

Wentz Weekly

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Stocks Pause as Economists Cut Growth Forecasts



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Stocks encountered weakness for the first time in months last week and declined every day of the holiday shortened week, ending the week 1.69% lower. The fact is we have hit a quiet period where there are very few earnings reports, no significant economic data beside this week's consumer price index report, and no market moving Fed events until the FOMC meeting next week. This leaves investors focused on slowing economic growth and elevated market valuations. Economic growth was expected to slow from the very strong 6.6% annualized pace in the second quarter, but many Wall Street economists have cut third quarter growth forecasts and the Fed's Beige Book, which reports on current economic conditions, reported growth slowed in July and August mainly driven by a pullback in leisure activities because of the delta variant. Goldman Sachs cut its third quarter growth forecast from 5.25% to 3.5%, Morgan Stanley cut its forecast from 6.5% to 2.9%, and the Atlanta Fed's GDPNow model forecasts a 3.7% growth rate compared to 5.3%. As a matter of fact, the market is essentially flat since many of cuts to growth forecasts were announced beginning in mid-August.

In addition, there were several other topics that may have led to weakness last week. Another political headwind is the government's debt ceiling approaching - Treasury Secretary Janet Yellen said the Treasury will run out of cash and its extraordinary measures to fund the government sometime in October if Congress does not act. But investors for now have been more concerned with how the potential increase in corporate taxes (to help fund the Democrats reconciliation package) will impact profits, in addition Congress just returned from recess and Democrats have already introduced a new tax proposal, calling for a 2% tax on money spent on corporate share buybacks. Another sign of slowing, particularly in leisure travel, is several airlines saying at an airline conference last week that third quarter revenue and capacity will be lower than originally forecasted due to weaker travel demand and rising delta cases. Then there are the inflation concerns - the producer price index rose 0.7% in August and wholesale prices are now 8.3% higher than the same time a year ago, another all-time high. We would not be surprised if the markets continue its pullback from these levels but remain optimistic and would use any pullback as a buying opportunity.

At a Cowen airline conference last week, a group of airlines updated forecasts to reflect the recent uptick in Covid cases which have dampened travel demand. Many of the major airlines said travel demand has weakened in recent weeks with an uptick in cancellations, leading management teams to cut revenue and capacity forecasts. TSA throughput numbers were averaging about two million per day in June, July, and early August, but began to move lower in mid-August as the positive Covid numbers began to creep higher. In fact, according to TSA throughput data, the number of travelers hit the second lowest level on Saturday since early May. United Airlines said it no longer expects to operate at a profit in the quarter with a 33% decline in revenues compared to the same quarter in 2019 and says it may be at a loss in the fourth quarter too if these conditions continue, with similar comments from Southwest. Airlines were forced to cut capacity as a result in order to meet lower demand. But there is optimism - most airlines said they expect a rebound once cases peak, with Delta even saying bookings have stabilized over the past 10 days.

The Federal Reserve's Beige Book, a report prepared about two weeks prior to the next Fed meeting that reports on economic conditions in each Fed district based on communication with consumers and businesses, indicated a slowing economy over the summer months. The report said conditions slowed, while prices continued to rise and supply chain problems were a constraint on business output. The slowdown was linked to rising Covid cases which led to a pullback in dining out, travel, and tourism. The report notes some events were forced to cancel or be postponed because of the increase in cases as a precaution. The issues with supply chains and shortages of workers also held back growth in certain sectors like autos and home sales, with some businesses saying shipping delays and higher freight costs have harmed their businesses. These issues caused many respondents to say they anticipate price hikes on their products and services in the months ahead.

In what will likely be the next major political deadline, Treasury Secretary Janet Yellen said the Treasury will run out of cash and its extraordinary measures to fund the government most likely sometime in October. In a letter to Congress, Yellen said waiting until the last minute to suspend or increase the debt limit has led to weakened consumer and business confidence, as learned in the past. Yellen called on Congress to take action on the debt limit "to protect the full faith and credit of the United States by acting as soon as possible." House Speaker Pelosi responded, saying the \$28.5 trillion debt limit must be raised, but said Democrats will not include a provision to raise the limit in the reconciliation legislation they hope to pass. Failure to increase the debt limit could lead to a government shutdown, which has happened three times in the past 10 years.

Company News

- Match Group, Ceridiam HCM, and Brown & Brown all opened higher last week after S&P Dow Jones Indices said the three companies will be added to the S&P 500 index. The three companies will replace Perrigo, Unum Group, and NOV Inc.
- PayPal said it is acquiring Paidy, a Japanese payments platform that allows users to buy items now and pay later, for \$2.7 billion in cash.
- Boston Beer, maker of the Truly hard seltzer brand, said it has withdrawn its fiscal year 2021 financial guidance, citing decelerating growth trends in its hard seltzer products. The company said its hard seltzer products continue to grow faster than any other category but sees uncertainty over demand for the remainder of 2021.

The Week Ahead

Several economic data reports come out this week, but the earnings calendar remains very light. The main economic reports include the consumer price index, released Tuesday morning, where the expectation is for a 0.4% increase in prices for August, and August retail sales on Thursday where the current estimate is for a 0.8% monthly decline. Other data include the Philly Fed and Empire state manufacturing surveys mid-week, along with jobless claims Thursday morning, and the University of Michigan's Consumer Sentiment index on Friday. Notable earnings reports are released from Oracle on Monday and Trip.com on Thursday. In other corporate news there will be several company investor day events where we could potentially see updates on third quarter forecasts, along with Apple's fall event where it is expected to launch several products, including the next gen iPhone models.

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