

Wentz Weekly

August 31, 2020

Average Inflation Targeting



Investment management for your lifetime

At the annual Economic Symposium, held in Jackson Hole, WY, central bankers convene to discuss important economic issues facing the U.S. and global economies, and occasionally announce significant policy changes. That was the case this year, where the meeting was held virtually, when the Federal Reserve announced a major shift in how it will manage inflation. In a move to address the “quite difficult macroeconomic context of low interest rates, low inflation, relatively low productivity, and slow growth” Jerome Powell said the Fed will adopt average inflation targeting. Rather than preemptively raising interest rates to prevent a potential rise in inflation, the Fed will now let inflation run above its 2% target. If this strategy had been implemented five years ago, the Fed would likely have not raised rates, and would have waited until there was clear evidence inflation was trending above 2%. The policy shift is expected to benefit the equity markets directly. A more dovish Fed and lower interest rates will result in higher equity multiples. We expect the broad market, especially interest rate sensitive sectors, to continue to perform well.

The Dow Jones Industrial Average, a major U.S. stock index many refer to gauge the daily moves of the stock market, will be getting a major shakeup. S&P Global, who maintains the index, said three companies will be swapped in the index; Pfizer, Exxon Mobil and Raytheon will be coming out, and Amgen, Salesforce.com and Honeywell will be going in. The main reason is simple; Apple’s 4-for-1 stock split. Dow is a price-weighted index and that means a higher stock price will have a higher weighting in the index. When Apple stock split, it will have a smaller makeup of the index and therefore less exposure in the index to technology. Salesforce.com is taking over for Exxon to increase technology exposure and due to software’s growing importance in the economy. Amgen is replacing Pfizer due to it being a more pure biotech company. Raytheon is the former United Tech, but after the split is more of a pure aerospace and defense company, and Honeywell is more diversified. The headline moved the stocks, but we believe the stocks will be affected nothing more than the initial move due to a small amount of assets being benchmarked to the Dow. For example, there is \$12 trillion indexed and benchmarked to the S&P 500, but just \$31 billion indexed or benchmarked to the Dow. The change will take effect as of the open on Monday August 31st.

The battle to acquire TikTok took a turn last week when a new bidder entered the conversation. Not too long ago, President Trump issued an order that would ban the video-sharing service from operating in the U.S. citing national security concerns – unless acquired by a U.S. company. Walmart emerged as the latest looking to acquire the U.S., Australian and New Zealand operations. However, Trump’s plan was to have the lead buyer be a technology company, which would be a better fit from a national security perspective. As a result, Walmart has teamed up with Microsoft and appear to be the front runners at this point. CNBC reported the deal is likely to be in the range of \$20 billion to \$30 billion. Walmart’s intention is to become the exclusive e-commerce and payments provider for TikTok, with access to user data, providing an important way for it to reach and serve omnichannel customers. A deal is expected to be officially announced any day.

The housing market has been one of the best sectors of the economy this year, which may come as a surprise given we have had a recession that began in February and a global health pandemic that has swept across the nation at the same time. The market has been fueled by all-time low mortgage rates, changing demographics, and the work-from-home movement spurring an urban flight. Sales of newly constructed homes increased 14% in July to an annualized pace of 901,000 and 36% above the rate a year ago. On the other hand, sales of existing home rose 25% in July to an annualized pace of 5.860 million which is 8.7% above the sales rate from a year ago. Consequently, the lack of supply of homes on the market has led to higher prices. The median price of a new home and existing home is 7.3% and 8.5% higher compared to a year ago, respectively. The boom is expected to continue, as Wedbush analyst Jay McCanless notes, “you have the three largest population groups looking right now” referring to baby boomers, millennials, and generation Zers.

Company News

- Apple and Tesla will begin trading at the split adjusted prices Monday at the market open. Apple announced a four-for-one split while Tesla announced a five-for-one stock split, meaning if you own one share of Apple, after the split date you will receive an additional three shares. At the same time, the stock price will be adjusted accordingly to reflect the additional shares.
- Veeva beat second quarter estimates with revenues growing 32.5% compared to a year ago. The company provided guidance for the current quarter, along with the full year, that was increased to a range above analysts’ estimates.
- Best Buy beat analyst estimates on its second quarter, with revenues up 3.9% from a year ago. Comparable store sales were up 5.8% versus the 2.3% increase expected, with online sales increasing 242%. Products seeing most sales growth included computers, tablets, and appliances. So far in August sales are up 20%. The company did not provide guidance.

The Week Ahead

The economic calendar picks up and the earnings calendar slows down this week. On the economic side, results from key manufacturing surveys will be released Tuesday, providing any sort of indication if manufacturing activity continued to recover through August. Also on Tuesday, the Census Bureau will report data for construction spending for July. On Wednesday Factory Orders are released followed by the weekly jobless claims figure on Thursday. Friday is the main event with the Department of Labor’s employment report. The estimates have payroll growth of 1.300 million for the month of August, after 1.760 million in July. The earnings calendar is not completely quiet, we will still see quarterly results from Zoom Video, Macy’s, Five Below, DocuSign, and Broadcom. There will be a couple corporate actions Monday at the market open, with Tesla and Apple stock both trading split adjusted.

The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index. The NASDAQ composite is an unmanaged index of securities traded on the NASDAQ system. Information contained herein was received from sources believed to be reliable, but accuracy is not guaranteed. Information provided is general in nature and is not a complete statement of all information necessary for making an investment decision and is not a recommendation or a solicitation to buy or sell any security. Investing always involves risk and you may incur a profit or loss. Keep in mind that individuals cannot invest directly in any index. Past performance does not guarantee future results. There is no assurance these trends will continue, or forecasts will occur.