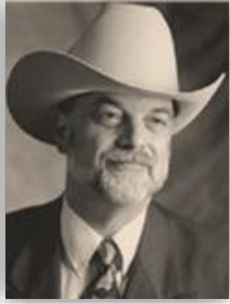

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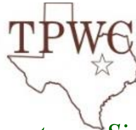

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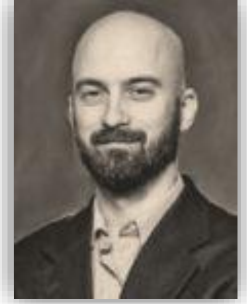

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TPWC Market and Economic Update

The Markets

The stock market, represented by the S&P 500 Stock Index (SPX), turned in another typically wobbly October week as we pass through the months in which the bulls and the bears historically fight it out. For the week ending on October 8, the SPX bounced around before finally stabilizing on Thursday and Friday as the debt ceiling was extended for a couple of months, closing at 4391.34, up 0.79% for the week, but down just over 3% from its high in early September. It now has a 16.91% gain this year. The other equity index we follow, the CRSP Mid-Cap Value Index, reflected the rotation from larger high-growth companies to smaller, value-oriented stocks, rising 1.09% for the week to close at 2471.56, up 20.46% this year, and only about 1% below its record high.

The yield on the U.S. Treasury 10-year note soared almost 10% for the week, to 1.607%, driven higher by the threat of default if the debt ceiling is not resolved this year and the reduced unemployment rate. The 30-year bond followed suit and rose to 2.163%, increasing the steepness of the yield curve, and thereby forecasting faster economic growth is on the way. West Texas Intermediate crude oil (WTI) seemed to take its cue from the bond market as it rose almost 5% for the week to $79.48. WTI has risen a startling 28% since the end of August, and over 64% this year.

The Economy

The economic headline this week was not just the number but the surprise that the U.S. economy only added 194,000 jobs in September. The consensus estimate was that we would see something like a half million jobs created and filled, so the relatively low number was quite a shock. Despite the surprisingly low number of new hires, the official unemployment rate fell to 4.8%. Digging a bit deeper into the Labor Department report a couple of facts jump out. First, apparently quite a few people who have been looking for jobs for months decided to give up and left the labor market. That was the prime reason the unemployment rate fell. Currently there are about 1.5 job openings for every unemployed person, but the openings are largely in areas where the pay is less than optimal and do not match the skill sets of many older workers. There also appears to be an underlying issue of people who are unwilling to work in a job that puts them in contact with a lot of people, and thus at risk for COVID infection. Notably, the end of the extended federal unemployment benefits does not seem to have improved the labor shortage. The second and far more encouraging item was that the new jobs numbers for August and September were increased by about 169,000. If we add the increased and the new September jobs, things look pretty good.

China's slow motion real estate collapse continued during the week as Evergrande was joined by Chinese luxury developer Fantasia as it missed a $206 million dollar bond payment. There is growing evidence that the defaults in that country's real estate market are just getting started. Those who flocked to the high interest payments promised by those real estate bonds are learning that high interest loans do indeed indicate high risk.

The other big issue globally that is likely to be felt here at home is the soaring price of natural gas in the rest of the world. China has recognized that the horrific air pollution created by coal-fired power plants was threatening

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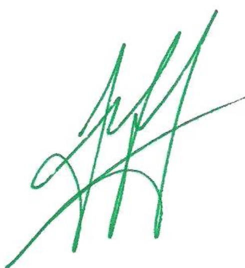
its economy and is forcing a large-scale shift to natural gas. Europe, at the same time, has been on a long-term rotation to the same fuel. Natural gas was so abundant and cheap just a few years ago that oil companies burned it at the well head rather than pay to transport it. The world adjusted to use the cheaper, cleaner fuel, but then the pandemic hit. The abundance of gas was largely tied to the high level of oilfield drilling and fracking, but the oil price collapse in 2020, burned a lot of drillers who have reduced their activity. The result is that the supply of natural gas, which is a major U.S. export, has largely stopped growing just as the global demand increased to record levels. Like in so many other areas, supply and demand are out of sync, and it will take a while to turn that around.

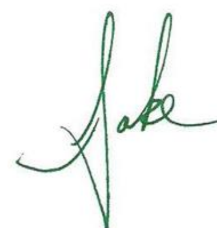
In an economic bright spot, the U.S. ISM Manufacturing Index stayed strong in September, rising to 61.1 from August's 59.9 on a scale where numbers above 50 indicate expansion. Any number above 60 is historically rare. Respondents to the survey reported a "monumental" backlog of orders, suggesting that the high manufacturing growth is likely to endure for some time. On the other side of the economy, the September ISM Services Index rose to 61.9. Taken together, the high readings indicate a high near-future growth rate for the economy.

The chaos continues in the supply chain and labor markets and that turbulence has now reached the energy markets. The rising prices and shortages are not just a supply issue but an indication of an economy that is hitting the stops as capacity is reached in critical areas. In short, we are seeing the opposite of a recession, and there are worse things than more business than companies can handle. It is looking like the third quarter U.S. GDP growth rate might be disappointing as supply and labor shortages impede the recovery, but as the pandemic begins to recede, the logjams are likely to abate, and we may see economic growth accelerate a lot in the fourth quarter and into 2022.

Until next week, we remain focused on providing the best portfolio management, investment advice, and service we can imagine.

Happy autumn!





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