Summary

Economic data for the week included stronger-than-expected results for retail sales, while inflation continued to come in elevated for producer, consumer, and import prices. Job openings and jobless claims also continued to strengthen as labor markets show improvement.

Global equity markets rose along with improving economic data, and inflation that came in no worse than expectations. Bonds also gained as long-term interest rates declined. Commodity prices continued to rise with prices for copper and other metals overtaking the energy story last week.

Economic Notes

(+) **Retail sales** for September rose by 0.7% on a headline basis, surpassing expectations of a minor -0.2% decline. Removing the more volatile components pushed the core/control result up a tenth, to 0.8%, which also outperformed expectations. As seen by both results, sales were strong across the board, with areas such as sporting goods/hobby stores up 4% on the month, followed by general merchandise and miscellaneous retail each up 2%, perhaps due to back to school effects. On the other hand, electronics/appliances and health/personal care fell a percent each—the former likely to due to lack of inventory availability. On a year-over-year basis, retail sales are up 14%, or nearly 20% from Feb. 2020—the last 'normal' month prior to Covid.

(-/0) The **Empire manufacturing index** for October dropped by -14.5 points to a still-expansionary 19.8 reading, and underperformed the 25.0 level expected by consensus. Under the hood, new orders, shipments, and employment all fell, but remained in expansionary territory. However, prices paid and delivery time both expanded by a few points, remaining solidly in expansion—a reflection on current inventory and logistics roadblocks in a variety of industries. Assessments of business conditions six months in the future also ticked up 4 points to a solidly expansionary reading of 52, which reflects general optimism for ongoing improvement.

(-) **Import prices** rose 0.4% in September, reversing the decline of the prior month, and falling just short of the 0.6% median forecast estimate. However, removing the 4% price gain for petroleum brought the ex-petroleum figure down to a 0.1% increase for the month. Food and industrial supplies prices rose a percent for the month, while prices for other consumer goods (including autos) and capital goods barely changed. Overall, this brought the year-year-over import price gain up to 9.2%.

(0/+) The **Producer Price Index** in September rose by 0.5% on a headline level, short of expectations calling for 0.6%. On a core measure, excluding food and energy, PPI rose only 0.2%, well short of the 0.5% expected and the faster pace of recent months. The differential was due to a 3% rise in energy and 2% rise in food prices over the month, with medical care services rising in the core portion and passenger transportation prices falling sharply. Year-over-year PPI gained 8.6% on a headline basis, while core PPI rose 6.8%. In keeping with stronger commodity prices and production costs, the higher PPI rate is an exaggerated version of inflation seen on the consumer side.

(0) The **Consumer Price Index** for September ticked 0.4% higher on a headline level, and 0.2% on a core measure, excluding food and energy. Each were about a tenth of a percent stronger than expectations. Looking at the underlying metrics, the pace of both rent and owners' equivalent rent came at the fastest pace in 15 years—each up just short of 0.5% on the month. New cars and auto parts also saw gains of around a percent for the month with continued shortages for semiconductors and supply chain impacts globally; however, used car prices fell back a bit. Travel-related segments including airfares (down -6%) and hotels also declined as the Covid delta variant weighed on both personal and business travel.

Year-over-year, headline and core CPI came in at 5.4% and 4.0%, respectively. These represented a slight reacceleration higher from the prior month, but the readings from the last several months remain contained around a similar range, with no severe breakout higher.

(-) The preliminary October **Univ. of Michigan index of consumer sentiment** fell by -1.4 points to 71.4, the opposite of an increase to 73.1 expected in the median forecast. Assessments of current conditions fell by several points, while future expectations declined by less than a point. Inflation expectations for the coming year rose by 0.2% to 4.8%, while those for the next 5-10 years interestingly decreased by -0.2% to 2.8%. The latter is meaningful, as it implies that a perhaps an 'inflationary mindset' has not been taking hold among consumers.

(-) The government **JOLTs job openings** report for August showed a decline of -659k to 10.439 mil., which fell short of the 10.954 mil. expected. However, this did remain the second-strongest number in the dataset's 20-year history. A -200k decline in retail employment weighed on the overall figure, in a reversal of the recovery trend. The job openings rate ticked down by -0.4% to 6.6%, while the hiring rate fell a similar -0.3% to 4.3%. The layoff rate fell to 0.9%, while the quits rate rose by 0.2% to 2.9% (an all-time high, and showing that worker choice has ramped up sharply). This reiterates other data that shows increasing leverage in the hands of workers relative to employers.

(+) **Initial jobless claims** for the Oct. 9 ending week fell by -36k to 293k, below the 320k expected and reaching a new low for the post-pandemic period. No extremes were seen, with larger states showing declines. **Continuing claims** for the Oct. 2 week declined by -134k to 2.593 mil., below the 2.670 mil. median forecast. Conditions continue to improve in labor markets from a claims standpoint, but there is further progress to be made.

(0) The **FOMC minutes** from the September meeting offered more clarity on recent discussions on asset purchase tapering. It appeared that all participants agreed on the concept that tapering would be warranted 'soon', with a starting point of mid-November or mid-December, with an end in mid-2022 as 'appropriate'. In fact, a few members advocated a faster taper timeframe. However, the current interest rate stance looks little-changed, with members noting that labor markets remain below 'maximum employment' and expectations for a reversion of inflation back toward normal by mid-2022. This inflation stance is in keeping with consensus forecasts by a variety of mainstream economists, based on taking it apart by its component inputs and considering supply chain disruption impacts.

The implications of the broad comments are a realization that the temporary bump to GDP during the pandemic recovery is likely short-lived, with a reversion to the longer-term mean of 2% or so economic growth. This is in keeping with the long-term inputs of tempered labor force growth and productivity, which have both fallen relative to history. Lower GDP growth has tended to go in line with forecasts of lower interest rates over the longer-term, based on few catalysts in place for these to rise (of course, absent current inflation forces moving from 'transitory' to more secular).

Market Notes

Period ending 10/15/2021	1 Week (%)	YTD (%)
DJIA	1.58	16.98
S&P 500	1.84	20.40
NASDAQ	2.18	16.18
Russell 2000	1.47	15.57
MSCI-EAFE	2.42	10.44
MSCI-EM	2.13	1.19
BBgBarc U.S. Aggregate	0.33	-1.72

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
10/8/2021	0.05	0.32	1.05	1.61	2.16
10/15/2021	0.05	0.41	1.13	1.59	2.05

U.S. stocks experienced its best week in several months, with stronger bank earnings and a robust retail sales report helping sentiment. Anecdotal news that recent supply chain issues could be peaking also raised investor sentiment. Nearly every sector was in the positive last week, led by materials, consumer discretionary, and information technology. Communications was the sole laggard, with weakness in the telecom services group. Real estate also gained several percent, with retail sales showing decent results and a pause in the rise of interest rates.

As we mentioned last week, earnings reports for S&P companies have started to roll out. Each quarter seems to have its own theme, which lately has been the increased executive discussion of 'costs' and 'inflation'. Rising costs are problematic for companies in that they can erode profit margins more directly, to the extent that higher costs can't be passed along to the consumer to maintain the same margin levels. (But sometimes they can be.) As the pace of overall economic growth improvement has begun to slow, worries over potential 'stagflation' (slow grow but high inflation) have risen somewhat. This was an unusual environment seen in the 1970's largely, when inflation and interest rates ran rampant. Calls for a repeat seem premature, but the current environment with supply shortages and logistical backups has provided a taste of what high inflation can look like. The fact that market sentiment remains strong and valuations remain relatively high seems to imply investors are looking past current constraints, and assume inflation will not be persistent. Although it may last a bit longer than initial estimates, with the wildcard being this near-term effect on company costs and potential lost revenue for a few more quarters, at least.

Foreign stocks outperformed U.S. equities, with strength in the U.K., Europe, and emerging markets. Gains were relatively broad-based, with global sentiment elevated from strong quarterly earnings results, as in the U.S. It was the odd week where there was little differentiation between countries, other than a decline in Turkey, where the administration dismissed several members of the central bank monetary staff for voting against interest rate cuts (a stance which most economists would tend to agree with in an inflationary environment).

U.S. bonds gained as long-term interest rates declined, and credit spreads tightened further. Internationally, a falling dollar acted as a slight tailwind, with emerging market bonds in both USD-denominated and local terms up nearly a percent on the week.

Commodities generally moved higher last week, in keeping with recent trend. Industrial metals gained sharply (led by zinc and copper), followed by energy and precious metals, while agriculture declined slightly. The price of crude oil rose by nearly 4% to just over $82/barrel, with continued concerns over available supply. A shortage of natural gas supplies in China (a net importer of energy) has resulted in spiking prices and elevated demand for coal—their primary backup. These high prices represent another economic growth threat in Asia.

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.