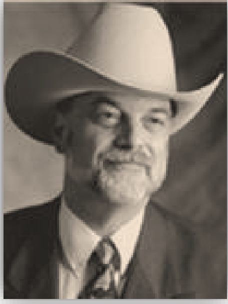

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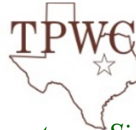

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TPWC Market and Economic Update

The Markets

The venerable S&P 500 Stock Market Index (SPX), doing its usual stand-in for the U.S. stock market, turned in a good week as Christmas Eve reduced it to four trading days. Since last Friday, the Index rose 2.28% to close at a new record high of 4725.79. The catalysts appeared to be reports on the relatively low hospitalization rate for Omicron infected persons, a good consumer spending increase in November, and suggestions that inflation may not be quite as bad or as long-lived as was recently feared. The SPX is now up 25.82% year-to-date and 27.62% from this time in 2020. Looking back to the misty time before COVID, the Index has averaged an astounding 23.48% per year for the last three years. The CRSP Mid Cap Value Index closed at 2547.13, up 1.29% for the week and up 24.2% year-to-date.

The ten-year U.S. Treasury note yield was up 6.25% to 1.495% at the end of the business day, again on general news that the future was looking more and more like boom times. West Texas Intermediate crude oil joined in the party, rising 5.26% to $73.83.

The Economy

Despite the increasing evidence that the Omicron variant of the pandemic-causing COVID-19 virus was spreading at a much higher rate than did any of its predecessors, U.S. consumers still managed to increase their spending by 0.6% in November over the previous month. The headlines suggested that was disappointing after the 1.4% rise in October, but we see it as exceptionally good. Annualized, that 0.6% comes to 7.2%, an amazingly high number when compared with years gone by. As we have often written and said, in an economy where the GDP is about 2/3 consumer spending, high numbers like that are prime drivers of future prosperity. The pattern did shift in the face of the increasing infection rate with diners seated at restaurants down 15% nationwide for the week ending December 22 according to Open Table. As we have seen in the last two years, consumers are again shifting their spending from services to goods, resulting in a net gain over both last year and 2019.

The sobering side to this week's data was that the Personal Consumption Expenditures Price Index (PCE), the Federal Reserve's preferred measure of inflation came in 5.7% above last year in November. When taken as a whole, consumer spending this year appears to be about 3.5% higher than last year, and still well ahead of 2019.

In other (good) news, the Conference Board's Index of Leading Economic Indicators (LEI) rose 1.1% in November after rising 0.9% in October and 0.3% in September. While the LEI has had some false alarms, it has never failed to fall substantially six to eighteen months before a recession. The Board also released the results of their consumer confidence study and reported it up to 115.8 in December from a reading of 111.9 in November.

Some good analysis came out from the Council of Economic Advisors about the underlying causes of the surge of inflation we are experiencing. Looking back in history, what is going on in the economy appears to be not unlike what happened in 1946-1948 immediately after World War II when wartime wage, spending, and price controls were relaxed. Year-over-year inflation surged to about 8% but the high rise in prices tapered down to historical norms after about two years. What appears to be driving this increases is not an unusual surge in spending because,

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after inflation, an annual rise of about 3.5% is well within normal parameters. Rather, it appears that the consumer shift from primarily spending on things like restaurant meals, movie tickets, travel, and other entertainment to mainly goods purchases overstressed our ability to make and transport and deliver those goods. Throw in the disruptions in production both here and overseas as absenteeism and imposed shutdowns occurred and a classical supply and demand imbalance emerged. A law of economics is that when there is more demand than supply, prices will go up, and they have. In short, what we are seeing mainly reflects the inherent dislocations from the pandemic rather than a result of excess government spending. The underlying drivers, at least so far, appear to be very different from those of the accelerating and systemic inflation of the 1970s.

Once more, the bottom line is that the U.S. economy is humming along very nicely, albeit with what appears to be a temporary spell of overheating. The primary threat to good times ahead continues to be the rapid spread of the Omicron variant with its potential to cause more disruptions but all signs appear to point to that threat resolving itself within a few months. The other major threat, geopolitical events such as a Chinese invasion of Taiwan or a Russian invasion of Ukraine appear to be real, but extremely unlikely. An example of why such events are unlikely is that the U.S. is now the number two supplier of natural gas to China. It is hard to imagine any country starting a war that would likely cripple its natural gas supply and thereby its economy.

Until next week, do rest assured that we are at our posts and doing our duty to provide the best fiduciary advice, portfolio management, and service we can imagine.

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