

## Markets Yawn as Prices Soar

The Fed's preferred inflation measure, core *Personal Consumption Expenditures* (PCE), jumped from +1.9% to +3.1% on a year-over-year basis in April, *the highest in 29 years*. Much of the spike can be attributed to "the base effect," as even normal prices would appear elevated relative to depressed price levels from a year ago during the lockdown. However, the base effect doesn't explain it all. The classic supply-demand relationship is seriously out of balance, and while the base effect will fade away over the next couple months, goods inventories are likely to be extremely lean for much longer. The next FOMC meeting, two weeks from now, will include a fresh round of forecasts and a new "dot plot." Fed officials have all toed the company line in recent weeks, repeating that it's too early to even begin talking about a shift in policy.

Fed officials are likely to increase their 2021 GDP forecast at the June FOMC meeting and will probably acknowledge that at least some of the price pressure goes beyond the base effect. Chairman Powell has been masterful so far in walking a tight line, especially during the post meeting press conference. But the economic data keeps getting stronger, and the inflation readings have been hotter-than-expected, and at some point Powell's nonchalant message could fall on deaf ears.

Last Friday, the preliminary IHS Markit Composite Purchasing Managers Index rose from 63.5 to a record 68.1 in May, but the bigger surprise was the service sector component, which soared from 64.7 to an all-time high of 70.1. The pre-pandemic level in January 2020 was 53.4 and the pandemic low was 26.7. What this May number is signaling is that the downtrodden service sector may be poised for a more substantial resurgence than previously thought. Of course, a strong rebound will require millions of new and returning service workers, and the labor market is a bit disjointed. Yesterday, initial jobless claims for the week ending May 22, fell to the lowest level in 14 months, although at 403k new weekly filings it's still oddly elevated relative to 216k in late February 2020, pre-pandemic. Continuing claims also moved lower, although some of the decline is a result of unemployed workers exhausting their 26 weeks of state benefits and transitioning to the extended federal benefit program. For nearly half the nation, this federal benefit will be ending sooner-rather-than-later.

Twenty-three states, including Texas and Florida, have announced they will no longer accept federal unemployment benefits with most turning off the spicket in June. A widely-held belief is that many unemployed Americans are choosing to not work because they're making more by staying at home. It's a convenient narrative, and it's probably true for some people, but there are millions of parents unable to work because kids aren't in school. Hopefully, this changes in September with most students returning to campus, which is probably why the benefits had originally been extended through early September.

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New and existing home sales both fell in April, which shouldn't indicate a cooling of the red-hot housing market, but rather continued effects of a skeletal housing supply. Lean housing supply continues to push home prices higher. The S&P CoreLogic Case-Schiller home price index of 20 large U.S. cities rose +13.3% year-over-year in March, the largest gain in more than seven years. Phoenix (+20%) and San Diego (+19.1%) topped the list.

Bonds rallied a bit today, not what you'd expect with a surging economy and higher inflation. Traders are probably covering short positions before the holiday weekend, but still...

All three major equity indexes are up on the day, in position to close the week higher and within spitting distance of peak levels from a month earlier. Next week brings a huge amount of key economic data, including the May employment report. At this point, all of the major releases are important in understanding where we are and how long we'll be here.

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## Market Indications as of 1:34 P.M. Central Time

DOW	Up 112 to 34,577 (HIGH: 34,778)
NASDAQ	Up 55 to 13,791 (HIGH: 14,139)
S&P 500	Up 11 to 4,212 (HIGH: 4,233)
1-Yr T-bill	current yield 0.04%; opening yield 0.03%
2-Yr T-note	current yield 0.14%; opening yield 0.15%
3-Yr T-note	current yield 0.30%; opening yield 0.31%
5-Yr T-note	current yield 0.80%; opening yield 0.82%
10-Yr T-note	current yield 1.60%; opening yield 1.61%
30-Yr T-bond	current yield 2.28%; opening yield 2.28%

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