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Portfolio Talk **Market Update 8/06/2021**

Wall Street firms are sharpening their pencils and revising their forecasts on where the S&P 500 will close at year end. Given that 88% of companies reporting financial results for the second quarter have beaten street expectation, confidence is growing[i]. This week two big firms, Goldman Sachs and Citigroup, raised their year-end projections for the S&P 500 to 4,700, up from a prior 4,300. Reasoning, earnings were accelerating faster than expected and guidance was above consensus. As we've stated in the past, markets tend to follow earnings so this shouldn't be surprising. The question is, will we be able to maintain this acceleration into 2022 when the earnings comparisons are against a post pandemic economy? This is where I believe we may face some challenges. In both of these forecasts offered by Goldman and Citigroup, they project the 10-year Treasury rising to 1.6% to 2.0% respectively. They further project that earnings will go back to normal growth rates, 4-6% for the S&P 500. Higher interest rates and slower earnings growth could lead to lower multiples meaning less market returns. If in fact we close the year at 4,700 on the S&P 500, that's another 6-7% above where the index is now. Could we be pulling 2022 returns into 2021? We thought the same about 2020 pulling 2021's returns in and yet 2021 has been a very good year. The point is that at some time we'll have to settle back to normal growth rate in earnings and returns in the markets. We often times don't see or understand what that is until it's too late.

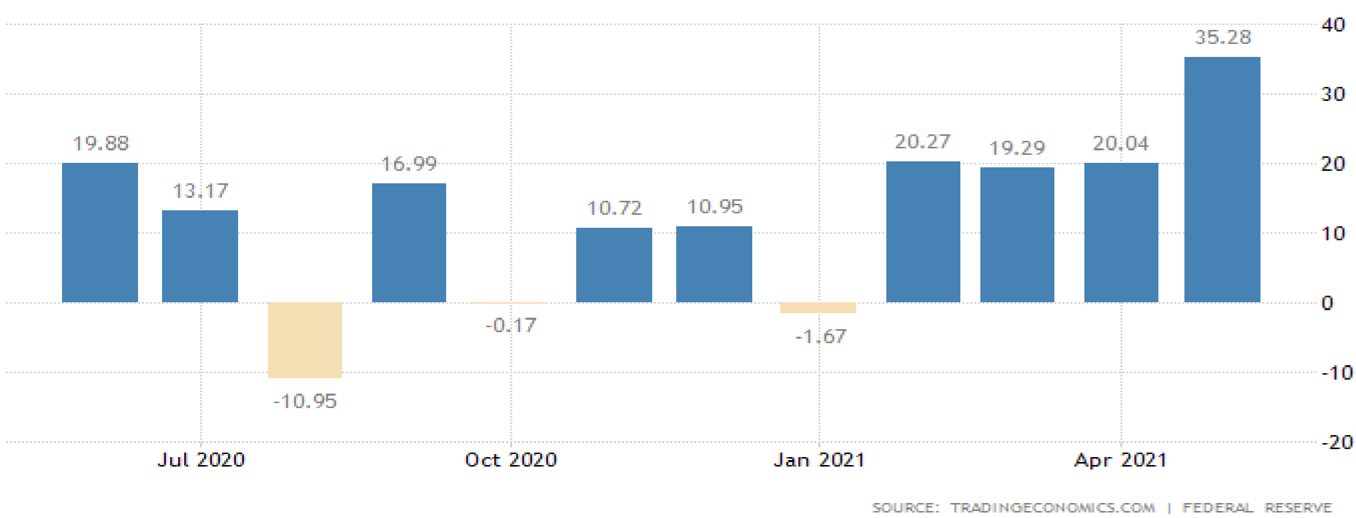
Looks like the US Senate is negotiating a $1.1 trillion infrastructure bill that could be passed as soon as this weekend. Sounds good given we are in desperate need of repair to roads, bridges, waterlines, airports as well as expanding our internet capabilities across our nation. The House of Representatives has stated there are doubts it'll pass in its current state. Is that surprising to anyone? Its political theater per usual even though both sides agree that the "spend" is needed! Hopefully rational minds will prevail. What this means for the economy is JOBS, JOBS, JOBS! I know that this may be a naïve statement given that under President Obama's presidency an infrastructure bill was passed, and it was supposed to be "shovel ready"! Much to his chagrin many of the projects were held up in local, state and federal government agencies waiting for approvals to initiate the projects. Sad to say much of the allocated funds were never used. Let's hope this time is different!

Economic News

- Monday:
  - Markit manufacturing PMI (final) for July, 63.4% vs. 63.1% expected and 63.1% previously…excellent!
  - ISM manufacturing index for July, 59.5% vs. 60.8% expected and 60.6% previously…excellent!

- Construction spending for June, 0.1% vs. 0.5% expected and -0.2% previously…slower, supply chain issues most likely.

- Tuesday:
  - Factory orders for June, 1.5% vs. 1.0% expected and 2.3% previously…very good.
  - Core capital goods orders (final) for June, 0.7% vs. 0.6% previously…very good.
  - Real household debt (year-over-year change) for Q2, 0.0% vs. 0.5% previously…flat line, good I guess?
  - Motor vehicle sales for July, 14.8 million vs. 15.4 million previously…chip shortage is the problem!
- Wednesday:
  - ADP employment report for July, 330,000 vs. 653,000 expected and 680,000 previously…a negative surprise.
  - Markit services PMI (final) for July, 59.9% vs. 59.8% expected and 59.8% previously…inline.
  - ISM services index for July, 64.1% vs. 60.5% expected and 60.1% previously…very good!
- Thursday:
  - Initial jobless claims (regular state program) for July 31st, 385,000 vs 385,000 expected and 399,000 previously…more inline vs. the ADP report on Wednesday.
  - Continuing jobless claims (regular state program) for July 24th, 2.93 million vs. 3.30 million previously… finally cracked the 3 million number, good!
  - Trade balance for June, -$75.7 billion vs. -$74.2 billion expected and -$71.0 billion previously…growing imports!
- Friday:
  - Nonfarm payrolls for July, 943,000 vs. 845,000 expected and 850,000 previously…Better than anticipated!
  - Unemployment rate for July, 5.4% vs. 5.7% expected and 5.9% previously…all good; labor participation increased to 61.7%, the U-6 underemployed decreased to 11.9% and the number of available jobs needing filled is little changed at 9.2 million!
  - Average hourly earnings for July, 0.4% vs. 0.3% expected and 0.3% previously…growing adding to inflationary pressures.
  - Wholesale inventories for June, 1.1% vs. 0.8% expected and 1.3% previously…hopefully building reversing the depletion trend.
  - Consumer credit for June*, **released later this evening*** vs. $24 billion and $35 billion previously…but is this a concern? The chart below shows an uptick in May, something to watch!



While the equity markets do show resilience given the spread of COVID due to the Delta Variant, the number of hospitalizations are up but the death rate is low. This is telling us that those vaccinated and getting the variant are having a less severe case of the virus. One issue of note is that since the Delta Variant has hit the US, those getting vaccinated has increased. While the numbers vary, given the organization reporting them, the US has fully vaccinated a little over 50% of the population. If you add in those that have received at least one shot of the vaccine and/or who have had COVID we reach close to 70%. Herd immunity is getting closer. The fear of our economy locking down again appears to be abating. The mask mandates are being reinstated in some communities as well as in some businesses in areas where the outbreak is highest, but the fear of going back to where we were in the fall of last year to the winter and spring of this year seems to be on the back burner. This is a legitimate risk, but at this time we see it as relatively low. We'll be watching it closely.

Companies in the portfolio reporting earnings were lighter this week with McKesson and Eaton both posting better than expected revenue and earning with better guidance going into the second half of 2021 and full year 2022. While we do have a few stragglers who will be reporting over the next few weeks, our companies continue to look good going forward.

Interest rates actually climbed yesterday and today. The 10-year Treasury is back to 1.28% as of this writing, up from 1.12% on Monday! Maybe Goldman Sachs and Citigroup are on track with their prediction of 1.6-2.0% by year end? Growth stocks are taking it on the chin today because of the rise, something we'll be watching closely if the trend continues.

Have a nice weekend and Stay Safe!

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[i] Sam Ro, Axios Markets dtd July 26, 2021