Financial Markets This Week

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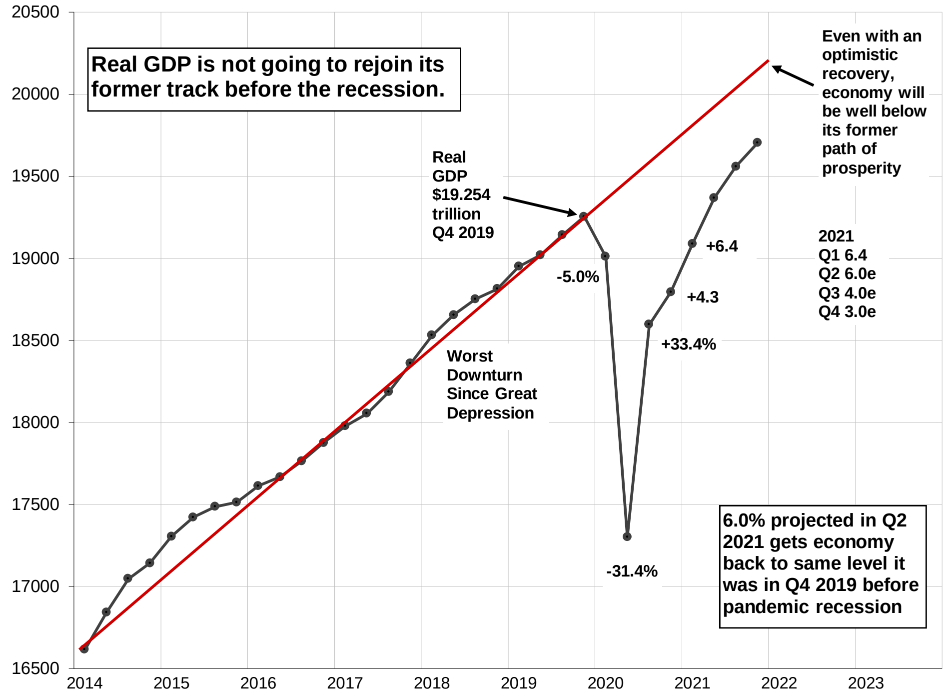
STRONGER MULTIYEAR GROWTH NOT ASSURED



First look at real GDP in the first quarter shows a 6.4% increase. It was 4.3% in Q4 2020. That's a big number today. But shouldn't it have been even bigger given the massive government assistance this quarter? The fiscal stimulus, the Economic Impact Payments (and how) with the $600 and then $1400 checks for most Americans even if they had a job, played a big role. The January $600 checks ($139 billion) and March $1400 checks ($339 billion) together are enough dollars to push up real GDP by 10.6% in the first quarter and 2.5% already for the full year on a Q4/Q4 basis with three quarters left to go. We don't know if all the checks were spent and the $1400 checks didn't hit the public's bank accounts until March 17, but it is a fact that the Federal government handout buys a lot of iPhones with Apple sales in the first quarter at $47.938 billion up 65.5% from last year even if iPhone sales were $65.597 in Q4 2020's holiday sales quarter. $600 and $1400 checks also bought a lot of hamburgers and fries too with McDonald's U.S. comparable sales up 13.6%. But still, it seems like first quarter GDP growth should have been even more.

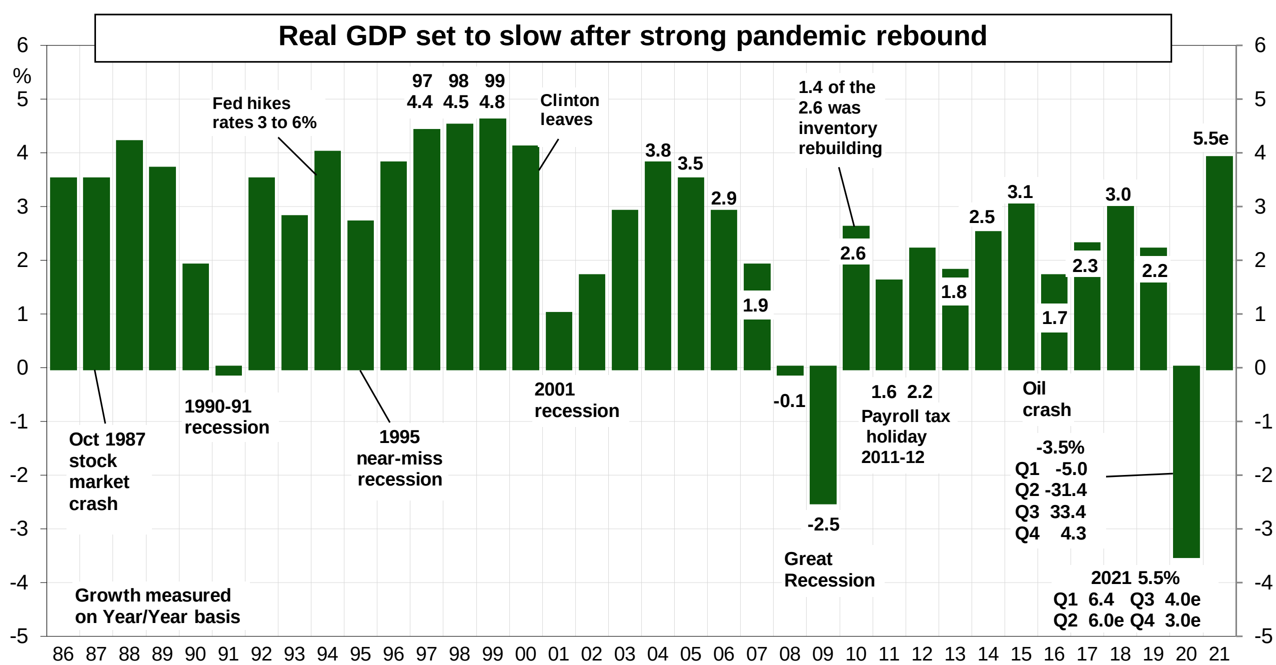
	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20	Q1 21p
REAL GDP	2.4	-5.0	-31.4	33.4	4.3	6.4
REAL CONSUMPTION	1.6	-6.9	-33.2	41.0	2.3	10.7
CONSUMPTION	1.1	-4.8	-24.0	25.4	1.6	7.0
Durables	0.2	-0.9	0.0	5.2	-0.1	3.0
Nondurables	-0.1	1.0	-2.1	4.4	-0.2	2.0
Services	1.0	-4.8	-22.0	15.9	1.9	2.1
INVESTMENT	-0.6	-1.6	-8.8	12.0	4.4	-0.9
Business Plant	-0.2	-0.1	-1.1	-0.5	-0.2	-0.1
& Equipment and	-0.1	-0.9	-2.0	3.3	1.3	0.9
Intellectual Property	0.2	0.1	-0.5	0.5	0.5	0.5
Homes	0.2	0.7	-1.6	2.2	1.4	0.5
Inventories	-0.8	-1.3	-3.5	6.6	1.4	-2.6
EXPORTS	0.4	-1.1	-9.5	4.9	2.0	-0.1
IMPORTS	1.1	2.3	10.1	-8.1	-3.6	-0.8
GOVERNMENT	0.4	0.2	0.8	-0.8	-0.1	1.1
Federal defense	0.3	0.0	0.2	0.2	0.2	-0.1
Fed nondefense	0.0	0.1	1.0	-0.6	-0.3	1.1
State and local	0.2	0.1	-0.4	-0.4	-0.1	0.2

Below line: Percentage point contributions to Q1 2021 6.4% real GDP

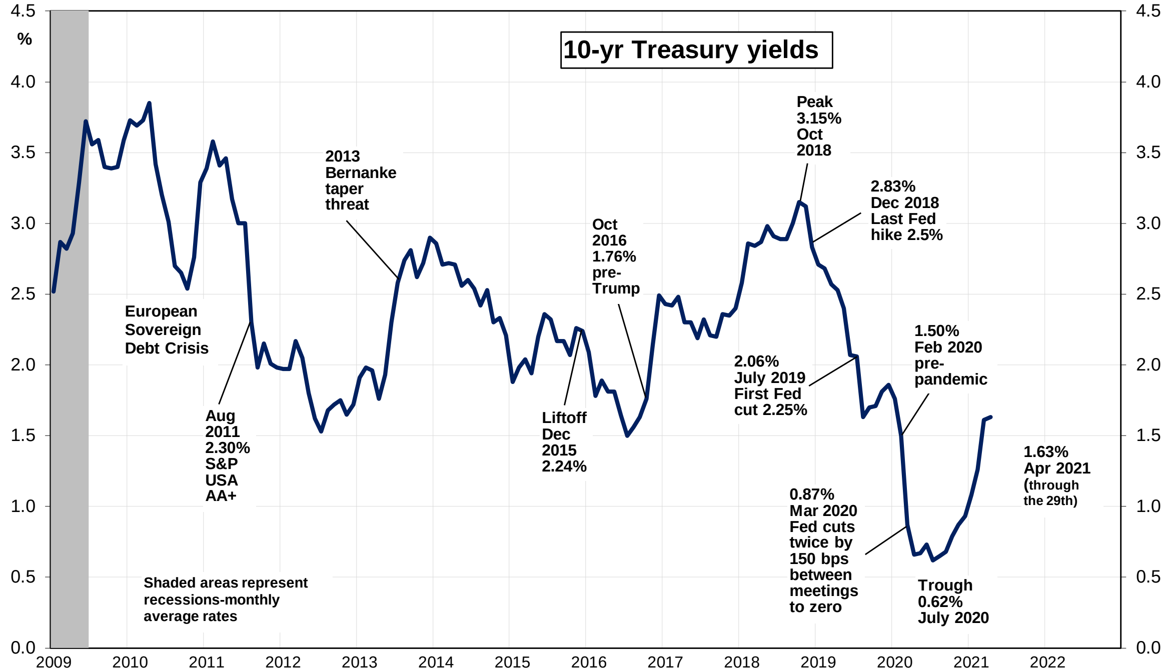
Second estimate for Q1 is Thursday, May 27

Real consumption expenditures rose 10.7% in Q1 2021 and contributed 7.0 percentage points to the 6.4% real GDP increase. Business investment added 1.3 percentage points to the 6.4% real GDP growth, but one wonders if that is sustainable as Covid-related computers and software purchases were three-quarters of the investment that won't be needed when America goes back to the office. Federal nondefense spending due to the handouts returned for the first time since the second quarter of 2020 during the recession and added 1.1 percentage points to growth. We get the sinking feeling that a lot of this growth won't be sustained as the economy reopens and things get back to normal. Hopefully not the Fed's idea of normal with their downbeat long run economic growth expectation of 1.8%. But growth should settle back to a 2 to 2-1/2 percent range fairly quickly.

Net, net, the stock market is excited about the prospects for growth and Federal Reserve officials are too with their go-big Q4/Q4 2021 6.5% GDP forecast. Our view is if something is too good to be true it probably is and the case for stronger multiyear growth is not assured. Washington has done a lot but further assistance given this was one of the quickest recessions in U.S. history, lasting barely two quarters, is also not assured. The $1.9 trillion American Rescue Plan with the $1400 checks is completed (the $1400 checks not deposited until March 17 so maybe there is some spillover spending for Q2). Waiting in the wings is the American Jobs Plan $2.3 trillion, and $1.8 trillion American Families Plan outlined by Biden last night. The latter two Biden proposals with tax hikes are not as friendly for Wall Street and investors are ignoring this for now. The economy and the stock market rally is on the move on the 101st day of Biden's term in office, but for how long. 6.4% growth is history and spending on computers and software from businesses won't continue; Federal nondefense spending won't continue; and consumers won't buy as many cars and groceries and clothing and furniture, or at least they will shift their dollars to attend sporting events, Disneyland, and bars and restaurants. The Biden Boom may have been bought with $600 and $1400 checks. More lasting growth may depend on the $2.3 trillion American Jobs Plan and the $1.8 trillion American Families Plan both of which face an uncertain fate in Congress.



INTEREST RATES

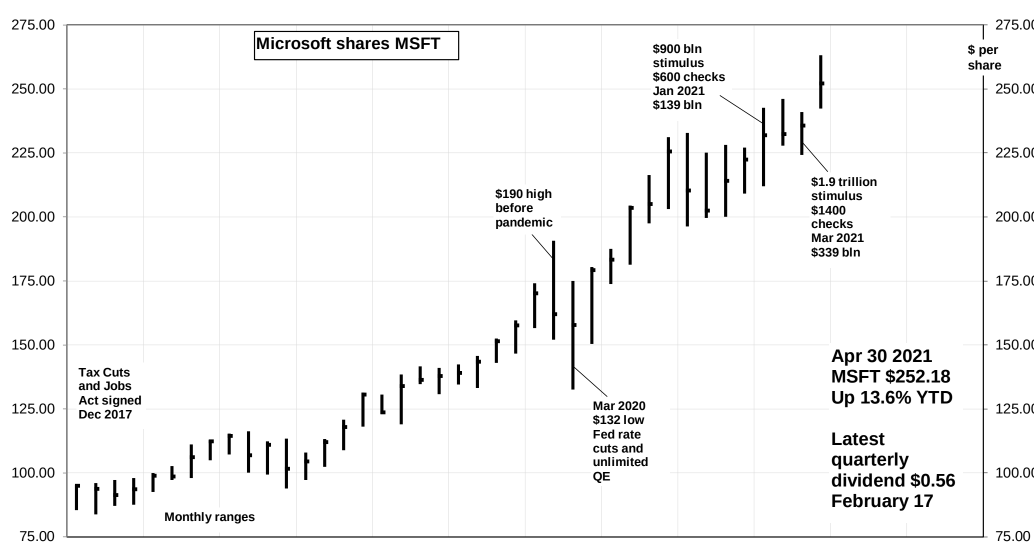


Bond yields closed 1.63% this week and mortgage rates were 2.98% or 138 bps higher off the survey base period. Economic growth is strong, but yields remain depressed and are far below the 3.15% yield peak in October 2018. The peak in the Fed funds rate was 2.5% at the end of 2018 and the current setting of 0.25% is likely to limit any bond market yield rally unless there is a lot of inflation. The Fed sees no rate hikes in their forecasts out through 2023. Fair value on bond yields is probably 1.5 to 2.0 percent for now. The kick in yields in March was helped along by massive auctions.

S&P 500 UP 11.3% YTD DRIVEN BY BIG TECH COMPANIES

Microsoft MSFT shares are up 13.6% in 2021 through Friday, April 30 12 close. Earnings for March 31, 2021 quarter were released April 27, 2021 with $41.7 billion of revenue that is 19% higher than a year ago, but less than $43.1 billion in December 2020 quarter. Intelligent Cloud revenue increased 23% to $15.1 billion from last year and was $14.6 billion in the December 2020 quarter.

S&P 500 Weights	
Top 6: 22% of S&P	
5.72	AAPL
5.27	MSFT
3.93	AMZN
2.10	FB
1.52	TSLA
1.84	GOOGL
1.77	GOOG
22.15	Top 6



FEDERAL RESERVE POLICY

The Fed met April 27-28, 2021 to consider its monetary policy. The press release devoid of any real news was released at 2pm ET Wednesday. Powell held a press conference from 2:30 to 3:30pm ET to talk about what they didn't do.

> Press Conference 4-28-2021
>
> Question
> I'm going to circle back to the housing market. It's just kind of confusing, the question and your answer. The housing market is strong. Prices are up, and yet the Fed is buying $40 billion per month in mortgage related assets. Why is that? And are those purchases playing a role at all in pushing up prices? Thank you.
>
> Answer
> Yeah. I mean, we started buying MBS because the mortgage-backed security market was really experiencing severe dysfunction. And we've sort of articulated, you know, what our exit path is from that. It's not meant to provide direct assistance to the housing market. That was never the intent. It was really just to keep that as, it's a very close relation to the treasury market, and a very important market on its own. And so that's why we bought, as we did during the global financial crisis, we bought MBS too. Again, not intention to send help to the housing market, which was really not a problem this time at all. So, and, you know, it's a situation where we will taper asset purchases when the time comes to do that, and those purchases will come to zero over time. And that time is not yet.

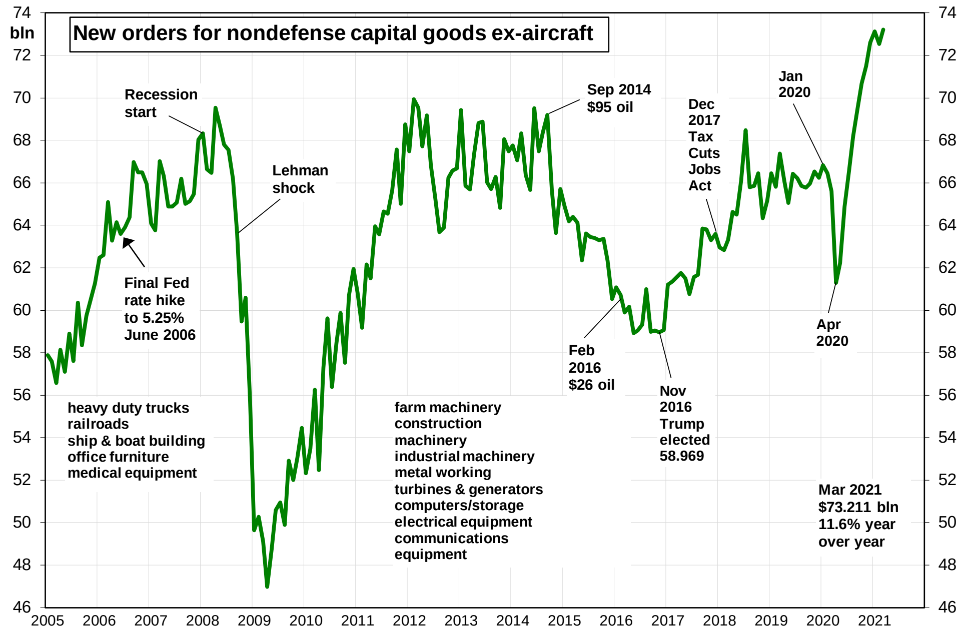
The emergency QE stimulus in the form of $120 billion of monthly purchases of Treasuries and MBS continues even as the country opens up and economic growth bounces back strongly. News reporters keep asking the Fed Chair when it will be time for the committee to talk about talking about paring the massive liquidity injection back. Late in the press conference the Fed Chair was asked specifically what the $40 billion monthly purchases of mortgage-backed securities (MBS) were doing, was it fueling a housing bubble for instance, and his answer showed that the highest Fed officials are uncertain about what exactly these QE purchases are doing other than broadly supporting financial conditions and the economic recovery. It doesn't seem as if the purchases are putting workers back to work faster or causing inflation to run hotter than would happen naturally. The original reason for QE MBS purchases in 2008 was to narrow spreads and bring down yields on 30-year mortgages that had widened in the unprecedented credit crunch. It wasn't until March 2009 that the Fed put its toe in the water and announced they would buy $300 billion of Treasury securities, Treasury purchases being true QE in our mind. It is interesting to speculate how high bond yields and mortgage rates might climb when the Fed starts buying fewer securities, but the way things are going, the FOMC might just take preliminary discussions at the Jackson Hole confab this year in August, and perhaps begin the QE cutback in the first half of 2022, a wind down to zero purchases that could take an entire year. There could be a new Fed Chair in February 2022 and that person would likely be even more reluctant to cut the QE support to the economic recovery as well. The markets, ourselves included, are probably kidding themselves that the Fed is going to pull back monetary policy support for the economy. But it is nice to think that savers might have a chance at higher yields on their savings accounts one day however unlikely in the immediate future.

> Powell Press Conference Opening Statement: Penultimate Paragraph 4-28-2021
> Our guidance for interest rates and asset purchases ties the path of the federal funds rate and the size of the balance sheet to our employment and inflation goals. This outcome-based guidance will ensure that the stance of monetary policy remains highly accommodative as the recovery progresses. (Biden proposed three programs in his first 100 days worth $6 billion so don't even think Powell is going to pull out Federal Reserve support, not before the unemployment rate falls back to 3.5%.)

OTHER ECONOMIC NEWS

Business spending on capital goods too good to last (Monday)

Breaking economy news. Durable goods orders. Surely the surge business orders in response to the pandemic where the public wanted stay-at-home goods is near the end. The very rapid growth in business capital goods orders is at record highs. How much new equipment does the economy need? Total durable goods orders rose 0.5% to $256.316 billion in March which is a rebound from the 0.9% drop in February that was likely the result of the severe winter weather hitting Texas especially hard. Manufacturing industrial production plunged 3.7% in February before bouncing part way back by 2.7% in March.

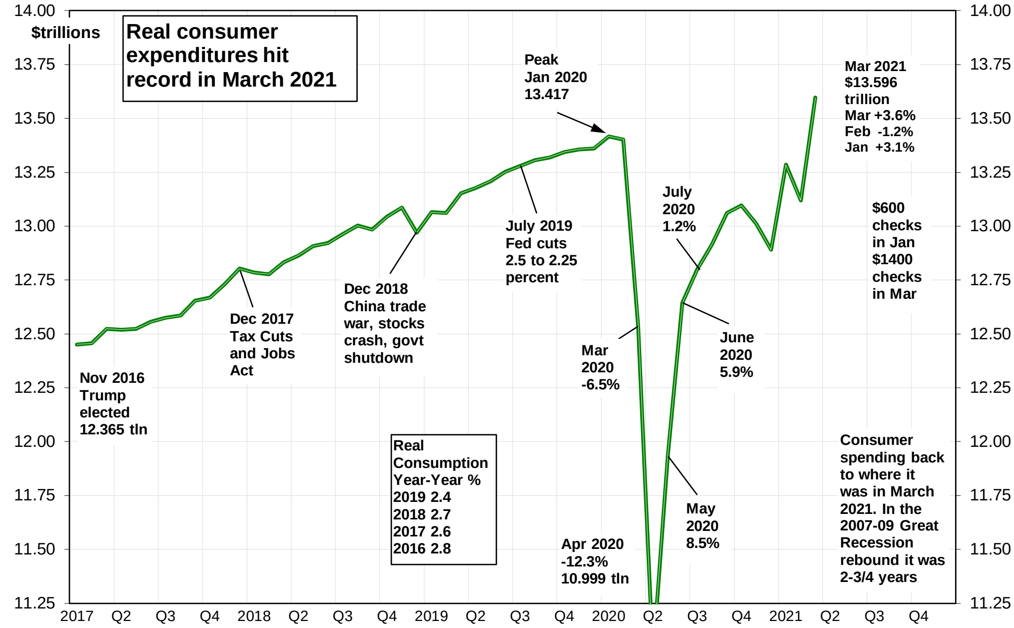


Total durable goods orders in March was $256.316 billion but our focus in on nondefense capital goods orders ex-aircraft which total $73.211 billion which is an increase of 0.9% in March to an all-time high following February's 0.8% decline. Business investment spending by this measure never really suffered during the pandemic recession. There was a big drop in April 2020, but that was the bottom. We should have known then it was okay to buy stocks and that the economy and eventually corporate profits would rebound. Still, though it remains to be seen if business investment spending will continue to advance to new records after the first quarter becomes history. Business spending could push economic growth at a double-digit rate in the Thursday report for the first quarter of 2021, but that will be the record this year and growth will not rise at that rapid of a pace again this year.

The spending of businesses on equipment needed in the Covid-19 economy was unprecedented. Over the last year, computer new orders up 15.5%, communication equipment orders up 14.9%, and electrical equipment and appliances rose 7.6%. These orders fit the stay-at-home economy where many workers are able to do the job from home. But other orders have seen a spending jump as well: machinery up 8.1%, fabricated metal products up 9.6%, and primary metals up 10.2%.

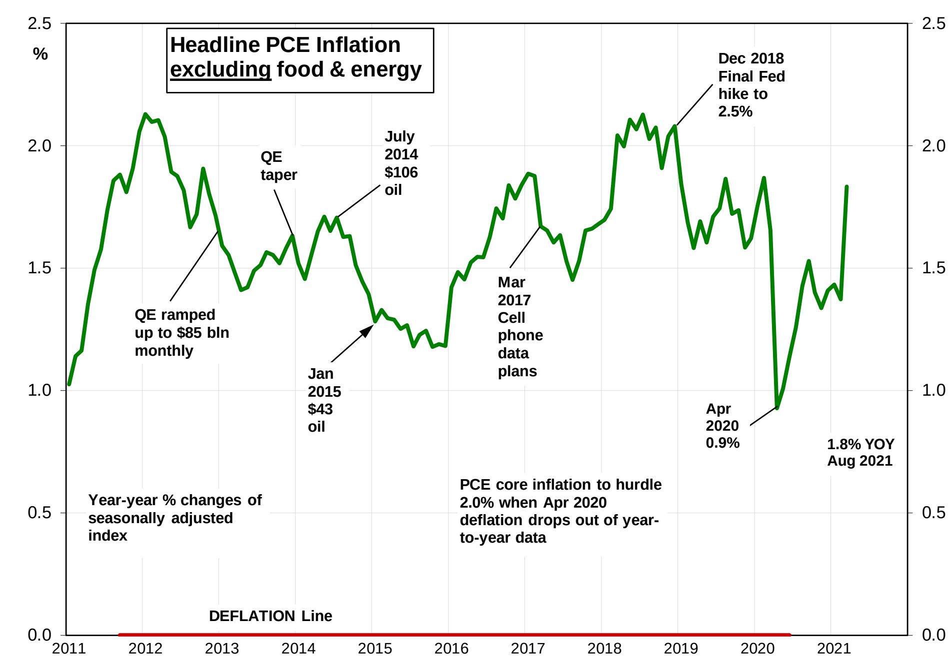
Net, net, business capital goods orders set a new record in March, but this could well be the high-water mark for orders this year as the economy reopens more fully after the pandemic shutdown. Those industries that prospered in this stay at home environment are unlikely to maintain their edge in the months to come. Investment drives the economy, and it takes innovation and often new inventions to kick off the demand for new equipment. The pandemic actually set off more investment spending than we had seen before which is a good thing for economic growth and kept the recession a brief one even if there is lingering unemployment for many workers displaced during the worst of the recession's fall. Stay tuned. Story developing.

Lots of personal income to fuel inflation and PCE inflation back to Fed's target (Friday)



Breaking economy news. The Personal Income report for March that has the Fed's PCE inflation and real consumption expenditures that were part of yesterday's 6.4% real GDP. Don't ask for how long the robust economic recovery can last because March may be the high-water mark for consumer spending this year. The $1.9 trillion Biden American Rescue Plan's $1400 checks hit consumers' bank accounts on March 17 and it looks like they spent every penny of it. Inflation is heating up as well with the Fed's PCE inflation measure back at 2% target this month for the first time since November 2018. What did Fed Vice Chair Clarida say? No rate hikes until monthly PCE inflation runs 2% YOY for over a year, so one month down, eleven more to go. Savers will rejoice.

Personal income soared thanks to the $1400 checks. Economists like to think personal income and savings will keep the economic recovery roaring for years, but it actually looks like the money is being spent immediately. The economic impact payments have made measurement of personal income look topsy-turvy because don't forget those $600 checks that hit consumer bank accounts on January 4. So ready? Monthly change in personal income in January plus 10.3%, February minus 7.0%, and March plus 21.1%, this can't last and it won't. This strengthening economic recovery is looking too good to be true. Personal income jumped 21.1% to $24.207 trillion in March, but the $1400 checks are part of the Other government social benefits to persons (and how) that were $4,750 trillion or 19.6% of the total this month. This can't last and it won't.



Real consumer spending in March jumped 3.6% with durable goods up 10.3% and services up 1.7%. People won't be buying as many cars in the future but the offset will be more services spending like dining out and vacations. There will be some momentum into the second quarter which is probably why economists' GDP forecasts remain high after 6.4% in the first quarter. If we use the jump in March spending and say there is no change in this level of real purchases in April, May, and June, then real consumption expenditures will be 8.1% in Q2 after 10.7% in Q1. Maybe we should rethink our lowly 5.0% GDP forecast for Q2 which seems to be an outlier. Dallas Fed President Kaplan says the risk to his 6.5% growth forecast this year is to the upside.

Net, net, consumer purchases sent economic growth skyward in March as the economy opened up further following the lifting of more pandemic restrictions and aided by the over-the-top Federal giveaway of $1400 checks. Red hot economic growth can engender a little inflation and sure enough core PCE inflation moved up 0.4% in March after a softer 0.1% rise in February. Core PCE inflation year-on-year jumped to 1.8% in March from 1.4% in February and is going higher as March (-0.1%) and April (-0.4%) 2020 were deflation months where prices dropped during the height of the pandemic. Stay tuned. Story developing. Powell says pay no attention to that inflation behind the curtain. $120 billion of QE purchases to support the economy will continue. Bet on it.

Analyst Certification

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