MV CAPITAL MANAGEMENT

Weekly Market Flash

Macro Matters

June 4, 2021

There is a lot of economic news out there to digest. Unlike the first half of the year, which seemed to be more about the capricious tradewinds of momentum and less about the underlying fundamentals, what happens in the second half could largely be a function of those monthly jobs, inflation and related numbers. They will be influencing Fed deliberations on monetary policy as well as guidance from corporate management teams on how we should understand the impact of higher prices, at both the wholesale and retail level, on profit margins. If there is a mantra for market performance in the months ahead it might be simply this: Macro Matters.

Finding Joy in the Mediocre

The jobs report this morning was the last bit of monthly employment information the Fed will have to consider at the next Federal Open Market Committee (FOMC) meeting in the middle of the month. It was a mediocre result: economists expected to see 650,000 payroll additions and got 559,000 instead, with some modest growth in hourly wages. That's just fine, as far as the market is concerned. A blowout ADP Employment Survey yesterday of 978,000 new jobs raised expectations that today's BLS report might also surprise to the upside. That would immediately raise the specter of an overheating economy and bolster expectations of one of the dreaded t-words – tapering or tightening – happening sooner rather than later.

But a dismal underperformance of payrolls along this lines of last month's 278,000 fizzle would also have been a wet blanket, fanning fears of a truly dysfunctional jobs market where help wanted signs go unfilled, restaurants desperately seek kitchen staff and everybody demands to be paid in cash (nudge nudge, wink wink). Nobody likes numbers that are really hard to explain in common-sense ways. So the actual outcome – a bit soft but not too soft – is a Candide-like best of all possible worlds for Mr. Market.

Your Prices and the Fed's Prices (They Are Different)

Next up: inflation. The Consumer Price Index for May comes out next Thursday. The headline CPI is expected to increase by 4.6 percent on a year-on-year basis, with the core measure that excludes the volatile categories of food and energy due to rise by 3.4 percent. Both of those are comfortably the highest figures in more than a decade. While this report will come out in time for the Fed to digest it at the mid-month FOMC meeting, the CPI is not the Fed's preferred gauge of inflation. That would be the core (again, excluding food and energy) Personal Consumption Expenditure (PCE) index, the next reading of which comes out on June 25.

For you – assuming you are a person who buys groceries every week and fills up the car with gas on a regular basis – that headline CPI number of 4.6 percent is much more relevant than the core PCE figure the mandarins in the Eccles Building will pore over during the FOMC meeting. Crude oil prices are up more than 40 percent since the beginning of this year. The UN Food and Agriculture Organization's food price index is up more than 40 percent from its level one year ago. You are feeling the impact of this kind of inflation every time you go to the store. If you are a sharp consumer you may even be onto a little trick one of our colleagues here referred to the other day as "size-flation." That's when you seem to pay the same price for something as you are used to, but there is actually less of that "thing" in the box or bottle

or what have you – 16 ounces when there used to be 20, or three quarters of a pound versus the old one pound standard. Keep your eyes open!

What Goes Around

The Fed has been serenely complacent about inflation for many months now, and it is extremely unlikely that Jay Powell will start complaining about cereal prices at the post-FOMC press conference in a couple weeks. Sooner or later, though, the inflation numbers that matter for you and me are going to matter to Powell and his colleagues as well. Prices flow through a value chain that starts with basic raw materials and other input costs, and end up as what we pay at the register. Companies at each stage of production and distribution have choices to make as to whether they can absorb price increases into their own profit & loss accounts or try to pass them onto the next stage of the chain.

When they absorb the costs it impacts profit margins – a figure analysts are keenly focused on during corporate earnings season. When they pass them on they run the risk of losing customers and market share. At some point it becomes clear that higher prices are having a meaningful economic impact. If it goes on for too long – if it looks to be a driving force in a longer economic cycle rather than a transitory phenomenon – then the Fed will have to act accordingly. The so-called "Fed put" – the assurance that the central bank can paper over any disruption in stock market prices with more easy money – will be far out of the money.

There are plenty of other variables swirling around this mix, more than we can cover in this brief commentary. Fear not, there will be much more to say about this in the weeks ahead. Macro matters.

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