Wentz Weekly

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Infrastructure Proposal Approved, Unlikely to Pass

Stocks closed at new record highs last week as prospects of another massive government spending program were on the rise. After months of meetings and negotiations with many disagreements, President Biden said last Thursday that he reached an agreement with a bipartisan group of senators on a proposal to fix the nation's infrastructure. Biden gave some details on the $1.2 trillion spending plan, roughly two-thirds of what he initially proposed, and includes $579 billion in new spending that is planned to be used on modernizing roads, bridges, railways, water systems, public transit systems, and broadband. Plans for funding the massive proposal saw a lot of disagreement, but the two sides reportedly agreed on using unused Covid-related funds as well as revenue generated from several other activities, though the remaining funding remains unknown.

Biden said neither side got everything they wanted and this agreement is only half of his two-part infrastructure agenda, a major reason we think the proposal will not pass Congress (not to mention the unknown details on funding). The agreed on proposal would fix some of the nation's physical infrastructure issues, but the other half of Biden's $4 trillion economic plan that includes human infrastructure and tax increases was not included in the plan. After Biden said he will not sign the bipartisan proposal without commitments on reconciliation for the remaining portion of his agenda, we believe most Republicans will be hesitant to pass the proposal Biden said was agreed on. We still believe any infrastructure package will have to be passed through budget reconciliation, leading to a more progressive bill that includes more spending and more tax increases. Expect more volatility in the weeks ahead as Congress faces deadlines near the end of summer on the debt ceiling and budget.

Personal income and spending patterns have shifted back and forth since the start of the pandemic and have shown how consumers habits have changed. The Personal income and outlays report, released monthly by the Bureau of Economic Analysis, is one of the better indicators of what is happening in the U.S. economy. For May, the data showed income fell 2.0% in the month, however all the decline was from a significant reduction in government benefits (-12%) such as stimulus payments and unemployment benefits (-38%). The wages and salaries portion, a better indicator of what people are earning from working, rose 0.8% in the month, a very strong gain, and is now 5% higher than before the pandemic, indicating Americans with a job are doing better than before the pandemic. The higher wages and salaries should attract more people back into the labor force that have left after the pandemic. It will also increase the chance of longer inflationary pressures as businesses costs rise.

Spending on goods and services by Americans was flat in May compared to April but was 14.5% higher than a year ago. Spending on goods, up 16.6% from a year ago, has outpaced spending on services, up 13.3% from a year ago, as most services-oriented businesses were closed for a good portion of the pandemic. We expect this to shift as more service related businesses get back to full capacity. For example, in May spending at movie theatres, amusement parks, and passenger trains all jumped between 15% to 20%, while motor vehicles fell almost 10% after several months of double digits growth. The savings rate is approaching a normal level after increasing to the highest on record. In April 2020 the savings rate surged to 33.6%, fell, then surged again to 27.6% in March 2021 as Americans received stimulus payments and saved extra cash. As the economy continues to recover, consumers feel more confident, and as stimulus and unemployment benefits wind down, this number should drift lower to the upper single digits.

The report also includes the Fed's preferred measure of inflation; the PCE price index, which rose 0.4% in May and 0.5% excluding food and energy. Compared to a year ago the price index is 3.9% higher, after having average about 1.5% to 2.0% prior to the pandemic. The pickup in prices is mostly attributed to transitory or temporary factors such as oil, motor vehicles, and travel like hotels, restaurants, and airfares. However, with wages and salaries increasing at a 5.0% annual clip, we are still concerned inflationary pressures may prove to be more long lasting than the Fed has been saying.

An estimate reported by Barron's says nearly $200 billion in shareholder returns could be announced by some of the largest banks after Monday's market close. The Federal Reserve said after its latest round of stress tests that all 23 big banks would remain well capitalized in the event of a severe economic event. Strong trading activity and the banks' ability to release a significant amount of reserves for loan losses affords banks the ability to return more capital to shareholders after the latest round of stress tests. Banks were forced to halt buybacks and cap dividends from the pandemic which is expected to be reversed after this latest round. On average, analysts expect banks' net capital return to shareholders to be around 10%, with 8% of that coming from share buybacks. Banks have to hold off until Monday at 4:30 pm to announce plans to give them enough time to examine and understand their stress test results, according to the Fed.

Company News

- Google said it is delaying its effort to phase out third-party cookies on its Chrome browser by about two years. Google's Digital Product Officer said, "considerable progress" has been made on the initiative, but its "clear that more time is needed across the ecosystem to get this right." The announcement had a positive impact on advertisers & ad agencies.
- American Airlines canceled hundreds of flights to avoid potential strains on its operations as travel demand recovers. The flights canceled amount to just 1% of planned flights in the first half of July, according to the company.
- Nike reported its fiscal fourth quarter results Friday that exceeding analysts expectations. The company said its revenue was up 141% in North America compared to the same quarter last year, and up 29% compared to 2019 levels.

The Week Ahead

The second quarter ends this week and volume is expected to be lower toward the second half of the week as many start their 4th of July weekend early. The earnings calendar is light before cranking up in a couple weeks with second quarter results. Highlights this week include Bed Bath & Beyond, General Mills, Constellation Brands, and Micron on Wednesday, McCormick and Walgreens Boots Alliance on Thursday, and CarMax on Friday. Elsewhere on the corporate calendar, United Airlines and ConocoPhillips will hold their annual investor day and banks are able to announce capital plans after the close on Monday where many dividend increases and share buyback announcements are expected. The economic calendar picks up a little this week with many beginning of the month reports. On Tuesday, the S&P Case-Shiller report on home prices is released along with the latest survey of consumer confidence. On Wednesday, ADP releases its report on private payroll growth. On Thursday, several manufacturing surveys are releases along with data on construction spending and the latest on weekly unemployment claims. The week concludes with trade data which is expected to be strong after two record months, along with the Department of Labor's June employment report. Economists are forecasting 675,000 jobs were added in the month, mostly service-related jobs. Although an agreement on the initial infrastructure proposal was struck last week, negotiations will continue this week.