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Five Minutes with Commerce Trust's Chief Economist – Scott Colbert
11/12/21

Scott Colbert:

Good afternoon. It's Friday, November 12th, and the markets are closed. We've had another strong week on the back of another strong quarter. And of course, the financial markets are off to a very, very strong start for the quarter. Since September 30th, we essentially have the S&P 500 up almost 9% now, quarter-to-date. And mid- and small-cap stocks have performed nearly identically here in the U.S. International stocks, of course, are up, but not up nearly as much, about half what the S&P 500 is up. And even emerging market stocks are up this quarter despite all the problems over in China. The real headache probably in the financial markets is the fact that the bonds that you own aren't giving you any return at all. Interest rates continue to tick up just a little bit. And as interest rates rise, of course, the price of your bonds fall, and they're falling just about enough to offset the coupon that you get off those bonds.

The Bloomberg Barclays Index, the broadest measure of the bond market, the aggregate, is down about 13 basis points so far for the quarter. So basically, prices (are) offsetting the income. All the returns you're generally getting in your portfolio have generally been from either the commodity side or the stock side. We've had a couple interesting pieces of news since we've last talked two weeks ago. I'll say, let's call it three. We've had an FOMC (Federal Open Market Committee) decision where they've agreed to reduce the amount of bonds that they're buying. In other words, they've begun to taper their bond purchasing. Over the next eight months, they're going to reduce that to zero. They're still going to buy an additional $480 billion of treasury and mortgage backed securities between now and when they slow this to essentially a zero pace, which will let them end up with something like a $9 trillion balance sheet, which essentially means that the Federal Reserve has purchased an awful lot of the outstanding treasury market to help us finance the deficit.

Secondly, surprisingly to almost everybody, Congress quickly passed the bipartisan infrastructure bill. Now this is an additional $550 billion of spending, and it really does go to infrastructure. Fortunately, since it's going to infrastructure, we view that as fairly productive and not likely inflationary, plus they're spreading it out over the next 10 years. Specifically, about $110 billion goes to roads and bridges. So a fifth of it is directly into roads and bridges. We also have about $65 billion each into the light rail system up in the Northeast corridor, think Amtrak. We have about $65 billion going into broadband, particularly with additional broadband access to low income families. We have $65 billion into the power grid. And then the final monies are largely spent on water and public transport. So I think it's a very, very positive move forward. And of course, it was pulled forward, the passage of this, largely because of election results, both in Virginia and New Jersey over the last two weeks.

Now, the worst piece of news that we've gotten is this Consumer Price Index. It's up 94 basis points for the month, 6.2% on a trailing 12 month basis. It's primarily been driven, of course, by surging energy prices and rapidly increasing food prices, but it's relatively broad based. We expect the Consumer Price Index to remain fairly elevated and think can even be up more and more in November and December as we work towards the year end rush of probably what's likely to be a very, very strong retail selling period. We need to get to the weaker seasonals, meaning in the spring or early spring, January, February. It's when we tend to buy a lot less goods and services to help reduce probably some of these bottlenecks that have accrued. Plus, it gives time for the economic pipe to grow. And as our economic pipe and the ability to get all of the economic activity through it begins to grow, that ought to be able to take some inflationary pressure.

But don't be surprised if we see something approaching or even surpassing a 7% year-over-year CPI headline, and the markets are going to have to digest that. Now, going forward between here and the end of the year, there are

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probably four things to focus on. You've always got politics, and we've got a debt ceiling that's going to be a fight coming up in December, that'll be a major topic, as well as the other Build Back America Plan that's supposed to go along with the infrastructure bill. I think it's going to be very tough to pass that Build Back Better Plan now with inflation surging because so many people view that as unlikely to be paid for and more inflationary, particularly from the moderate democratic side.

We've got earnings to digest. Earnings increased in the third quarter, will they increase again in the fourth quarter? Our answer to that is probably, and it'll help keep the market at an elevated level. We're going to be focusing on all the Christmas sales and all the retail sales, and that'll be a big topic of discussion. And then finally, the last thing we're going to focus on is the Federal Reserve. The Federal Reserve will have a meeting in December where they will produce their so-called “dot plots,” which is essentially a forecast for the average member to show you when they think they're going to start to raise rates. We can't help but think, with inflation surging, the coronavirus coming down, economic activity looking awfully positive, that they won't begin to pull forward their initial rate hike forecast, which right now is forecast to happen either very late in 2022 or early in 2023. So, the market will be looking for that to be pulled forward, and we'll see how the market digests that. We'll be back in a couple weeks to react to all the economic news that's going on, and look forward to talking to you then.

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