February 19, 2021

2/19/2021		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	31,494.32	35.92	0.11	1.92	2.90	7.74
S&P 500	3,906.71	-28.12	-0.71	1.48	4.01	15.92
NASDAQ	13,874.46	-221.01	-1.57	0.72	7.65	42.55
S&P MidCap 400	2,535.39	-9.16	-0.36	1.31	9.92	21.36

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.11	Euro/Dollar	1.21	0.07
5-Year	0.58	Dollar/Yen	105.63	0.62
10-Year	1.34	GBP/Dollar	1.40	1.19
30-Year	2.13	Dollar/Cad	1.26	-0.76

Source: Bloomberg/FactSet

What Caught Our Eye This Week

Earlier this week, a winter storm hit Texas, leaving in its wake significant property damage and millions of people without power and reliable sources of water and food. Beyond these hardships, the freezing weather and power outages have disrupted both the Lone Star State's and nation's energy supply. The Gulf Coast handles roughly half of the country's oil refining capacity. Difficulty in extracting oil and natural gas, refining it, and transporting the commodity has brought temporary shortages, spiking prices of the commodities. In addition, modern manufacturing depends on complex supply chains and the logistic networks that link them. These relationships are often unappreciated until extreme weather exposes the vulnerability for both producers and consumers. Texas' geographic location means a lot of intermodal freight (movement of containerized products and raw materials by a variety of transport modes such as shipping, road and rail) passes through the state. Earlier this week the Union Pacific Railroad shut down most of its intermodal freight network from the Pacific Northwest to Texas and reduced the lengths of its trains for safety reasons. Most intermodal terminals will soon reopen, but it will take time to clear up the backlog on a network that was already stressed by record import levels from the West Coast. End consumers can expect delays and potentially higher electric and natural gas bills.

Economy

The most anticipated report this week was in retail sales, which was released on Wednesday. Retail sales surged 5.3% in January well above expectations. This is the largest increase in seven months, and overall retail sales are up 7.4% year-over-year. Clearly, the $600 stimulus checks from the December Response and Relief Act are playing a huge role here. The "control" category, which excludes food service, autos, gas and building materials, registered a 6.0% gain in sales. Once again, non-store retailers led the way, posting a 11% advance. In summary the larger gains were seen by retailers of discretionary products such as electronics and sporting goods. In other news this week the producer price index came in much stronger than expected, increasing 1.3% in January. The "core" PPI gained 1.2%, which is the largest monthly increase for the series which began in 2010. Industrial production figures were posted on Wednesday and for the fourth consecutive month these numbers rose, increasing 0.9%. Manufacturing output advanced 1% and capacity utilization rose to 75.6%. Finally, on Thursday housing starts disappointed, declining 6.0% in January to 1,580 million units at an annual rate.

Fixed Income/Credit Market

The long-end of the U.S. Treasury curve steepened week-over-week driven by the known bearish underpinnings that have facilitated a significant move higher in longer duration Treasury yields since the beginning of 2021; reflationary expectations, U.S. Treasury supply, and optimism surrounding the economic recovery. The steepening has also been further exacerbated by the FOMC holding short-term yields close to the zero-lower bound (ZLB). Using the 2-year and 10-year yield spread (2/10 spread) as the proxy, the slope of the U.S. Treasury curve increased 13.1 basis points (bps) this week and 43.7 bps since the beginning of the year. The benchmark spread is now roughly 123 bps, 12.9 bps from a five-year high of 135.9 bps achieved shortly after the nomination of former President Donald Trump. For additional context, the average over the same 5-year period for the 2/10 spread is just 60.4 bps. Despite the continued back up in interest rates, inflation expectations have noticeably waned during the week. Both 5-year U.S. and 10-year U.S. breakeven rates have dropped from their recent highs 3.3% and 4%, respectively.

Equities

U.S. domestic equities posted a mixed session on Friday, rounding out a week of mostly lower performance. The NASDAQ, S&P 500, and Russell 2000 all finished with losses for the week, declining -1.57%, -0.71%, and -0.99%, respectively. The Dow posted a modest weekly gain of 0.11%. Stocks came under pressure as stretched valuations and higher bond yields weighed on overall sentiment during the holiday shortened week. Investors remain enthusiastic the economy will continue to recover with positive news on the Covid case count and vaccine optimism as well as the prospect for additional stimulus. Optimism regarding the economy and steepening yield curve boosted the energy and financial sectors as investors favored economically sensitive areas of the broader stock market. Rising 2.81% and 3.06% respectively, for the week, financials and energy handily outperformed the remaining sector groups, as most saw losses for the week. Consumer discretionary lagged its peers with a -1.92% drop. Furthermore, growth trailed value, dropping 1.7%, while its counterpart gained 0.28% on the week.

Our View

The most meaningful driver of the U.S. economy is the consumer and after a year of altered and suppressed activity due to the pandemic, the consumer is ready to spend. Moreover, despite a difficult start to 2020, household net worth increased by an aggregate $5 trillion through the third quarter of last year according to the Federal Reserve. The rise in household net worth has been largely fueled by the incredible rebound in the equity market coupled with solid appreciation in the housing market due to extraordinarily low interest rates. The household debt service ratio, which peaked in the fourth quarter of 2007 at 13.2% has since dropped 410 basis points to 9.1%. U.S. personal savings is also elevated due to limitations on social gathering, government stimulus and the uncertainties over the future ramifications of the virus. But not everyone is ready to increase their spending patterns as the new normal has disproportionately hurt those in the most impacted sections of the economy. The labor market lost an astonishing 22.4 million jobs in February through April of last year and has since only regained 12.5 million jobs. However, the main driver of consumer spending in the near term will largely be predicated on the vaccine rollout. With cases, hospitalizations and fatalities in the U.S. trending in a downward trajectory and vaccinations on the rise, there are undoubtedly reasons for optimism. Also, the Johnson & Johnson vaccine, which was submitted for FDA approval earlier this month, only requires one dose and does not require severe cold storage which will help ease availability constraints once it is approved. With the foundation for future consumer spending appearing strong at this point, economic data should be quite robust in 2021. But, the equity market (S&P 500) is forward looking and has priced in almost 23% earnings growth over the next 12 months. Valuations are expensive with the S&P 500 trading at 143.9% of its 20-year average price-to-earnings ratio, but can be justified, to a degree, in the low interest rate environment. However, interest rates have been on the rise since the start of the year and the yield curve has steepened, which could weigh on longer duration equities if the trend continues.

COMING UP NEXT WEEK NEW		Consensus	Prior
02/22 Leading Indicators SA M/M	(Jan)	0.25%	0.30%
02/23 Consumer Confidence	(Feb)	90.0	89.3
02/25 Durable Orders SA M/M (Preliminary)	(Jan)	0.95%	0.47%
02/26 Personal Consumption Expenditure SA M/M	(Jan)	2.3%	-0.20%
02/26 Personal Income SA M/M	(Jan)	9.9%	0.60%

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