

Wentz Weekly

August 2, 2021

Above Trend Economic Growth To Continue



Investment management for your lifetime

Economic output in the U.S. for the second quarter has fully recovered from its losses in the first half of 2020, one of the quickest snapbacks in economic activity on record. Gross domestic product in the quarter rose at an annualized rate of 6.5%, and though was almost 2% below economists' expectations, was stronger than the headline suggest. The most important category, consumer spending (makes up nearly 70% of GDP), rose a much better than expected 11.8% in the quarter and contributed 7.8% to the headline GDP number. Vaccinations and the reopening of businesses drove a 12% increase in spending on services, which has lagged spending on goods since the pandemic began. Driving the headline number lower than expected was a significant drop in the change in inventories as businesses continue to deal with supply constraints and bottlenecks, along with a decline in residential investment as home builders struggle to keep up with demand, and lower government spending. As we move forward, we expect the economy to continue to grow at an above trend growth rate thanks to additional job gains, significant pent-up demand, monetary and fiscal support, and a strong consumer with high confidence despite the headwinds from another wave of Covid.

The Hang Seng Index, a market cap weighted index of the largest companies on the Hong Kong Exchange, lost over 10% over the two weeks ended last Tuesday and is down 20% since its highs back in mid-February, reflecting the increased risk of investing in Chinese stocks. A regulatory crackdown on a growing list of industries and specific Chinese companies is the reason behind the recent slide in Chinese markets and Chinese listed stocks on U.S. exchanges. It appears to us the Chinese government is targeting companies that have listings on U.S. exchanges. Regulators began their crackdown on several high-profile tech companies such as Ant Group and recent IPO Didi with the latest targeted industry in for-profit education companies. As a result of the increased risk and volatility, the SEC has suspended registrations for all Chinese IPOs until they review additional risk disclosures. China attempted to calm markets toward the end of the week by saying they will consider market impacts prior to making additional regulatory moves.

In the Federal Reserve's latest Open Market Committee, the members agreed to keep monetary policy unchanged and maintain its \$120 billion in purchases of treasury and mortgage-backed securities each month to continue supporting the economic recovery. The post-meeting statement was essentially unchanged, but importantly did include additional verbiage saying the economy has made progress toward its goals, which would be assessed in coming meeting in determining its pace of asset purchases. Given the pace of the recovery and its inflation goals being met, policymakers have begun discussing the timing and pace of reducing those asset purchases but did not make any final decisions. Regarding the labor market Chairman Powell would not give much detail beside saying there is still ground to cover before substantial further progress is made. On the risks of the Delta variant, Powell said some people will pull back from activity, but said the Fed has seen there has been less of an economic impact with each wave of the virus.

A bipartisan group of senators have been working on and agreed to a \$550 billion infrastructure bill which finally passed a procedural vote last week. The infrastructure bill consists of \$110 billion in funding for roads and bridges, \$73 billion for the power grid, \$66 billion for rail transportation, \$65 billion for broadband, \$55 billion for water infrastructure, \$39 billion for public transit, and another \$115 billion for other areas. The bill would be financed through redirecting unused pandemic relief funds, corporate user fees, and additional tax enforcement on cryptocurrencies. Importantly for both sides it covers physical infrastructure and for Republicans it avoids any tax changes. However, for certain Democrats, it is not broad enough and does not include spending on social programs. Several Democrats have voiced opposition already and threatened the bill unless there was a commitment on passing the \$3.5 trillion budget reconciliation, which would include a majority of the Democrats social infrastructure initiatives. There is momentum in the Senate to pass the bipartisan bill, and a vote is expected on the Senate floor Thursday pending any setbacks.

Results from the already high expectations for second quarter earnings season have to this date come in well ahead of estimates, continuing a trend since the pandemic began. As of Friday, approximately 60% of S&P 500 companies have reported earnings so far with 87% of those beating expectations by an aggregate of 19%, both well above historical averages. The 19% is the final number it would be the fourth best surprise rate since data began by FactSet. Just as surprising is 88% of the companies that have reported so far are beating revenue estimates, above the 5-year average of 65%. When the quarter began, earnings were expected to have risen 64% from a year ago. As we are just halfway through earnings season, that number is already 10.4% higher, reflecting stronger sales and higher margins than expected. In fact, profits margins have expanded from the already high 13.0% in the first quarter to 13.1% in the second quarter so far, despite higher input costs for most businesses.

Company News

- Amazon reported mixed quarterly results, reflecting a shortfall in its core e-commerce business with the CFO noting wider availability of vaccines leading to consumers leaving the house more. The cloud business, Amazon Web Services, beat expectations with revenues of \$14.8 billion, growing 37% from a year ago.
- Founder and ex-CEO of Nikola, Trevor Milton, was charged by the U.S. Attorney's Office in Manhattan with three counts of making false and misleading statements to investors, including claiming the company had a fully functioning semi-truck when it was in fact inoperable.
- Square announced over the weekend it has agreed to acquire the "buy now pay later" company Afterpay. The all-stock deal is valued at \$29 billion, a 31% premium to Afterpay's price as of Friday's close.

The Week Ahead

The calendar remains busy this week. There will be at least 143 – or almost a quarter of – S&P 500 companies reporting their quarterly results, with more earnings coming from smaller companies. Notable companies reporting this week include Take-Two Interactive on Monday, Alibaba, BP, Nio, Lyft, and Under Armour on Tuesday, CVS, GM, Uber, Fox, Roku, and Booking Holdings on Wednesday, Moderna, Square, FireEye, Beyond Meat, Yelp, and Wayfair on Friday and Goodyear Tire, AMC and DraftKings on Friday. The economic calendar has another busy week of data releases. On Monday we will see the PMI survey results on manufacturing conditions along with June construction spending. Then Thursday we will see an update on weekly unemployment claims and the Department of Labor's employment report on Friday. The consensus sees 900,000 new jobs added in the month of July.

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.