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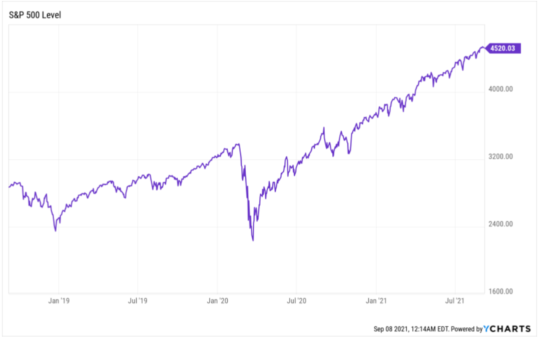
AN UPDATE FROM PAUL DIETRICH

# COVID VS. THE ECONOMIC RECOVERY: WHAT DO LEADING ECONOMIC INDICATORS SIGNAL?

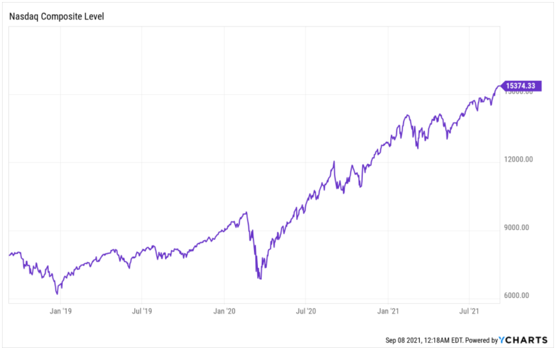
## Market Update

As of the market close on September 7, 2021, the S&P 500 Index is up 20.75% year-to-date.




The Dow Jones Industrial Average is up 15.56% year-to-date.


The tech-heavy NASDAQ index is up 19.21% year-to-date.




## September Market Outlook: Just Look At The Headlines

Historically, September is the worst month for the stock market. The S&P 500 Index has not seen a 5% decline since last fall, making this one of the most prolonged periods without one over the past decade. Stock markets, on average, experience about three 5%+ declines every year. Technically, this makes the stock market more vulnerable in the short term, but I don't expect any pullbacks to last very long.

Stocks are already at record highs thanks to a seven-month winning streak for the S&P 500.

Although corporate profits have surged this year, the S&P 500 is still trading at a price-to-earnings ratio that is well above its five- and ten-year averages, according to FactSet.

## Covid Is Slowing The Economy

While state and local governments are trying to avoid another round of stringent lockdowns, many companies have delayed their return to office plans until 2022.

Covid-19 hospitalizations, deaths and new variants are surging nationwide among the unvaccinated.

The start of a new school year raises enormous risks, especially since children under age 12 are not yet eligible to receive vaccines.

More than 1,400 schools in 35 states have shut down over the past two weeks because of new Covid outbreaks.

Nearly 252,000 children have been hospitalized by the Covid Delta variant this past week.

The U.S. economy was growing like gangbusters —and then the Delta variant came along, slowing things down substantially.

The Delta variant is now threatening the job market recovery. Last month, the U.S. economy added only 235,000 new jobs, far fewer than expected and vastly missing economists' expectations of 750,000 new jobs.

The Covid Delta variant is beginning to reduce consumer demand. During August, 5.6 million people said they had not been able to work or worked reduced hours because their employer was affected by the pandemic.

Nationwide, leisure and hospitality jobs were mostly unchanged in August, but restaurants and bars registered a loss of 42,000 jobs. Most leisure and hospitality sectors have complained of worker shortages. Rising Covid-19 infections have led to a return of mask mandates and health safety guidance halting many people's travel plans. OpenTable's restaurant reservations are a nearly real-time indicator of dining out demand. They cited a significant drop in restaurant reservations nationwide in late July and August.

Concerns about becoming infected from unvaccinated Americans and what Covid might mean for the recovery also began weighing on consumer sentiment, which in August collapsed to its lowest level since December 2020.

With the slowdown in job growth, many economists are increasingly concerned about the remainder of this year. Some worry about a repeat of last winter when Covid cases increased and led to renewed restrictions and lockdowns that resulted in job losses in December. That would be bad news for the recovery.

Childcare is another major issue. Economists had been hopeful that children returning to school this past month would help ease the childcare burden on many Americans allowing them to go back to work. But Covid has ruined that, too.

Many analysts believe that it is just a matter of time before a large percentage of schools close down and return to virtual learning at home. This will continue to keep many parents, particularly women, out of the workforce.

Covid-19 has also led to supply disruptions that distort the jobs market, consumer prices, and the broader economy.

On The Bright Side: The new surge in Covid cases could make investors *less worried* about inflation and *more confident* that the Federal Reserve will keep interest rates lower for longer. ***That's a recipe for stocks to continue their record run, even as the virus outlook gets worse.***

## How To Look At The Economic Slowdown In Perspective

Despite the continued optimism about the country's recovery, U.S. economic growth is already starting to slow.

Lakshman Achuthan and Anirvan Banerji are co-founders of the **Economic Cycle Research Institute (ECRI).** The ECRI is a major research institute on Leading Economic Indicators cycle changes within the U.S. economy.

They point out that "*year-over-year comparisons to the catastrophic conditions in the spring of 2020 have been puffing up recent economic growth data.*

*At the bottom of a severe recession, the economy is like a coiled spring that jumps back up in the early part of the recovery. Once it's almost fully uncoiled however, its rebound slows.*

*That's where we are today. While the economy continues to recover, our work shows that the pace of the recovery is already starting to decelerate.*

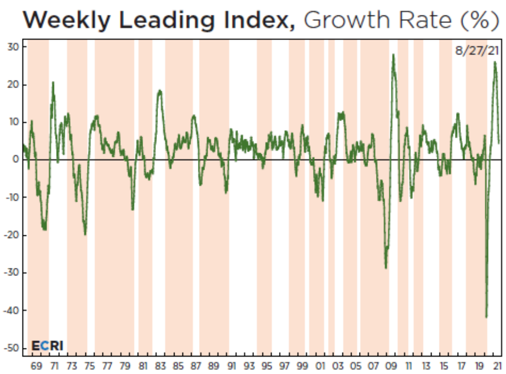
*The latest data shows that the U.S. economy's growth rate peaked at almost 20% in March 2021 and slowed to 5% in June. Moreover, our analysis anticipates that the economy will keep decelerating in the coming months.*

*To be clear, a full-blown recession is nowhere in sight. And in the second quarter of 2021, we saw the most robust year-over-year GDP growth in 70 years. But even* *with the economy on track for full reopening in the months ahead and the jobless rate set to eventually decline, economic growth is already decelerating.*

*Part of this slowdown story is that —well before the Delta variant concerns surfaced —consumer spending on goods started falling because spending was redirected away from goods and toward services as the economy reopened further. But the renewed spending on services isn't entirely offsetting the plunge in spending on goods. And the spread of the Delta variant could make things even worse.*

*Separately, a confluence of factors—ranging from red-hot home prices deterring first-time homebuyers to shortages of raw materials and construction workers—is slowing growth in home-building. And this slowdown is acting as an additional headwind for overall economic growth."*

Here is an ECRI chart that shows a slowing growth rate percentage for the economy. Remember, the economy *is still growing*—but at a slower rate.



Shaded areas represent U.S. growth rate cycle downturns.

## What Are The Leading Economic Indicators Telling Us Now?

The ten Leading Economic Indicators that make up the Conference Board's *"Index of Leading Economic Indicators"* are intended to forecast future economic activity. These variables have historically predicted trends in the economy, either turning downward before a recession or upward before an economic expansion.

What are they telling us now?

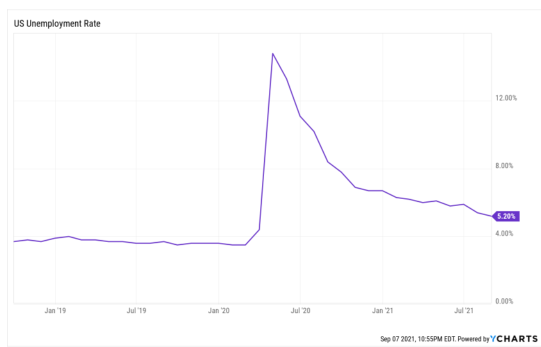
*Investors need to be clear-eyed to both the economic challenges and the positive trends in the economy and stock market.*

*At the moment, positive trends outweigh and offset most of the negative challenges from Covid.*

Currently, the Leading Index is in an overall upward trend and is consistent with strong economic growth in the second half of this year. While the Covid Delta variant is raising inflation fears that could create headwinds for the U.S. economy in the near term, the Conference Board expects real GDP growth for 2021 to reach 6% year-over-year before easing to a still robust 4% growth rate for 2022.

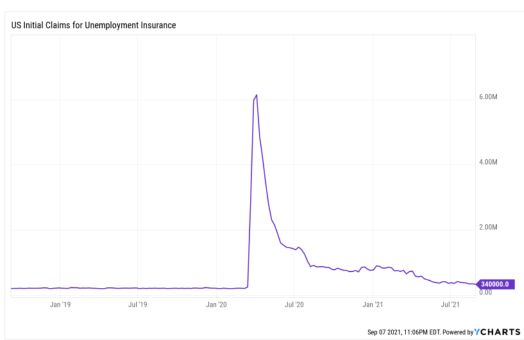
Let's look at the directional trend of each of the ten Leading Economic Indicators:

### U.S. Unemployment Rate




U.S. Unemployment Rate is at 5.20%, compared to 5.40% last month and 8.40% last year. This is lower than the long-term average of 5.77%. *Unemployment is trending in the right direction—down.*

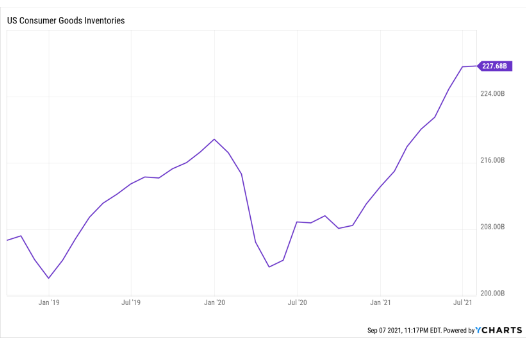
### U.S. Department of Labor U.S. Initial Jobless Claims




The U.S. Initial Jobless Claims, provided by the U.S. Department of Labor, provides underlying data on how many new people have filed for unemployment benefits in the previous week. Given this, one can gauge market conditions in the U.S. economy with respect to employment; as more new individuals file for unemployment benefits, fewer individuals in the economy have jobs.

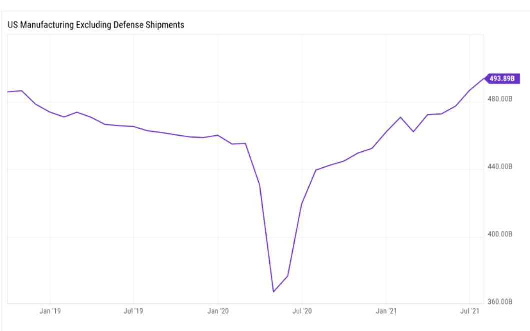
The U.S. Initial Claims for Unemployment Insurance is at a current level of 340,000, down from 354,000 last week and down from 872,000 one year ago. This is a change of -3.95% from the previous week and -61.01% from one year ago. *The U.S. Initial Jobless Claims for Unemployment is trending in the right direction—down.*

## U.S. Consumer Goods Inventories




U.S. Consumer Goods Inventories is currently at 227.68B, up from 227.58B last month and up from 208.82B one year ago. This is a change of 0.04% from the previous month and 9.03% from one year ago. *U.S. Consumer Goods Inventories is trending in the right direction—up.*

## U.S. Manufacturing Excluding Defense Shipments



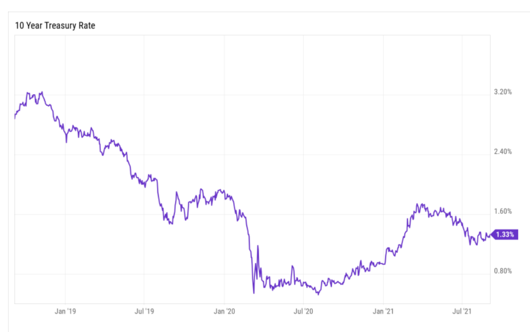

U.S. Manufacturing Excluding Defense Shipments is at a current level of 493.89B, up from 486.84B last month and up from 439.66B one year ago. This is a change of 1.45% from the previous month and 12.33% from one year ago. *U.S. Manufacturing Excluding Defense Shipments is trending in the right direction—up.*

## U.S. Building Permits


As defined by the Census Bureau, Building Permits represent government-issued approval or authorization to legally work on construction projects in permit-issuing places, in this case, specifically for new privately-owned housing units. An increase in building permits is a leading indicator of the health of the U.S. Housing sector and often the U.S. economy at large.

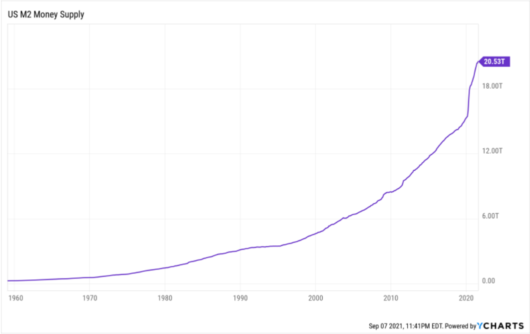
U.S. Building Permits are at a current level of 1.635M, up from 1.594M last month and up from 1.542M one year ago. This is a change of 2.57% from the previous month and 6.03% from one year ago. *U.S. Building Permits data is trending in the right direction—up.*

## 10-Year Treasury Rate




10-Year Treasury Rate is at 1.33%, compared to 1.29% the previous market day and 0.63% last year. This is lower than the long-term average of 5.98%. *The U.S. Treasury Rate is trending in the right direction by staying below its long-term average.*

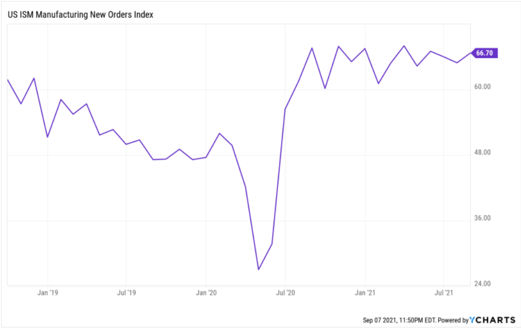
## U.S. M2 Money Supply




U.S. M2 Money Supply refers to the measure of money supply that includes financial assets held mainly by households such as savings deposits, time deposits, and balances in retail money market mutual funds, in addition to more readily-available liquid financial assets as defined by the M1 measure of money, such as currency, traveler's checks, demand deposits, and other checkable deposits. The U.S. M2 Money Supply is critical in understanding and forecasting money supply, inflation, and interest rates in the U.S.

U.S. M2 Money Supply is at a current level of 20.53T, up from 20.39T last month and up from 18.32T one year ago. This is a change of 0.72% from the previous month and 12.11% from one year ago. *U.S. M2 Money Supply is trending in the right direction—up.*

## US ISM Manufacturing New Orders Index

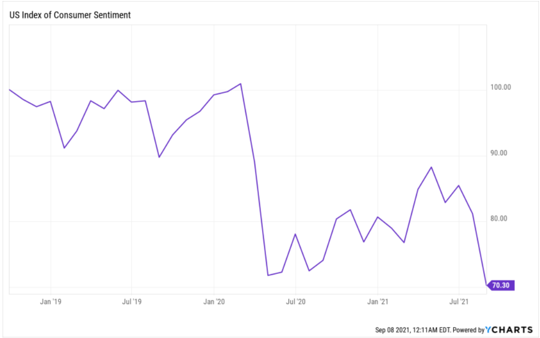



U.S. ISM Manufacturing New Orders Index is at a current level of 66.70, up from 64.90 last month and down from 67.60 one year ago. This is a change of 2.77% from the previous month and -1.33% from one year ago.
*The U.S. ISM Manufacturing New Orders Index is trending sideways. This may be due to supply chain issues recovering from the Covid lockdowns.*

## S&P 500 Index


The S&P 500 Index is at a current level of 4358.13, up from 4246.88 last month and up from 3352.46 one year ago. This is a change of 2.62% from the previous month and 30.00% from one year ago. *The S&P 500 Index is trending in the right direction—up.*

## The U.S. Index of Consumer Sentiment




The U.S. Index of Consumer Sentiment (ICS), as provided by the University of Michigan, tracks consumer sentiment in the U.S. based on surveys of random samples of U.S. households. The index aids in measuring consumer sentiment in personal finances and business conditions, among other topics. Historically, the index displayed pessimism in consumer confidence during recessionary periods and increased consumer confidence in expansionary periods.

U.S. Index of Consumer Sentiment is at a current level of 70.30, down from 81.20 last month and down from 74.10 one year ago. This is a change of -13.42% from the previous month and -5.13% from one year ago.
*This is the one Leading Economic Index that is negative. Most analysts believe the negative sentiment is due to the surge in Covid.*

## The Stock Market Outlook For The Rest Of 2021

Even if there is a stock market pullback before the end of the year, the Leading Economic Indicators point to an overall growing and expanding economy.

**Stock Market Momentum Continues:** The S&P 500 Index has more than doubled since it hit 2,240 on March 23, 2020, to over 4,500 today. It has also set 51 record closes this year. While this can't last forever, it does show strong momentum growth through almost every economic sector.

**Federal Reserve Low Interest Rates Will Remain For The Foreseeable Future:** With the shadow of Covid-19 hanging over the economy, it is unlikely the Federal Reserve will raise rates until 2023. This will be bad news for bond investors but excellent news for stock market investors.

**Wall Street Analysts Believe There Is More Growth In The Economy & Stock Market:** Over 56% of Wall Street analysts are continuing to recommend "buy" signals for S&P 500 stocks. They believe there is more upside in the future.

**Home Prices Are At Historic Levels:** Most investors have retirement investments in the stock market and own their homes. This is sometimes referred to as the "wealth effect." Americans with stock market investments and a home have never been wealthier. For most Americans, their home represents as much as two-thirds of their total assets. Coupled with their stock investments, their general perceptions of the economy and the stock market are shaped by this "wealth effect," which should support spending and investment sentiment through the end of this year.

**Real Inflation Risk Is Low:** There have been many articles and complaints about inflation over the past few months, but most of the inflation has been and will continue to be temporary. These articles also don't include the whole story. In July, the year-over-year inflation rate in the U.S. hit a 20-year high of 5.4%. Still, if you eliminate food and energy prices that are historically volatile, the "core" monthly rate of inflation was just 0.3% in July—which is significantly below the long-term average expectation of a 0.4% gain.

**Investors Should Ignore Short-Term Trends:** For most investors, it pays to ignore short-term trends and keep your eyes on your long-term retirement plan. According to Goldman Sachs research, S&P 500 stock market returns have averaged 9.2% per year over the past 140 years. There are always going to be some very bad years along the way, but if you stay invested long enough, you are almost sure to come out significantly ahead.

## President Biden's $3.5 Trillion Spending And Tax Legislation Is In Trouble!

While most Democratic senators favor raising corporate tax rates to at least 25% and imposing a minimum 15% tax on global companies, they are generally opposed to President Biden's proposal to raise capital gains taxes and estate taxes. Since there are now ten Democratic senators who oppose the capital gains and estate tax provisions, most legislative analysts believe that part of the legislation is dead.

Senator Manchin (D-WV) and several other Democratic senators have said they would only vote for Biden's social spending bill through "reconciliation" if it is fully paid for with no deficit spending.

This week, Senator Manchin warned the White House and congressional leaders that he could not support most of President Biden's $3.5 trillion social spending dream—but that he possibly could support $1 trillion of it, and at most, he says he is open to supporting $1.5 trillion.

This amount would be on top of the $1.2 trillion bipartisan infrastructure deal passed by the Senate and awaiting House action on September 27.

Manchin has specifically raised concerns about Biden's plan to spend $400 billion for home caregivers. He also wants "means-testing" for other key proposals, including extending the enhanced Child Tax Credit, which provides an additional $300 per child per month, free community college, universal preschool, and child care tax credits.

As I mentioned last month in my *Market Commentary*:

"Depending on the projections you use, raising corporate taxes to 25% and adding a 15% minimum corporate tax for global companies would provide about $1 trillion to $1.5 trillion over the next 15 years.

That means if the Democrats modify and eliminate most of their anti-fossil fuel, climate change portions of the legislation to please Senator Joe Manchin, they could pass and fund about $1.5 trillion in spending. If they add anything else, it would have to be financed by issuing new Treasury bonds and deficit spending.

**Bottom Line:** The betting is that something will pass with all Democratic senators' support for about $1.5 trillion. The corporate tax raise to 25% and the 15% minimum global corporate tax rates could also pass. None of the personal capital gains and estate tax changes will pass."

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Paul Dietrich is focused on managing investments for private investors, retirement funds and private institutions throughout the United States. He also serves as a frequent on-air commentator and regularly contributes market analysis to business and financial media including *CNBC, Fox Business, Bloomberg TV, CNN, The Wall Street Journal, Yahoo! Finance, Reuters* and *The Washington Post.*