Summary

Economic data for the week included the Federal Reserve beginning its 'taper', coupled with weaker manufacturing results, but new all-time highs in services sentiment. The employment situation report for October surpassed expectations, reversing disappointment of the prior month.

Global equity markets gained with continued economic and earnings improvement, and less hawkish-than-expected world central bank policy. Bonds fared well globally as interest rates declined. Commodities ended the week mixed, with declines in energy and industrial metals offset by gains in precious metals.

Economic Notes

(0) As discussed earlier in the week, the **FOMC** felt that the start of the 'taper' was appropriate for mid-November. The main difference in the tone was less certainty about the use of 'transitory' for inflationary forces. This is not to say that high inflation is expected to be permanent, but could last longer than first thought, and largely dependent on the often-mentioned supply and transportation disruptions. This is a real-life example of how today's globally-integrated supply chain has broken down, creating effects far beyond what could have been anticipated by policymaker-induced closures in the early days of the pandemic.

The Q&A session following the meeting seemed dovish enough to not rattle markets, in addition to this being an extremely well-telegraphed policy move (the taper having been discussed for months, the lessons of the taper tantrum a decade ago having been learned). According to Bloomberg, over the past month, the expected fed funds policy rate by year-end 2022 has indeed doubled from about 0.3% to 0.7% or so. This indicates a higher likelihood of rate hikes, but at a tempered pace.

However, there are some contrary views out there. In fact, the supply disruptions, high debt levels, employment dislocations, and slow secular growth dynamics have a few economists talking higher recession probabilities brought on by the recent hurdles. This may be premature, but the possibility of growth fading is never zero.

(0/+) The **ISM manufacturing index** for October fell by -0.3 of a point to 60.8, and still beating the median forecast calling for 60.5. While employment rose by several points, further into expansion, production and new orders fell, but still remained strongly expansionary. Supplier deliveries and prices paid also gained, even further into expansion, in keeping with ongoing supply disruptions and inflation. Anecdotal comments from respondents were centered around rising input/freight costs, raw materials shortages, and problems with finding enough employees. This is much that same as we're been reading for months.

(+) The **ISM services/non-manufacturing index** for October rose by 4.8 points to 66.7, beating the 62.0 expected, and representing another all-time high for the series (which goes back to the late 1990s). New orders and business activity rose substantially, as did supplier deliveries along with the ongoing backlogs, and prices paid. The employment segment fell back a bit, but remained expansionary at over the 50 level. As has been the ongoing story this year, demand continues to look strong, but has been held back by supply limitations.

(-) **Construction expenditures** for September declined by -0.5%, the opposite of a 0.3% gain expected by consensus. Activity appeared to be held back by hurricane/flooding activity earlier in Sept. By segment, private and public construction both declined, with private residential faring slightly better than the overall index, while public residential fell nearly -2%.

(+) The **ADP private employment report** for October showed a rise of 571k, surpassing the prior month's downwardly-revised number by nearly 50k, as well as expectations calling for 400k. Services jobs rose by 458k, 40% of which were in the hard-hit leisure/hospitality segment, while jobs in goods production rose by 115k. In the details, construction jobs reached a 14-year high, with similar gains in manufacturing (although the latter are still a few percent below pre-Covid employment levels). While this measure can diverge from the official government number later in the week, it has continued to show robust recovery on the private side in a variety of industries. But, job numbers have yet to reach pre-Covid levels in many cases, which is the primary concern of the Fed and labor economists.

(+) **Initial jobless claims** for the Oct. 30 ending week fell by -14k to 269k, below the 275k level expected. **Continuing claims** for the Oct. 23 week dropped by -134k to 2.105 mil., under the 2.150 mil. median estimate. Claims increases and decreases were mixed across a variety of larger states, with no overwhelming trend. Overall levels continue to improve.

(+) The employment situation report for October came in stronger than expected, surpassing September's disappointing numbers. It appeared that the expiration of enhanced employment benefits and some improvement in the Covid case environment provided a boost.

Nonfarm payrolls rose by 531k, exceeding the 450k consensus number. The past two months were also revised higher, by a total of 235k, which improved their lackluster initial results. Growth in employment was widespread, in over two-thirds of industries, with key gains in leisure/hospitality (164k), professional/business services (100k), manufacturing (60k), transportation/warehousing (54k), and construction (44k). Jobs in public education continued to decline, however. Overall, nonfarm payrolls are down -2.8% (4.2 mil.) from their pre-Covid Feb. 2020 level, indicating that room to go remains. Part of the decline has been due to retirements, but significant 'slack' remains, which is what the Fed is constantly referring to in their communications.

The key U-3 **unemployment rate** ticked down by -0.2% to 4.6%, with no change in the labor force participation rate. The household survey measure rose by 359k, and the U-6 underemployment rate also fell by -0.2% to 8.3%.

Average hourly earnings rose by 0.4% in the month, decelerating from September, but bringing the year-over-year change to 4.9%. Unsurprisingly, the largest earnings gains in recent months were in transportation and leisure/hospitality—both of which have been in desperate need of additional workers. **Average weekly hours** fell by a tenth of an hour to 34.7. Notably, when the rise in hourly pay is combined with the number of hours worked over the past year, total pay is up over 9% year-over-year, and 7% since Feb. 2020.

In an earlier report, **nonfarm productivity** declined at a -5.0% annualized rate in the third quarter, about two percent further than expected, and reversing the improvement of the prior quarter. **Unit labor costs** rose at an annualized 8.3% in Q3, surpassing expectations by over a percent. On a year-over-year basis, these costs rose by 4.8%.

Market Notes

Period ending 11/5/2021	1 Week (%)	YTD (%)
DJIA	1.43	20.47
S&P 500	2.03	26.56
NASDAQ	3.08	24.59
Russell 2000	6.11	24.35
MSCI-EAFE	1.64	12.83
MSCI-EM	-0.04	-0.31
BBgBarc U.S. Aggregate	0.64	-0.95

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
10/29/2021	0.05	0.48	1.18	1.55	1.93
11/5/2021	0.05	0.39	1.04	1.45	1.87

U.S. stocks continued their gains on the back of a Fed beginning their taper, but with a 'dovish' tone, strong economic data, and positive surprises in corporate earnings. Small caps sharply outperformed large caps. By sector, consumer discretionary, technology, and materials led with gains over 3%; financials and healthcare were the laggards with negative returns. Real estate gained nearly a percent, led by malls and retail, benefitting from lower interest rates.

The Q3 earnings season has been solid, even more so than expected. Per FactSet, 89% of S&P firms have reported, with 81% of these experiencing a positive earnings surprise and 75% having a revenue surprise. The overall year-over-year earnings growth rate currently lies at 39%. A good percentage of these have been in financials (as write-off reserves have been lowered) and energy (with higher petroleum prices passed on to consumers). However, a variety of consumer discretionary and industrial firms (such as airline travel) have outperformed low expectations. Full year 2021 earnings growth is anticipated to be in the range of 45%, with revenue up 15%. Earnings and revenue growth for 2022 are unsurprisingly expected to normalize to 9% and 7%, respectively (obviously all subject to change on a near-weekly basis).

Profit margins also continue to expand, with commentary from a variety of companies alluding to how recent rising costs have been passed through to consumers. Interestingly, this might be easier for consumers to bear, since the narrative about rising cost expectations is so pervasive. (By contrast, it's harder for a single company to do it arbitrarily and not face pushback eventually.) Of course, there's likely a limit to this.

Foreign stocks in Europe and Japan gained in line with U.S. equities, while the U.K. lagged. As in the U.S, a strong earnings recovery and dovish central bank tone appeared to drive sentiment. Emerging markets ended with a flattish week on net, with most nations in the positive, except for China, which declined as new Covid cases surged and additional real estate developers experienced liquidity problems.

U.S. bonds experienced large gains as investors appeared satisfied with the Fed's discussion following the FOMC meeting. Investment-grade and high yield corporate bonds both outperformed treasuries slightly, although bank loans also experienced gains.

In keeping with the expected FOMC taper announcement, the U.S. treasury yield curve has changed shape. Along with the predicted timeline of rate hikes, the 2-year has risen relative to longer maturities, which has flattened the curve. Also, the 30-year bond yield fell below the 20-year, representing a partial curve inversion. This was an indicator that perhaps the market fears the Fed may raise rates to the point where a recession becomes more likely in coming years. The general flattening of long treasury rates has been an indicator that economic slowing fears are beginning to overtake the bullishness demonstrated by a upwardly-sloping yield curve.

Foreign bonds also saw gains over 1% in both developed and emerging markets, despite little change in the dollar. The Bank of England voted to keep rates at 0.1%, rather than raise them to 0.25%, which had been expected due to their recent rhetoric about inflation concerns (although the rate there is lower than in the U.S. currently). Interestingly, they also voted to maintain their bond purchasing program. While inflation concerns continue to be higher in Europe (despite lower levels than in the U.S.), economic growth is also lower, tempering the need for a move to hawkish policies.

Commodities fell back generally, with declines in energy and industrial metals offset by gains in precious metals. The price of crude oil fell by nearly -3% to over $81/barrel. The OPEC+ group decided to keep production unchanged, despite protests from world leaders, such as President Biden, that high energy prices were straining the Covid recovery. This came with threats to tap the U.S. strategic petroleum reserve, which helped ease prices a bit, as did the scheduled resumption of nuclear talks with Iran (which, if resulting in an end to sanctions, resumed oil output).

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, Guggenheim, 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.