Summary

Economic data for the week included manufacturing indexes which leveled off a bit from highs, while on the positive side, jobless claims fell to new cyclical lows. Home sales and housing starts were mixed, with prices moving higher and inventories remaining tight.

Global equity markets continued their positive performance, due to strong earnings results for the prior quarter. Bonds suffered, as interest rates rose again in keeping with improving conditions. Commodities were mixed, with metals falling back, while energy again experienced gains.

Economic Notes

(-) **Industrial production** in Sept. fell by -1.3%, which disappointed relative to the expectation of a 0.1% increase. The manufacturing production component fell -0.7%, which included a minor increase in business equipment, but a -7% drop in auto production due to well-discussed microchip supply issues. Mining production (which includes oil/gas extraction) also fell -2%, which was noted as largely being the result of Hurricane Ida. Utilities fell -4% on the month—a sector normally driven by weather factors—as temperatures cooled from the prior month. **Capacity utilization** fell by -1.0% to 75.2% for the month. Extreme weather and supply chain issues were largely blamed for the lackluster report.

(0) The **Philadelphia Fed manufacturing index** fell by -6.9 points to a level of 23.8 for October, below the 25.0 level expected by consensus, but remaining solidly expansionary. However, under the hood, new orders and shipments both increased further into expansion. Prices paid and delivery times also rose, indicative of ongoing supply disruptions. Importantly, assessments of business conditions 6 months out rose by several points, and remained solidly in expansion.

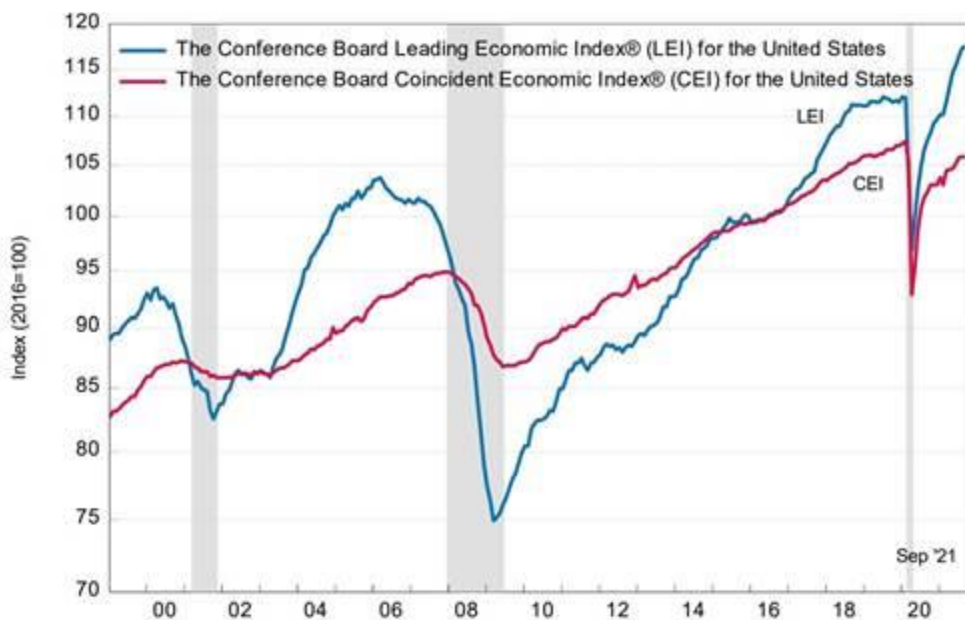
(+) **Existing home sales** for Sept. rose 7.0% to a seasonally-adjusted annualized rate of 6.29 mil. units, surpassing the median forecast calling for a 3.7% gain. This was the best single-month result over the past year. Single-family units gained 8%, followed by condos/co-ops up just over 1%. Every region experienced gains, led by the South and West, in the middle- to higher-single digits. The median sales price rose 1.5% for the month to $352,800, which represented a 13% year-over-year gain. Inventory tightened again, however, as the months' supply of homes fell by -0.2 to 2.4—which is about two-thirds of what it was prior to the pandemic.

(-) **Housing starts** in Sept. fell by -1.6% to a seasonally-adjusted annualized rate of 1.555 mil. units, which disappointed relative to market expectations calling for no change, after a negative revision for the prior month was included. Multi-family starts down -5% led the overall figure down, while single-family starts were flat. The Northeast saw a significant decline of -27%, followed by the South down -6%—figures likely influenced by Hurricane Ida and its flooding aftermath during the month. Starts in the West and Midwest, by contrast, gained. Over the trailing 12 months, starts are up 7%, mostly led by the 40% rise in multi-family. **Building permits** fell by -7.7% for the month to 1.589 mil., reversing a gain the prior month and beyond the -2.4% consensus estimate. Single-family permits declined by -1%, while multi-family fell by -18% to lead the index downward. The Northeast and West saw double-digit drops, while the Midwest was the only region to experience a minor rise.

(+) The **NAHB housing market index** for October rose by 4 points to 80, beating expectations calling for a slight decline. All three components of current sales, futures sales, and prospective buyer traffic came in positively and within a point of each other. Regional strength was good as well, with all in the positive, led by the Northeast up 6 points. Overall, sentiment continues to look robust among homebuilders, with strong demand, yet no noted major impact from materials supply or labor disruptions.

(+) The **Conference Board Index of Leading Economic Indicators** for September continued its winning streak by rising 0.2% for the month, albeit at a slower pace than in July and August. The coincident indicator was unchanged, while the lagging indicator rose by 0.3%. Over the past six months, the indicator rose at an annualized 11.1% rate, which surpassed the 7.6% annualized growth rate of the prior six months that ended in March 2021. The unusualness of the past two years have caused these measures to converge and diverge based on starting and ending dates, so have to be viewed with a grain of salt.

The Conference Board noted that the obvious factors of Covid/delta variant, inflation, and supply chain disruptions have tempered recent exuberance a bit. Nevertheless, strength among six of the ten components (such as ISM new orders, interest rates, and improving jobless claims) outweighed weakness in building permits and consumer sentiment. Again, this index doesn't provide any information we don't already know, but the mix provides an interesting 30,000-foot view of the economy. At present, strong growth rates have fallen back a bit, but remain positive, which keep chances of a recession low.



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

(+) **Initial jobless claims** for the Oct. 16 ending week declined by -6k to 290k, below the median forecast expectation of 297k, and touted as a new pandemic-era low. **Continuing claims** for the Oct. 9 week fell by -122k to 2.481 mil., below consensus forecasts calling for 2.548 mil. Initial claims were mixed, with a 17k rise in CA offset by declines in several other large states, such as VA and PA. No major news appeared to impact claims broadly, with a continued national trend showing consistently lower claims. This points to ongoing labor market repair.

Question of the Week

With various crypto-based ETF products rolling out, does this change the outlook for the asset class?

The rollout of several crypto-oriented ETFs has fanned the flames of this investment trend over the last few weeks. In accordance with what's being allowed by the SEC at this time, the new ETFs invest in bitcoin futures contracts, as opposed to the actual currency. More on that distinction towards the end.

With crypto being such a new technology, it's been difficult for many investors to understand what they're actually buying. This complicates the assessment of potential return and risk involved. This is not an endorsement or condemnation of the asset class. We've discussed this topic periodically in the past, but it might be helpful again to cover the highlights. Firstly, it's important to break the asset down into its component parts.

- Blockchain technology, which is what cryptocurrencies and transactions are based on, appears to have some commercial promise in its own right. Although there are practicalities to be worked out, it's feasible for blockchain digital ledgers to replace outdated recordkeeping systems (like paper) for contracts, such as property deeds, or other assets requiring the maintenance of an ownership chain. That doesn't mean the technology itself will necessarily end up being hugely profitable. Historically, many new technologies have created efficiencies and lowered costs for consumers, without resulting in investment windfalls for the providers.
- Cryptocurrencies represent digital units traded via blockchain, which allows for the tracking of ownership changes and is assumed to avoid duplication. Bitcoin is the oldest and most liquid of these currencies, and is what the new ETFs are tracking, so we'll use that as the primary example, but thousands of other cryptocurrencies have been created. Unlike currencies issued and backed by world central banks, these are not backed by any government.

What is the appeal of crypto?

- Anonymity. This refers to the ability to transact privately, akin to exchanging briefcases of untraceable cash. Unsurprisingly, demand has come via illicit transactions, or tax avoidance, but also presumably from those just wanting high levels of secrecy. According to recent reports, though, the U.S. government has apparently been able to locate and retrieve stolen and ransomed bitcoins, so these transactions may not be as 'private' as once thought.
- (Assumed) Scarcity. There has been a set cap of 21 million total units of bitcoin to be ever produced, although it's been debated whether that can be verified practically for various cryptocurrencies. That also assumes other digital currencies don't emerge that are superior in technology or gain popularity for other reasons. This is a historical attribute common of all currencies: if there is unlimited money printing, each unit will lose proportionate value. Traditional currencies tend to have an advantage here, since individual nations (or blocs) tend to only issue a single currency, which results in a limited universe of possible options, rather than thousands. Then again, recent massive spending and money creation by the U.S., Europe, and other regions in response to Covid has caused many to wonder about the eventual impacts on these currencies as well.
- Avoidance of or protection from the financial system. This would be similar to the hoarding of gold or silver bars, for example. In fact, bitcoin has been referred to as the 'digital gold'. The drawback is that, like with gold/silver, the price of bitcoin itself is extremely volatile. That erodes a lot of its safe-haven appeal. Moreover, rather than acting as a 'risk off' asset as precious metals have, bitcoin has started to act more like a 'risk on' asset similar to stocks, which provides even less diversification against sell-offs in other assets which some buyers have hoped it would protect against. Due to its short history, the track record versus inflation is also inconclusive.

Coming to the question of investment merit, we also have to ask: What is a currency? And, what do we expect from currencies?

- Medium of exchange. Bitcoin and Ethereum (the second most popular) have been offered for use by some vendors, but availability is far from widespread. There are literally thousands of crypto coins available (including some developed originally as a joke) that can't be accepted anywhere for payment—which limits their use to speculation. There is some network effect present for bitcoin, due to its first mover advantage, but for any asset to hold its value in theory, there have to be at least some willing buyers and sellers (and preferably many). The volatility of bitcoin has caused problems as a payment

medium, not unlike the constant repricing of goods required during periods of historical currency debasement, notably Weimar Germany in the 1920s.

- Unit of account. Bitcoin and others qualify since they have a numerical value, so can be mathematically counted and tracked. Then again, other than the rough parameters around bitcoin's capped number of creation units, there is little transparency about limitations on other currencies.
- Store of value. Does bitcoin hold its value? That's could be under debate, since its price has fluctuated wildly between $10,000 to $60,000 over the course of a few months. That volatility is more reflective of a speculative asset. The argument against crypto is that there aren't underlying characteristics, usefulness, or long historical legacy that give digital currencies any fundamental value—we really don't know if the true worth should be $1,000,000/coin or zero—it's entirely based on popularity. The relative attractiveness of common currencies such as the dollar, pound, yen, euro, etc. is that they're backed by large governments with substantial asset holdings, such as land and natural resources, taxing power, military might in most cases, as well as the ability to uphold rule of law (important for the predictability of settling commercial contracts). That's not saying inflation won't erode a currency's value over long periods, but that's the rationale for investing in other assets such as stocks, bonds, real assets, etc.
    - Bitcoin, being the first, and mostly well-known, may score better on some metrics than others, including its larger network effect. Although, there are still questions about what a person physically owns (electronic bits). For the remainder of cryptocurrencies, it's becomes harder to extract value from a real asset standpoint. What makes the 1001st currency unique from the 1000th? If anyone can create a cryptocurrency, and without a market for it, does it have any value?

If an investor desires crypto exposure, how can it be approached?

- Directly. From a longer-term standpoint, this is purest and likely lowest-cost method. But this is not the end of it. As with any asset not under traditional custody, one needs to be cognizant of operational risks involved with online storage (such as hacking/theft risk, which has happened many times already). Some experts seem to think the best and most private method is 'cold storage', which is essentially downloading one's crypto onto a drive for secure physical storage (safe, safe deposit box, etc.), just as one would collectable coins, computer files, or important documents. An investor still needs to worry about security, lost passwords, etc., since that's often the only way to retrieve the coins.
- Indirectly. This is would be through financial futures contracts or one of the new ETFs (which own bitcoin futures, not the actual coins). As with commodities, owning futures contracts provides exposure to an asset, but the price of the futures (or ETFs based on contracts, due to their own market price vs. net asset value dynamics) can drift from the actual spot price of the asset. Futures are prone to the familiar 'contango' or 'backwardation', due to the use of near-term expiring contracts, and the need to continually replace them (this is referred to as 'roll risk'). This may get less noticeable as ETF products become more popular or spread the operational risk of ETF position limits, or it may not. There are also management fees to consider, which look to be just under 1% level so far. Given that list of caveats, if someone wants liquidity, ease of use, or just a way to speculate without needing much precision in the short-term, owning an ETF is obviously more convenient than going through the crypto exchange and cold storage process noted above.

Market Notes

Period ending 10/22/2021	1 Week (%)	YTD (%)
DJIA	1.12	18.30
S&P 500	1.66	22.39
NASDAQ	1.30	17.68
Russell 2000	1.14	16.88
MSCI-EAFE	0.62	11.13
MSCI-EM	0.75	1.95
BBgBarc U.S. Aggregate	-0.37	-2.09

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
10/15/2021	0.05	0.41	1.13	1.59	2.05
10/22/2021	0.06	0.48	1.22	1.66	2.08

U.S. stocks fared well last week, as earnings results continued to come in positively, in line with or better than expectations. Every sector gained last week, led by health care, financials, and utilities. Communications lagged with flattish returns, weighed down by concerns over social media advertising revenue for the remainder of 2021 (interestingly, blamed on new iPhone privacy settings to some extent). Real estate fared positively, up several percent, despite a continuation of the rise in interest rates.

Debate continues over the amounts and timeline surrounding the Congressional infrastructure plan. As announced by the President specifically, in response to recent Senate negotiations, it has been steadily downgraded from around $3.5 trillion to closer to $2 trillion (as many expected would happen eventually), which included a paring back in amount and timing in a variety of the bill's components. Helping equity sentiment were reports that proposed corporate tax increases could be pared back or eliminated entirely from the bill.

Foreign stocks fared positively as a whole last week, although Europe gained to a lesser degree than U.S. stocks. Stronger earnings results appeared to lead the way, as they have domestically. Japanese stocks suffered declines. Emerging market stocks were mixed, but pulled down by a -10% decline in Brazil, due to government efforts to provide more fiscal stimulus to citizens that has put additional pressure on the real (an example that emerging nations have far less ability to effectively provide massive stimulus than developed nations).

U.S. bonds suffered as interest rates rose—almost to 1.7% on the 10-year treasury. Declines of around a half-percent were similar across the board, while floating rate bank loans rose a slight amount. Helped by a minor drop in the dollar, developed market bonds were flat, while emerging bonds declined. The ability of Chinese property developer Evergrande to make an important interest payment alleviated markets concerns somewhat, although there are several more payments to go before now and year-end.

Commodities were mixed on the week, with gains in precious metals, and minor increases in agriculture and energy, offset by a pullback in industrial metals (aluminum and copper, specifically). The price of crude oil rose by over 2% to just under $84/barrel.

Have a good week.

Ryan M. Long, CFA
Director of Investments

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.

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