat. Emerging markets outperformed other groups, with leadership from Brazil and Russia—both commodity producers.

U.S. bonds fared positively, as interest rates continued to moderate, notably with several Fed officials noting the continued slack in the economy and labor markets (seen by Friday's weaker-than-expected employment situation report). This has to lessened fears of an earlier Fed tightening cycle. Credit spreads also declined, which contributed to the outperformance of corporates over treasuries. The Fed also announced that the Secondary Market Corporate Credit Facility (including the controversial purchase of ETFs) would be would down by year-end. Foreign developed market debt was flattish on the week, while emerging market bonds gained in both USD- and especially in locally-denominated terms as investors sought risk and higher yields generally.

Commodities continued their upward momentum last week, with gains in energy and agriculture offsetting minor declines in industrial and precious metals. The price of crude oil rose 5% to nearly $70/barrel, as higher expected demand this summer and tighter near-term supplies in the U.S. have outweighed expanded OPEC production goals and continued speculation about bringing Iranian output back online.

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.