# *Financial Markets This Week*

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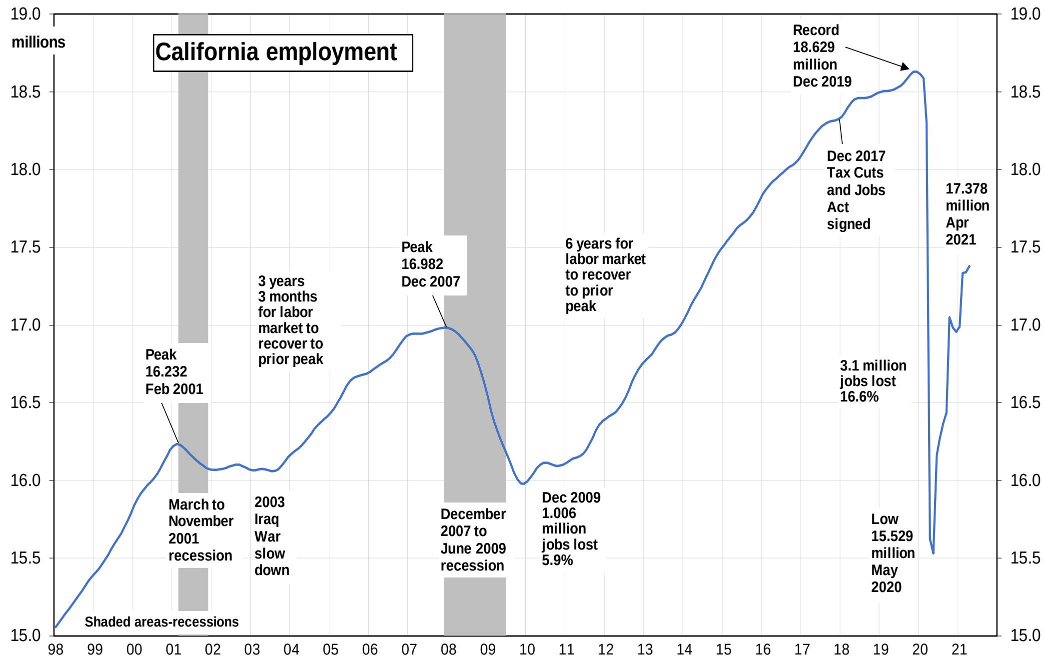
## California Dreaming

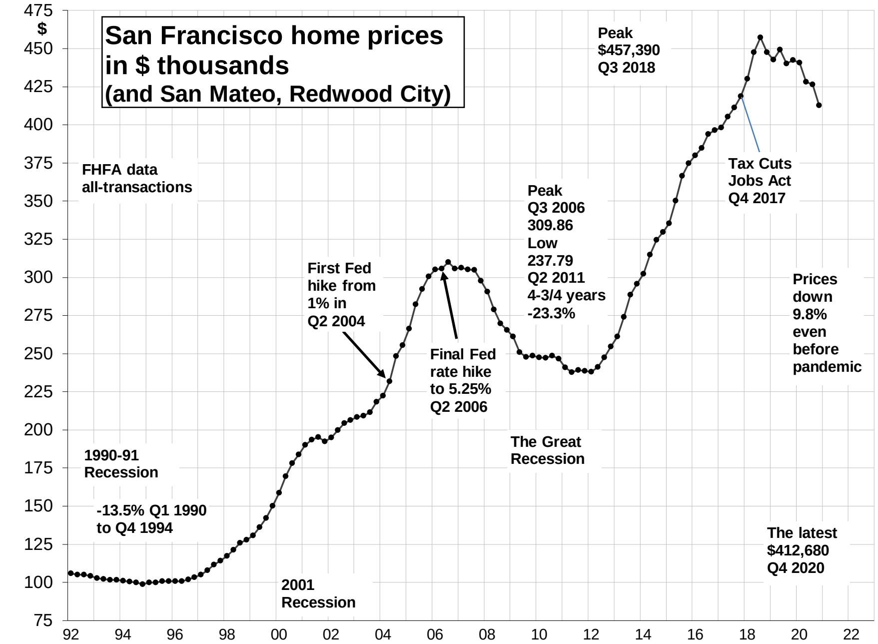



"I'd be safe and warm if I was in LA." Actually, people are starting to leave California even if it is still the biggest state in the union. Caifornia lost a seat in Congress after the 2020 Census and Texas picked up two seats. California employment is still the highest at 16.4 million based on unemployment insurance tax records, and Texas has a total of 12.0 million jobs. (New York state 8.7 million.) California' economy has made progress getting people back to work, but with employment at 17.378 million it is some 6.7% below the record in December 2019 before the pandemic. This is one of the fastest rebounds in economic growth in any recession, but the labor market recovery still always lags growth. Hopefully, jobs will return faster than after the 2007-09 recession where it took 6 years to get back to the prior peak. Employment is 6.7% off its highs, more than the worst point of the 2007-09 recession with its 5.9% loss of jobs, and yet tax collections have improved enough so that California Governor Newsom is going to mail out $600 checks to two-thirds of Californians that is billed as the biggest state tax rebate in American history.

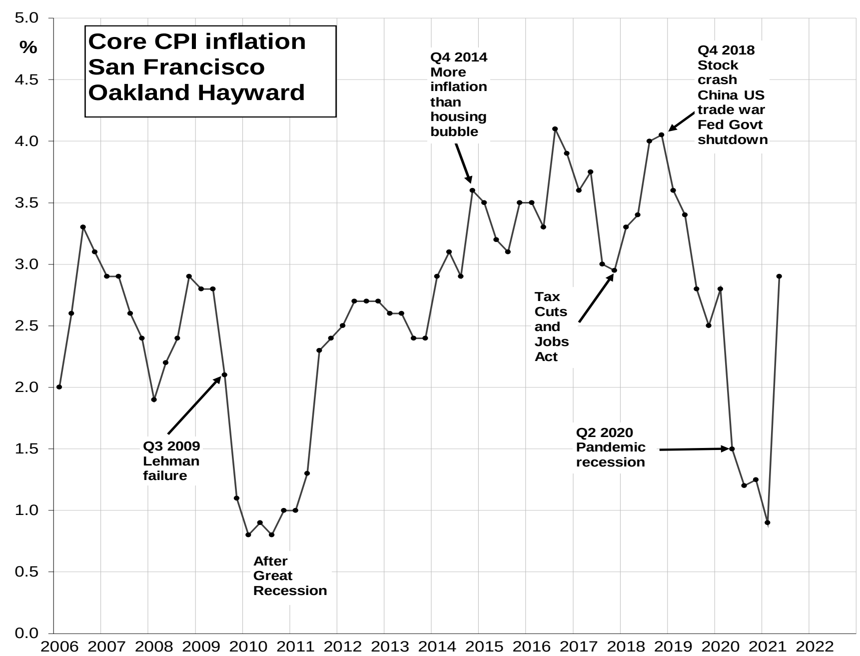
**California Labor Market Trends**

| Thousands | Dec 2019 | Apr 2021 | Change | % Chg |
|---|---|---|---|---|
| Employment | 18,629 | 17,378 | -1,251 | -6.7 |
| Unemployed | 807 | 1,576 | 769 | -- |
| Rate | 4.2 | 8.3 | 4.1 | |
| Payroll employment | 17,554 | 16,248 | -1,306 | -7.4 |
| Mining/Logging | 22.1 | 19.1 | -- | -- |
| Construction | 894.2 | 885.7 | -8.5 | -1.0 |
| Manufacturing | 1,328.2 | 1,252.2 | -76.0 | -5.7 |
| Trade/Trans/Utilities | 3,064.2 | 2,983.7 | -80.5 | -2.6 |
| Information | 569.6 | 525.7 | -43.9 | -7.7 |
| Financial activities | 848.1 | 807.8 | -40.3 | -4.8 |
| Professional/Business | 2,749.0 | 2,662.9 | -86.1 | -3.1 |
| Education/Health | 2,851.2 | 2,758.7 | -92.5 | -3.2 |
| Leisure/Hospitality | 2,053.9 | 1,480.8 | -573.1 | -27.9 |
| Other Services | 580.2 | 469.2 | -111.0 | -19.1 |
| Government | 2,593.6 | 2,402.4 | -191.2 | -7.4 |

The other measure of labor market employment, nonfarm payroll jobs, is down 7.4% from the end of 2019. Leisure and hospitality jobs are down 27.9% which is the worst sector followed by Other Services with losses of 19.1%. Information jobs that California startups are famous for were not spared and employment is down 7.7% which includes publishing, motion pictures, broadcasting, data processing, and hosting services.



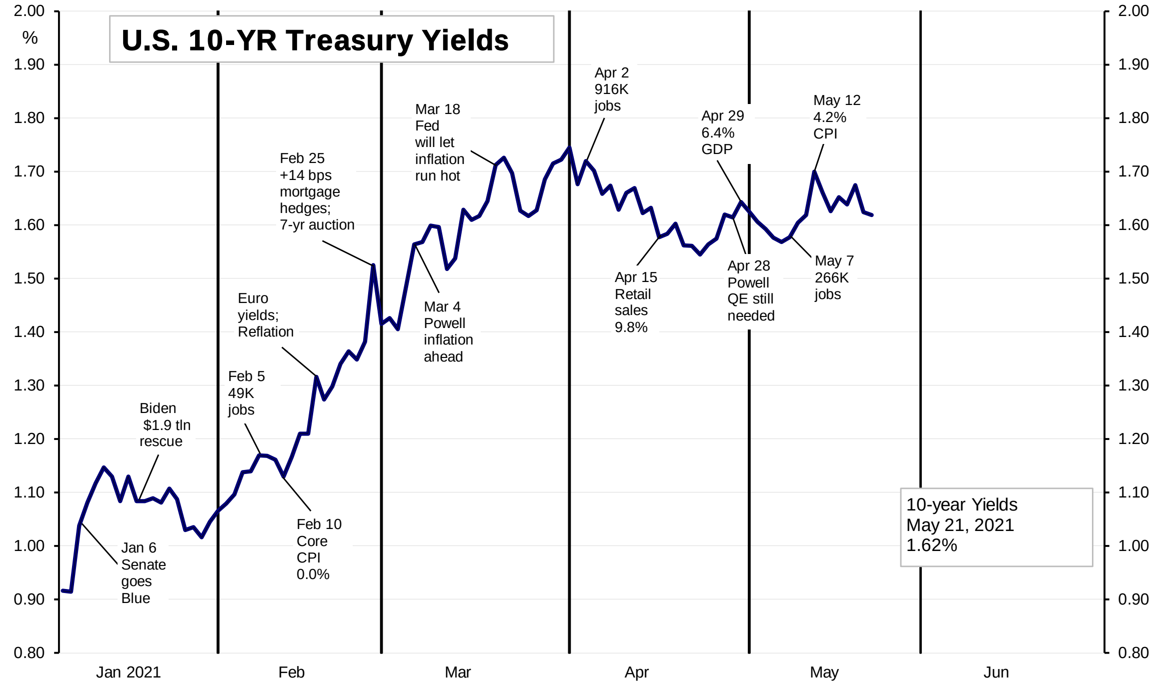

Meanwhile, there is no housing bubble in San Francisco where prices have fallen 9.8% from the peak in Q3 2018 perhaps as the work-from-home crowd has left the city. These are data from the FHFA that includes sales and real estate appraisals. The drop is perhaps due in part to more cautious real estate appraisals where lenders are guarding against a downturn in prices after years of steady gains. Home prices also cooled as the Tax Cuts and Jobs Act put a $10,000 cap on the federal tax deduction for property taxes. The interest deduction on mortgages was reduced to $750,000 from $1 million. It is important to remember that this is San Francisco real estate where the latest existing single-family home sales data in the West say year-to-year prices are up 20.6% in April 2021.




There was certainly no inflation in San Francisco until recently. Core CPI is rising 2.9% year-on-year in April 2021 where it had been below 1% year-year in the first quarter of 2021. Inflation is likely to heat up further as the state economy opens up and life starts to look more normal.

To conclude, this has been a fast recovery, but the labor market is going to take its time and many workers who lost their jobs will not quickly find new employment. This has been what has ocurred in most recoveries. The Federal Reserve's low interest rates and money printing are not going to bring jobless workers back on line any quicker. Its proactive policies could be inflating asset prices like the stock market and housing.

## INTEREST RATES

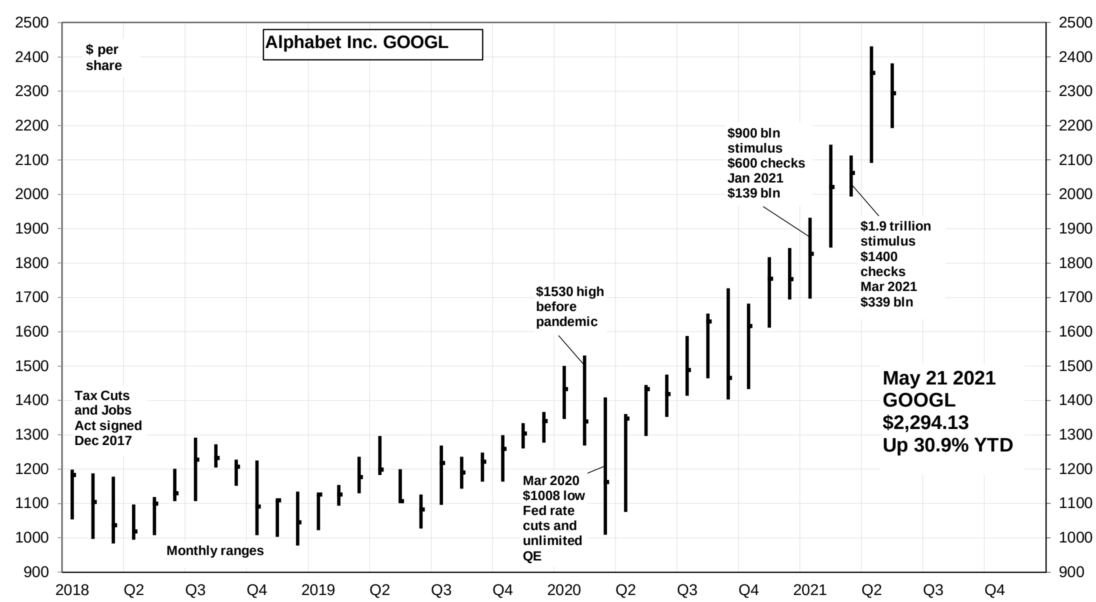



There was some movement on Wednesday even if it didn't always match up perfectly with the news. Higher inflation in the U.K. (1.5%) and in Europe (1.6%) moved yields higher in the early morning although it is nothing like the U.S. 4.2% CPI inflation reported last week. Yields came down with crashing stocks and Bitcoin and started rising back as those markets stabilized. A 20-year auction and the Fed meeting minutes sent yields to the 1.695% highs for the week later Wednesday afternoon.

## Alphabet Inc. GOOGL up 30.9% YTD

Alphabet Inc. GOOGL shares closed Friday up 30.9% YTD. Its two share classes have a combined weight in the S&P 500 index of 3.96%. The company reported March quarter earnings on April 27 and said the results were boosted by online activity during the pandemic. Diluted EPS is $26.29 in Q1 21 versus $9.87 in Q1 20. Revenue was $55.314 billion in Q1 21 (Cloud 4.047). Google Advertising is $44.684 billion (YouTube ads $6.005 billion). All of the operating income is from Google Services.

| S&P 500 Weights | |
|---|---|
| Top 6: 23% of S&P | |
| 5.86 | AAPL |
| 5.37 | MSFT |
| 4.19 | AMZN |
| 2.21 | FB |
| 1.54 | TSLA |
| 2.00 | GOOGL |
| 1.96 | GOOG |
| 23.13 | Top 6 |



## FEDERAL RESERVE POLICY

The Fed meets June 15-16, 2021 to consider its monetary policy. They will issue new forecasts of the economy and interest rates. In the March forecast, four out of eighteen Fed meeting participants looked for a rate hike in 2022, that's by the end of 2022, no indication of when within the year.

The FOMC April 27-28, 2021 meeting minutes were released on Wednesday at 2pm ET. The Fed is inching closer to talking about talking about exiting its emergency QE stimulus according to news headlines, although bond yields had already moved a little higher on the day prior to the 2pm ET news, in part due to more inflation in data out of the U.K. and Europe earlier in the morning. The April 27-28 meeting was before the alarming April CPI report of 4.2% year-on-year headline inflation reported on May 12. The hawkish interpretation of the markets (bond futures fell 20 ticks) may have been exaggerated by St. Louis Fed President Bullard's comments to reporters after a speech on Wednesday where he said although it is Powell's call on tapering timing, "if it got to the point where we were comfortable on the public health side that the pandemic was largely behind us… then I think we could talk about adjusting monetary policy."

| **Selected Fed assets and liabilities**<br>Fed H.4.1 statistical release<br>billions, Wednesday data | 19-May | 12-May | 5-May | 28-Apr | March 11 2020** pre-Covid |
|---|---|---|---|---|---|
| **Factors adding reserves** | | | | | |
| U.S. Treasury securities | 5071.821 | 5054.395 | 5040.418 | 5014.762 | 2523.031 |
| Federal agency debt securities | 2.347 | 2.347 | 2.347 | 2.347 | 2.347 |
| Mortgage-backed securities (MBS) | 2277.561 | 2191.325 | 2191.325 | 2191.305 | 1371.846 |
| Repurchase agreements | 0.000 | 0.001 | 0.000 | 0.000 | 242.375 |
| Primary credit (Discount Window) | 0.661 | 0.581 | 0.545 | 0.731 | 0.011 |
| MMLF | 0.000 | 0.000 | 0.000 | 0.000 | |
| PDCF | 0.000 | 0.000 | 0.000 | 0.000 | |
| Commerical Paper Funding Facility | 8.554 | 8.556 | 8.556 | 8.556 | |
| Paycheck Protection Facility | 82.635 | 79.922 | 76.453 | 72.394 | |
| Corporate Credit Facility (CCF) | 25.966 | 25.901 | 25.996 | 25.970 | |
| Municipal Liquidity Facility | 11.127 | 11.125 | 11.123 | 11.121 | |
| Main Street Lending Program | 30.550 | 30.668 | 30.659 | 30.894 | |
| Term Asset-Backed Facility (TALF II) | 4.922 | 4.922 | 4.922 | 5.284 | |
| Central bank liquidity swaps | 0.652 | 0.587 | 0.653 | 0.703 | 0.058 |
| Federal Reserve Assets | 7972.1 | 7879.8 | 7859.6 | 7829.3 | 4360.0 |
| 3-month Libor % | 0.15 | 0.15 | 0.17 | 0.19 | 0.77 |
| **Factors draining reserves** | | | | | |
| Currency in circulation | 2169.173 | 2169.384 | 2167.663 | 2163.465 | 1818.957 |
| Term Deposit Facility | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| U.S. Treasury Account at Fed | 860.833 | 864.253 | 946.134 | 932.287 | 372.337 |
| Treasury credit facilities contribution | 50.278 | 50.278 | 50.278 | 50.278 | |
| Reverse repurchases w/others | 293.998 | 209.257 | 162.800 | 166.732 | 1.325 |
| **Reserve Balances (Net Liquidity)** | 3823.979 | 3955.864 | 3900.803 | 3889.018 | 1779.990 |
| Treasuries within 15 days | 95.705 | 118.774 | 124.849 | 100.168 | 21.427 |
| Treasuries 16 to 90 days | 300.258 | 283.706 | 278.205 | 327.552 | 221.961 |
| Treasuries 91 days to 1 year | 643.626 | 630.986 | 630.363 | 628.477 | 378.403 |
| Treasuries over 1-yr to 5 years | 1933.283 | 1948.027 | 1942.674 | 1902.633 | 915.101 |
| Treasuries over 5-yrs to 10 years | 918.938 | 910.943 | 906.238 | 906.047 | 327.906 |
| Treasuries over 10-years | 1180.011 | 1161.958 | 1158.090 | 1149.886 | 658.232 |

**March 11, 2020 start of coronavirus lockdown of country

MMLF: Money Market Mutual Fund Liquidity Facility: loans secured by assets bought by banks from money market funds

PDCF: Primary Dealer Credit Facility: o/n and term funding with maturities to 90 days

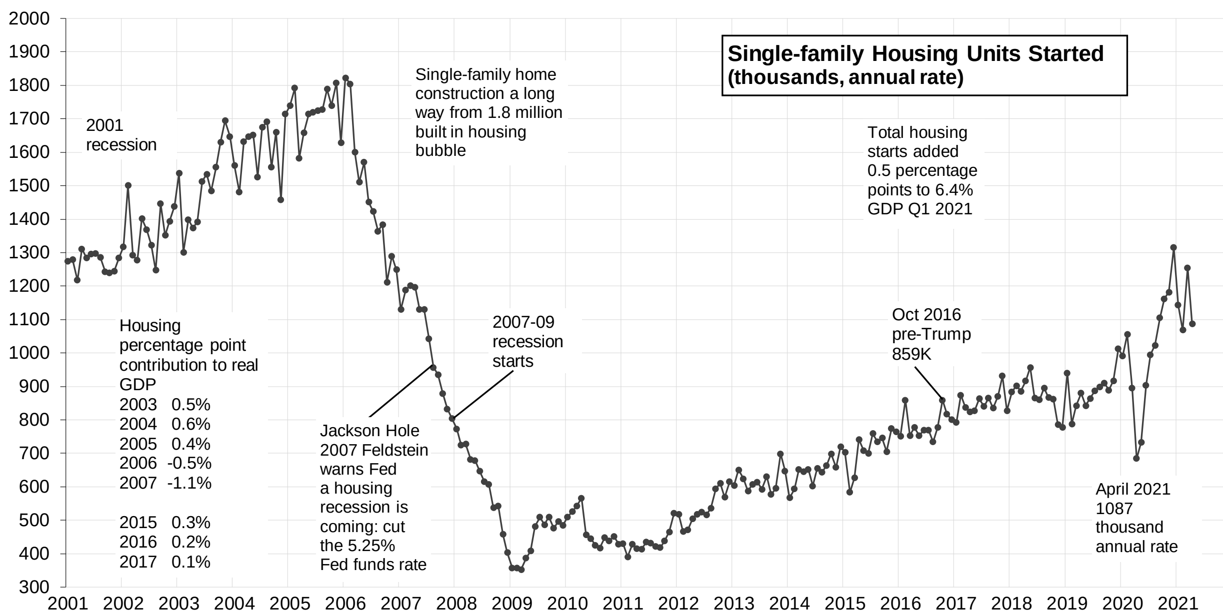
CCF: Corporate credit facility: Primary market (PMCCF) and Secondary Market (SMCCF)

Sounds good. The virus has been beaten, the Fed can start to withdraw. We hardly don't know what to say. The Fed is over-emphasizing the labor market as a marker that tells them when it is time to pull back on the stimulus. In the old days they would have pushed the Fed funds rate to normal 2.5% when the unemployment rate reached 3.5% the best point of the last business cycle. Now they have to be assured that it is going there before they even stop cutting back the $120 billion of monthly QE purchases ($1.440 trillion per year). That was then, now is now. Was there anything in the April 27-28 FOMC meeting minutes (which of course are still not a verbatim transcript after all these years) that says the Fed is inching closer to tapering its QE purchases even before the shocking CPI report on May 12? "A number of participants suggested that if the economy continued to make rapid progress toward the Committee's goals, it might be appropriate at some point in upcoming meetings to begin discussing a plan for adjusting the pace of asset purchases." That's it. That's the sentence that made the market think the Fed is inching closer to making a taper decision. Dream on markets. Dream on.

## OTHER ECONOMIC NEWS

### Not enough construction to cool the shortage-based housing price bubble (Tuesday)

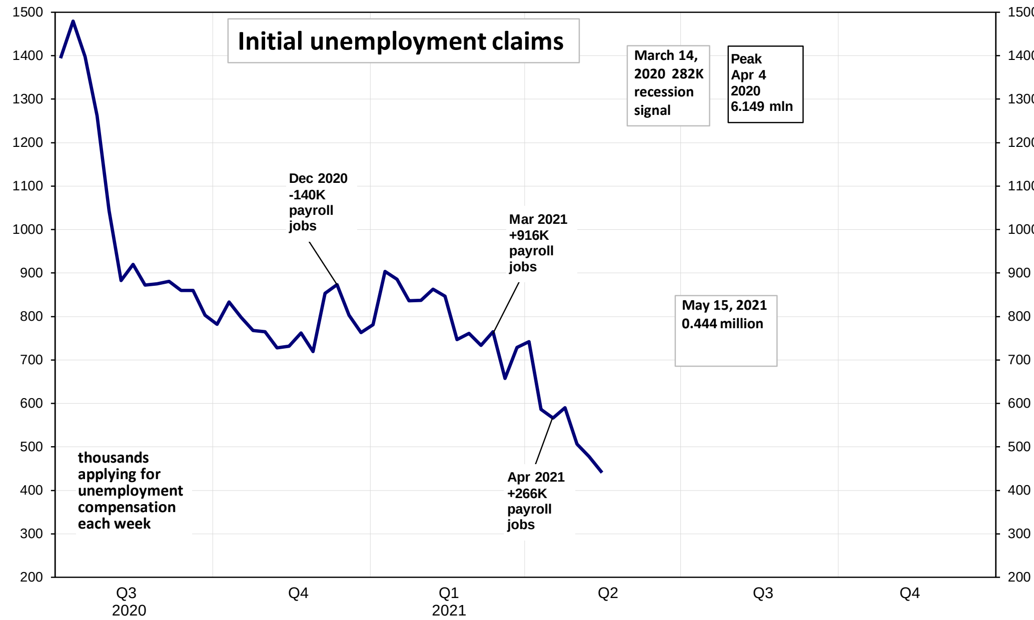
Breaking economy news. April housing starts fell 9.5% to 1.569 million at an annual rate. Single family home construction fell 13.4% to 1.087 million. During the housing bubble years, single-family construction reached 1.8 million for a few months in 2005 and early 2006 before the crash. There are 332 million Americans, and for some reason, residential construction cannot get up to speed whether it is due to zoning-problems for the land, sky-high construction costs thinking of lumber or simply whether builders are getting cold-feet at putting up more million-dollar homes that the public increasingly cannot afford. The seasonal factors may be out of whack here given the huge drop in payroll jobs of over 20 million last April which was the worst point of the pandemic recession. It is hard to explain the big jump in construction in March only to fall back in April. Single-family home construction down 13.0% in the Northeast, 32.3% in the Midwest, 12.5% in the South, and unchanged, that's a big zero for you, out in the West. Despite mortgage rates at near record lows, the Federal Reserve's policy is doing nothing for homebuilders right now.




Net, net, residential housing construction is stuck in a rut with a moribund lack of home building activity that will do nothing to alleviate the nation's housing shortage and stop the runaway bubble in home prices. Even at the peak of the housing bubble in 2006, prices never rose more than 10% per year and this year home prices nationwide are up 18.4% in the year ending March 2021, with demand from work-from-home employees in the Northeast leading to nearly a 25% jump in prices there with more data coming our way this Friday. Talk about income inequality that the Fed's emergency stimulus continues to feed: millions of American families are no longer able to afford their own home.

Residential housing construction contributed 0.5 percentage points to 6.4% real GDP in the first quarter which is a small but essential contribution to the economy because it drives consumer spending on furnishings, appliances and associated building services. This critical driver of growth will stop adding to GDP in the second quarter as the volatile residential construction data continue to disappoint.

## Jobless claims fall even if the $300 additional weekly benefits remain in most states (Thursday)



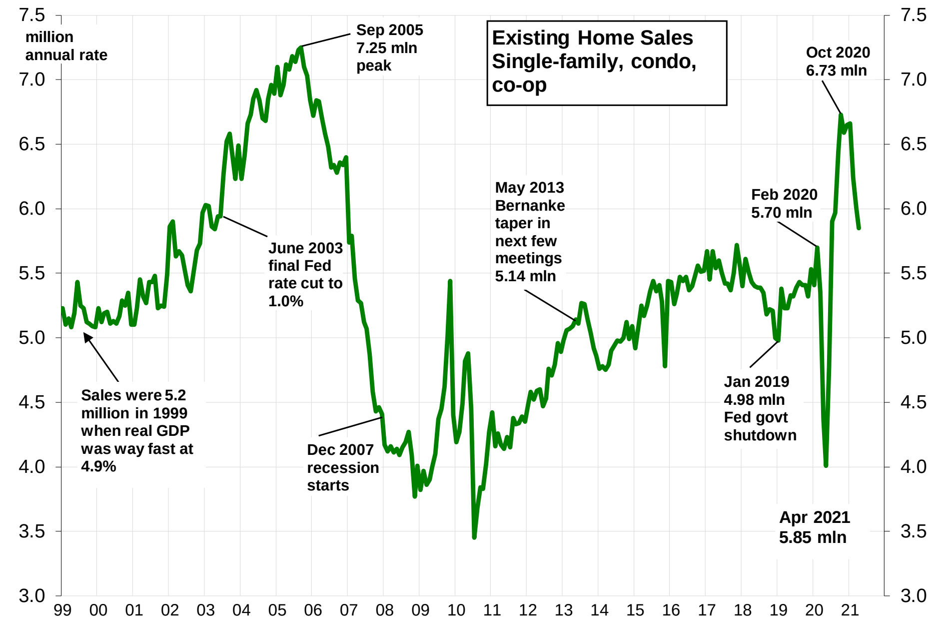

Breaking economy news. Initial unemployment claims fell 34 thousand to 444 thousand in the May 15 week. Last year there were 2.149 million applications filed in this week so the economy is clearly on the mend and the Federal Reserve can stop printing money. New jobless applications are at a new low in this recovery from the recession which is good news for the May monthly payroll jobs report even if it cannot forecast whether businesses will hire 250 thousand workers or one million workers this month when the report is released Friday, June 4 at 830am ET. The data continue to provide a confusing picture of labor market weakness. The total number receiving unemployment benefits in the May 1 week was 15.975 million while the employment situation report for April said there are only 9.812 million out of work behind the 6.1% unemployment rate. The only thing we can say for sure is that companies are continuing to slowly hire back the workers they let go during the steep downturn a year ago.

Net, net, there is still a question mark over the degree of labor market tightness out there in the country and the elevated level of new jobless claims is no guarantee that the economy is still battling to free itself from the recession. For one thing, the processing problems leading to a substantial backlog of unemployment claims in many of the larger states means today's claims reflect economic and business conditions over a month ago. It is more troubling the thought perhaps that maybe businesses are not going to rehire all the workers they had prior to the pandemic as is often the case in recessions. A deep downturn in the economy prompts management to reassess their businesses and they often realize they didn't need as many workers as they had prior to the recession. We are already seeing this perhaps in the restaurant industry where sales have returned very close to pre-pandemic levels in early 2020 while employment has lagged significantly. It's a game of musical chairs this economy and there won't be as many seats for workers as there were back in the good old days before the pandemic. Bet on it.

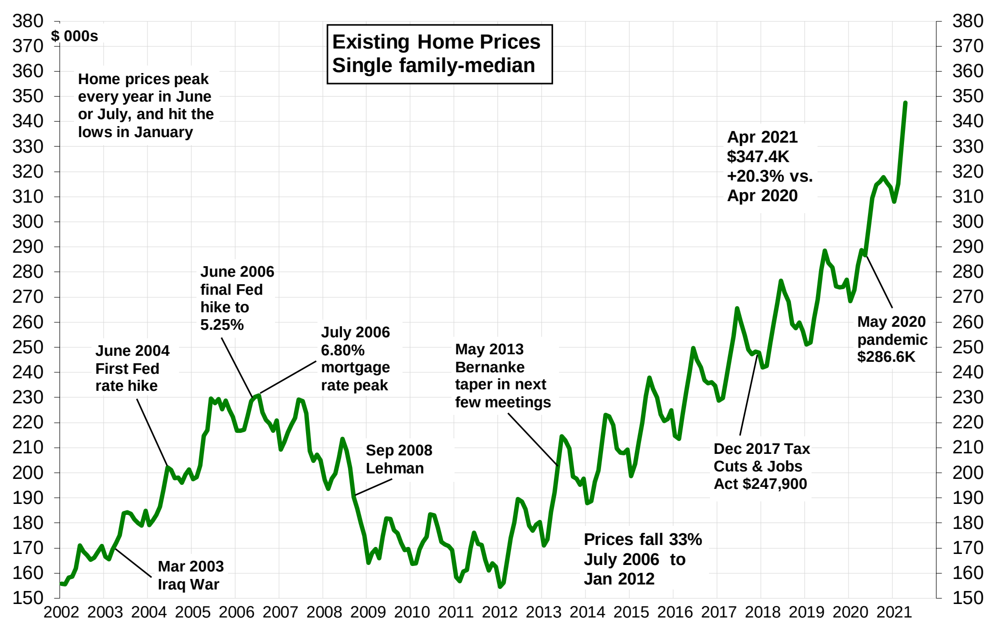
**Unemployment Benefits Recipients**

| 5/1/2021 | Program | Prior Year |
|---|---|---|
| 3,668,831 | Regular State | 20,798,651 |
| 13,785 | Federal Employees | 15,396 |
| 7,321 | Newly Discharged Veterans | 10,908 |
| 6,605,416 | Pandemic Unemployment Assistance | -- |
| 5,141,311 | Pandemic Emergency UC | -- |
| 456,805 | Extended Benefits | 426 |
| 1,753 | State Additional Benefits | 5,803 |
| 80,226 | STC/Workshare | 143,441 |
| 15,975,448 | TOTAL | 20,974,625 |

## Panic home buying is over (Friday)




Breaking economy news. Existing home sales fall 2.7% to 5.85 million at an annual rate in April. It is the start of the spring selling season, but you would never know it with sales down 13.1% from the 6.73 million peak in October 2020 which was the height of the COVID-based sales frenzy. A double-digit reduction in sales nationwide is all the evidence one needs to see that the storm-surge in home buying is over. The pandemic is over and so are the panicky purchases from exiting city dwellers so they could work from home in nicer surroundings with more space. It is no accident that the Northeast has seen the biggest jump in home prices given its proximity to New York City. Over the last year, single-family home prices rose 23.9% in the Northeast, 20.6% in the West, 17.1% in the South and 14.0% in the Midwest. Housing is more unaffordable than ever and this makes us question whether the breakneck speed of the economic expansion from the recession can continue at its current pace. Our best guess is the economy got a top-up from those $600 and $1400 checks in the first quarter and it is all downhill from here.




Net, net, the storm surge in panic-buying of homes during the pandemic is slowly subsiding as the stay-at-home restrictions have been lifted. We hope there isn't buyer's remorse that leads to selling because home prices have jumped way out of line with the long-run market fundamentals based on economic growth, employment and wages. The economy is getting back to normal but what isn't normal was the 20 percent jump in single-family home prices. The Federal Reserve's money-printing and its slashing of interest rates backstopped the surge in home prices, but what happens to this latest housing price bubble when the Fed backs away and the economy gets back to normal? Stay tuned story developing. We already had one of the last three recessions caused by a housing bubble, we don't need another one. The panic buying of homes is over, and the next shoe to drop may well be home prices.

## Analyst Certification

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