Financial Markets This Week

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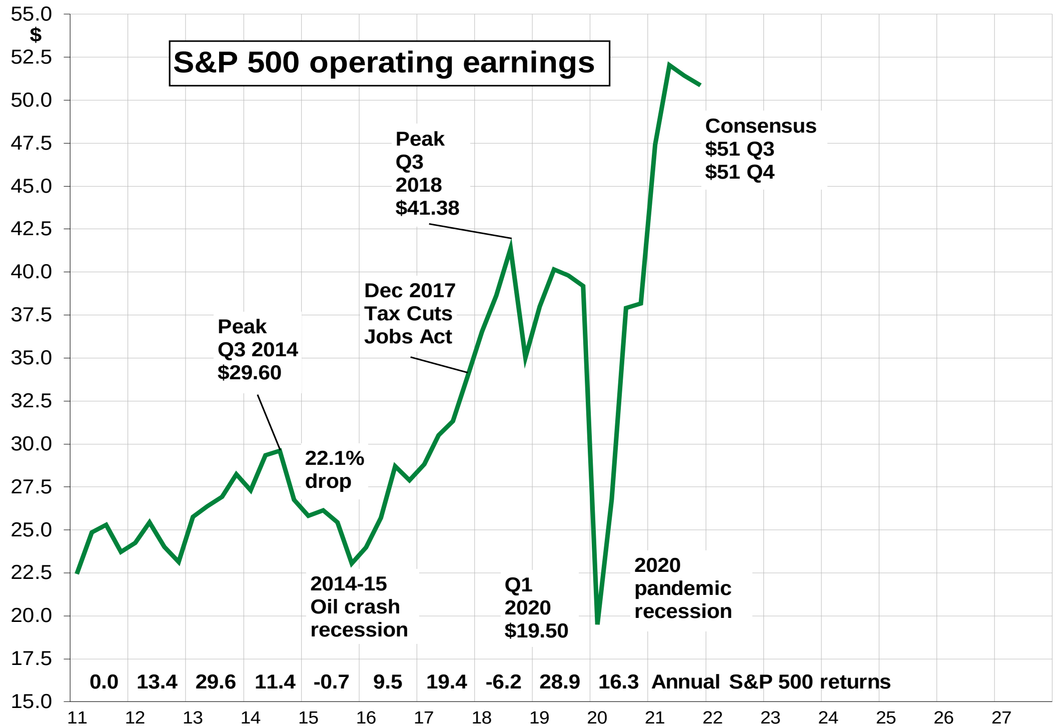
STOCK MARKET VALUATION

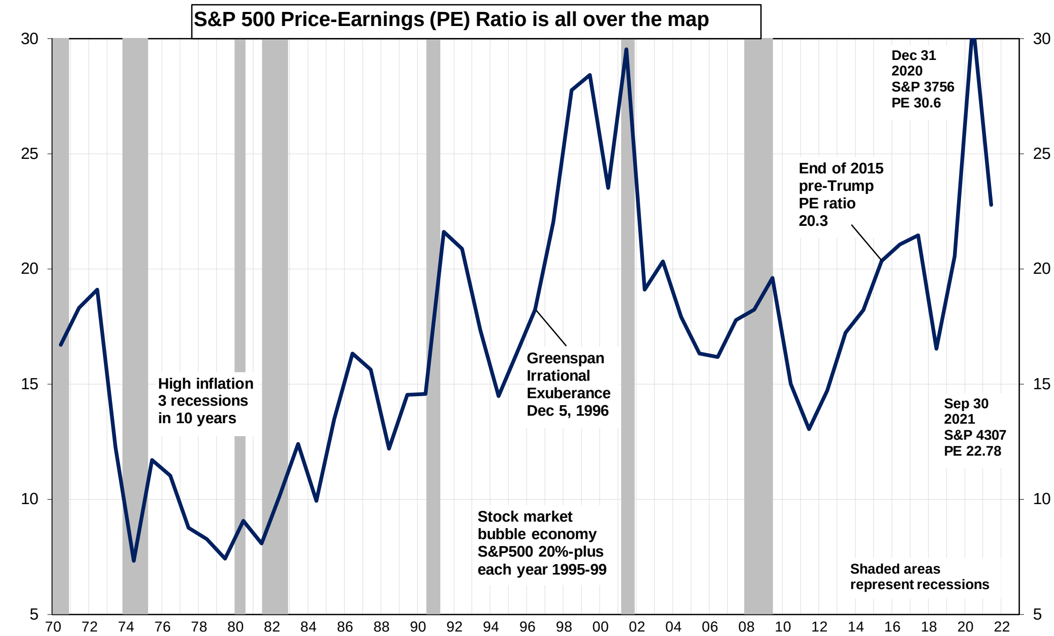
The richest stock market recession in history just keeps getting richer and richer. No wonder some Americans don't want to go back to work. If the "50 percent of Americans with stocks" have more money than cents, who needs a paycheck? Labor shortages and labor force dropouts aren't going away if the stock market is any guide to the jobs market.



Stock market valuation in the long run is simple: companies make 7 percent more profits each year on average, so the stock market goes up 7 percent per year on average. Try to forget the times it drops over 50% like in the 2001 recession and again in the 2007-09 recession. And believe us, there's a reason stocks are down 50 percent, and you won't feel like buying any shares when it gets down there at half-off sale prices.

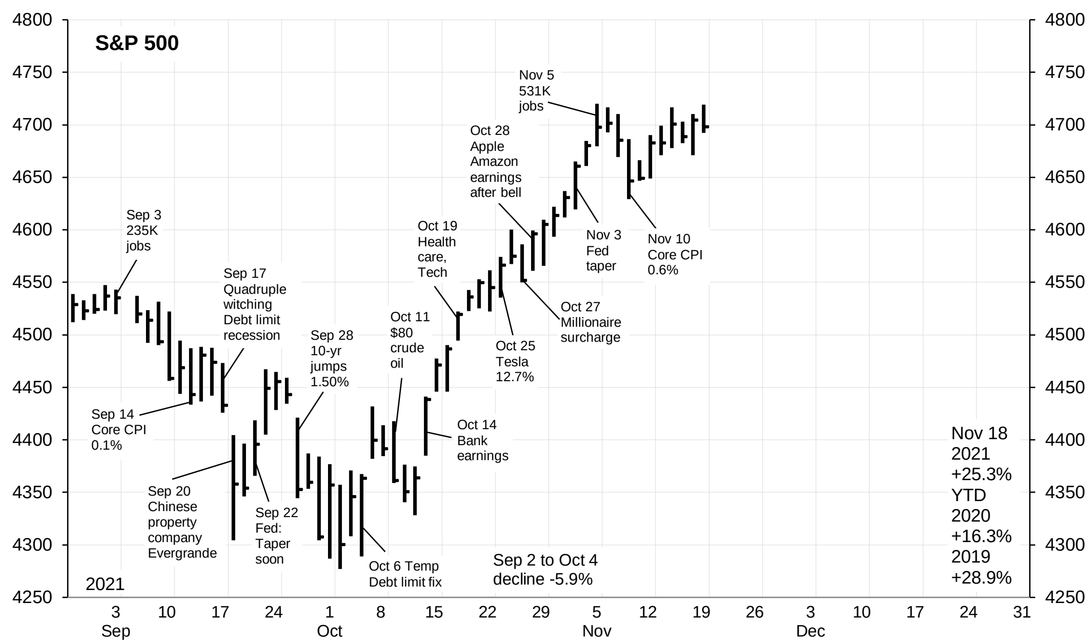
When we last looked back at corporate earnings in June this year, Wall Street expectations for profits were high, but not sky-high. Actual earnings turned out to be sky-high. Those who kept buying stocks on pullbacks were lucky that companies made more money than any time in history. Price was out in front of value for a long while, but now earnings have caught back up to prices. It is still a puzzle how the economy could be doing so much better than it was in Q4 2019 before the pandemic, but there you go.

The PE ratio was over 30 at the end of 2020 based on operating earnings over the four quarters of 2020. But with the sky-high earnings of over 50 dollars a share in Q2 2021, and expected to be roughly the same for Q3 2021 with over 90% of companies reporting, the PE ratio is back down to 22.78 in Q3 2021 which is high historically but not overly so given the low Federal Reserve interest rates and speculative times we live in.

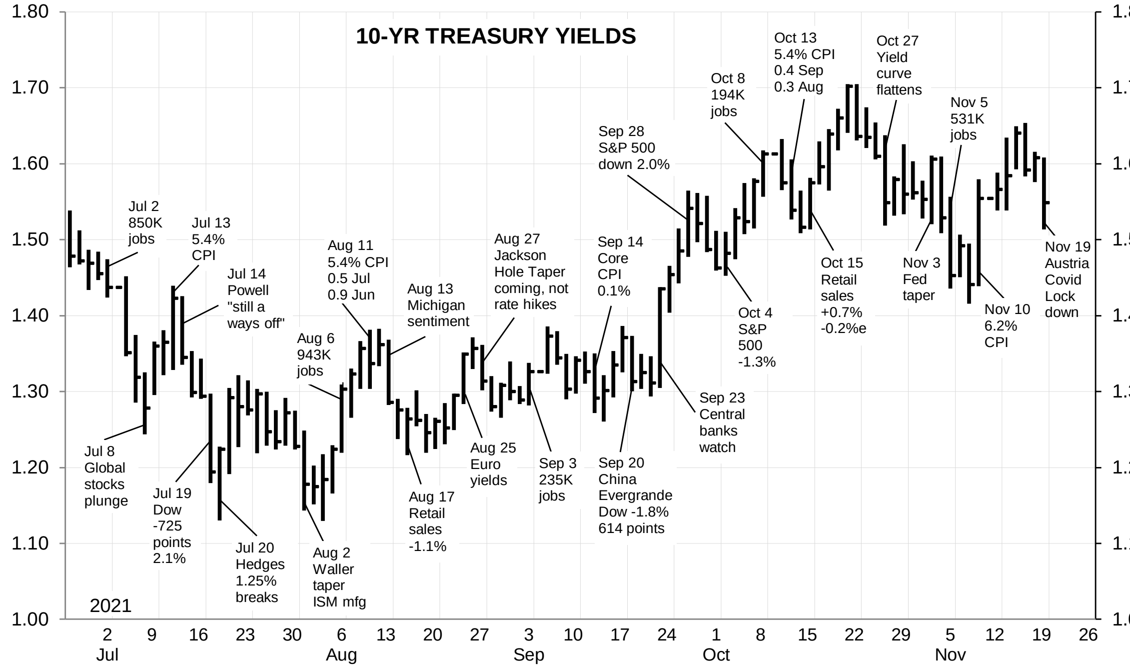


Stock earnings tend to move higher with inflation as companies generally pass the price increases on. Stock prices were low relative to earnings in the double-digit inflation years of the late 70s and early 80s. But there were also two recessions in 1980 and in 1981-82 weighing on the stock market. The PE ratio was down around 10 or lower for most of the period. The other issue for stocks in a high inflation period is what is the Fed doing about it. If the Fed raises rates to too high of a level, that is not good for stock prices in the short run.

To conclude, the stock market runs on without a care in the world. We are still wondering whether this pandemic rebuilding period for the economy has generated super-normal profits that are simply not sustainable. But earnings remain strong for now. The PE ratio was 22.78 at the end of September 2021 when the S&P 500 was 4,307.54. The index closed 9.1% higher at 4697.96 on Friday, November 19, and if quarterly operating earnings stick at $50 per share, then 4 X 50 = 200 means the PE ratio is about 23.49 at Friday's close. Stay tuned. Story developing. Watch here where the world goes next.



INTEREST RATES

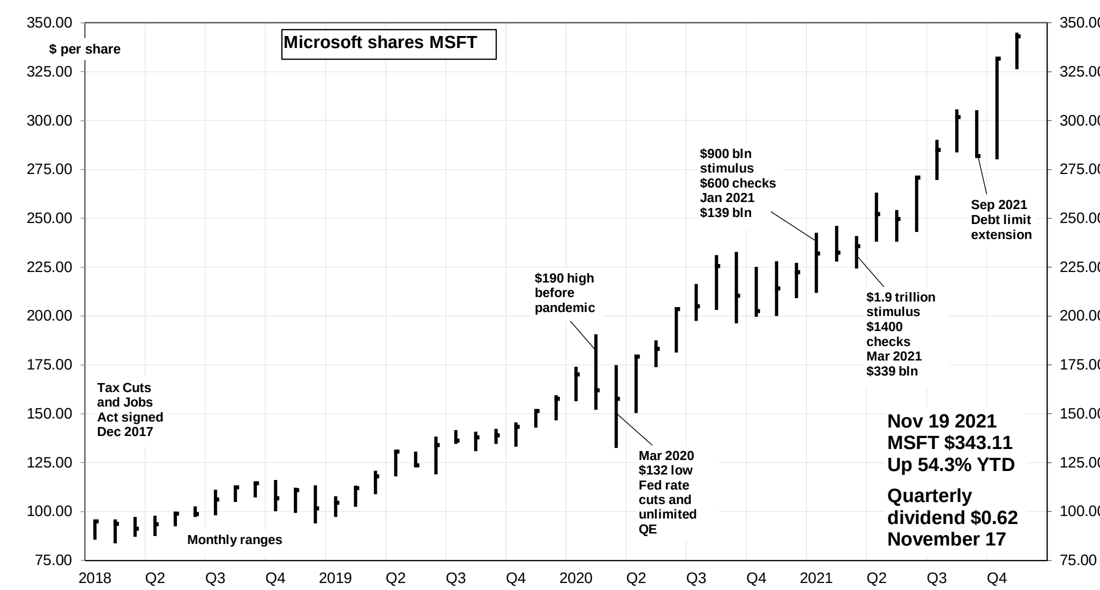


The bond rally didn't last very long, just a couple more days after 531K payroll jobs. October CPI inflation of 6.2% year-year sent yields back up the day before the Veterans Day holiday where the bond market is closed and the stock market stays open. Gasoline prices up 49.6% year-year with a 3.83% weight in the total index is part of the story. Shelter prices are up only 3.5% year-year and we always wonder what if they put the home price increase in our town, up over 20% the last year, in the core CPI index. That would make for a big inflation headline. This week you had to be up early with a headline Friday bringing bond yields down at 425am ET: Austria locks back down starting Monday.

Microsoft Corporation MSFT up 54.3% YTD

Earnings for the September 30, 2021 quarter were released October 26, 2021 after the bell. Revenues were $45.317 billion, 21.3% above last year but down from $46.152 billion in the June quarter. Revenues are down slightly every third quarter from the second since 2018 that we looked at except in 2020 during the pandemic. We guess the cloud isn't saturated yet as the press release headlined Microsoft intelligent cloud strength drove the results. For now.

S&P 500 Weights	
Top 6: 25% of S&P	
6.42	MSFT
6.21	AAPL
4.03	AMZN
2.23	TSLA
2.02	Meta
2.26	GOOGL
2.13	GOOG
25.30	Top 6



FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					March 11
Fed H.4.1 statistical release					2020**
billions, Wednesday data	17-Nov	10-Nov	3-Nov	27-Oct	pre-Covid
Factors adding reserves					
U.S. Treasury securities	5573.525	5552.607	5533.219	5513.329	2523.031
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347
Mortgage-backed securities (MBS)	2603.431	2593.366	2527.824	2527.777	1371.846
Repurchase agreements	0.000	0.000	0.000	0.000	242.375
Primary credit (Discount Window)	0.355	0.449	0.259	0.605	0.011
Paycheck Protection Facility	43.681	46.471	48.047	49.930	
Corporate Credit Facility (CCF)	0.515	0.515	0.515	0.515	
Municipal Liquidity Facility	9.786	9.785	9.783	9.782	
Main Street Lending Program	30.466	30.516	30.507	30.289	
Term Asset-Backed Facility (TALF II)	4.491	4.491	4.490	4.496	
Central bank liquidity swaps	0.265	0.328	0.332	0.323	0.058
Federal Reserve Assets	8724.5	8712.5	8624.3	8605.2	4360.0
~~3-month Libor %~~ SOFR %	0.05	0.05	0.05	0.05	1.15
Factors draining reserves					
Currency in circulation	2215.367	2213.872	2207.681	2205.482	1818.957
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	178.972	231.421	241.627	236.495	372.337
Treasury credit facilities contribution	26.397	26.397	26.397	26.397	
Reverse repurchases w/others	1520.000	1448.623	1343.985	1433.370	1.325
Reserve Balances (Net Liquidity)	4188.837	4178.586	4149.830	4123.154	1779.990
Treasuries within 15 days	77.857	110.097	127.192	66.945	21.427
Treasuries 16 to 90 days	315.439	285.678	273.726	318.997	221.961
Treasuries 91 days to 1 year	715.588	707.348	702.180	706.530	378.403
Treasuries over 1-yr to 5 years	2127.892	2131.956	2121.068	2113.812	915.101
Treasuries over 5-yrs to 10 years	1008.848	1005.551	1001.373	1006.665	327.906
Treasuries over 10-years	1327.901	1311.978	1307.680	1300.380	658.232

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

The Fed meets on December 14-15, 2021 to consider its monetary policy. Policy makers agreed to start scaling back their asset purchases at the November 2-3, 2021 meeting which is good. Except that the current wind down pace where tapering is completed in the middle of 2022 means the Fed's hands are tied for any interest rate hikes until the asset purchase program is wound down to zero. We guess. There's a lot of talk and there are 18 participants talking between meetings. We don't even know if Powell will be reappointed yet: he took office for a four-year term on February 5, 2018. Even the Trump administration put forward Powell's name for Chair on November 2, 2017 before Yellen's term expired on February 3, 2018. The clock is ticking. We won't characterize Jay's term in office except to say if he lets inflation gain a foothold in this economy under the guise of helping the labor market recover from the pandemic, Powell will go down in history as the worst Fed Chairman in half a century. The stock market will also lose a friend as he paused rate hikes in early 2019 saying they could be patient after the stock market crash in December 2018. History will also judge that Powell panicked by cutting rates twice between two regularly scheduled meetings because he was frightened by the stock market's drop in March 2020 as the pandemic struck. Other than that, we would love to see Powell reappointed for four more years. If we have learned anything at all during his term in office, we have found that it is far better to have a Fed Chair who is not an economist.

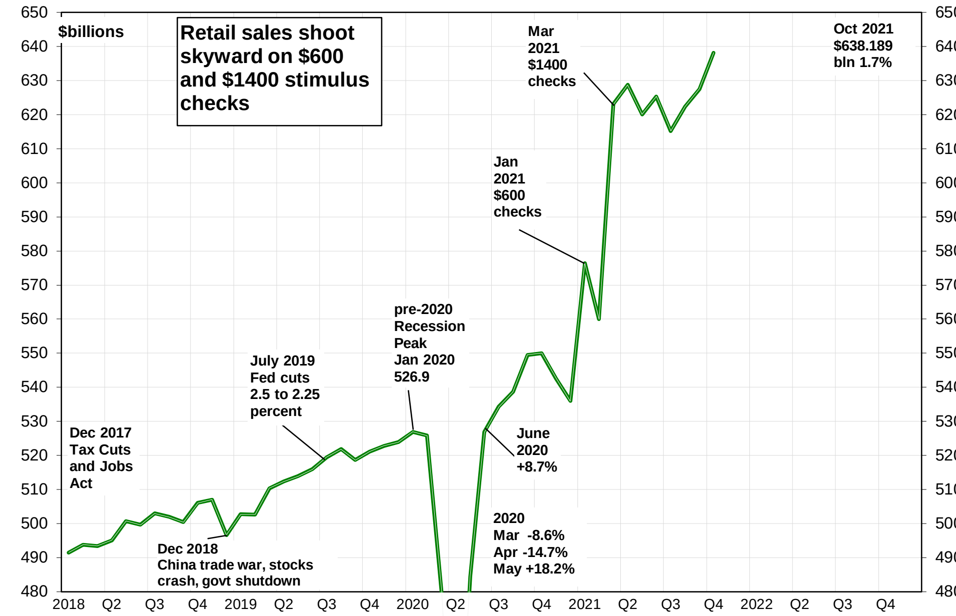
Meanwhile, it is official. The schedule for asset purchases is out. The great American wind down has begun. The New York Fed says it will purchase $70 billion, down from $80 billion, of U.S. government securities over the period of November 15 to December 13. The first operation began 1010am ET on November 15. We did not see any discernible effect on the stock market… yet. Then again, the first operation on Monday did purchase $10.851 billion. Money printing is still going on to buy stocks.

We replaced Libor in the table above with SOFR. The secured overnight financing rate was all of 0.05% on Wednesday, November 17, the end of the Fed banking week. New York Fed President Williams said a while back, "SOFR is based on a much higher volume of underlying transactions than LIBOR, making it more representative of market conditions and less vulnerable to manipulation. It's also the rate selected by the Alternative Reference Rates Committee (ARRC) as its preferred replacement for USD LIBOR." Less vulnerable to manipulation means regulators want to make sure everyone can get the best price for their securities of every stripe and color, except during a market panic where no one gets the price they want because the enormous volume means price reports are lagging and no one knows where the market is. Anyway, the repo market, the financing of Treasury securities is not representative of money market conditions because it is a specialized market that is off in its own alternative universe that does not represent where the money market yield for interest rates is. Policy makers might well have used the 0.25% top of the Fed funds rate target as a proxy for short-term interest rates. Okay, lost cause, SOFR is the one. We'll see where it trades in the parallel universe of the repo market once the Fed start raising rates, our call is the July 26-27, 2022 meeting, possibly June 14-15, 2022 if they speed the QE tapering up as we think we heard Fed Vice Chair Clarida say on Friday it might.

OTHER ECONOMIC NEWS

Christmas comes early for retailers this year (Tuesday)

Breaking economy news. Retail sales jumped 1.7% in October after a soft patch for spending in the third quarter. Auto sales were part of the story with a big chunk share of 19.8% of total retail sales in October. But there is so much more that consumers bought as Christmas comes early for retailers this year.



Consumers crowded back into the shops and malls and literally cleaned the shelves this month. This retail sales report has inflation written all over it as the nominal prices of goods up and down the aisles of stores across America are shooting higher and higher. There is a permanence to this inflation that has been sparked by and more than met by an incredible surge in consumer demand that shows no sign of letting up. The pandemic has scrambled the plans of consumers and turned the world upside down and there is no way out but to buy a whole new set of store bought goods to meet an increasingly uncertain future.

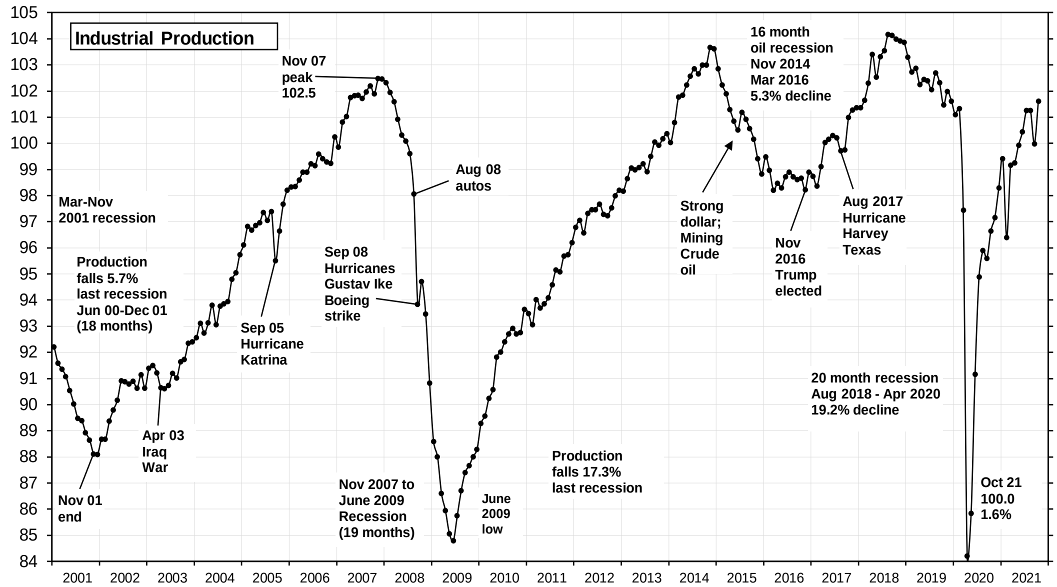
Wages are going up in one of the biggest labor shortages in history and those wages in workers pockets are going right back out to pay for groceries, electronics, sporting goods… everything but the kitchen sink and bars and restaurant sales this month. Forget about that paltry 2.0% economic growth in the third quarter because retail spending in the fourth quarter is going right back up. This economic recovery is still going straight up. Bet on it. The consumer is clearing the store shelves and the economic outlook is strong regardless of what those dire, woe-is-me consumer confidence and sentiment surveys are saying. The consumer got the message. The ports are clogged and ships cannot unload the goods to make this holiday bright, so get out there and buy early if you can. October sales are Christmas sales in this crazy pandemic upside-down world.

Retail spending, actual dollars, each month

	$million	% to	Percent Changes %		
	Oct 2021	Total	Oct	Sep	Year/year
Total Retail Sales	638,189	100.0	1.7	0.8	16.3
Motor vehicles/parts	126,586	19.8	1.8	1.2	11.5
Furniture/furnishings	12,153	1.9	0.4	-1.1	11.9
Electronics/appliances	8,422	1.3	3.8	-0.2	18.4
Building materials/garden	40,452	6.3	2.8	0.2	10.2
Food & beverage	77,129	12.1	0.9	0.2	8.3
Health/personal care	32,093	5.0	-0.6	-1.0	7.4
Gasoline stations	53,986	8.5	3.9	3.2	46.8
Clothing/accessories	26,119	4.1	-0.7	2.1	25.8
Sporting goods, books	9,442	1.5	1.5	4.5	17.6
General merchandise	72,654	11.4	0.8	2.0	15.9
Department stores	12,853	2.0	2.2	1.0	27.6
Miscellaneous retailers	15,043	2.4	2.8	2.8	25.8
Nonstore retailers (internet)	91,688	14.4	4.0	-0.8	10.2
Eating & drinking places	72,422	11.3	0.0	0.4	29.3

Production roars back after Hurricane Ida (Tuesday)

Breaking economy news. The Fed's own economic statistic, industrial production, bounced back by 1.6% in October after sinking 1.3% in September due to the effect of Hurricane Ida that shut down many factories temporarily. Output at manufacturing plants jumped 1.2% in October to an index level of 99.8 which is the best recovery level seen yet since the pandemic recession started in February 2020. Manufacturing is still operating at 2.1% less than the record high of 102.0 in August 2019. Among product groups, consumer goods jumped 1.4% which was tied mostly to an increase in automotive products.

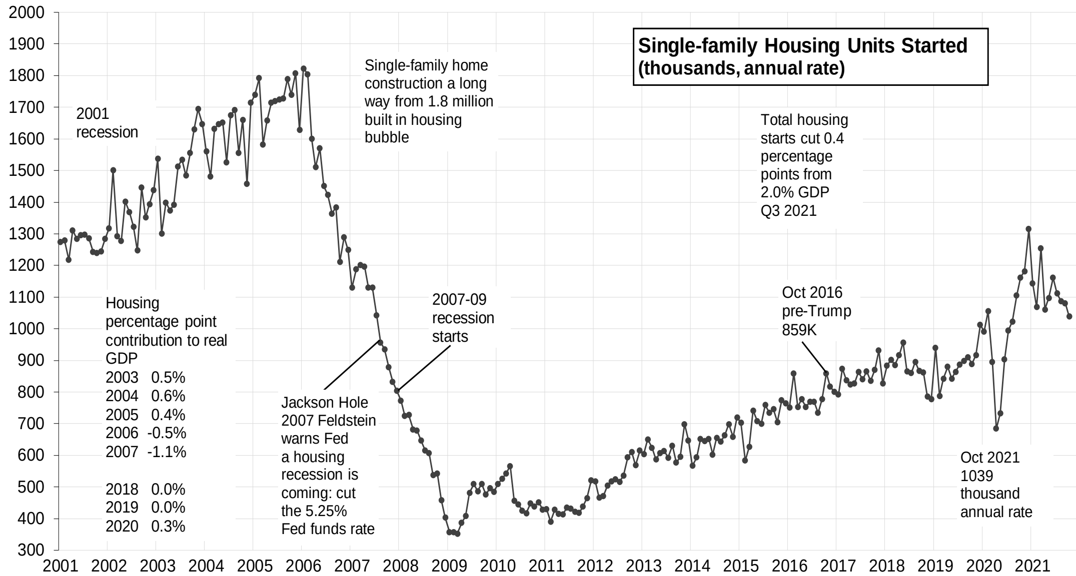


Net, net, the factory lights turned back on in October as manufacturing attempts to stay ahead of the unprecedented surge in consumer demand. Auto inventories on dealer lots are near record lows. The consumer is on a tear leading the way forward for the economy and manufacturers are doing all they can to keep the retail shops stocked. Supply chain problems and logistics foul-ups didn't hold back American factories this month. Manufacturing output soared as industries are keeping the factory lights burning all night long to meet the demand. This economy is strong. Bet on it. It doesn't need any more stimulus from Washington that's for sure. Stay tuned. Watch here where the world goes next.

Percent changes			Industrial Production Oct 2021		
Aug	Sep	Oct	YOY		Weight
0.0	-1.3	1.6	5.1	Total Index	100.0
-0.3	-0.7	1.2	4.5	Manufacturing	75.9
-0.6	-2.3	4.1	11.8	Mining	12.2
2.9	-3.7	1.2	3.0	Utilities	11.9
			Manufacturing payroll jobs 12.5 million +374K YOY 9.9% of Private Payroll Jobs		

Residential housing construction languishes, meaning home price inflation will continue (Wednesday)

Breaking economy news. Housing starts fell 0.7% to 1.520 milion at an annual rate in October, and was little changed from 1.514 million a year earlier in October 2020. Single-family starts are floundering while multi-family construction of 5 or more units is fairly strong. Residential housing construction languishes and this means home price inflation will continue to inflate the biggest speculative bubble since the one that finally burst in 2006. It's coming. Wait for it.



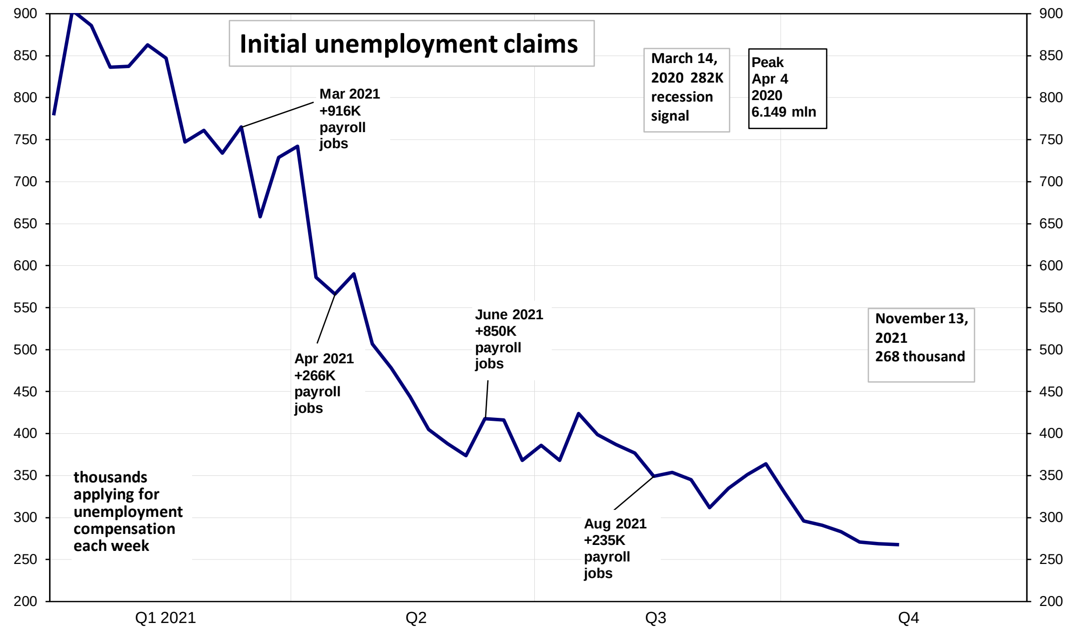
Net, net, residential housing construction activity continues to flounder and despite Washington's infrastructure bill, no one has figured out how to produce more homes for Americans where shortages and home price inflation persists. There are zoning problems, higher land costs, a lack of labor, and inflation has inflated the cost of raw building materials, and all these issues are being blamed for the shortage of housing. Stay tuned. But the story remains the same.

Housing Permits Total, Single-Family, Multi-Family

	United States			Northeast		Midwest		South		West	
000s	Total	1 unit	Multi	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit
Oct 2021	1520	1039	470	122	56	226	124	792	610	380	249
Sep 2021	1530	1081	440	123	66	214	134	800	621	393	260
Oct 2020	1514	1162	337	84	56	208	153	840	668	382	285
% Chgs											
Oct/Sep	-0.7	-3.9	…	-0.8	-15.2	5.6	-7.5	-1.0	-1.8	-3.3	-4.2
Oct/Oct	0.4	-10.6	…	45.2	0.0	8.7	-19.0	-5.7	-8.7	-0.5	-12.6

Another week another low for unemployment claims (Thursday)

Breaking economy news. Unemployment claims plummets 1 thousand to 268 thousand new people applying for benefits in the November 13 week because they were laid off. Another week another new low for jobless claims makes us wonder if there are Americans without work.



Net, net, if there are Americans still out of work from the pandemic, they aren't applying for unemployment compensation which suggests the economy is closer to full employment than Washington officials believe. In fact, there is a massive shortage of workers in the labor pool right now and employers are finding it nearly impossible to hire. There are labor force dropouts in the millions this recession, but they are not experimenting with temporary jobs and then reapplying for benefits and dropping back out. One reason for this is the fact that over half the drop outs are over 65 years old and are likely retiring whether they like it or not. It is a pipe dream of Washington officials that people will somehow return to the labor force once the pandemic is cured.

Unemployment Benefits Recipients		
30-Oct-21	Program	28-Aug-21
1,946,287	Regular State	2,656,747
8,023	Federal Employees	8,723
5,001	Newly Discharged Veterans	6,054
791,060	*Pandemic Unemployment Assistance	5,487,233
272,974	*Pandemic Emergency UC	3,805,795
136,208	Extended Benefits	98,730
3,172	State Additional Benefits	1,063
21,932	STC/Workshare	42,382
3,184,657	TOTAL	12,196,727
* Programs expired September 6, 2021		

The jobless rate from those covered by the unemployment insurance program was 1.2% before the pandemic, and now today it is 1.5% which should be close enough to full employment for anybody. During the worst point of the recession, this joblessness rate was as high as 15.9% which shows you how far the economy has recovered. Other signs of a tight labor market are the surge in wages as companies struggle to bring workers aboard. In the Great Recession, insured unemployment was 1.9% in October 2007, went as high as 5.0%, and returned to 1.9% normal again in May 2014; the Federal Reserve didn't apply the brakes on the economy until over a year later in December 2015. Monetary policy was behind the curve coming out of the last recession and they are behind the curve in raising interest rates back to normal levels in the recovery from the current recession. The labor market is tighter than you think and is producing wage inflation that risks turning transient inflation into a more durable and dangerous inflation that hurts everyone with a paycheck. Washington hasn't got the message yet, and we fear it will be too late when they do.

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