Wentz Weekly

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Fed Delivers More Hawkish Tone

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The Federal Reserve's Federal Open Market Committee (FOMC) concluded its meeting last Wednesday with a post-meeting statement that contained no surprises and remained relatively unchanged from the FOMC April meeting. The surprise was in the Fed's Summary of Economic Projections (SEP) and its "dot plot." The SEP showed the Fed expects stronger growth and higher inflation this year while growth and inflation expectations in 2022 and 2023 remained largely unchanged. However, the bigger surprise was in the dot plot. The dot plot indicates each Fed member's judgement on where they anticipate the appropriate interest rate should be at a future date. The consensus still sees the first rate increase in 2023 but the dots indicate a shift upwards of 50 basis points (0.50%), with 13 of the 18 members now seeing at least one rate increase in 2023 and 11 of those members seeing at least two increases in 2023. Furthermore, an additional three members see the first increase in 2022, bringing the total to seven. We believe bonds sold off on this news with the yield on the 10-year U.S. Treasury note increasing 9 basis points to 1.58% after the release.

In Chairman Powell's press conference, he reiterated his and the Fed's view that inflation pressures are transitory but did acknowledge that some inflationary forces could be more persistent. Powell noted short-term increases in prices are due to certain reasons that should fade over time, and even decrease. On the labor market, Powell said the Fed expects a robust labor market in the years ahead but noted the likelihood the participation rate could remain low due to demographic trends and increasing retirements, something that will result in a lower labor market supply for longer than expected. What we were looking most forward to was the discussion on tapering the Fed's $120 billion in asset purchases per month. The Fed, as expected, did not change this policy and had very little to add on timing of tapering. Powell did however say to think of this meeting as the "talk about talking about" meeting. We view this as Powell preparing the markets that the Fed will begin more detailed discussions on tapering at one of the next meetings. An important date coming up is the annual Jackson Hole Economic Symposium beginning August 26. The event is known to be a time the Fed announces major economic policy changes. At its meeting last year, Powell adopted the Fed's average inflation targeting policy which was a major shift in its inflation policy. We will keep this date circled on our calendar as a likely date the Fed will make a bigger announcement on beginning the talks of tapering and possibly details on its plans, although we don't believe actual tapering will happen until at least the end of the 2021 or early 2022.

Following the Fed meeting markets immediately priced in the chance of a sooner rate hike. According to futures, the market is now pricing in a 44% chance of at least one rate hike by the Fed's July 2022 meeting, up from a 30% chance prior to the Fed meeting. Treasury yields on the shorter end of the yield curve rose while longer dated yields declined. The 2-year Treasury yield was up from 0.17% to 0.21% after the meeting and closed the week at 0.28% while the yield on the 30-year bond rose 0.03% to 2.20% after the meeting but fell back down to 2.01% by the end of the week. It may be the case the market became concerned rate hikes could outpace economic growth, which is what caused the yield curve to flatten. In addition, Friday morning involved an interview by St. Louis Fed President James Bullard. A known hawk, Bullard said the taper talk discussion is now open, but will take several meetings to organize and the Fed's inflation goals would be met by this meeting or next. All of this confirms our thoughts the Fed has already began its discussion on tapering and an announcement will be made at some point in the second half of 2021.

More signs of inflation pressures are evident in the producer price index report, which was released last week for May by the Bureau of Labor Statistics. The report showed input prices that producers of goods pay rose a higher than expected 0.8% in the month and are 6.6% higher compared to the same month a year ago. Excluding the volatile food and energy categories, the price index is 5.3% higher than a year ago. Higher producer prices could lead to higher prices for consumers as some businesses may decide to pass on the higher prices to the consumer.

Retail sales in May showed a large shift in consumer spending habits thanks to the increase in vaccination rates, wider spread economic reopening, and the effects of government stimulus fading. Retail sales in the U.S. fell 1.3% in May, a steeper drop than expected, reflecting less spending by Americans compared to the stimulus-inflated months of March and April when most received their stimulus payments. In addition, a shift in spending habits was notable as more Americans spent money on services such as eating out and things they couldn't do during the pandemic. Spending on bars and restaurants rose 1.8% in the month with sales at food service places now higher than pre-pandemic levels. Online sales declined, indicating a pivot to more in person shopping. Clothing sales (such as department stores) rose 3.0% in the month as more people prepare to go out more often. Consumers spent less on big ticket items such as vehicles, furniture, electronics, and building materials, categories that boomed during the pandemic months.

Company News

- ZoomInfo said in its investors day it is targeting annual revenue of $2 billion by 2025, implying a +30% compounded annual growth rate from 2021-2025. It also raised its total addressable market to $52 billion from $24 billion at the time of its IPO as result of acquisitions and new products
- General Motors says it will boost its investment on electric vehicles and autonomous vehicles by another 30% to $35 billion through 2025. As part of the plan, GM will also build two additional battery plants in the U.S.
- Cleveland Cliffs again raised its current quarter and full year forecasts for EBITDA due to strong demand and higher prices. This forecast uses a "conservative assumption" for steel prices.

The Week Ahead

It will be another quiet week on the earnings calendar with the busiest day being Thursday. Notable reports include KB Homes on Wednesday, Carnival, FedEx, Rite Aid, Darden Restaurants, Nike and Blackberry on Thursday, and CarMax on Friday. The House Judiciary Committee will vote this week on a package of antitrust bills which could affect companies like Apple, Amazon, Facebook, and Google, among others. Elsewhere in the corporate world, on Thursday the results of the stress tests for some of the largest banks will be released after the close. The stress tests are meant to determine if banks have enough capital to absorb losses in times of stress (due to recent regulations, they typically do). The economic calendar has several reports, a couple focusing on the housing sector with the NAR's existing home sales report Tuesday and new home sales from the Census Bureau on Wednesday. The final revision on first quarter GDP is released Thursday with no expected changes in the annualized 6.4% growth rate. The latest jobless claims data is also released Thursday morning and the week ends Friday with the personal income and spending report that includes the Fed's preferred measure of inflation in the personal consumption expenditure price index.