Summary

Economic data for the week included stronger retail sales, industrial production, and sentiment for several regional manufacturing surveys. Consumer price inflation rose, but at a reduced rate relative to prior months. Jobless claims were mixed, as labor markets combat skill mismatches and ending benefits.

Equity markets fell back last week as investors weighed decent economic data with continued uncertainty about the pending infrastructure packages passage and eventual Fed policy. Bonds were little changed in the U.S., while foreign bond prices fell due to a stronger dollar. Commodities were mixed, with metals losing ground, but energy rising a few percent.

Economic Notes

(+) **Retail sales** for August rose 0.7%, which beat expectations calling for a -0.7% decline. Removing autos and gasoline from the measure improved the result to 2.0%, sharply exceeding expectations, as did the core/control reading, being up 2.5%. By segment, non-store retail (aka internet), furniture, and general merchandise sales rose all rose in a range from 3-5%, while cars and electronics declined 3-4% (largely affected by production- and logistics-related parts supply disruptions). Retail sales remain up 15% on a year-over-year basis, and are also up 18% from the pre-pandemic benchmark date of Feb. 2020, led by online sales rising 35% over that time (offsetting brick-and-mortar weakness). As seen in variety of economic data points, ample consumer demand appears to be present; it's the availability of products that has caused these numbers to not come in even stronger.

(0) **Industrial production** rose by 0.4% in August, lagging expectations by a tenth of a percent. It appears that Hurricane Ida, and its associated plant shutdowns, negatively affected conditions a bit later in the month, as these were focused on petroleum refining and derivatives, such as plastics. Business equipment production rose by a half-percent, helping the manufacturing segment, while auto production ticked just slightly higher. Utilities production led other groups, gaining over 3%, although that measure tends to be weather-driven. Over the past year, industrial production outside of the auto sector is up 7%, while auto remains down -5%. **Capacity utilization** increased 0.2% to 76.4%.

(+) The **Empire manufacturing index** for September rose by a dramatic 16 points to 34.3, beating expectations calling for a slight decline to 17.9. Shipments, new orders, and employment all gained, further into expansion. On the other hand, prices paid declined slightly, although remaining solidly in expansion. Additionally, expected business conditions six months out ticked up by a few points, remaining solidly expansionary.

(+) The **Philadelphia Fed manufacturing index** rose by 11.3 points to 30.7, beating expectations calling for a slight decline to 19.0. Under the hood, shipments rose further into expansion, while new orders, employment, and prices paid fell by several points—although all remained expansionary. Expected business conditions six months out also fell by -14 points, but remained solidly in expansion.

(+) **Import prices** declined -0.3% in August, which surprised on the downside compared to an expected 0.2% increase. Removing petroleum from the measure trimmed the decrease to -0.1%, with prices for petroleum and industrial supplies each down -2% for the month. This was offset by minimal upward changes in capital goods, while food prices rose just over a half-percent. This was a welcome input as the 'undesirable' part of inflation originating from abroad.

(0/+) The **consumer price index** for August came in a bit lower than expected, rising 0.3% on a headline level, and 0.1% for core, excluding food and energy. This actually represented the most tempered month of 2021 so far. For the single month, prices for energy (up 2%) and new cars (up 1%) were offset by a pullback in used cars (down -1.5%), while a variety of other key segments, such as services and shelter, were little changed. It appeared that the Delta variant may have played a role in the month's downturn in activity, leading to weaker pricing numbers, coupled with a few summer seasonality issues.

On a trailing 12-month basis, headline CPI decelerated a bit to 5.3%, as did core to 4.0%. The difference in the year was represented by a 25% rise in energy (40% rise in energy commodity prices specifically). While the Fed's definition of 'transitory' inflation remains controversial, there does appear to be some flattening in the more extreme categories—used cars being a prime example. On the other hand, strong house price increases as of late could push implied rental rates higher, if historical tendencies hold true. The consensus opinion of economists appears to be a continued period of above-average inflation over the next year (as in 3-4% perhaps), as older and more extreme data rolls off, before it normalizes to the levels of the prior cycle. How this unfolds remains one of the biggest mysteries of the economic and political policy world. The stakes are high—inflation can be one of the more disruptive and angering social ills, with comparisons to the late 1960s and 1970s continuing to be made as to the effect of monetary policy mistakes.

(+) The preliminary **Univ. of Michigan index of consumer confidence** for September rose by 0.7 of a point to 71.0, falling short of the 72.0 reading expected. While consumer assessments of current economic conditions fell by over a point, expectations for the future increased by 2 points. For inflation, expectations for the coming year ticked up by a tenth to 4.7%, while those for the next 5-10 years were unchanged at 2.9%. It appears consumer sentiment remains tied to the current Covid delta variant impact, with inflation also top of mind, particularly as it applies to the prices of consumer goods and gasoline.

(0) **Initial jobless claims** for the Sep. 11 ending week rose by 20k to 332k, exceeding the median forecast calling for 322k. Initial claims were mixed by state, with no large outliers apparent. **Continuing claims** for the Sep. 4 week declined by -187k to 2.665 mil., below the consensus forecast calling for 2.740 mil. When combined with extended programs through the end of August, continuing benefits fell by nearly -200k to a shade below 7 million. In months to come, jobless claims will have to be looked at in context with potential improvement in employment numbers to gauge the true health of U.S. labor markets.

Market Notes

Period ending 9/17/2021	**1 Week (%)**	**YTD (%)**
DJIA	-0.05	14.58
S&P 500	-0.54	19.26
NASDAQ	-0.46	17.28
Russell 2000	0.45	14.01
MSCI-EAFE	-1.38	11.34
MSCI-EM	-2.20	0.67
BBgBarc U.S. Aggregate	-0.03	-0.77

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
9/10/2021	0.05	0.23	0.82	1.35	1.94
9/17/2021	0.04	0.23	0.88	1.37	1.91

U.S. large cap stocks lost ground again last week, while small caps earned minimal gains. Few new themes rose to the surface, with decent economic data (such as retail sales) accompanied by weaker data in China, and a higher likelihood of Fed paring back on accommodative bond-buying sooner than later. More clues may be available from the Fed following their FOMC policy meeting this coming week. By sector, energy ended the week with gains over 3%, along with higher oil prices, while most all other sectors experienced at least minor declines—led by materials and utilities.

There is also irony and some mixed feelings surrounding the pending infrastructure package being negotiated by Congress. On one hand, the large price tag means large spending into the economy, translating to corporate revenue and earnings; however, it could come at the cost of higher taxes. The earlier finished $1 tril. infrastructure bill, designed as a 'companion' bill, is sitting waiting for the up-to-$3.5 trillion dollar reconciliation component. The sticking points remain on corporate tax raises (21% up to 26.5%, although down from hoped-for 28%), top individual tax rate (37% back up to 39.6% again), as well as higher-income bracket capital gains treatment (max rate of 20% up to 25%). Reconciliation requires a simple majority in the House or Senate, which is a minimal threshold. The moderate Democrats, including Sen. Manchin and several others, have been holding back their support of the higher package due to worries over higher debt national security concerns. In that case, $1.5-2.0 tril. could be more likely in the coming month or two. Interestingly, some ideas being discussed include a carbon tax, penalties for high CEO pay, and potentially a tax on stock buybacks. Interestingly, these individual controversial pieces seem to be moving back and forth into and out of the draft version of the bill. It does seem that items such as disqualifying the cost basis step-up on death, and real estate 1031 exchanges, have been taken off the table due to the complexity of doing so and extensive lobbying efforts. Regardless, provisions remain fluid, so are probably not worth speculating on further.

It's noteworthy that the S&P 500 has not experienced a 5% correction since last October. On top of that, September is noteworthy for providing the worst single-month returns of the year historically (at least going back to 1926, per Morningstar and our own calculations). While this specific result hasn't always held true, the autumn has been known for a higher level of volatility—at least compared to the lighter typical trading volumes of summer. At the same time, 60% of S&P components have experienced at least one -10% drawdown since May (according to JPMorgan research). This fall offers plenty of reasons for potential vol, including persistent Covid case counts, flattening economic growth (especially in China), as well as the likely announcement of the dreaded Fed 'taper'. Investors have no doubt been reminded of this many times before, but a 'pause that refreshes' is often a healthy financial market development. After rising over 100% since Spring 2020, equities are at least fairly valued and a bit rich by some measures. Letting some speculative overflow 'run off' from time to time can reset expectations for the coming year. However, long-term, stock indexes are driven by dividends and earnings growth. Growth has remained strong in the aftermath of reopening activity, fiscal stimulus, corporate investment, and of course, low interest rates. Such trends are often multi-year in duration, so an extension of the current run wouldn't be out of the question based on history. What can kill a rally? The Fed raising rates sharply could certainly do it, and has been historically a bear-market inducer. At present, though, they remain quite cautious with underlying secular growth far lower than in prior cycles.

Foreign stocks lost ground in Europe and U.K., not helped by the stronger dollar and continued concerns about Covid's impact on economic growth, while Japan gained with continued optimism over the change in governmental leadership. Emerging markets lost over -2% to lag other groups. In EM specifically, while Russia fared positively along with strong commodity markets, while China and Brazil each declined by -4%. In China's case, weaker economic results, negative sentiment surrounded the government's turn to further regulation of the Macau gaming industry (specifically speculative loans), as well as the deteriorating fortunes of one of the nation's largest real estate development firms, China Evergrande Group. These concerns have carried over through the weekend. The imminent default of the firm is looked to be a test of the Chinese government's backstop on the growing corporate debt problem, and has investors looking at the health of other over-extended property developer debt, which has been popular with speculators over the past several years.

U.S. bonds were little changed on the week, along with minimal changes in the treasury yield curve. Investment-grade and high yield corporates outperformed by a few basis points. Foreign bonds were most heavily affected by a stronger dollar, creating losses in developed market debt, and emerging markets bonds, to a lesser degree.

Commodities experienced mixed results, with gains in energy and agriculture, offset by declines of several percent in industrial and precious metals. The price of crude oil rose by 3% to just under $72/barrel, as supplies and storm activity raised concerns. Natural gas prices also gained for similar reasons.

Have a good week.

Ryan M. Long, CFA
Director of Investments
FocusPoint Solutions, Inc.

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.

The information above has been obtained from sources considered reliable, but no representation is made as to its completeness, accuracy or timeliness. All information and opinions expressed are subject to change without notice. Information provided in this report is not intended to be, and should not be construed as, investment, legal or tax advice; and does not constitute an offer, or a solicitation of any offer, to buy or sell any security, investment or other product. FocusPoint Solutions, Inc. is a registered investment advisor.

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