Great-West Investments Capital Markets Perspective

Week in Review: April 26th - May 2nd

INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD	INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD
Dow Industrials	Lg. Cap Eq.	33,874.85	-0.50%	11.50%	FTSE 100	UK Equity	6,969.81	0.45%	7.88%
S&P 500®	Lg. Cap Eq.	4,180.95	0.02%	12.08%	Nikkei 225	Japan Equity	28,812.63	-0.72%	4.99%
NASDAQ Comp.	US Equity	13,962.38	-0.39%	8.71%	EEM:US	Emkt. Equity	$53.95	-1.25%	4.91%
S&P Midcap 400©	Mid-Cap Equity	2,726.23	-0.71%	18.19%	EFA:US	Non-US Equity	$77.93	-1.44%	6.75%
Russell 2000®	Sm. Cap Eq.	2,264.87	-0.31%	14.46%	UST 10y (yield)	US Treasury	1.63%	+0.07%	+0.72%
Stoxx 50	Europe Eq.	3.974.74	-0.96%	11.29%	B/Barc AGG	Fixed Inc.	2,329.61	-0.05%	-2.52%

It was the FAANGs, from post to pole.

Last week's earnings results were pretty spectacular, at least as far as the "FAANGs" are concerned. (As a reminder, the FAANGs are the five firms epitomize the new, new economy: Facebook, Apple, Amazon, Netflix and the company formerly known as "Google.") Four of the five reported first quarter earnings last week, and although Netflix jumped the bell a little bit and reported during the prior week, **all five blew past estimates about as convincingly as Medina Spirit when he bested the other 19 horses in the field at last weekend's Kentucky Derby**.

Probably the biggest difference between Medina Spirit's weekend performance and that of the FAANGs was that **the FAANGs were *expected* to win, while Medina Spirit's post-to-pole win was more of a surprise** (he came in at 12-1 odds prior to the race – not exactly a long shot, but no lead-pipe-cinch, either…) But make no mistake, last week's FAANG earnings were just as surprising as the Thoroughbred's performance, if not more so: for example, Amazon's first quarter earnings were about 60% ahead of the median analyst estimate, while Google/Alphabet beat analyst estimates by more than $10 bucks(!)[1]. So, while **few people were probably surprised by the fact that the FAANGs all ended last quarter with a win, the margin of victory was kind of eye-opening**.

But the way each company reacted in the wake of their respective earnings releases **illustrates exactly how complicated things can get when you're trying to analyze markets and the assets that comprise them**. Google and Amazon did just fine, trading higher immediately after releasing earnings and closing the week with nice, tidy gains. And Facebook was the fastest of the lot, with its stock reacting very well to not only better-than-expected earnings, but also a robust recovery in ad revenue and a guide higher for future quarters. But Netflix, who beat estimates by a comfortable margin but reported subscriber growth figures that left some wanting more, and Apple, who reported an equally strong first quarter but also suggested that the ongoing shortage in semiconductors could dent its prospects in the near-term, weren't as lucky. Both actually lost a little ground on the week of their respective reports[2].

[1] Zacks.com, seekingalpha.com, company reports.
[2] Ibid., and Bloomberg for price returns.

The point is that while **it's tempting to assume that all that needs to happen for a stock to perform well is for the company to outpace analyst estimates** and for its CEO to hint at better times ahead, **that turns out not to always be the case**. **As we've tried to highlight before, it's complicated.**

And the same is true for the economy at large. Last week's economic reports once again supported the idea that **the US is booming:** whether it was the 20%-plus boom in personal income[3], a(nother) record high in year-over-year home price appreciation according to FHFA data[4], a resumption in the upward trend of durable goods orders[5] or an off-the-charts Dallas Fed manufacturing report[6], **pretty much all signs are pointing up**. In reality, you don't even need to look much further than the BEA's preliminary estimate of first quarter GDP, which showed the US economy expanded at 6.4% during the first three months of 2021 – *way* ahead of normal trend for an economy of this size.

But just like the FAANGS and their not-always-so-obvious reactions to first quarter earnings at the individual stock level, **you have to read a line or two below the economic headlines** to get a sense of how things might actually be working. For example, the massive 21% growth in **personal income was once again driven by government stimulus payments that some believe may be losing their effectiveness**. As for the continued acceleration in home prices, it's a clear sign that the housing market is still enormously strong (and is probably still a great thing if you currently own a home,) but a few more months of acceleration **could begin to impair affordability for the marginal homebuyer** and thereby threaten to choke off what has so far been the best success story of the post-COVID recovery.

And as for that crazy-strong **Dallas Fed and the BEA's way-above-trend GDP report**, both once again **contained hints of that most controversial beast of all – inflation**. To be clear, the BEA's 3.5% estimate of so-called PCE inflation (which is short for "personal consumption expenditures",) probably didn't raise too many eyebrows given the Fed's stated desire to see that figure (and its close cousin, PCE inflation excluding food and energy) appreciably above 2% for a while before freaking out and doing something crazy like tapering asset purchases or raising rates. But of somewhat greater concern was the anecdote – admittedly just that, a small anecdote – **that wage growth as reported by the Dallas Fed in its monthly report rose to an all-time high**. Small anecdote or not, that could matter if it continues to become a theme in other reports because even inflation doves would admit that accelerating wages could be a game-changer for inflation.

So I'll say it again – it's complicated. With all this good news swirling around on both the earnings stage and the economic front, market returns have been kind of *meh* as of late. Surprising? Perhaps not: just like picking a winner in the Kentucky Derby, it's not enough to simply predict who will win or by how much. For things to really pay off nicely, you also have to know the odds and how everyone else at the track is handicapping the race. And that's a difficult task indeed.

Okay, we'll close with a quick discussion of the <*yawn*> Fed, because well, it's the Fed and we'd be remiss not to**. As expected, there were no changes to the Fed's current course** on rates (low for longer) or asset purchases (keep 'em coming.) Chairman Powell was also predictable when he reiterated that while the economic recovery has been somewhat stronger than expected, the Fed is still a long way from achieving it policy objectives and will continue to sit on its hands until it does.

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[3] https://www.bea.gov/news/2021/personal-income-and-outlays-march-2021
[4] https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-HPI-Up-0pt9-Percent-in-Feb-Up-12pt2-Percent-from-Last-Yr.aspx
[5] https://www.census.gov/manufacturing/m3/adv/pdf/durgd.pdf
[6] https://www.dallasfed.org/research/surveys/tmos/2021/2104.aspx.

What to Watch This Week: May 3rd – 9th

Notable economic events (May 3rd-7th)

Monday: ISM/PMI manufacturing

Tuesday: Factory orders, PFE earnings

Wednesday: ADP payrolls, ISM/PMI services, GM earnings

Thursday: Jobless claims, Challenger layoffs, MRNA earnings

Friday: Payrolls and unemployment

And, here comes the rest of the pack.

Continuing with the horse racing theme that we tortured in the pages above, **we've reached the point in the first quarter earnings derby where the leaders have crossed the finish line and the camera has turned to rest of the pack** as they each straggle in at their own pace. And, like that ubiquitous camera angle common to horse races and marathon coverage alike, the field will be literally choked with competitors: **no fewer than 950 companies are expected to report on Wednesday and Thursday alone (and a total of almost 1,500 this week,)** giving analysts plenty to chew on.

But as we've suggested before, the real race has probably already been mostly run: with the FAANGs and a handful of macro- and COVID-relevant companies out of the way, **attention will once again start to turn away from company-specific anecdotes** and potential macro read-through that earnings season is known for **and back toward the macro itself. Because it also happens to be payrolls week, it will be an easy transition**.

Before launching into a discussion of jobs data, though, **it's worth remembering that** just because companies don't have the same glamorous reputation or index cred as the FANNGS and their ilk, **there are still interesting things to be learned**. For example, both Pfizer and Moderna are expected to report this week (**Pfizer** on Tuesday and **Moderna** on Thursday,) which could provide a different point of view into how vaccine distribution is progressing. For **color on the ongoing microchip shortage**, General Motors will report at mid-week, perhaps adding its two cents into whether and how much that particular supply chain mishap is mucking up its operations compared to other automakers. Regardless, just as in horse racing, **there's always a long shot candidate who can upset the field or make headlines all on its own** (which, after all, is why the cameras keep rolling after the lead pack crosses the finish.) **With 1,500 runners still out on the course, there will be lots of opportunity**.

But about that jobs data: **as always, payrolls week is a three-day affair**, kicking off with ADP payrolls on Wednesday and wrapping up with the official Labor Situation Report on Friday, with Challenger layoffs sandwiched in the middle. As always, these are the most important three days on the monthly macro calendar, with **added importance this time around, as afforded by the Fed's almost singular focus on progress in employment** as its benchmark for changing direction while the economy continues to recover from COVID.

A distant second – but still relevant – will be the **purchasing managers indices data we get this week: two manufacturing reports on Monday and two services reports on Wednesday**. Ordinarily the so-called ISMs and PMIs attract almost as much attention as payrolls, but this time around the safe money is betting all four reports will show continued expansion at a pretty robust pace. The ISM/PMI reports will therefore only be worth a close read if they hint at a change in direction.

Finally, I'd like to close by offering our friends and colleagues in India heartfelt sympathy and well-wishes as you continue to confront this awful virus. Our thoughts and prayers are with you in this dark time. Please be well.

Source for index data: Bloomberg.com; GWI calculations.