Wentz Weekly

March 22, 2021

The Steepening Yield Curve

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Following the FOMC meeting last week, the Fed reiterated its accommodative monetary policy stance, keeping interest rates at 0% and maintaining its asset purchases of $120 billion per month. Projections improved, with the Fed now seeing 2021 GDP at 6.5% up from 4.2%, while core PCE inflation was upgraded to 2.4% up from 2.2% in 2021, before coming back down to 2.0% in 2022. Fed Chair Powell's comments remain dovish – it is not yet time to talk about talking about reducing the pace of asset purchases, and the Fed wants to see "actual" progress toward its inflation goal rather than "forecasted" progress as it has in the past. Several Fed members pulled forward their projections for the first rate hike but the median still projects that will not happen until 2024. Despite the dovish stance, markets have pulled forward its expectations, with the futures markets now pricing in at least one rate hike in the first quarter of 2023. The result for the market has been a steepening yield curve, where longer-dated bond yields have risen at a much faster pace than shorter term yields, benefiting certain sectors such as financials.

In addition to the FOMC meeting and the latest policy announcement, the Federal Reserve Board said it will let supplementary leverage ratio (SLR) relief expire at the end of March, which has the chance of causing forced selling of Treasuries and potential liquidity issues. This may be another cause of the recent rise in Treasury yields. The move is important for banks, who must meet certain capital requirements. Following the onset of the pandemic, the Fed exempted Treasuries and deposits from the SLR in April, enabling banks to expand their balance sheets, provide more credit to households and businesses, and calm the Treasury markets. The decision comes at an interesting time, shortly after the $1.9 trillion stimulus bill was passed which will increase consumer deposits and expand balance sheets. The decision could also be political, as several Democrats have called on Powell to let SLR relief expire, in attempt to earn their support and another term as Fed chair. We would expect this to have a short-term and temporary impact on the Treasury market, forcing selling and causing an increase in yields.

After far surpassing expectations in January with a 7.6% increase, which was revised up from a 5.3% gain thanks to government stimulus payments in the month, retail sales fell 3.0% in February, a disappointment and even lower than the lowest estimate. Some of the blame is on harsh winter weather, a tough comparison with such a strong January, and the fact February is typically a quiet month for sales as store get ready for spring selling season. Some of the weakness could also be blamed on auto sales being negatively impacted by production cuts due to the ongoing semiconductor shortage. Auto sales fell 4.2% in the month. One of the only categories with an increase was gasoline sales, up 3.6%, due to the continued increase in energy prices. Compared to a year ago sales are up a strong 9.5%, while e-commerce sales are driving much of the gains, up 25.9% from a year ago.

The Manufacturing Business Outlook Survey by the Federal Reserve Bank of Philadelphia showed the strongest level of change in manufacturing conditions for the region in over 50 years. The index for manufacturing activity hit 51.8 for March, up from 23.1 in February. About 59% of firms reported increases in activity, up from 35%, while only 7% reported decreases. New orders, production, shipments, backlogs, employment, outlook, and prices all posted multi-year highs. In fact, over 60% of firms surveyed indicated labor shortages and said they are having difficulties finding skilled workers. Just as significant, firms are indicating mounting price pressures, a trend that has intensified in the latest month.

Airport throughput volumes hit their highest levels in over a year last week and airline executives are beginning to give a more optimistic tone. According to TSA, throughput volume exceeded the year ago levels for the first time since the pandemic began. Although the comparisons are becoming easier it is still a positive step and suggests travel is trending in the right direction. That news was followed by positive commentary from several airlines. United said it expects cash flow for March to be positive given the new trajectory of bookings which are coming in better than previously expected. Alaska Air and Delta made similar comments, both expecting positive cash flow in March, along with Southwest and JetBlue who said demand has significantly improved with more people making plans to travel. Delta said bookings began picking up around the beginning of February with revenues improving 40% from February to March. We would expect to see this trend continue, after a 60% drop in traffic in 2020, as the vaccination rollout continues to accelerate.

Company News

- Amazon's Amazon Care, the company's virtual health program that has been in pilot mode for two years, will now expand to all its employees this summer with plans to expand it to other employers later this year.
- The Financial Times reported Canadian Pacific Railway has agreed to acquire Kansas City Southern in a $25 billion cash and stock offer, with Kansas City shareholders owning roughly 25% of the combined company. The deal combines the two smallest of the seven major North American freight carriers and will create the first freight rail network that links the U.S., Mexico, and Canada.
- Disney announced it will reopen Disneyland in Anaheim, California on April 30, with its parks operating at 15% capacity to begin. The company also said it hopes to be operating its cruise lines by the fall.

The Week Ahead

This week, along with the next couple, will be quiet on the earnings calendar before first quarter earnings season heats up. Notable reports this week include Adobe and GameStop on Tuesday; General Mills and KB Homes on Wednesday; and Darden Restaurants on Thursday. The economic calendar has several housing reports – including existing home sales on Monday and new homes sales on Tuesday. Wednesday will see durable goods orders, often an indicator of business fixed investments. On Thursday, the latest figure on unemployment claims is released and the final revision on fourth quarter GDP where the consensus still sees a 4.1% annualized growth rate in Q4. The week wraps up with the personal income and outlays report for February, which includes the Fed's preferred measure of inflation in the PCE price index. Jerome Powell will make an appearance Monday through Wednesday – Monday for a discussion on Central Bank innovation and Tuesday and Wednesday to testify before Congress on the CARES Act.