Great-West Investments Capital Markets Perspective

Week in Review: July 19th – 25th

INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD
Dow Industrials	Lg. Cap Eq.	35,061.55	1.08%	15.40%
S&P 500®	Lg. Cap Eq.	4,411.79	1.96%	18.27%
NASDAQ Comp.	US Equity	14,838.99	2.85%	15.54%
S&P Midcap 400©	Mid-Cap Equity	2,672.74	2.13%	15.87%
Russell 2000®	Sm. Cap Eq.	2,209.65	2.15%	11.67%
Stoxx 50	Europe Eq.	4,109.10	1.82%	15.05%

INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD
FTSE 100	UK Equity	7,027.58	0.28%	8.78%
Nikkei 225	Japan Equity	27,548.00	-1.63%	0.38%
EEM:US	Emkt. Equity	$52.51	-2.02%	2.12%
EFA:US	Non-US Equity	$79.22	1.15%	8.52%
UST 10y (yield)	US Treasury	1.28%	-0.01%	0.37%
B/Barc AGG	Fixed Inc.	2,374.12	+0.19%	-0.66%

Imagine if you threw a "COVID-is-over" party and no one bothered to show up.

Worse than that, imagine that you not only promoted your party on national and international media, but you even created a quasi-national holiday, called **"Freedom Day,"** to mark the occasion. Then you find yourself quarantined on the day of the party and – despite claiming executive privilege – entirely unable to even attend your own shindig[1]. And as a final insult, your best friend in the entire world goes on social media and blasts out a warning to stay away from your house – exactly one day after your party[2].

That's kind of how last week went for Boris Johnson, the controversial Prime Minister of the UK. After building up last Monday as "Freedom Day" – **the day that his country would remove most of its remaining COVID restrictions** – all of the above happened, including being slapped with a fresh "do not travel" advisory by the US Department of State. Freedom Day flopped: **the restrictions are indeed gone, but poor Boris was left looking more than a little silly**.

But maybe the bigger news is that **Freedom Day is starting to look looking like a fairly good meme for the virus' continued impact on markets and the economy more generally**. All of us are tempted, Boris Johnson style, to celebrate the fading away (if not the outright defeat) of COVID. But **the reality is that the virus is still dictating its terms to us in many, many ways,** including an ability to influence the mood of the market in more or less direct fashion: a fairly steep decline in stocks during last Monday's session was attributed by many to headlines detailing a surge in delta-variant cases over the weekend.

While it's entirely possible that such attribution was just a function of lazy and bored market commentators looking for a scapegoat while they plan their post-COVID summer vacations, their claims were made at least somewhat credible by the character of the decline: **so-called "re-opening stocks" got hit hardest, while tech and growth held up relatively well**. **That feels a lot like the pandemic script we all go so used to last year**, even if Monday's declines were later

[1] https://www.reuters.com/world/uk/pm-johnson-pleads-caution-freedom-day-arrives-england-2021-07-18/.
[2] https://travel.state.gov/content/travel/en/traveladvisories/traveladvisories/united-kingdom-travel-advisory.html

reversed as **the "buy-the-dip crowd" stepped in and allowed stocks to finish the week in the green** (and yes, the UK's market lagged…seems that poor Boris simply couldn't catch a break.)

But I'm of the opinion that **for something to be declared truly durable in its ability to influence markets,** it has to be deeper and more fundamental than a salacious and ironic headline or one-off scaremongering – **it has to show up in fundamentals like published economic data or corporate earnings** as well. As it turns out, we had evidence that COVID is still at least partially in charge from both sources as well last week.

Let's start with economics. **Labor markets are still being distorted by the lingering impacts of the virus**, including last week's initial jobless claims report, which came in unexpectedly high at 419,000 but also saw a big drop in the number of continuing claims during the two weeks prior[3] – a strange juxtaposition of current- and past trends in the jobs market that was quite likely partially a function of the 25 states who opted out of extra federal payments early. Then there was this tidbit from the Kansas City Fed's monthly manufacturing survey: 91%(!) of area manufacturers reported that workers are in short supply, and a majority of those have had to resort to paying higher wages to attract employees[4]. Moreover, a similar number of **manufacturers in the Midwest** report continued supply chain difficulties as a result of COVID-related disruptions and more than a few are **turning away business because they simply don't have the raw materials or workforce to meet demand**[5].

Of course, **these issues are nothing new**: supply chain stress and persistent worker shortages have been central discussion points in other regional Fed reports – as well as forward-looking reports like flash PMI data (which last week called out "capacity constraints" as a key factor behind strong but still disappointing results for the services sector[6]) – for a very long time. **One would've perhaps hoped, though, that they'd have begun to fade by now if COVID is truly on the wane.** The fact that they haven't is **further evidence that dismissing COVID** the same way that the hapless Mr. Johnson tried to with the whole "Freedom Day" debacle **would be premature**.

And then there was earnings season. Last week's headliners included a large number of COVID-relevant companies, including **a whole squadron of airlines**. Results from the country's air carriers were on the whole fairly encouraging, with most (but not all,) losing less money than analysts had predicted[7]. Among the more common themes were the idea that **domestic leisure travel has recovered nicely, but higher-margin things like business- and international travel have not**. That squares with the idea that **COVID isn't through with the travel sector just yet**.

The airlines weren't the only COVID-relevant reporters, with transportation and logistics companies reporting difficulties of their own. Examples included one trucking company's lament that rising **driver compensation costs had largely offset higher rates received from their customers**, as well as some evidence of **challenging operating conditions among the rail operators** that reported last week, echoing difficulties highlighted during the prior week by some of their competitors and at least somewhat reminiscent of well-publicized difficulties at the world's maritime shipping ports.

And then there was **the most visible COVID-related industrial distortion of them all: the ongoing shortage of semiconductors** wrought by COVID-related plant shutdowns and associated mismatches between supply and demand. Industry bellwether Intel sold off after reporting second quarter earnings that beat estimates but were nonetheless viewed as lukewarm because the company's forward-looking guidance wasn't as upbeat as it could have been and hinted at margin pressure to come. It also didn't help things that the company's CEO, in a fit of honesty, told the street that **it will take at least another year or two for chip industry capacity to catch up with demand**.

So COVID remains at least partially in charge, with evidence coming from both the corporate sector and the published economic data. And that's mildly depressing. But at the same time, **it's worth remembering that any market dislocation** – even a global pandemic – **creates both winners and losers**. Two of the best examples from last week included ASML –

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[3] https://www.dol.gov/ui/data.pdf

[4] https://www.kansascityfed.org/surveys/manufacturing-survey/tenth-district-manufacturing-activity-increased-further

[5] Ibid

[6] https://www.markiteconomics.com/Public/Home/PressRelease/5c13aaa0acb3461eb9acd7113cd2bb40

[7] Company reports, Zacks.com, seekingalpha.com

which supplies advanced lithography machines that allow chipmakers to expand capacity – and auto retailer Autonation (who, incidentally, does a substantial amount of business in the red-hot used car market.) Both companies sit comfortably on the other side of the trends that are ailing their respective industries, and both finished last week substantially higher after reporting second quarter results.

And that's the real beauty of the market: even when something as sweeping and scary as COVID is in charge, **investors are still capable of finding – and rewarding – those few companies that are well-positioned to take lemons and make lemonade**. So, the flopping of Freedom Day and all it implies for the rest of us aside, its encouraging that there is almost always an upside to be found somewhere.

What to Watch This Week: July 26th – August 1st

Notable economic events (July 19th – 23rd)

Monday*:* New home sales, Dallas Fed, *earnings*: TSLA

Tuesday: Home prices (x2), Consumer confidence, Richmond Fed, *earnings:* AAPL, GOOG, MSFT

Wednesday: FOMC announcement, *earnings*: FB, BA

Thursday: 2Q GDP, weekly claims, pending home sales, *earnings (n=361)*: AMZN

Friday: Income and outlays, UofM consumer sentiment, *earnings*: XOM, CVX, WY, CAT

Sorry Jerome, you've been upstaged.

In an ordinary week Chairman Powell's **post-FOMC press conference** would get top billing, but this time around he's quite **likely to be upstaged by the busiest week of second quarter earnings season so** far. That's not to say that Mr. Powell and his buddies at the Fed aren't *capable* of shocking and awe-ing the markets into a big reaction when they announce the results of their regularly scheduled rate-setting meeting on Wednesday, its just that **any kind of market-rattling surprise seems like a long shot to say the least**.

That is to say, barring something like a surprise announcement that the Fed will stop buying $120b worth of bonds every month or has changed its view on the temporary nature of all this inflation we're seeing (both of which seem about as likely as Iran or Japan winning Olympic gold in basketball,) **the Fed's meeting this week is likely to be as much of a non-event as an FOMC meeting ever *could* be**. Expect more of the same, with maybe a little more dissent in the ranks than we've seen recently. Markets may not even notice.

That will of course leave earnings to drive the bus. And will they ever: this week will feature **all of the FAANGs minus Netflix** (who's membership card in the FAANG club is currently under review for revocation anyway,) in what will probably be **the biggest week of the second quarter earnings season of all**. Apple and Alphabet/Google kick off on Tuesday, followed by Facebook on Wednesday and the newly space-faring Amazon on Thursday. Add in Tesla (Monday) and Microsoft (Tuesday) and you get **a whole lot of high-growth market-cap spread over just a few days. Buckle up, space tourists**.

Other earnings reports worth paying attention to include **a few more airlines** (Jet Blue on Tuesday and Spirit Air on Wednesday,) who seem likely to re-confirm what we learned about post-COVID travel last week from the likes of United, American and Southwest. For **a cross-check of the banks' assertion two weeks ago that the consumer's balance sheet is all but bulletproof, keep an eye on Visa (Tuesday) and Mastercard** (Thursday) for evidence that charge-offs are almost unbelievably low for an economy in this stage of the cycle. **A few more chipmakers** and their suppliers will report (including AMD, STMicroelectronics and Phillips) as well as **transport and logistics companies** like trucker CH Robinson and railway Norfolk Southern (Tuesday and Wednesday, respectively.)

Friday will showcase Caterpillar and its read-through into the macro, together with **a whole batch of energy companies** including Exxon, Conoco-Philips and Brazilian super-major Petrobras. Energy stocks have been in the spotlight recently given questions about demand volatility as well as smoothed tensions within OPEC, setting up these companies and others for added attention. Ditto with **Weyerhaeuser**, which will get added scrutiny for its **efforts to manage the boom (and more recently, the bust) in lumber prices**. But if you're looking for something a little spicier than that standard fare, keep an eye on a company called Microstrategy, which reports on Thursday and has become, for reasons a little beyond the scope of this commentary, a window into how the wonderful world of bitcoin is feeling.

That's a lot of earnings reports to sift through. But there are still a few **relevant economic data points** on tap as well – the biggest of which will likely be **Friday's income and outlay report**. That's the monthly release that details how much Americans are earning and spending and has become particularly interesting as the place where the impact of all the COVID-related stimulus on incomes is most obvious. **If that stimulus is set to go away soon**, then Friday's report is as good a place as any to **draw inferences about what that means for consumer health**.

Speaking of consumer health, we get **two reads on confidence** this week: the Conference Board's consumer confidence report on Tuesday and the University of Michigan's on Friday. Both contain hints about how likely Americans are to keep making big-ticket purchases like cars and houses, which brings us to the **collection of housing market data** expected this week: two reads on home prices (Tuesday,) as well as new- and pending home sales. While we didn't call it out above, **last week's housing data seemed to indicate that the boom in housing may be over**. We'll get a chance to test that theory at a little deeper level this week.

Finally, we'll get our **first read of second quarter GDP on Thursday**. Preliminary GDP numbers usually aren't that interesting, but this one might get some attention if for no other reason than as a cross-check to all the economist estimates that suggest the US economy is booming. Forecasts for quarter-over-quarter growth range from around 5.5% all the way up to 10%, **an unusually wide range of guesses that underscores exactly how difficult it is to measure exactly what's going on in the economy today**.

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