Five Minutes with Commerce Trust's Chief Economist – Scott Colbert 9/2/21

Scott Colbert:

Good morning. It's Thursday, September 2nd, and we thought we'd take a moment to review economic activity in August and have it highlight why we're still so positive on our economic momentum going forward.

So what happened in August? Number one, we had huge employment growth. There were over 950,000 jobs created last month, and wages and salaries are growing at over a 4% plus pace. And it's that combination of increasing jobs and increasing wages that allows us to expect an ongoing, self-sustaining economic recovery. Risk assets continue to win. The S&P 500 is up almost 3%, and as we're sitting here today it's reached a new high, up almost 21.5% year to date. Corporate earnings continue to rise. In fact, they continue to explode. Corporate earnings in the second quarter came in at about $220 per S&P 500 share; the S&P 500 is at about 4,500; that puts the price to earnings ratio at about 20.5, much more reasonable than it was at the end of the year when it was well in excess of 30 and almost we went into the year with a PE of 40.

Home sales, as you know, continue to increase, and inventories are exceptionally tight. On a year-over-year basis, the median home price is up an astonishing 17%, and on a two-year basis it's up 29%. And it's kind of interesting that the median price of a home is rising faster than the average price, because the bid is for these lower-priced houses, entry-level houses that people postponed buying during the great recession as they move towards apartments or perhaps even lost their house. And there's just a huge demand at the lower end, and why wouldn't there be with mortgage rates still lower than 3%? And then finally, it's something we don't talk about a lot, but the global leading economic indicators are back to their record high prior to the pandemic. The last time, during the great recession and our economic downturn, it took nearly seven years for economic activity in terms of the leading economic indicators to fully recover. And this time they recovered in less than two years.

Now, there's certainly some downside risks out there. Number one of course on everybody's mind is the coronavirus. Coronavirus cases during July to August nearly doubled, and in fact, coronavirus cases on a seven-day average basis are running at about 162,000. That's 57% the pace of their previous high back in January 11, but much higher than people had anticipated back in June when new cases hit a lull of about 11,000 to 12,000 per day. So a huge acceleration in coronavirus cases. And of course, because of the coronavirus cases, this has pushed back on our economic reopening. We've seen high-frequency data, like of course restaurant reservations, hotel reservations, flight reservations, pushed back a little bit. And it's why we've had to pull back our third quarter economic growth.

But there is a silver lining to pulling back the economic growth, and even with the coronavirus, if you will. Because of the surge in coronavirus cases, vaccination rates are up. They've nearly doubled from their lows of 400,000 per week to about 900,000 per week. We've seen the coronavirus cases, while they continue to grow, the acceleration rate has continued to decline. And in fact, in the most highly contagious states, we've actually seen a rollover where the coronavirus was the strongest.

And then finally, this probably also pushes growth into the future. Inventories are still exceptionally low. The bottlenecks are still every bit as big as they were. The lead time to fill an order in the surveys has continued to grow, but this simply pushes growth out into the fourth quarter and perhaps next year. And it probably even takes a little bit off the edge of inflation, which we're also going to have to fight. That's going to be much more sustained and a lot less transitory than what the Federal Reserve considers as transitory. We're stuck with some serious inflation for a period of time. And that ultimately means we're going to have to confront several other downsides, right? Number one is the Federal Reserve is going to take some of the “punch bowl” away. They're eventually going to slow down their bond purchasing, probably by the end of the year, and they'll turn it off by the end of next year. They're eventually going to have to hike interest rates, probably to push back a little bit against inflation.

We've always got the problem of another variant of the coronavirus coming along. We've certainly got to unplug our shipping lines and our chip shortage, as evidenced by the fact that car sales declined in August. Now, you wouldn't think that car sales would decline because demand is still strong, but the problem is there are no inventories. Car sales peaked at about 18 plus million on an annualized basis back in April. They're down to only 13 plus million today, but it's not for lack of demand, it's for lack of inventory. Total inventory in the car space, there's only 200,000 units of inventory right now. Normally on a yearly average, there's about 1.2 million units of inventory. So, we're talking about inventory being pushed down to basically about one sixth of what it typically is.

And then we're also going to have to work through probably the Democratic packaging of the budget, which probably entails a number of tax hikes. So that's probably going to create some type of financial market volatility that we're going to have to work through as we progress through the year. But our outlook still remains positive, driven primarily by the outlook for jobs, the tremendous wealth effect, increasing corporate earnings, and basically the compounding effect that comes with wages and salaries growth on a year over year basis. So we look forward to seeing you in a couple weeks, we'll review the new economic activity, changes to the financial markets, and we hope you all have a great Labor Day.

general education, information or illustration only. It is not to be considered as the opinion of Commerce Trust Company or Commerce Bank regarding any individual investment, investment account or market behavior. Neither Commerce nor any of its affiliates, officers, employees, or agents have made any recommendation or given any advice as to the terms, beneficial interest or profitability of any investment on market activity which may be referenced here, and this information may not be relied upon as such. Accordingly, you understand that you are always fully responsible for any investment transaction you choose to enter into, and that you shall not have relied only on any of the proceedings or following information for Commerce as a basis for any investment decision. In considering whether to trade or invest, you should inform yourself and be aware of the risks. The risk of loss from investing in securities and other investments can be substantial. You should consider whether investments entered into directly by you or on a discretionary managed basis through Commerce Trust Company or elsewhere are appropriate for you in light of your investment objectives, financial circumstances, tax status, your tolerance to risk, investment time horizon, and your investment experience. Past performance is no guarantee of future results, and any opinions and other information in the commentary provided as of this date are subject to change. Diversification does not guarantee a profit or protect against all risk. Markets, economic forecast and aspects of specific investments can change from time to time based on a variety of individual interrelated or complex factors. This disclosure statement cannot present all the risks and other significant aspects of investments, economies, or markets in which you may elect to transact from time to time. You should therefore carefully study investment arrangements in advance of making decisions about investing. Providing this information, which may be a value to you or others does not detract from an investor's responsibility to take all such steps and make all such inquiries as may be necessary to ensure a full understanding and familiarity with any potential future investment. If you are in doubt about the risks involved in trading or investment arrangements, or have not understood any aspect of this risk disclosure statement, you should seek independent professional advice. Please also note that Commerce does not offer tax, legal or specific estate planning advice. And while we may provide information or express general opinions from time to time, such information or opinions are not offered as professional tax or legal advice.

September 2, 2021

Commerce Trust Company is a division of Commerce Bank