Summary

Economic data for the week included a slight drop in manufacturing, offset by continued strength in services. The July employment situation report came in stronger than expected, on both job creation and a lower unemployment rate.

Global equity markets saw gains across the board, although emerging markets were held back a bit by China. Bonds fell back as interest rates moved higher. Commodities fell back, largely due to a sharp correction in crude oil prices based on demand fears.

Economic Notes

(+) The **ISM manufacturing index** for July declined by -1.1 points in July to 59.5, falling below the 61.0 expected by consensus, but remaining solidly expansionary with all but one of the eighteen industry groups showing growth. Under the hood, the employment measure gained several points, back into expansion from a contractionary dip last month. On the other hand, new orders, production, supplier deliveries, and prices paid all fell by a few points, but remained solidly expansionary. Inventories also remain very low, which has been reported for many months, but has served to depress activity (as a company can't sell what it can't make, even if demand is there). Although there's been some deceleration, manufacturing has continued to show a generally sharp recovery since lows. However, forward progress could be more muted.

(+) The **ISM services/non-manufacturing index** rose by 4.0 points to 64.1 in July, beating expectations calling a far smaller increase to 60.1, and representing a new all-time high (albeit only going back 25 years). Under the hood, business activity, new orders, employment, and supplier deliveries all increased further into expansionary territory. Prices paid also rose several points to a very high level of 82, representing the impact of recent cost inflation. Services, which represents two-thirds of the U.S. economy, continues to look strong, and strengthening, based on this confidence measure. At the same time, some anecdotal commentary that accompanied the report noted the well-known negatives of rising cost inputs, supply issues, and difficulty in finding enough workers.

(0) **Construction spending** for June rose 0.1%, but fell short of the consensus forecast calling for 0.4%. Residential spending rose on both the private and public side, but about a percent each; non-residential spending fell about an equivalent amount for both groups.

(0/+) **Initial jobless claims** for the Jul. 31 ending week fell by -14k to 385k, which was just 2k above median expectations. **Continuing claims** for the Jul. 24 week fell by a far more dramatic -366k to 2.930 mil., well below the median forecast calling for 3.255 mil. Initial claims were mixed by state, with minor increases offset by a variety of decrease, with no general trend for the week. However, a decline of over -250k in Calif. explained the bulk of the continuing claims figure. Overall, also considering the extended benefit programs nationwide, the mid-July claims figures were slightly improved, to about 7.8 mil.

(0) The **ADP private employment report** showed an increase of 330k jobs in July, representing very strong growth in the context of all months of the past decade. However, it fell substantially short of the prior month and the 690k level expected. Services jobs, as usual, took up the bulk of activity, rising by 318k—nearly half of these jobs were in the recovering leisure/hospitality industry, although down sharply from prior months. Goods-producing jobs accounted for 12k. Overall, good-producing jobs, such as construction and manufacturing appear to be nearly back to their late 2019 pre-Covid levels. This report represented a bit of a disappointment, but the correlation between this measure and the government payroll number a few days later isn't always high, due to different statistical inputs and industries covered.

(+) The July employment situation report on Friday came in stronger than expectations on several fronts, and continued to point to labor market repair. Most importantly, the jobs market strength may push the Fed into an earlier 'taper' announcement, although that still isn't expected to occur until later in the year.

Nonfarm payrolls rose by 943k, which was similar to the pace of June's increase, and included revisions higher for the two prior months (by 120k total). This exceeded the consensus forecast calling for 870k. Areas of strength in July included leisure/hospitality (380k, two-thirds of which was restaurants), education (261k), and professional/business services (60k). Manufacturing and construction also saw job increases; however, retail experienced a minor decline.

The **unemployment rate** declined by a significant -0.5% to 5.4%, which was further than the slight improvement of -0.3% expected. This represents a strong recovery from peak levels from last year, but remains above the 3.5% trough from Feb. 2020, pre-Covid. The U-6 underemployment measure improved similarly, by -0.6%, to 9.2%, as the number of part-time workers declined. Generally, the number of workers reported as being on temporary layoff continued to decline sharply—at the best rate in nearly a year.

Average weekly earnings rose by 0.4% to $30.54, which included notable gains in the leisure/hospitality sector, and beat expectations by a tenth. This took the year-over-year rate to 4.0%, with slightly higher pace reported for production workers, experiencing a more volatile year than management employees. The **average workweek length** was unchanged at 34.8 hours.

Question of the Week

What's been behind the government regulatory crackdowns in China?

Financial markets in China have been roiled by several surprise government crackdowns on several domestic industries. Over the past several months, and escalating in recent weeks, announcements have affected firms in ecommerce, online gaming, media distribution, ride-hailing, health care, and most recently, for-profit education/tutoring.

While a surprise due to the cryptic nature of the announcements, these appear to be part of the government's ongoing (but evolving) long-term plan. Moreover, per the opinions of various China experts, the actions may not be as controversial as they look. In some respects, concerns appear more similar than not to those raised in the U.S. and Europe surrounding competitive practices, consumer rights, labor fairness, small business protection, anti-monopoly concerns, and inequality of access.

Despite some headlines, the decisions may not necessarily indicate a breakdown of the longer-term Chinese move towards a more private and entrepreneurial economy. Rather, two of the recent one-off cases, Ant Group and DiDi, were focused on founders 'crossing the line' by challenging the government's regulatory practices—resulting in a more focused and severe crackdown. Unfortunately, commentators have also noted that the poor communication of these government actions has led to misunderstanding by global financial markets.

It's no surprise that China operates as a command-and-control economy, with the communist party managing not only broader long-term political and economic policy, but also being involved in micro-affairs. The underlying goal of these policies has been to ensure both stability and 'social harmony'. Ultimately, this is thought to underpin the sustainability of the political philosophy and current government that has run the country since the late 1940s. Actions have been taken over time to ensure business interests are aligned with government policy goals, seeking to minimize adverse side effects that could undermine long-term goals. Due to the more concentrated leadership, and lack of debate, they're able to move much more quickly than democracies in implementing regulatory changes.

In the specific case of education, one might not think immediately about long-term policy choices made decades in the past to have current carryover impacts, but China's one-child policy of 1980 caused a significant demographic shift. Fewer children born in a generation create a dip in the number of potential workers to generate the same level of productivity (a key part of the formula needed for strong economic growth). It also further pressures smaller/younger generations to provide for a larger older cohort. This isn't unique to China—the developed world broadly has experienced this phenomenon, with similar pressures on pension systems in the U.S., Japan, and Europe.

To ease these pressures, the Chinese government chose to relax their family policies (to two children in 2015). However, social pressures have added difficulty in implementing such a policy, with family resources focused on education and perceived inability to 'spread the wealth' to more children. This social and educational competition led to the rise of tutoring to provide students with a leg up. However, these resources, which have included intensive evening and weekend study, have risked greater inequality, stress, and burnout—which are seen as threatening the social harmony objective. This is just one of the sectors under scrutiny, but a good example of the underlying deeper thinking behind these policy announcements.

Do these events deem Chinese investments undesirable from a financial perspective? Most likely not. Firms affected by recent regulatory actions appear to represent less than a quarter of Chinese stocks (with longer-term prospects possibly less impaired than feared). The growth of the Chinese economy remains robust and is the primary engine of the emerging market world. Additionally, the nation has become reliant on foreign investment capital. While growing pains are to be expected, made more difficult by the persistent lack of transparent information, a variety of firms in this part of the world offer unique high-growth potential, and make for important additions to an asset allocation. This is especially true when valuations have become more attractive, and high growth potential remains a valuable commodity at a time where it's difficult to find elsewhere on the globe.

Market Notes

Period ending 8/6/2021	**1 Week (%)**	**YTD (%)**
DJIA	0.79	16.22
S&P 500	0.96	19.12
NASDAQ	1.14	15.56
Russell 2000	0.98	14.41
MSCI-EAFE	1.05	10.80
MSCI-EM	1.18	1.40
BBgBarc U.S. Aggregate	-0.42	-0.92

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
7/30/2021	0.06	0.19	0.69	1.24	1.89
8/6/2021	0.06	0.21	0.77	1.31	1.94

U.S. stocks gained to further new highs last week, with continued strength in economic growth and a positive Friday jobs report (although the latter ran the risk of the 'good news is bad news' theme if it raises the likelihood of earlier Fed movement).

By sector, financials led with gains of nearly 4%, along with higher interest rates which steepened the yield curve and improved net interest margins, with utilities coming in next, at over 2%—the bulk of other sectors were oddly little changed. Consumer staples were the only losing group for the week. Real estate assets also gained during the week, despite an increase in interest rates.

Foreign stocks rose at about the same pace as domestic equities, with U.K. and Europe faring slightly better than Japan and the emerging markets. European economic conditions and earnings are showing improvement, albeit to a slower degree than the U.S.—as has been the case for the past year. The Bank of England has already begun to discuss monetary tightening in more certain terms, in keeping with greater European concerns about rising prices. At the same time, the IMF downgraded Japan's growth prospects for this year, which wasn't ideal for sentiment. Conditions were especially mixed in the EM world, with China continuing to experience declines upon the regulatory uncertainty noted earlier, as well as a rising Covid case problem, while India and greater Asia rebounded.

U.S. bonds fell broadly as interest rates ticked higher on Friday, following a strong jobs report. Treasuries fared slightly better than investment-grade corporates. Foreign bonds fared a bit worse than domestic, with the added headwind of a stronger dollar, especially noted with a percent loss in emerging market local debt.

Commodities fell mostly across the board last week, along with a stronger dollar. Although agriculture experienced a gain of several percent, but was offset by an over -5% drop in the energy sector, in addition to a drop in metals. While natural gas prices spiked due to continued hot summer weather and air conditioning needs, the price of crude oil plummeted by nearly -8% to just over $68/barrel. The key issue appeared to be a combination of higher supplies coupled with fears of a demand decline resulting some from re-implemented travel restrictions in areas like China—designed to combat the Covid delta variant.

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, Matthews Asia, 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.