Zacks
INVESTMENT MANAGEMENT

Mitch on the Markets

Portfolio Manager Investing Insights

WEEKLY CLIENT COMMENTARY October 11, 2021

Is the U.S. Economy Set to Rebound from Summer Lull?

Macroeconomic headwinds started to build throughout the summer, which was also when the surge of the highly contagious Delta variant started to take a toll. Many businesses reluctantly delayed office re-openings and in some parts of the country, indoor capacity restrictions were reinstated. The travel and hospitality industry largely reported that bookings hit a soft patch.

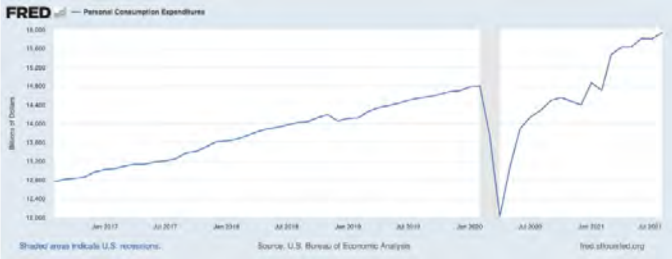
Meanwhile, supply chains have not helped – product shortages, ballooning shipping costs, and backups at U.S. ports have hampered inventory restocks and snarled production at factories globally. Everything from cars to toys to Christmas decorations is in tight supply and starting to experience price pressures.

The effect on U.S. growth was palpable – consumers trimmed spending on hospitality services and travel in July, and supply constraints led many economists to trim GDP growth estimates for Q3. In one notable recalibration, the forecasting firm IHS Markit lowered their Q3 GDP forecast from 7.8% in July to 3.6% by late September.[1]

Taken together, the persistent pressures on the global economy have led many investors to increase inflation expectations while lowering growth expectations, and for some, the outlook for the U.S. economic expansion has soured. I've even noticed the more frequent use of the term "stagflation" in the news lately, which describes the scenario of high inflation and low or negative growth. I think these worries are overblown.

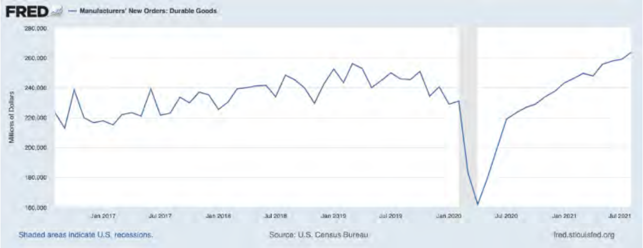
Households have a record $142 trillion in net worth, wages are on the rise, and there are still roughly as many job openings as there are unemployed Americans. Consumers are paring spending on big-ticket items, like vehicles and furniture, but they are spending more in areas like retail and services. According to one estimate, households have still only spent about 25% of 2021's stimulus payments.

In a sign that spending and growth remain in an upward trend, personal outlays on goods and services rose 0.8% in August compared to July, according to the Commerce Department. As you can see in the chart below, U.S. consumer spending has not missed a beat.



Source: Federal Reserve Bank of St. Louis[2]

August also saw companies report a strong increase in new orders for durable goods, such as appliances, computers, TVs, and home furnishings. Even though a late-summer lull may have seen consumers hit the 'pause' button on economic activity, businesses are still largely reporting a struggle to meet demand in the marketplace.



Source: Federal Reserve Bank of St. Louis[3]

Finally, I remain optimistic about the economic expansion because of further labor market improvements I see in the coming months. September was the first month that the expanded federal unemployment benefits expired, and school re-openings should pull some workers off the sidelines. There is, of course, no shortage of jobs waiting for those who re-enter the workforce – as I mentioned previously, the number of job openings in the U.S. roughly equals the number of unemployed Americans. Wages are also higher.

Bottom Line for Investors

If there is one thing I've learned about economic expansions over the years, it is that analysts are always looking for reasons to doubt the expansion's resilience. July's weak retail spending, which showed sales at retailers and restaurants falling -1.1%, was enough for many to start calling into question whether growth would last. A short period of weak growth coupled with largely expected high inflation readings was enough to declare stagflation.

I disagree. In addition to the fundamentals detailed above, I would also point out that the economic drag from the latest Covid-19 surge was far more tempered than previous surges, which to me indicates the economy and businesses have learned and are adapting. In my view, aggregate demand and future growth were not lost as a result of the Delta surge but were merely delayed by a few months. I'm adjusting my growth expectations higher for Q4 2021 and 2022, accordingly.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] Wall Street Journal. September 29, 2021. https://www.wsj.com/articles/u-s-economy-set-to-pick-up-speed-after-delta-driven-downturn-11632907800?mod=markets_lead_pos10

[2] Fred Economic Data. October 1, 2021. https://fred.stlouisfed.org/series/PCE#0

[3] Fred Economic Data. October 4, 2021. https://fred.stlouisfed.org/series/DGORDER

Weekly Market Update

Important Market News We Think Worth Considering

IN FOCUS THIS WEEK

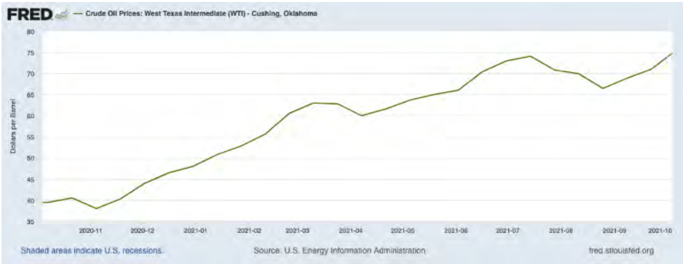
- **U.S trade deficit reaches new record**
- **Oil prices rise as OPEC raises production**
- **Higher unemployment rate**

U.S. Trade Deficit Reaches New Record

American businesses and consumers imported goods at a record pace in August, buying $287 billion worth of foreign items from toys, to clothes, to pharmaceutical products. The Commerce Department also reported that the difference between imports and exports expanded to $73.3 billion, also setting a new record. Trade deficits are often framed as negative for the economy since at a basic level the U.S. is buying more goods and services than it's selling. But the real metric that matters is *total trade,* as it is a better indicator for the overall level of economic activity. The good news here is that even as imports climbed to record levels, exports also rose – a good sign for the global economy. Trade relations with China – which took center stage this week as the Biden administration negotiates a path forward – showed weaker data. The U.S. trade deficit with the world's second-largest economy expanded to $31.7 billion in August, a by-product of rising imports but falling exports.[1]

OPEC Slowly Raises Production, Oil Prices Rise

Surging demand has featured prominently in 2021, as U.S. households picked up travel and vacation trips. This return of demand has not been met with the surging supply of oil – in the U.S., oil drilling and output have moved higher, but they are far from pre-pandemic levels. According to oil-field-services firm Baker Hughes, the last time crude oil prices were at these levels, there were over 1,000 additional rigs drilling for oil. OPEC stirred markets additionally this week by announcing they would increase production, but not nearly at levels needed to meet current demand. OPEC plans to produce more barrels incrementally, rather than in large quantities immediately – they plan to raise collective output by 400,000 barrels a day in monthly installments. As you can see in the chart below, crude oil prices continue responding to rising demand and too-low supply, climbing to $75 a barrel and showing few signs of retreat.[2]



Source: Federal Reserve Bank of St. Louis[3]

Would a Higher Unemployment Rate Actually Be a Good Thing?

The unemployment rate is notoriously calculated in a wonky format – it only accounts for Americans *actively seeking work* but unable to find it. If some Americans are unemployed but also not looking for work, they are not counted towards the unemployment rate. That's why seeing a slight increase in the unemployment rate would not necessarily be a bad thing, assuming that the uptick was due to more people coming off the sidelines in search of a job. According to the Labor Department, there are millions of Americans who stopped working and have not actively looked for work since early 2020, when the pandemic stifled economic activity. This dynamic is measured by the labor-force participation rate, which measures the number of adults seeking work. In January 2020, the labor-force participation rate was 63.4%, but it has not crossed above 62% in some time. Economists will be watching this metric especially closely this fall, as federally expanded unemployment benefits have ended and most schools have reopened.[4]

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[1] Wall Street Journal. October 5, 2021. https://www.wsj.com/articles/u-s-trade-deficit-widens-to-record-august-as-imports-rebound-11633438717?mod=djemRTE_h

[2] Wall Street Journal. October 4, 2021. https://www.wsj.com/articles/opec-russias-gradual-oil-hike-pushes-prices-to-seven-year-high-11633356803?mod=djemRTE_h

[3]Fred Economic Data. October 4, 2021. https://fred.stlouisfed.org/series/DCOILWTICO#0

[4] Wall Street Journal. October 3, 2021. https://www.wsj.com/articles/falling-unemployment-could-add-to-worries-about-the-u-s-labor-market-11633269601

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