***Summary***

Economic data for the week included a slight revision higher in Q2 U.S. GDP growth, stronger durable goods orders and ISM manufacturing sentiment, as well as stronger housing price and sales data. Jobless claims and consumer sentiment were mixed.

Global equity markets fell back again last week, with continued investor concerns about inflation, rising interest rates, and an upcoming treasury debt ceiling. Bonds declined as well, in keeping with higher rates. Commodities continued to see gains, on the back of spiking petroleum prices.

***Economic Notes***

(0/+) The 3rd and final **U.S. GDP** release for Q2 was revised 0.1% higher to 6.7%, compared to expectations for little change from the prior estimate. In keeping with this minimal change, details were insignificant, with slightly higher personal consumption and equipment investment, while residential investment and intellectual property investment were revised downward. Core PCE inflation was essentially unchanged at a 6.1% quarterly annualized rate, with the year-over-year rate of 3.4%.

GDP estimates for Q3 have come down a bit, due to the slowing impact of the Covid delta variant and product supply issues. The Atlanta GDPNow indicator estimates Q3 growth of only 2.3%, which is at the lower level of the range of Blue Chip Economist Indicator forecasts (the average being around 5%). Unfortunately, the New York Fed Nowcast estimates have been suspended for the time being, due to the challenges of Covid and recovery requiring some retooling of their quant-based model. While Q3 growth is expected to be far more tempered than Q2, above-average rates are estimated into the next year, before settling back down toward the long-term trend of around 2%. As we mention regularly, long-term economic growth is driven by the size of the labor force and productivity, which have been roughly equal in their (low) contributions. This is not just a U.S. issue, but a global one, especially with falling growth levels in China. Global expectations seem to be falling accordingly.

(0) **Personal income** rose 0.2% in August, meeting expectations, and resulting in an income gain of 6% over the past 12 months. Personal spending rose 0.8%, exceeding expectations of 0.6%, for a 12% year-over-year increase. This brought the personal savings rate down by -0.7% to 9.4%, still about two percent above the pre-Covid rate. The **PCE price index** gained 0.4% on a headline basis and 0.3% for core, excluding food and energy, with each about a tenth higher than consensus expectations. The year-over-year PCE inflation change for headline and core, respectively, was 4.3% and 3.6%—each obviously elevated, along with most inflation measures.

(+) The **ISM manufacturing index** for September rose by 1.2 points to 61.1, exceeding estimates calling for 59.5, and remaining at an elevated and expansionary rate. All but one of the 18 industries saw expansion, in fact. Under the hood, employment rose back into expansion, while production fell a bit, although remaining expansionary. New orders were unchanged from last month, but remained solidly expansionary, at nearly 70. Supplier deliveries, inventories, and prices paid all rose further into expansion.

(0) **Construction spending** was unchanged in August, underwhelming compared to expectations of a 0.3% rise, although it featured some prior month revisions. Public non-residential spending rose a half-percent, which offset negative public residential spending. Private spending had the opposite impact, rising in residential and falling in non-residential.

(+) **Durable goods orders** for August rose by 1.8%, beating consensus calling for 0.7%. This resulted in a year-over-year gain of 18%. Core capital goods orders rose by 0.5%, which exceeded expectations by a tenth, with the smaller figure due to commercial aircraft being a primary driver of headline growth. Core capital goods

shipments rose 0.7%, which also outperformed by two-tenths. Demand for goods continues to run at a strong trajectory, albeit hampered by the oft-discussed supply delays.

(0/+) The **S&P/Case-Shiller home price index** rose 1.5% in July, which fell short of the 1.7% expected. By city, Phoenix, Tampa, and Las Vegas led with each rising a rounded 3% for the single month. On a year-over-year basis, the national index re-accelerated by another 0.8% to an all-time high of 19.9%. It's interesting to note that the national and more concentrated 10- and 20-city indexes have all now surpassed their prior 2005 highs.

(0/+) The **FHFA house price index** for July rose a similar 1.4%, but also fell short of consensus, by a tenth of a percent. Home prices rose in all nine regions, led by the South Atlantic (DE south to FL) and East South Central (KY, TN, MS, AL), which experienced gains just short of 2%. Year-over-year, the pace of acceleration ticked up by 0.3% to 19.2%—which was also a record for the 30-year-old series.

(+) **Pending home sales** for August rose 8.1%, exceeding expectations that called for 0.4%. However, this represented a -8.3% decline from last year at this time. Regionally, the South and Midwest saw stronger activity, in keeping with moderate house prices, while the West and Northeast also saw gains. Per the National Association of Realtors, rising inventory and some moderation in price gains have been the catalyst for stronger activity.

(0/-) The Conference Board **consumer confidence** index for September fell by -5.9 points to 109.3, falling short of expectations calling for 115.0. Consumer assessments of both current conditions and future expectations declined to largely similar degrees (the latter falling a bit more). The labor differential fell by nearly -2 points, but remained at a historically high level.

(+) The final September reading of the **Univ. of Michigan index of consumer sentiment** rose by 1.8 points to 72.8, exceeding expectations of no change at 71. Consumer assessments of current conditions rose by three points, while expectations for the future gained a single point. Inflation expectations for the next year ticked down a tenth to 4.6%, but ticked up a tenth to 3.0% for the next 5-10 years.

(0) **Initial jobless claims** for the Sep. 25 ending week rose by 11k to 362k, higher than the 330k consensus estimate. **Continuing claims** for the Sep. 18 week declined by -18k to 2.802 mil., but still above the forecasted 2.790 mil. Initial claims gained sharply (by 19k) in CA, due to a movement from federal benefits to standard state benefits, while other larger states were mixed on the positive and negative side.

### ***Question of the Week***

### ***What is right with the world? (Fall edition, and the counter to last week's more negative focus.)***

Despite a variety of autumn headwinds, a variety of which have been ongoing, there are positive takeaways for investors.

**Growth.** From both the standpoint of the economy and corporate earnings, numbers are growing. At the risk of oversimplifying, long-term equity market returns have largely tracked long-term corporate earnings growth. When this earnings growth slows or declines, typically coinciding with recessions, risk assets have performed poorly. However, if the numbers are simply expanding, the probability of positive outcomes is far higher. The term 'TINA' (There Is No Alternative) applies to the choice of stocks as the preferred current place to invest, with bond and cash yields so low from an after-inflation basis. This has no doubt driven valuations higher, in keeping with stronger fundamentals. Of course, stocks have risks, with bonds often still the place investors flock to in times of crisis, which makes them vital portfolio building blocks.

**Strong consumer and business demand.** Over the past year, demand has surged for a variety of goods and services; the hang-up, unfortunately, has been the difficulty in getting supplies and manufacturing enough to satisfy market demand. The supply difficulties have manifested as production slowdowns and transportation delays, leading to inflation in several CPI price categories. This is especially the case for goods needing semiconductors (which includes more household items than one might think, like washing machines, ranges, etc.). Why is this happening? Most simply, the factory shutdowns in the early part of the pandemic, ongoing factory disruptions abroad, and a difficulty in finding qualified and willing labor. Logistical issues have been highlighted by a lack of personnel to unload container ships (dozens of ships have been sitting off of Los Angeles harbor waiting to dock), as well as a shortage of U.S. truck drivers. The good news is that once the supply dynamics ease, demand for finished products has been exceptionally strong. This translates to higher corporate revenues and earnings, which is what the stock market relies on. (By contrast, waning demand is more indicative of late cycle dynamics moving into recession, which is certainly not the case today.)

**Accommodative monetary policy.** Aside from the recent 'taper talk', low interest rates are expected to remain low for several years, and allow for several positive conditions to occur. These include lower consumer and corporate borrowing rates, higher modeled valuations for equities and real estate, and a subtle pull of investor assets away from savings and into stocks. The latter is debatable over the last cycle, as trillions of dollars remain in savings and money market mutual fund assets yielding near zero; this implies the safety component is far more important currently than the negative real yields currently being earned. If and when rates begin to rise (which we started to see a dose of last week), the implication is that the economy is strong enough to handle it without Fed intervention again to push rates downward.

**Pandemic duration and end.** The Covid delta variant added another significant wave of cases, just when many (including experts) thought it was close to being over. Medically, spread was worse than the initial wave due to a higher infection r-value, but higher vaccination rates appear to have kept death rates contained in many areas. This is a unique event for the today's world, but historically, pandemics haven't lasted indefinitely. Typically after several waves, they've 'burned out', when the majority of the population becomes immune. An interesting aftermath of the 1918 flu pandemic (although complicated by the co-effect of World War I) was the beginning of the Roaring '20s—a period of strong economic expansion and significant societal change. It's been speculated that the immense number of WWI deaths (of younger men, specifically) was an important catalyst for many of these changes, particularly with women's rights, more progressive attitudes, as well as general optimism. Historically, pandemics have been catalysts for societal and economic shifts, so this isn't totally surprising.

A key forward-looking factor will be how much the Covid pandemic effects future economic behavior, including comfort being in larger groups, shopping online vs. in-person, urban vs. suburban living, business travel, office vs. home work, etc. Some of these trends were already in place, but the pandemic accelerated these several-fold—particularly, with productivity technologies like teleconferencing. Market leadership in 2020 favored such companies, with valuations rising as well. Their investment value isn't just about winning industries, it's about the price being paid. Are investors too optimistic about digital? Conversely, are investors too pessimistic about the decline traditional/brick-and-mortar companies?

**Benefits of Diversification.** Many investors think of U.S. stocks as 'the market'. However, 40% of the world's stock market capitalization is domiciled abroad. These stocks have traded more cheaply than U.S. equities for some time, for a variety of reasons, including slower growth and less favorable (less tech-heavy) sector composition, but U.S. vs. foreign leadership has tended to vacillate over multi-year periods. With the U.S. having led for much of the last decade, and growth rates picking up abroad, a foreign stock comeback would reward a more globally diversified asset allocation portfolio. We have already seen the benefits of owning assets such as commodities, real estate, and floating rate bank loans during periods of rising inflationary pressures and interest rates. Even government bonds can become more attractive the higher rates rise, as multi-year bond total return is largely based on starting yields.

***Market Notes***

| Period ending 10/1/2021 | 1 Week (%) | YTD (%) |
|---|---|---|
| DJIA | -1.36 | 13.72 |
| S&P 500 | -2.19 | 17.26 |
| NASDAQ | -3.19 | 13.58 |
| Russell 2000 | -0.24 | 14.31 |
| MSCI-EAFE | -3.14 | 7.52 |
| MSCI-EM | -1.41 | -1.76 |
| BBgBarc U.S. Aggregate | -0.12 | -1.28 |

| 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 |
| 9/24/2021 | 0.03 | 0.29 | 0.97 | 1.47 | 1.99 |
| 10/1/2021 | 0.04 | 0.27 | 0.93 | 1.48 | 2.04 |

U.S. stocks fell back again last week, with the tech-focused Nasdaq experiencing its worst single day since March. However, the recently market volatility overall has not resulted in a net drawdown of even -5% yet. Optimistic news over a Merck treatment for Covid patients boosted sentiment by the end of the week. By sector, energy was the only positive performer, rising over 5% on continued strength in oil and gas prices. Health care and technology were the lagging groups, each falling over -3%. Real estate also declined -2%, in line with rising interest rates.

Tuesday's decline was led by a 'spike' in Treasury interest rates, in no small part by Fed Chair Powell's Senate testimony, which noted that inflation is likely to stay elevated for the coming months. The end of the U.S. government fiscal year on Sept. 30 and potential for a federal shutdown added to concerns, as has the estimated Oct. 18 (or so) date where the government essentially runs out of money. The debt ceiling debate being pushed down the road has been identified by a variety of Washington strategists as the most pressing and concerning issue in recent months, even surpassing the pandemic as of late. In fact, echoing ideas from past experiences, Congress has considered minting a high-value commemorative coin (such as a $1 tril. platinum variety) to swap with the Federal Reserve for cash assets. However, such an idea has remained controversial.

It might be interesting to note that despite the seemingly unprecedented nature of a technical default on U.S. debt, it's happened before, although not well-publicized. It could also be argued external debt defaults occurred in 1790 and during the Great Depression in 1933. In April-May 1979, redemptions on maturing T-bills were held up by high volumes by small investors, a mechanical breakdown of check-processing systems (remember, these were times of 'manual' processing of securities and high interest due to double-digit interest rates), but also a Congressional failure to raise the debt ceiling. So, these political issues over debt have hovered over the treasury function for decades. So, while perhaps the semantics and details could be debated, it wouldn't be unprecedented. But the effects would be painful to the economy.

It's not a surprise to many investors that rapid interest rate increases (such as those in the 2-standard deviation variety, at least on a monthly basis) are not absorbed well by the stock market. Then again, these can be followed by rate reversals (particularly if a 'flight to safety' accompanies a further equity downturn). An underlying concern is a potential reappearance of 'stagflation', which characterized the 1970s, but which many of today's investors have not lived through. This remains one of the primary intermediate-term concerns, although inflation caused by supply/logistical issues appears more 'solvable' than the inflation psychology-fueled episodes of the past; because of that, officials are watchful of a new inflation expectation psychology taking hold.

Foreign stocks declined to a similar degree as U.S. equities, with concerns over peaking economic growth and rising inflation abroad as well. German inflation ticked up to 4.1%, a nearly three-decade high, and 3.4% in the Eurozone on a trailing 12-month basis (however core only ticked up to 1.9%). After inflation in Europe having lagged that of the U.S., recent readings look to be pressing yields higher, which also pressures equities. Additionally, several U.K. energy firms have gone out of business over the past two weeks, due to rising gas prices and supply issues.

The Evergrande situation in China appears to be improving in some respects, with the government pushing several state-owned enterprises to absorb a percentage of the firm's problems. While the idea of this being a 'Lehman moment' looks less directly likely, the domestic resources needed to absorb the problem could weigh on Chinese growth further. The government's regulatory crackdown has continued, with toughened restrictions on cryptocurrencies, with bans on mining and trading. This put a damper on global crypto exchanges, and sentiment around the industry in general, due to China's sheer size in those markets.

U.S. bonds were hampered by the earlier-mentioned rising treasury yields. These higher yields, though, are attractive on a global basis, which has exacerbated the stronger U.S. dollar. Treasuries outperformed corporates, with widened spreads. Foreign bonds lost nearly a percent, due to rate and currency influences.

Commodities continued their gains during the week, led by energy, with industrial metals the only negative sector. The price of crude oil rose by over 2% to just under $76/barrel, while natural gas rose another 8% last week (55% over the past three months). Most newsworthy, gasoline shortages in the U.K. have brought back images of gas lines from the early 1970s. An upcoming OPEC meeting will be addressing the issue, although hoped-for outcome of higher production is far from assured.

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, Forbes, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Seeking Alpha, 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.