Financial Markets This Week

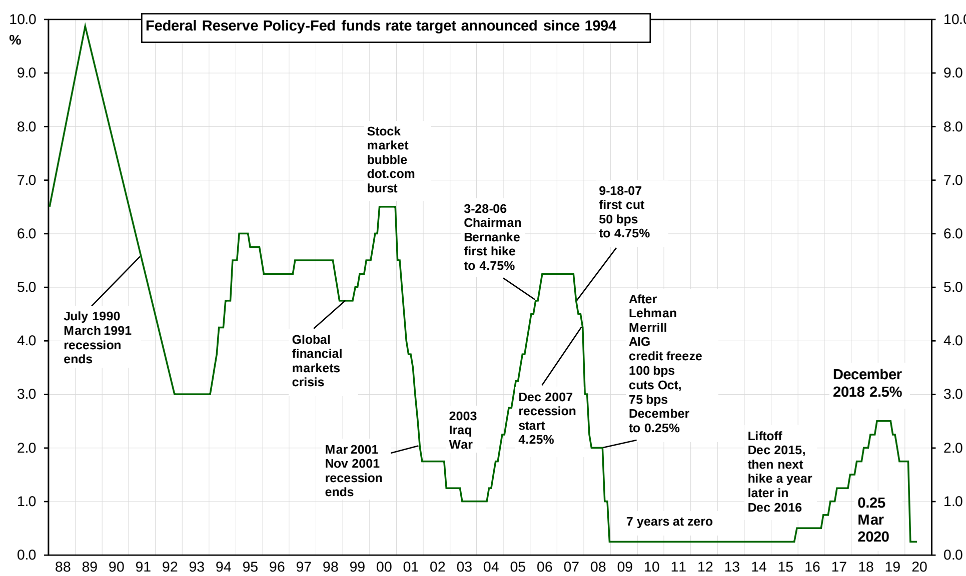
Christopher S. Rupkey, CFA
Chief Economist
crupkey@fwdbonds.com

27 AUGUST 2021

ILL-TIMED POLICY MOVE COULD BE HARMFUL

The Fed meets on September 21-22, 2021 to consider its monetary policy. We don't know if his foot-dragging on stopping the emergency stimulus has the full support of the Committee, but this week there were stories out about how Yellen supports his nomination for a second term as Fed Chair. Another four years for a Fed Chair who is not an economist. Great. Savers in America have even longer to wait for the chance of earning income off their retirement accounts that sit in banks losing money to inflation month after month.

Don't ask when rate hikes are coming

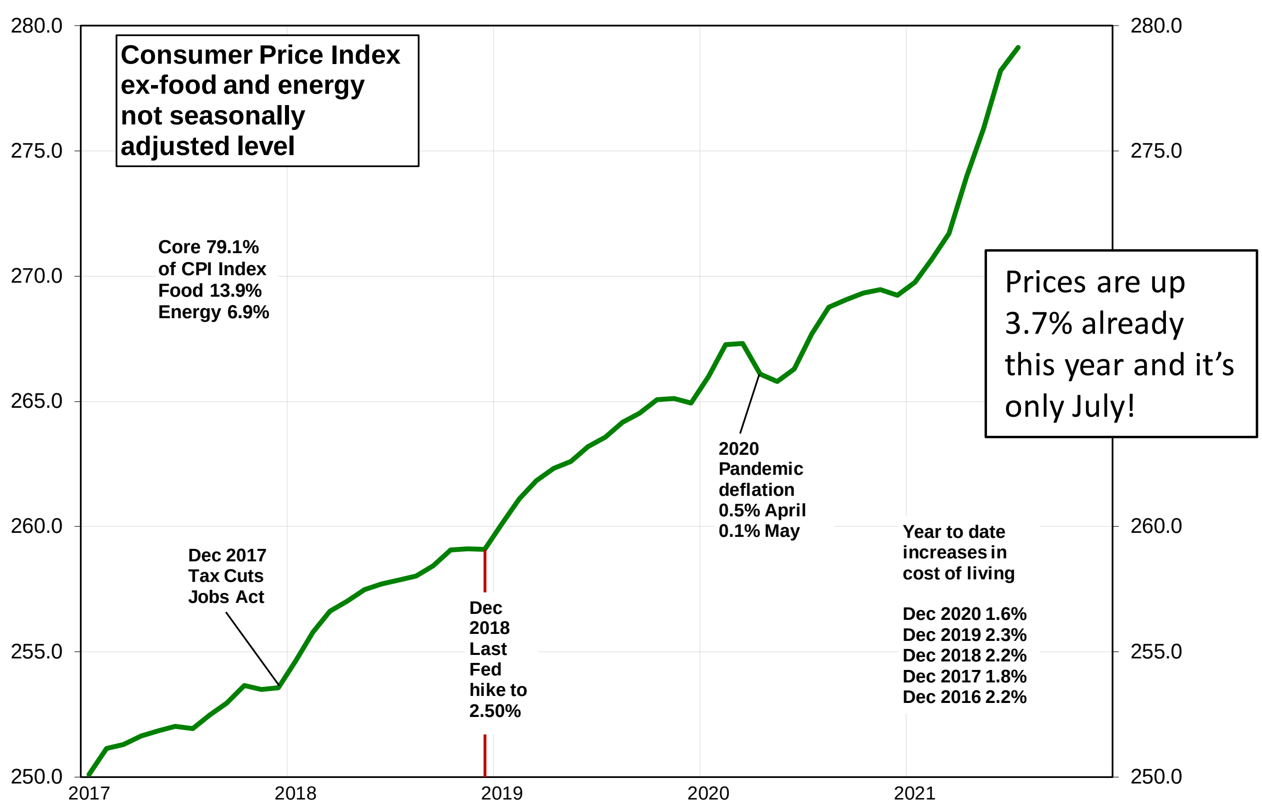


Powell gave his Jackson Hole speech on Friday at 10am ET. Stock market and bond market seemed to think tapering wasn't imminent. The S&P 500 was up about 0.3% ahead of the headlines and closed Friday up 0.9% on the day. Some Fed officials said Thursday that tapering should come sooner rather than later. We were hoping for a September meeting taper announcement to start cutting back in October. Near the end of the speech he commented on the path ahead for monetary policy. It is still disturbing to us that Powell says the Committee will provide support for the economy until there is a full recovery. This along with his mention of the test for when it is time to actually lift interest rates: that the test for a rates liftoff is "more stringent" worries us. It sounds like they won't lift interest rates until the unemployment rate falls all the way to 3.5% where it was in the "best economy in fifty years" before the pandemic. We honestly thought that interest rates should be back at 2.5% when the unemployment rate was back down at 3.5%.

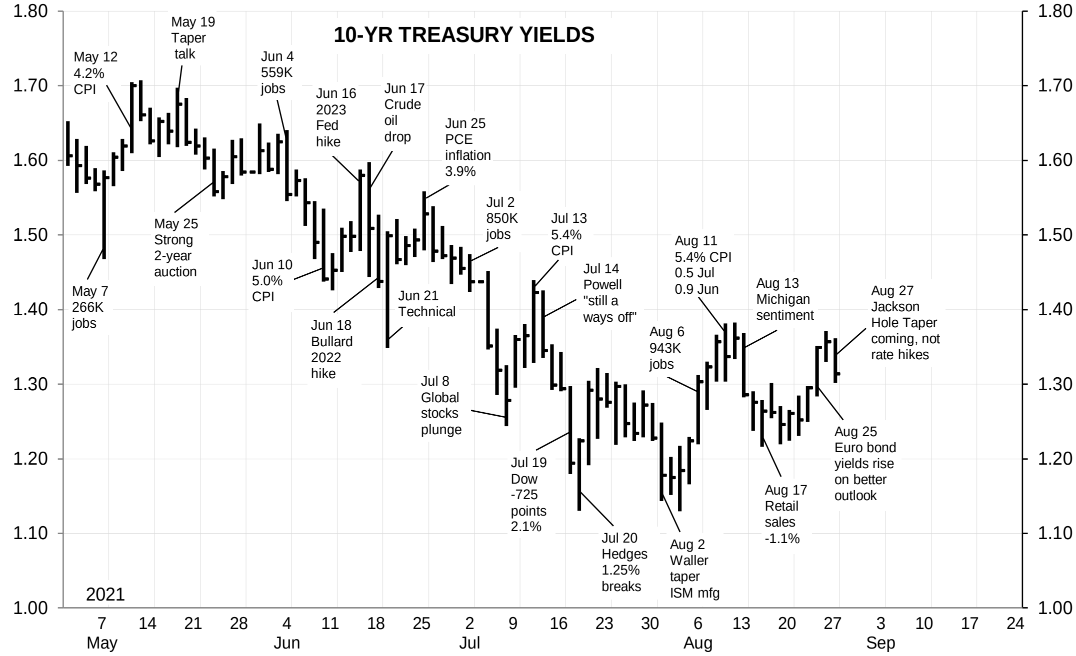
Anyway, in terms of the path ahead Powell talks like tapering is coming soon although his language could just mean a formal announcement by the end of 2021. He said, "The timing and pace of the coming reduction in asset purchases will not be intended to carry a direct signal regarding the timing of interest rate liftoff, for which we have articulated a different and substantially more stringent test." He finished on a positive note… his words "positive note." The positive is that he thinks the economy is on the path to that 3.5% unemployment rate. One Fed official said this week, if they get another 943K big payroll jobs number on Friday, September 3, that could make them announce a taper at the September meeting. The only problem with this is the 943K number was boosted artificially by faulty seasonal factors for teacher hiring/firings. Local teacher hirings boosted payroll jobs by 220K. If the teacher measurement problem reverses it could potentially drop payroll jobs back to a gain of just 500K which may not be enough for Powell who wants to continue to support the recovery and help the labor market heal. Stay tuned. Story developing.

P.S. Did anyone else have a problem with this line in Powell's speech? "My view is that the "substantial further progress" test has been met for inflation." This seems to miss the point. More inflation isn't progress, it is ruining people's lives by making the price of goods go up faster than their incomes. The harm is already done and the Fed's policies worsen it. Save the QE for an emergency like twenty years from now when the baby boom retirees' needs for social security and health care benefits will send Federal government spending to the sky and bankrupt the nation.

Second P.S. We cannot bring ourselves to repeat his comment that an ill-timed policy move could be harmful and slow hiring in the labor market. They give themselves too much credit.



INTEREST RATES

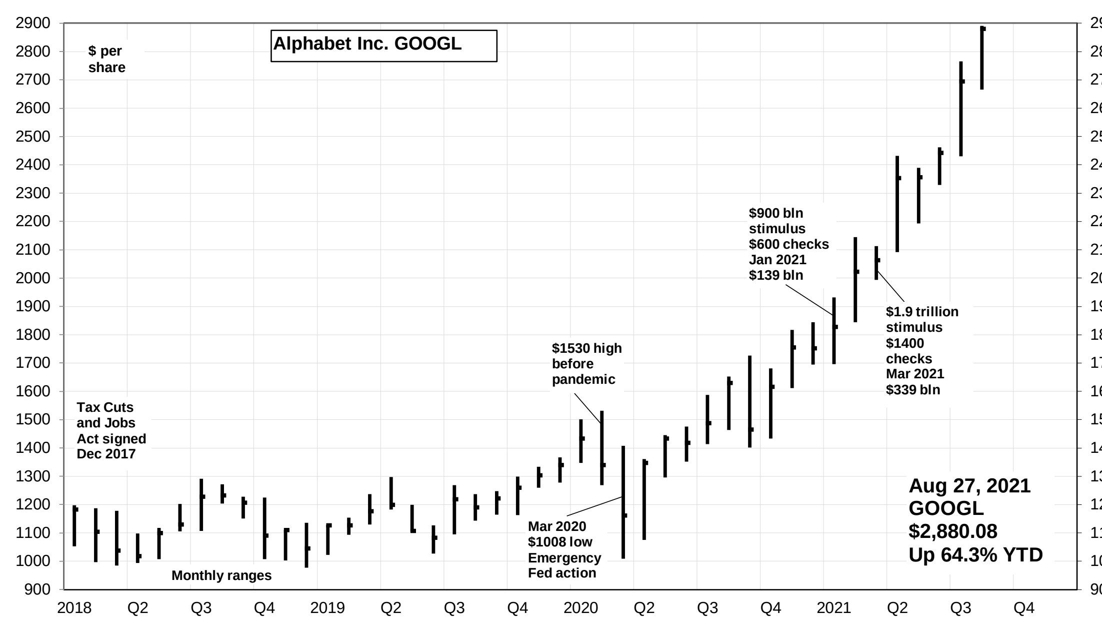


The 1.30% yield level was important for 10-yr Treasuries. Who knew in these less liquid summer markets. Yields rose to 1.30% in last month's 943K jobs report, and here we are again ahead of the August jobs data due Friday, September 3 at 830am ET. This week yields broke above the 1.30% line on Wednesday helped along by European yields that rose the most since February on some ECB officials saying better economic times ahead. Powell's Jackson Hole remarks rallied stocks more than bonds. Stocks liked that tapering isn't quite yet, and rate hikes look even further away.

Alphabet Inc. GOOGL sees best stock performance since Q2 earnings releases

Google is up 9.2% since its calendar Q2 earnings release after the bell on Tuesday, July 27 when Microsoft (+4.6%), and Apple (+1.2%) also reported. Amazon is down 7.0% as of Friday's close from its calendar Q2 earnings reported after the bell on Thursday, July 29. Alphabet said its latest results were boosted the last year from "elevated consumer online activity and broad-based strength in advertiser spend." Operating income was $19.361 billion versus $6.383 billion in calendar Q2 2020.

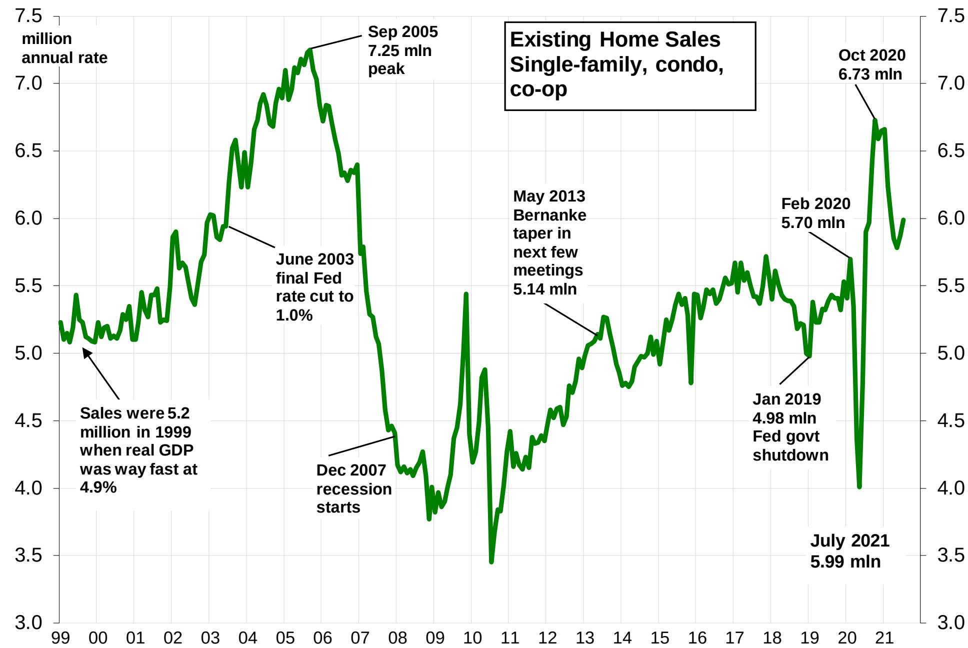
S&P 500 Weights	
Top 6: 23% of S&P	
6.12	AAPL
5.95	MSFT
3.76	AMZN
2.31	FB
1.45	NVIDIA
2.25	GOOGL
2.14	GOOG
23.98	Top 6



OTHER ECONOMIC NEWS

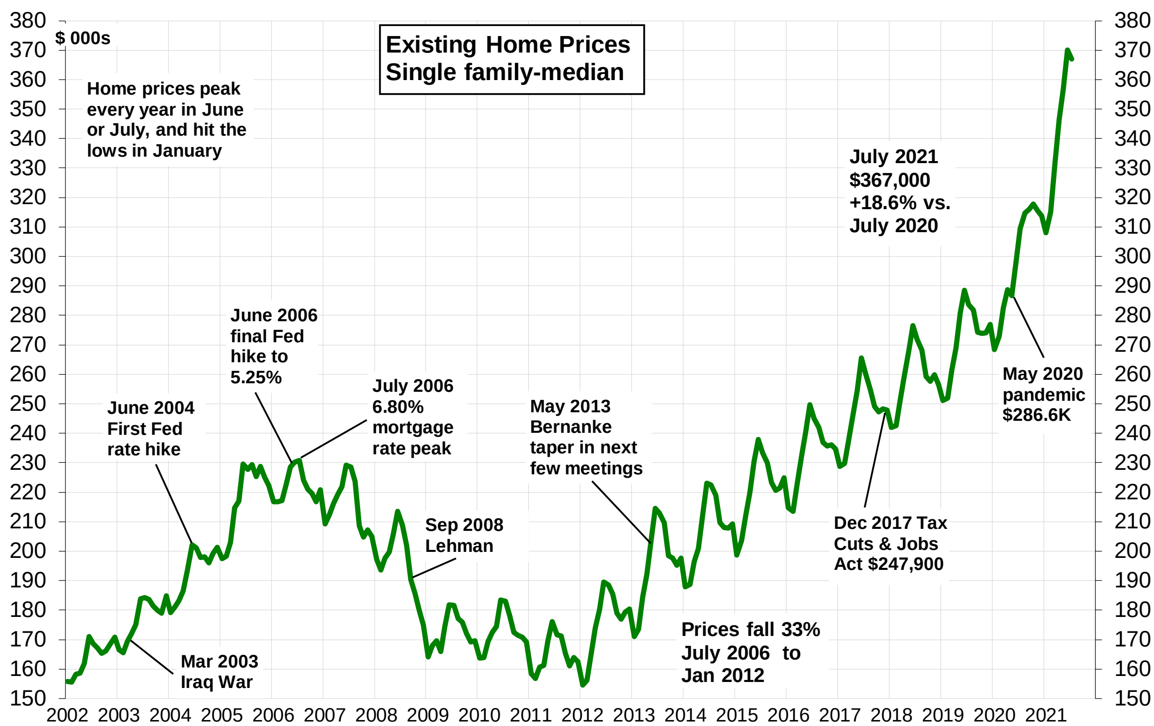
Housing price bubble peaks for existing homes (Monday)

Breaking economy news. Existing home sales rose 2.0% in July to 5.99 million at an annual rate. 2% this month, 1.6% last month… it really starts to add up. Not really. The peak was 6.73 million last October which was the height of the sales frenzy during the pandemic. That was the peak regardless of how good the market is right now according to your friendly realtor.



We are secretly glad that home prices fell this month because we were tired of constantly having to redraw all these graphs during the wide swings in data during this extraordinary time during and after the pandemic. It is after the pandemic, isn't it?

It wasn't much of a price decline in July to $367,000 from $370,100 in June for single-family existing homes. We won't calculate how much more expensive this is than the $274,600 average price level in the 2019 year before the pandemic. Punch the numbers in a calculator and weep if you don't already own a home.

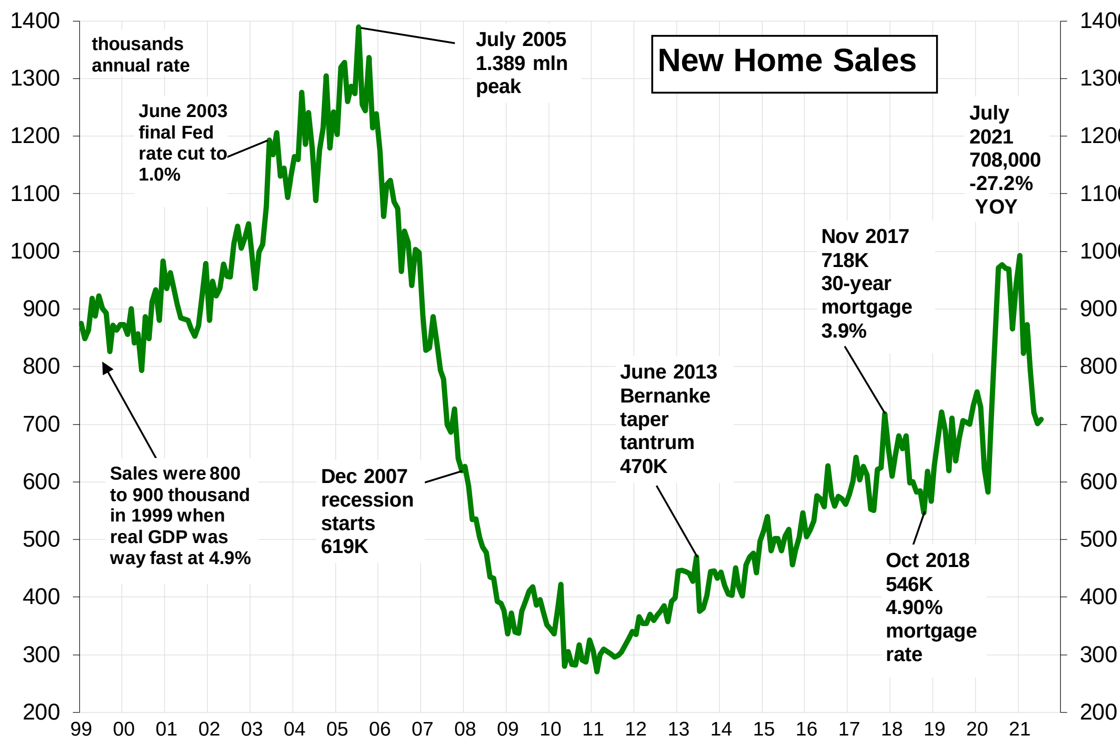


New home sales remain subdued with plenty to choose from (Tuesday)

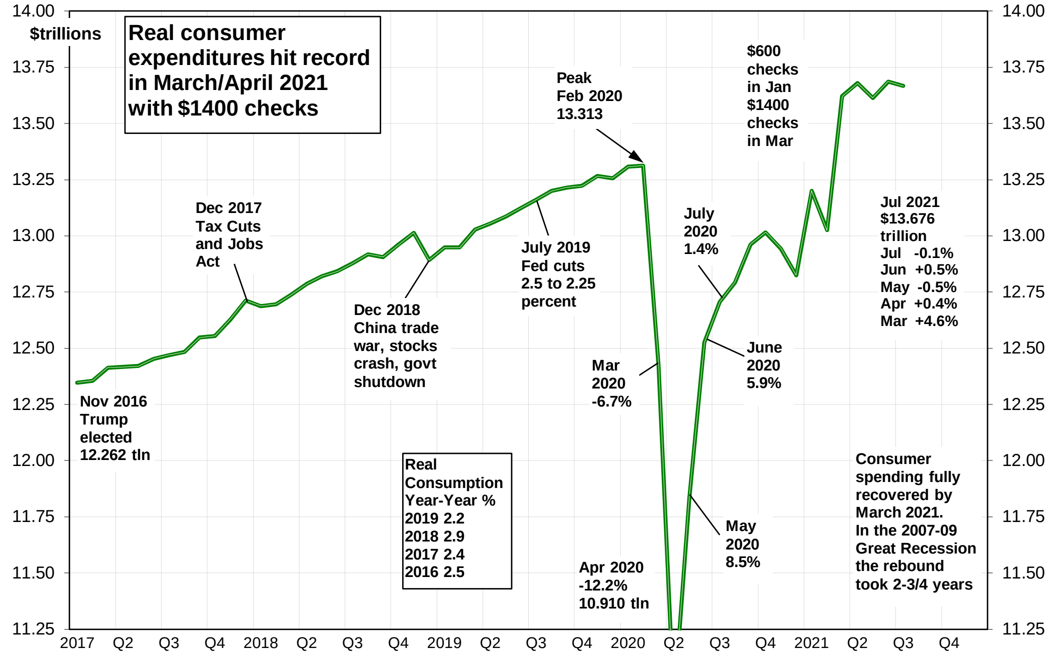
Breaking economy news. New home sales remain well off the pace seen at the start of the pandemic and lack of supply doesn't seem to be the problem. Consumers are more cautious about buying the biggest big-ticket purchase of their lives and one factor seems to be most responsible. New home prices are simply too expensive. The median sales price in 2019 was $321,500 and in July 2021, the median sales price is $390,500 which means new homes are 21.5% more costly today than they were in the full year before the pandemic. There have always been temporary peaks and valleys in the price of new homes throughout history and this is looking more and more like a peak, where the potential for a correction in home values ahead is clearly making new buyers skittish.

New home sales in July 2021 rose 1.0% to 708K from 701K in June 2021. The results were mixed across the country with Northeast and Midwest sales down over 20% this month, while sales in the biggest market in the South were up a modest 1.3% despite the spread of the Delta variant, and sales in the West jumping like hotcakes up 14.4% for the best turnover in sales activity since January this year.

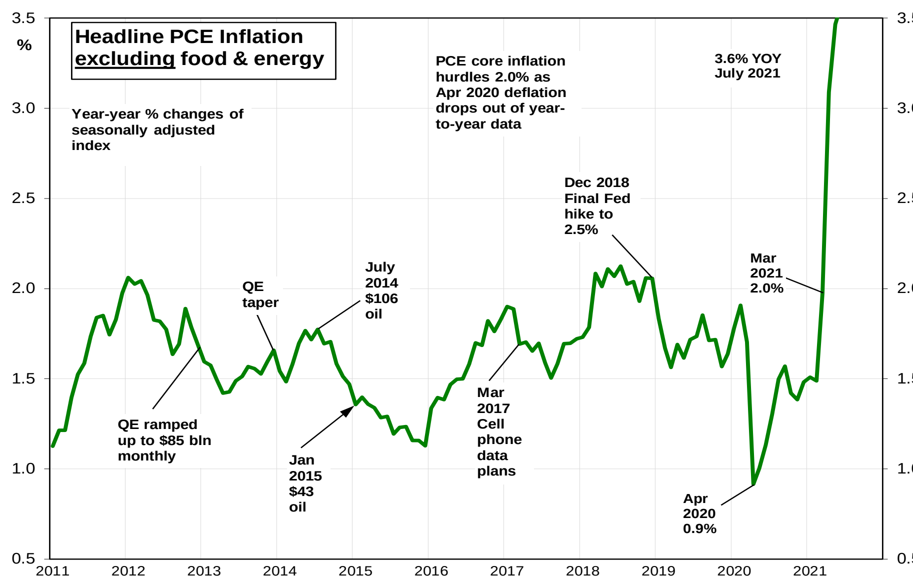
Net, net, it looks like the buyer's rush to get a new home during the pandemic, when working from the office was not a possibility for millions of company employees, it looks like the gold rush panic buying is over for now. The stampede to own a new home was largely in the months of July to October last year with sales nearly one million at an annual rate, but now it looks like everyone has found a new home. There is plenty on the market certainly with 6.2 months' supply available for would be buyers. We are keeping our fingers crossed that home prices won't suddenly correct in the downward direction after the sharp double-digit runup seen during this unprecedented period of uncertainty following the pandemic if it is truly over. Stay tuned. Story developing.



Consumer spending drops, inflation slows (Friday)



Breaking economy news. Philadelphia Fed President Harker says he wants to taper because he doesn't think the $120 billion QE purchases each month are helping the economy. Also thinks job market is different after the pandemic and maybe Fed shouldn't wait for it to heal. Kids don't want to work straight jobs. Okay, the economic news is the monthly personal income report for July with consumer spending and the Fed's preferred PCE inflation measure. Personal income jumped 1.1% although the reason was Child Tax Credit payments from the American Rescue Plan. Real consumer spending fell 0.1% in July. Is that all? Still wonder why spending hasn't dropped more after the $1400 government support checks were spent.



Maybe spending will drop more as the extra unemployment benefits well runs dry and the Supreme Court said yesterday that evictions could take place again which is a win for landlords but not for those who still can't get a job and pay the rent. Anyway, services spending was up $102.6 billion with consumers dining out, drinking away at bars and staying in hotels. Consumer goods spending dropped $60.4 billion due mostly to car sales, some clothing and other shoes dropped as well. What does it all mean? Well consumer spending that is two-thirds of real GDP went up 11.9% in Q2 2021, reported yesterday, which helped real GDP rise 6.6%, but now with July falling 0.1%, if there is no change in spending in August or September, the third quarter will be a dud with real consumer spending rising just 0.2%. No growth, no profits. Does the stock market care? No.

Inflation has slowed somewhat to 0.3% in July for core PCE inflation even if it is 3.6% higher than a year ago (it was 3.6% YOY in June as well). The monthly change was less than 0.6% in April and in May, and a 0.5% rise in June. Whew. Only 0.3% now the Fed doesn't have to taper. It can continue the purchases that don't do anything.

Net, net, the consumer took the month of July off with real spending falling 0.1% which puts the speed of the economic recovery in doubt for the third quarter. There is a chance that spending in the economy will fall flat in the second half of the year as purchases and investments made on the reopening from the pandemic have been made already. Possibly the only "growth" will be from an unwanted buildup of inventories assuming importers can find the ships to bring the goods in from China and elsewhere abroad. Stay tuned. Story developing.

Analyst Certification

The views expressed in this report accurately reflect the personal views of the research staff at FWDBONDS LLC, the primary analysts responsible for this report, about the subject securities or issuers referred to herein, and no part of such analysts' compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed herein.