THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

The old S&P 500 Stock Index (SPX) rose a mere 0.41% for the week but that was enough to eke out a new record high close of 4247.44. The market overcame a bout of worry as the Consumer Price Index rose more than has been seen in 13 years and initially began a swoon but those who had looked hard at the economic evidence swooped in with buy orders, resulting in a net gain for the Index. The SPX is now up 13.08% year-to-date. The CRSP Mid-Cap Value Index joined the Dow Jones Industrial Average in slipping backward, down 0.49% but up 21.70% for the year. The reported consensus on the street was that the stock market was priced fairly for the reported earnings from first quarter and would now need new positive economic information to continue rising at more than a sedate pace.

The yield on the benchmark ten-year U.S. Treasury note not only ignored the inflation alarms, but actually declined by well over 6% to 1.453% for the week. The indicators from the yield curve suggest that we have a healthy economy with plenty of growth ahead of us but with no structural inflation in sight. To say that the bond market behavior was frustrating to the inflation hawks was to make an understatement. West Texas Intermediate crude oil (WTI) rose another two percent to $70.78 per barrel on steadily increasing demand, the highest it has been since October 2018.

The Economy

The week's headline economic news was not exactly new or unexpected but potentially misleading. The Labor Department reported that May's U.S. Consumer Price Index (CPI) rose 5% from this time last year. If we eliminate the volatile food and fuel prices, the rise was a lower but still notable 3.8%. The misleading parts of that number are to be found in two areas. First, a year ago the U.S. economy was in free fall and prices were down and declining pretty much across the board. Measuring from that brief but significant period of deflation to the rather sudden return to something that looks a lot like "normal" and becoming alarmed that prices have risen is not a good assessment of the facts. The recovery from sudden, short recessions often produces sudden, short inflation spikes. Second, about one-third of that inflation number comes from a single element, used cars and trucks. This is pretty much an old story by now, but folks, there is a severe computer chip shortage in the auto industry. The combination of consumers released to hit the car lots and roads with their bank accounts bulging, and a dramatic slowdown in auto production has forced the overflow demand off into the used car lots. Lots of demand and a limited supply means prices will go up, in this case 7.3% in one month. The story is much the same as with houses. If you've got a used car, truck, RV, or house to sell, this is the time. Unfortunately, finding a reasonably priced replacement may be a bit of a challenge.

Looking at the CPI numbers from both a shorter and longer period gives some perspective. For one month, the overall prices rose 0.6%, or at a 3.6% per year rate. Removing the used vehicle element from that rise, the annualized rate drops to 2.4%. If we extend our time horizon and measure core CPI inflation from two years ago, it has risen about 2.3% per year. Both of those numbers are quite close to the Federal Reserve's current target of overshooting a 2% annualized rate for a couple of years. More, this spike in inflation appears to be a result of a temporary supply shortage rather than a buildup in long term demand. Historically, supply side inflation tends to be of relatively short duration, unlike demand-side inflation which can compound.

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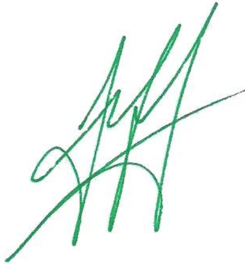
Complicating matters, COVID-19 outbreaks in southern Chinese ports are creating a further slow-down in the supply chains from which we draw much of what we buy here in America. That has raised shipping costs and those are being passed on. Expect more of the same as the world economic system oscillates back and forth as this pandemic continues. Here in the United States, with our high vaccination rate, we are hopefully mostly unencumbered by COVID with the Moody's-CNN Back to Normal Index up to 88%, but in much of the rest of the world it is as bad or worse than ever.

Speaking of back-to-normal, aggregate U.S. consumer spending has recovered back to trend levels that were expected prior to the pandemic. As you may guess, the spending is in areas that were not prepared to receive the demand and weak in others. Spending on goods is still quite elevated while services spending is still in a slump. It is also clear that excess savings are still present, so the big spending surge anticipated by economists is still in the future when consumer and business confidence fully recover.

The bottom line remains very much the same. The economy is still in recovery mode with a lot of momentum and little or no signs of structural weakness. Historically, such conditions have preceded decades of economic expansion, such as the 1920s and 1950s. Only time will tell, but we remain quite optimistic.

Until next week we remain dutifully at our respective posts, scanning the horizons for better and more stable investment returns and always for better ways to serve you, our sole employers.



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