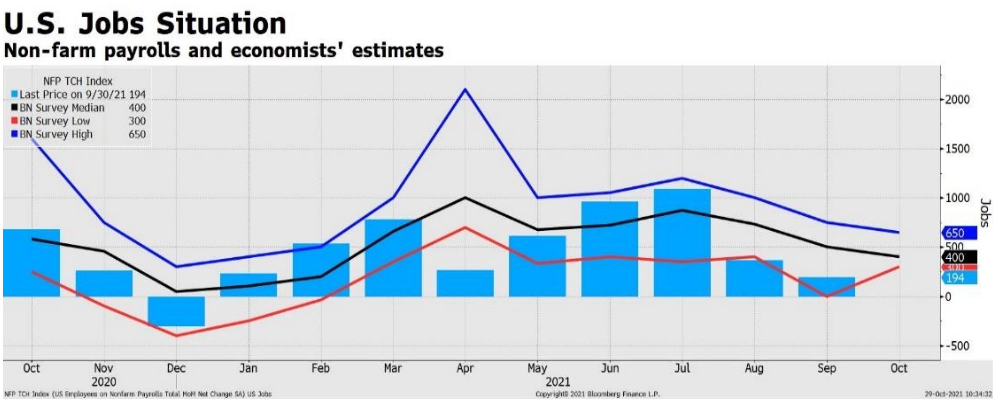
Courier Capital, LLC
Registered Investment Adviser
An affiliate of Five Star Bank

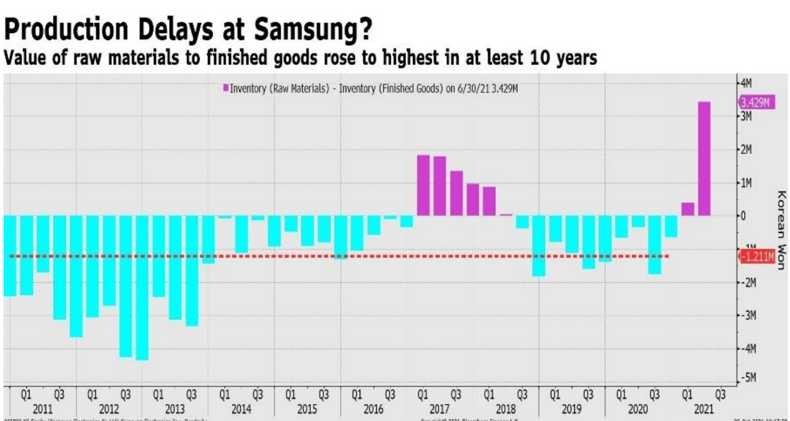
Economic and Market Update – GOOD NEWS, BAD NEWS, NO NEWS (10/31/2021)

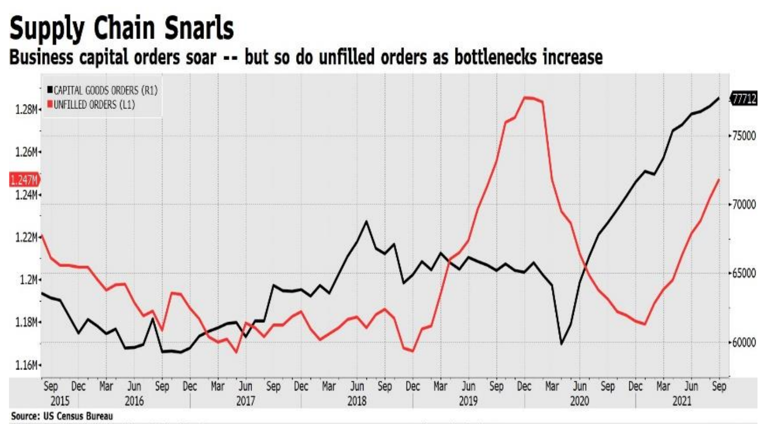
Latest Developments and Economics

When we entered the month of October several significant political and economic issues were left in limbo. This month saw a few of these issues resolved: some with good news, some with bad news and some still in a state of uncertainty. First, one of the more significant items was the Federal debt limit – which had the potential of creating a U.S. bond default. Fortunately, this was resolved in Congress with some relatively good news as there was an agreement reached to raise the debt limit by $480 billion to fund the government until December 3 (classic 'kick the can down the road'). In other news OPEC+ agreed to move forward with production increases but at the slower pace they had stated previously. The result will most likely keep oil prices at recent highs since oil demand is nearing pre-pandemic levels. Russia has agreed to supply Europe with more natural gas as we enter the winter season. Europe is becoming more dependent on Russia as a supplier for their largest energy source and natural gas prices are up nearly 500% this year however, there is some doubt that Russia will actually follow through on the supply promise.



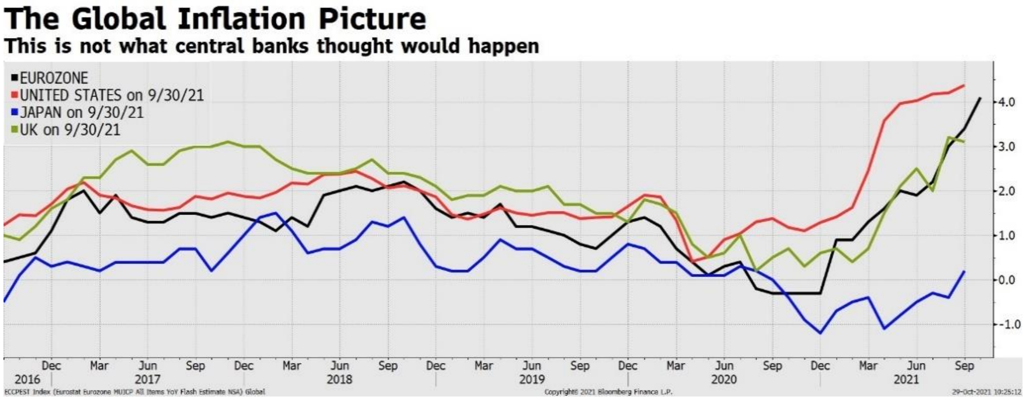
The October jobs number was a disappointing 194,000 new jobs added versus an expectation of 479,000. The result wasn't as terrible as the headline given that private payrolls increased by an estimated 317,000 and government jobs were down by 123,000. Leisure and Hospitality employment growth continues to fall short. The resulting unemployment rate is estimated at 4.8% but this also reflects a lower participation rate as an increasing number of people stay out of the workforce. The demand for workers has been a key contributor to wages rising at an annual rate of 7.6%. The situation has also given labor more negotiating power as "Striketober" brought to 183 the number of strikes in 2021 so far and against such large companies as Kellogg's, John Deere and Coca-Cola.





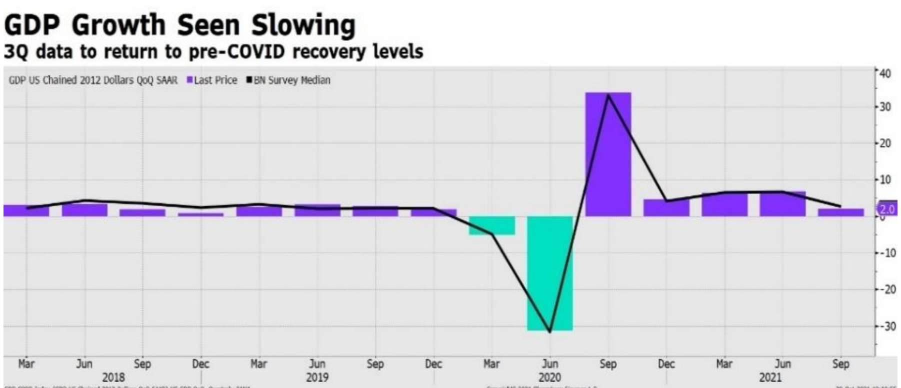
Evidence continues to mount indicating that the supply chain problems globally are going to take longer to get resolved. This condition is the result of a significant increase in demand (i.e.: retail sales up 15.8% year over year), production issues created by the pandemic, labor shortages and transportation and logistics capacity constraints at the docks and railyards. President Biden ordered the port of Los Angeles to run 24/7 but relief isn't expected until well into 2022.

The supply chain issues are also contributing to the global inflation picture over the last year. Some of the primary drivers also include the significant wage increases and commodity price surges we have seen lately. Energy continues to be a significant impact on headline Consumer Price Index (CPI).

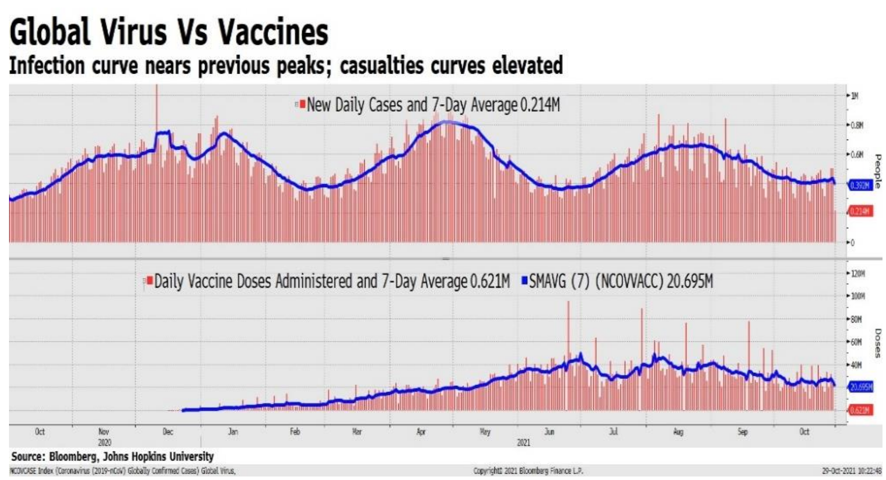


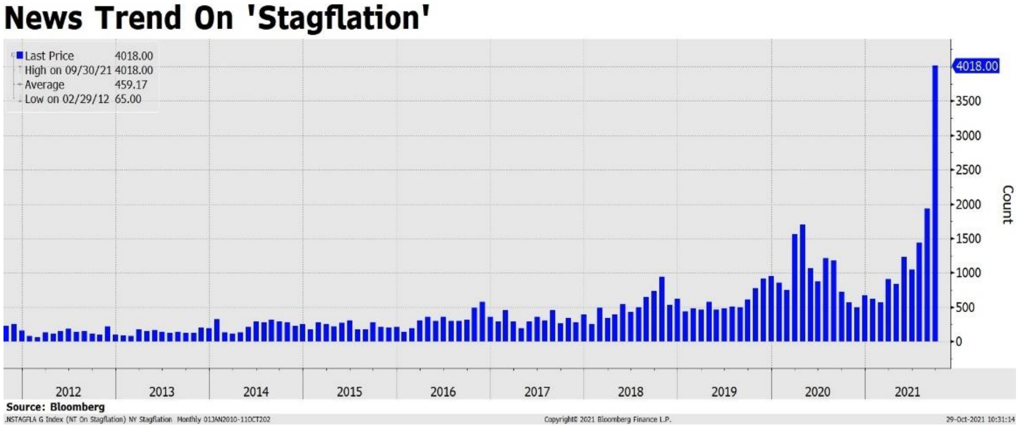
While the impact of recent inflation has been keenly felt in the United States we are not alone in the experience. The Eurozone has caught up to the U.S. in its price increases and, although they may be further ahead in vaccination, have lagged the U.S. in their economic recovery until recently. Even Japan has experienced price level increases rather than the recent bout of deflation.

The significant increase and length of inflation has caused investors to alter their view of 'transitory'. Though this term by the Federal Reserve came with no exact definition many did not expect it to last this long. The latest information from wage cost increases and from producers experiencing input cost growth lends credibility to the expectation that inflation will be above trend for the near term. The news that inflation will continue into next year has caused investors to discount the Fed's continued message of temporary inflation. Expectations of inflation continue to stay elevated as demonstrated in the chart above comparing yields of U.S. treasury inflation bonds (TIPS) to normal treasury yields (often called the 'breakeven inflation rate').

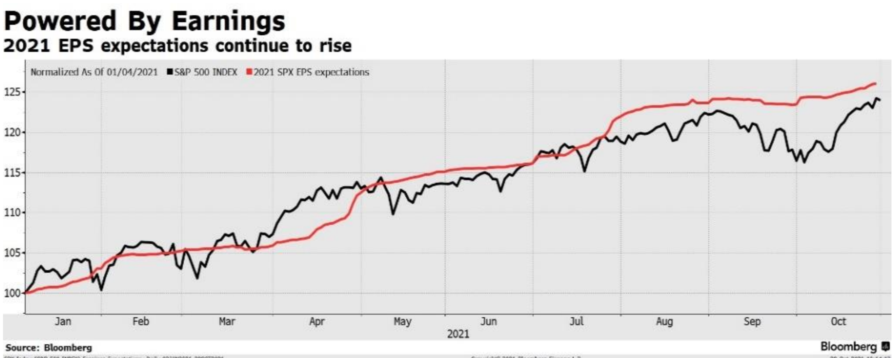


Although a slowdown was expected in GDP for Q3 the first reading came in at unexpectedly light 2.0% growth versus 2.8% consensus estimate. This is far short of the 6.5% annual pace set in the first half of the year while the U.S. was in full recovery mode. Behind the number consumer consumption was resilient at a 1.6% increase from the prior quarter (vs. 0.9% expected). Both business spending and consumers were negatively impacted by the supply chain and scarcity matters as well as the persistence of the Delta wave of COVID. The virus is also likely responsible for some of the labor shortage issues. The overall small increase in business spending was partly a build of inventory, which could create a headwind to future GDP growth since less needs to be manufactured in the near term. Durable Goods orders fell over 26% due mainly to supply issues and vehicles were a significant portion of that decline. Federal government spending also declined 4.7% due to the ending of pandemic fiscal response in Q3. Many are expecting a rebound in Q4 GDP as supply chain issues become less of a drag.

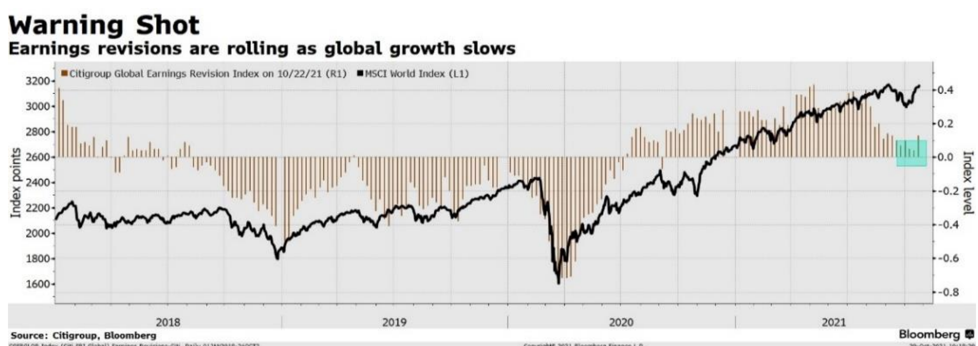




All the recent data on high inflation and lower than expected economic growth has conjured up the specter of 'stagflation' recently (as the chart on news trend shows). Stagflation, coined in the 1970's describes a period of sustained high inflation, weak employment and resulting poor demand. The good news is that current conditions are not at all close to fitting the definition. Inflation, though significant in degree, is not yet persistent and elements of it will dissipate as the supply chain and labor shortage issues get resolved. As far as jobs, unemployment is low relative to history and there are still 10.5 million jobs waiting to be filled – certainly not weak from a labor demand standpoint. In addition, the quit rate hit a record 3.3% indicating that people are feeling confident enough to leave their current jobs in search of something better. Finally, as far as demand goes, although the strong demand from reopening is leveling off, consumer demand is still strong (reference the retail sales growth above). In a word we are not meeting the "stag" part of term as economic activity is not stagnant.

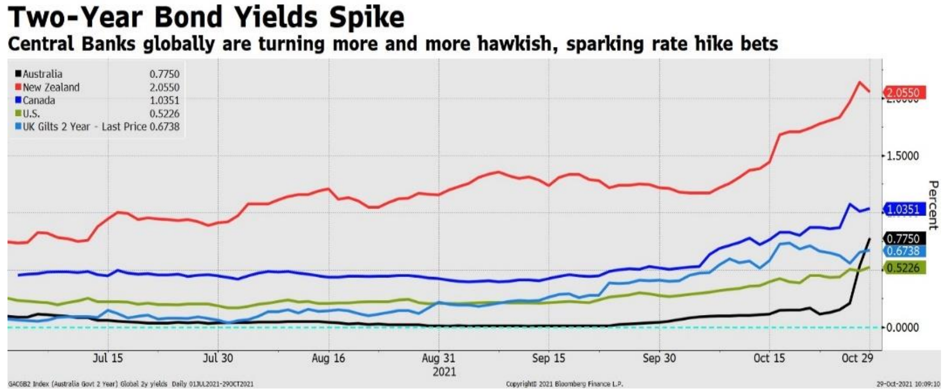


There was also a good news/bad news message in recent Q3 company earnings reports. With 56% of S&P 500 companies reporting so far, more are beating Q3 earnings estimates and by a wider margin than average. Analysts are expecting earnings growth of 40% for the full year vs. last year driven by the prior year's weak earnings due to COVID. The expectation for Q4 is 20% annualized growth. However, many companies are reporting not only troubles from supply chain and labor shortages, but many are also commenting on the significant price increases they are seeing in raw materials, commodities, labor and transportation. This is causing companies to lower future earnings estimates. Additionally, companies that can are raising prices. Consumer giants Proctor & Gamble and Unilever both announced upcoming increases to offset costs. Finally, the significant growth this year creates a high bar to achieve growth next year.



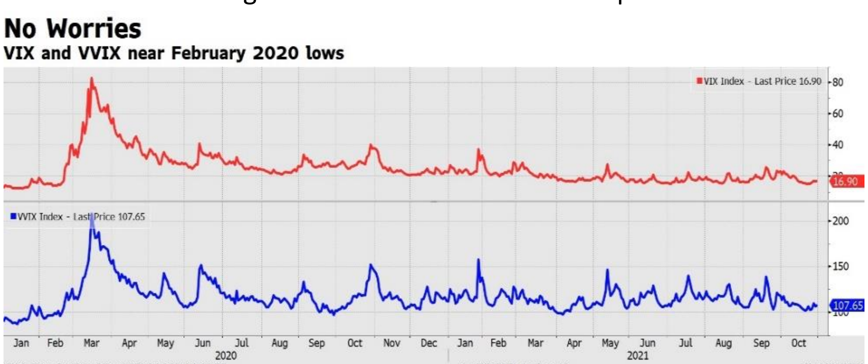
A quick update on the Chinese developer Evergrande situation and the $300 billion debt burden. During October the company twice made last minute interest payments of $83.5 and $47.5 million on their bonds to avoid default. It currently is not clear where they are obtaining funds to make the payments. There is still a massive amount of interest payments due and a default could trigger other defaults. So far, the Chinese high-yield market has been taking the brunt of the impact.

On the no news front the Biden Administration and Congress continue to delay a vote on the bi-partisan infrastructure bill as they debate the size and scope of the economic/social package. What started out as $3.5 trillion on top of the infrastructure bill has been trimmed to $1.75 trillion. The debate is mainly among the moderate and progressive wings of the Democratic party. Progressives had vowed to block the additional infrastructure bill until the economic bill was finalized and put to a vote. Moderates are not in support of the taxes required to fund the entire package and the total price tag of the bill so it was cut to a level that new revenues and taxes could support. Most of the discussion has been about the total cost of the entire package rather than its contents. Many of the initiatives in the original bill were cut out or shortened in duration. The major spending surrounds Clean Energy and Climate (approx. $550 billion), Universal Pre-K and Childcare ($400 billion), Child Tax Credit extended for 1 year ($186 billion) and Health Care ($300 billion). President Biden announced the framework before he left for the economic climate symposium in Glasgow but there has not been complete agreement on the package among the party just yet. Currently, progressive Senators are still talking about adding line items to the bill (prescription drugs, SALT relief, etc.) and, if they do, it would need to go back to the House for another vote after the Senate is done. The next proposed date for a vote on both bills is Tuesday November 2 but that looks problematic. The consternation among the party about these two bills as well as inflation and other factors are starting to weigh on the favorability of this administration. Latest polls show a significant drop in approval ratings for Biden and the Virginia Governor's race may be a mini-referendum on the current political direction.



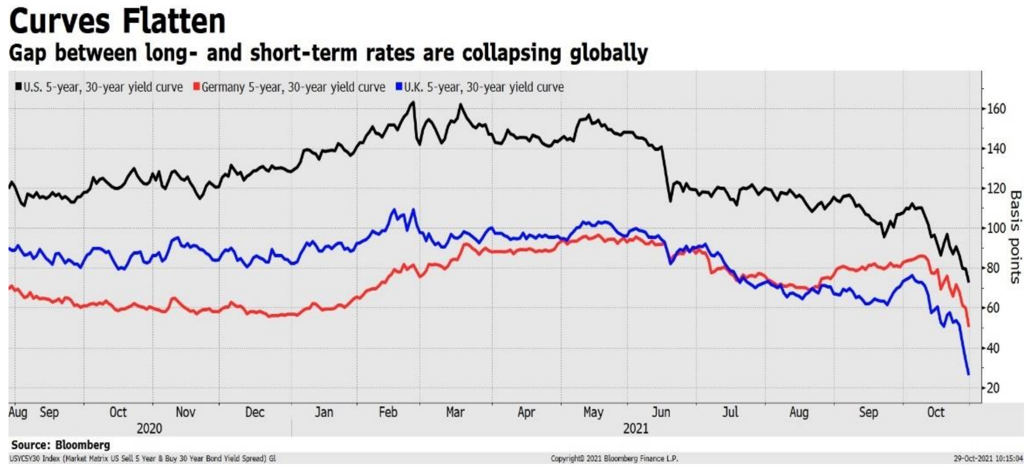
Financial Markets

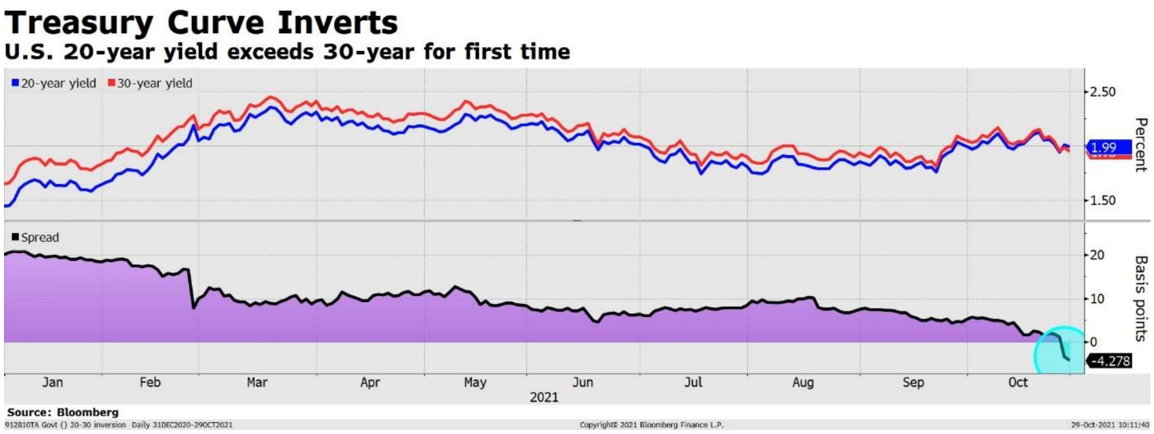
After a rare 2021 drawdown at the end of September the U.S. equity markets sprung back in October mainly on the back of company earnings. That good news propelled the indices to new highs as companies are beating expectations as described above. The 7% gain of the S&P 500 in October puts 12-month forward valuations at 21.1 P/E which is above the 5-year and 10-year averages. Large cap stocks also significantly outperformed mid and small in the month. The 21.1 is also higher than the 9/30 forward P/E of 20.1 which means prices have run further than earnings revisions. Investors have also become a little complacent, buoyed by company results despite the inflation, supply chain issues, tapering of Fed bond purchases and eventual rate increases. The volatility Index (VIX) is pretty much back to pre-pandemic levels.



In the midst of the euphoria about company earnings the bond market is starting to anticipate what may soon come. The Federal Reserve holds meetings early in November which will provide more information about their plans for tapering their bond purchases (a stated prerequisite to rate increases). In the meantime, market rates are already reacting. While the 10-year rate has stayed in the 1.60% range from the end of September there have been interest rate increases at different maturities. The 2-year treasury yield spiked in the U.S. and globally in October as other Central Banks are considering reducing the extreme support they put into place during the pandemic. Without rate increases by the Central Banks what we are seeing is a flattening of the yield curves globally – usually a sign that fixed income markets expect a potential economic slowdown.

This “flattening” is happening globally as the difference in yields between long-term bonds and short-term bonds shrinks. In the U.S. this difference caused an “inversion” where the 20-year bonds had higher yields than 30-year bonds – which does not happen normally unless fixed income investors expect interest rates to decline in the future. Essentially, the fixed income markets continue to tell a different economic story in the near future than do the equity markets.





Should you have any questions please contact us.

Image sources: Bloomberg and CNBC unless otherwise noted

Buffalo Office

1114 Delaware Ave.

Buffalo, New York 14209

PHONE: 716-883-9595

Jamestown Office

214 West Fifth Street

Jamestown, New York 14701

PHONE: 716-484-2402