Market Commentary - February

At Passage Wealth, it is important to us that you are well informed about what is happening in the markets. Here are a few of the key topics of conversation that we feel deserve the most attention this month. If you have any questions or would like to continue the conversation, let us know, and we appreciate the opportunity.

All eyes are on interest rates as the 10-year Treasury yield continues to grow. Rates are rising on increasing optimism the pandemic is coming to an end and the economy will return to "normal." If true, and the economy begins to gain speed, then the Fed may be forced to raise short-term interest rates to combat inflation.

Fed chair Powell told Congress this week that he has no intention of reducing its broad support for the economy or raising rates because the fears of inflation are overblown. This difference of opinion between markets and Chairman Powell are contributing to substantial swings in equity market volatility.

Part of the reason for Chairman Powell's opinion that inflation risk is low is the continued weakness in key economic data points. These include:

1. A long way to go to get back to pre-COVID employment figures with January's total nonfarm payrolls still nearly 10M below February 2020 (1). Last month's nonfarm payrolls data came in below consensus expectations surveyed by Bloomberg. Despite the miss, payrolls were still positive versus December, growing by 49K, significantly ahead of December's revised 227K decline but short of the 105K gain that was expected by economists surveyed by Bloomberg.
2. Unexpected weakness in manufacturing and construction employment (2).
3. Consumer sentiment unexpectedly dropped in February's preliminary readings. Expectations of economists surveyed by Bloomberg were for a slight increase, from 79.0 to 80.9, but the data came in nearly 3 points lower than January, at 76.2 (3).

However, there is some good news that show signs of continued recovery in economic data:

1. Inflation continues to remain muted with Core CPI up 0.3% over the prior month. In recent history the housing sector has kept core inflation figures relatively stable, but has contributed less in recent months with some weakness seen in the sector (4).
2. After a few disappointing months of retail sales data at the end of last year, January's 5.3% growth in retail sales far exceeded expectations of 1.1% (5). The end of the year stimulus bill helped propel spending along with momentum on vaccine distribution, leading to the surge in

activity that was most pronounced in discretionary spending, such as department stores, restaurants, furniture, and electronics.

3. Manufacturing output also rose more than expected in January, at 1% over December, putting the string of consecutive growth at four months. This beat expectations of a 0.7% gain and slightly above the 0.9% gain in December. According to the Fed's measure of factory output, it is now 1.9% below its pre-COVID level (6).

The ultimate wild card for the economy continues to be the next round of stimulus and a final rollout of vaccines. Expectations are clustering around July that vaccines will be available to anyone who wants one. If so, that puts the economy to be functioning without that effect of government limitations for most of Q3.

Talks are ongoing related to the Biden administration's $1.9T stimulus proposal. Major sticking points include pandemic-related items such as the income limits of those receiving a stimulus check and non-pandemic-related items such as raising the Federal minimum wage to $15. If the Democrats choose to use the budget reconciliation process to push the stimulus package through the Senate with only a simple majority, then it is likely the minimum wage portion will be eliminated. The delivery of the stimulus package is critical to the ongoing recovery. We see little risk the package will stall in Congress and expect to have a clearer picture of size and components of the final package soon.

Bottom line:

We expect to see periods of substantial volatility in equity markets over the course of 2021. Aside from the normal volatility markets experience in a normal year, 2021 will also see the government begin to back away from some of the extraordinary support that has been deployed to combat the pandemic. As that support goes away, we can expect to see some form of short-term volatility due to uncertainty. However, we believe economic data is stable enough to mitigate the risk of sustained market downturns. As always, we believe a proper financial plan is the best way to navigate uncertain times based on your unique goals.

(1) Source: U.S. Bureau of Labor Statistics
(2) Source: Bloomberg
(3) Source: Bloomberg
(4) Source: U.S. Bureau of Labor Statistics
(5) Source: Bloomberg
(6) Source: Bloomberg

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