

Wentz Weekly

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Retail Sales Shine, But How Much Is Inflation Related?



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Retail and food service sales have come in hot over the first half of the year, driven by the economic reopening, pent-up demand, and substantial federal stimulus for most Americans. In June most were expecting retail sales to cool down after several strong months, however actual sales increased 0.6% in June, a pace much stronger than expected. Much of the gain was driven by apparel stores, electronics, restaurants, and gasoline, offset by a small decline in vehicle and furniture sales. One can see trends in these reports. As the economy reopens and people go back to the office, or out for a meal or drink, things like clothing and restaurants are seeing strong sales, while the pace of building material, furniture and electronic sales decelerate as people are spending less time at home. Despite the strong retail sales, after taking inflation into account, sales were not as big as the headlines appear. In fact, actual retail volumes declined in the month, indicating the pickup in retail sales was mostly due to higher prices.

We knew inflation was picking up, but the consumer price index showed the increase was much more than expected in June. Prices rose almost double the expectation at a 0.9% monthly pace, the highest since June 2008, and are now 5.4% higher from June last year. Core prices, which exclude the volatile food and energy categories, are now 4.5% higher than a year ago for the highest rate in over 30 years. Used car prices continue to rise at an unprecedented pace with prices up 10.5% in the month and 45.2% from a year ago, contributing to a third of the headline gain. Inflation expectations are also starting to put a dent on sentiment. According to the University of Michigan's Consumer Sentiment index, consumers' optimism fell to its lowest level since February, driven by consumers' concerns over inflation. Higher inflation expectations could become self-fulfilling and lead to higher inflation. As these expectations on higher inflation continue to creep higher, the Fed's monetary policy decisions should become easier. We believe the Fed has met its inflation goal, with inflation well above its 2% target, and is on track to meeting its employment goal, which we still think will cause it to adjust its pace of asset purchases near the end of the year.

One day after the Bureau of Labor Statistics reported the highest core inflation rate in over 30 years, Fed Chair Powell sat before Congress for his semi-annual testimony to reiterate the Fed's stance that the pickup in inflation continues to be transitory. Senators continuously questioned Powell on what he means by transitory and what they should say to their constituents who say they are seeing an increasing pace of price increases. Powell reiterated that the Fed watches whether price increases happen year after year, and they wouldn't react to something that is likely to go away. Powell previously stated the Fed will look at actual inflation data in meetings its inflation goal and not inflation expectations. However, during the testimony Powell stated measures of long-term inflation expectations have moved higher and are in a range consistent with the Fed's goals, and they pay very close attention to that and would react if expectations moved materially higher. To us, this indicated the Fed will act in regards to expectations which we see as significant and has the potential to change policy sooner than what the Fed has been communicating.

Banks are typically the first to report quarterly results when earnings season begins and can set the mood for the remainder of the quarter. Several big banks reported last week with mostly mixed results. Lower interest rates and a drop in trading activity put a dent in some of the banks results, but others were thriving from their very strong investment banking businesses. Headline numbers were good for most banks, especially the bottom line as more reserves for potentially bad loans were released and flow directly to the bottom line. This benefit, as well as the benefit from a surge in trading activity, will fade and banks will need another reason to keep investors excited about the sector. It is not going to be interest rates anytime soon and based on recent results does not look like it will be from new loans either. Most of the banks reported very little growth in loans as consumers and businesses continue to pay down their debt rather than taking on new debt. Based on management commentary though, that could change. Goldman Sachs CFO was noted saying during the earnings call the bank expects loan growth to accelerate in the coming quarters.

Progress on the infrastructure package being worked on in Congress seems to change by the hour. The Democrat's \$3.5 trillion package will be challenged after West Virginia's Manchin said he is "very, very disturbed" about the climate change spending within the \$3.5 trillion proposal. The large spending portion on climate change initiatives was included to gain support of the progressives. Meanwhile progressives are saying they will "tank" the bipartisan bill unless Democrats pass the \$3.5 trillion bill through reconciliation. Over the weekend Senators agreed to drop the IRS enforcement funding from the \$1.2 trillion bipartisan bill, harming the progress of the bill. A bipartisan bill sounds unlikely, and as each day passes a reconciliation bill gets harder and harder. There is still a lot of work to do.

Company News

- S&P Dow Jones Indices said Moderna will join the S&P 500, effective prior to the open July 21. Joining an index sometimes has a large effect on the stock as investments that track an index will have to buy the stock, leading to a short-term increase in demand for shares.
- It was reported by the WSJ that Intel is exploring a deal to acquire GlobalFoundries, a deal that would value the company at \$30 billion. The move would accelerate Intel's plans to produce more chips for other tech companies.
- Zoom Video announced it agreed to acquire Five9, a cloud contact center provider. It will be an all-stock deal that values Five9 at approximately \$14.7 billion, a 13% premium to Friday's closing price.

The Week Ahead

The calendar remains busy this week. The pace of second quarter earnings reports picks up this week with at least 76 S&P 500 companies reporting. Notable reports include AutoNation and IBM on Monday, Philip Morris, United Airlines, Chipotle, and Netflix on Tuesday, Verizon, Johnson & Johnson, Coca-Cola, and Texas Instruments on Wednesday, AT&T, American Airlines, Intel, Twitter, Snap, and Las Vegas Sands on Thursday, and American Express and Honeywell on Friday. The economic calendar has several updates on the housing sector. On Tuesday, the Census Bureau releases its housing starts and permits report and on Thursday the National Association of Realtors releases its existing home sales report. The consensus sees a 2% increase in sales for the month bringing the annualized sales pace to 5.900 million homes. Also on Thursday, the latest update on jobless claims is released. Several events during the week include the Chicago Auto Show, the first major auto show since the pandemic began, and several events on Bitcoin.

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 Dow Jones Industrial Average (DJIA), commonly known as "The Dow" is an index representing 30 stock of companies maintained and reviewed by the editors of the Wall Street Journal. 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. Every investor's situation is unique and you should consider your investment goals, risk tolerance and time horizon before making any investment. Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification. 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.