February 12, 2021

| 2/12/2021 | | Wk | Wk | | YTD | 12 Mos |
|---|---|---|---|---|---|---|
| | | Net | % | Div | % | % |
| **STOCKS** | Close | Change | Change | Yield | Change | Change |
| DJIA | 31,458.40 | 310.16 | 1.00 | 1.92 | 2.78 | 6.45 |
| S&P 500 | 3,934.83 | 48.00 | 1.23 | 1.47 | 4.76 | 16.43 |
| NASDAQ | 14,095.47 | 239.18 | 1.73 | 0.66 | 9.37 | 44.93 |
| S&P MidCap 400 | 2,544.55 | 67.88 | 2.74 | 1.31 | 10.32 | 21.67 |

| **TREASURIES** | Yield | **FOREX** | Price | Wk %Change |
|---|---|---|---|---|
| 2-Year | 0.11 | Euro/Dollar | 1.21 | 0.77 |
| 5-Year | 0.49 | Dollar/Yen | 104.98 | -0.46 |
| 10-Year | 1.21 | GBP/Dollar | 1.38 | 0.90 |
| 30-Year | 2.01 | Dollar/Cad | 1.27 | -0.52 |

Source: Bloomberg/FactSet

**What Caught Our Eye This Week**

Semiconductor chips are the brains of modern electronics making possible cutting-edge technologies in healthcare, communications, computing, and transportation, among countless other applications. Rising overall demand for chips across a range of end markets drove a 6.5 percent increase in global semiconductor sales in 2020. Semiconductors and their ever-increasing importance had captured the attention of policymakers in Washington when a global shortage of chips began to disrupt the U.S. auto-motive supply chain. The confluence of the increased use of semiconductors in advanced vehicles, substantial swings in demand during the pandemic, and decades-long efforts to reduce costs and streamline supply chains have reduced inventories and left manufacturers vulnerable to disruptions. Suppliers find themselves facing a global shortage, unable to deliver components and needing to slow or halt manufacturing lines. Chip makers expect that the situation may not normalize until the second half of this year at the earliest, possibly even extending into next year. As a result, the global auto industry which had been primed for a strong post-COVID recovery, will produce nearly 700,000 fewer cars than planned for the first three months of 2021.

**Economy**

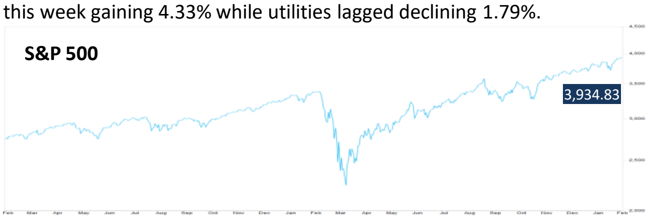
It was an uneventful week for economic data, and the main focus was on the consumer price index. On Wednesday, the CPI matched consensus expectations with an increase of 0.3% in January. The "core" CPI posted a slight increase, rising 0.03%, and is now up 1.4% year-over-year. Energy prices led the headline figure gaining 3.5% during the month. Earlier in the week, the JOLTS report (job openings and labor turnover survey) showed 1.8 million layoffs in December and 5.5 million hires. Total job openings are now at 6.6 million, the "quits" rate was little changed at 2.3%, and over the past twelve months there is a net employment loss of 5.5 million. On Thursday, weekly jobless claims declined 19,000 to 793,000 during the week ended February 6th. Filings have decreased by 134,000 over the most recent four weeks. As of January 30th, 4.5 million Americans were collecting unemployment benefits through regular state programs. Finally, on Friday, the University of Michigan consumer sentiment index missed expectations dropping from 79.0 to 76.2 in the preliminary report.

**Fixed Income/Credit Market**

Optimism regarding additional fiscal stimulus potentially coming to fruition coupled with dovish statements this week by Fed Chairman Powell encouraged fixed income investors to step out on a portion of the risk spectrum. The risk-on trade caused credit spreads to tighten with the Bloomberg Barclays U.S. Corporate High Yield OAS contracting 7 basis points (bps) on a weekly basis through Thursday, which brought the spread down to an extremely tight 326 bps (almost 2 standard deviations below the 5-year mean). Moreover, on Monday the yield to worst (YTW) on the Bloomberg Barclays U.S. Corporate High Yield Index dipped below 4% for the first time in history even with the corporate high yield default rate 2.68% above its 30-year average. With market-based inflation expectations starting to move higher (particularly over the next two years) investors are beginning to shy away from duration risk. Fixed income ETF flows are showing a net outflow of long-term securities equating to 1.7% of market capitalization thus far in February, according to Bloomberg. The most recent data clearly shows that investors are selecting credit risk over duration risk in the current market environment.

**Equities**

Domestic equities posted solid gains this week, and the S&P 500 closed at a new record high on Friday. The bullish narrative continues to focus on fiscal stimulus and vaccine optimism. Democrats are planning to pass a new coronavirus relief package through the Senate via a reconciliation process which only requires a simple majority vote. Although the proposed bill currently stands at $1.9 trillion, analysts are expecting some items to get removed resulting in a final bill in the $1.5-$1.7 trillion range. On the vaccine front, the U.S. is expected to have three approved inoculations in the next few weeks helping drive a meaningful increase in supply in March and April. Fourth quarter 2020 corporate earnings and guidance have been solid. According to FactSet, as of Monday, the blended earnings growth rate for the S&P 500 stands at 1.7% which would mark the first quarter of year-over-year earnings growth since Q4 2019. Some concerns that have been frequently cited revolve around a pickup in inflation which could push interest rates higher and impair stock market valuations. Investors also continue to focus on the potential negative impacts of coronavirus mutations. Energy stocks were the top performers this week gaining 4.33% while utilities lagged declining 1.79%.




**Our View**

The debate regarding President Biden's $1.9 trillion stimulus plan was joined this week by two renowned center-left economists, Larry Summers and Olivier Blanchard, who both raised concerns over the size of the stimulus package and its potential to overheat the economy. The core of their concern is that in the short run the demand created would potentially be too large for the productive capacity of the capital stock and labor supply of the domestic economy. Thus, demand would outstrip supply and prices would rise. A large escalation of inflation would possibly cause financial market instability, especially with asset valuations at current levels. Both Summers and Blanchard acknowledge the need for some additional stimulus but object to the size of the proposal. Several Fed officials, including Fed Chair Jerome Powell, made remarks this week that appeared to support the Biden plan in contrast to Summers and Blanchard. Powell's comments to the Economic Club of New York suggested that there remains considerable slack in the economy overall and that it will require substantial near-term support to restore full employment. The economy should grow at a relatively high rates as it reopens due to a massive amount of pent-up demand. During this acceleration of growth, we would expect an increase in the rate of inflation. Several market-based measurers of inflation expectations indicate that markets are already factoring in a brief period of higher inflation ahead. Supply dislocations caused by the economic disruptions during the last twelve months will be uncovered as demand suddenly emerges. A short-term mismatch between demand and supply will likely cause a spike in the general level of prices. However, a rapid supply-side response will in a reasonably short period ameliorate the pricing fluctuations, so the short-term price pressures will prove to be transitory. Additionally, the structural dynamics that caused the disinflationary environment prior to Covid-19 have not totally gone away. Those secular forces are still in play and will be recognized by the market. We agree with Messrs. Summers and Blanchard that rising inflation expectations could ultimately be a problem for the Fed and the financial markets, but it is probably too early in the economic recovery to be overly concerned about inflation.

| COMING UP NEXT WEEK | | Consensus | Prior |
|---|---|---|---|
| 02/17 PPI SA M/M | (Jan) | 0.40% | 0.30% |
| 02/17 Retail Sales SA M/M | (Jan) | 1.2% | -0.70% |
| 02/17 Industrial Production SA M/M | (Jan) | 0.50% | 1.6% |
| 02/19 Markit PMI Manufacturing SA (Preliminary) | (Feb) | 59.0 | 59.2 |
| 02/19 Markit PMI Services SA (Preliminary) | (Feb) | 57.8 | 58.3 |

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