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Weekly Newsletter — Newsletter - 5/17/2021

Week of May 10, 2021 in Review

Last week brought a double whammy when it comes to inflation, as the reports for April showed it is blisteringly hot!

Consumer inflation as measured by the Consumer Price Index (CPI) rose by 0.8% in April while the year over year reading increased from 2.6% to 4.2%. Not only was this a much larger jump than expected, it was the highest annual increase in 13 years! Core CPI, which strips out volatile food and energy prices, also made headlines as it was up 0.9% in April – the highest month over month increase in 39 years!

Wholesale inflation also came in red hot, doubling expectations, as the Producer Price Index (PPI) rose 0.6% in April. Year over year, PPI rose from 4.2% to 6.2%, which is one of the hottest readings ever! Core PPI also rose more than expected.

Inflation is critical to monitor because rising inflation can have a big impact on Mortgage Bonds and the home loan rates tied to them. Don't miss the important explanation below.

And speaking of inflation, the April National Federation of Independent Business Small Business Optimism Index showed that many companies were raising wages as a result of not being able to fill positions. Additionally, selling prices increased to the highest level in 40 years. This is just one of many contributing factors to the red-hot inflation readings we're seeing.

There was some good news regarding Initial Jobless Claims, as the number of people filing for unemployment for the first time fell by 34,000 in the latest week to 473,000. While the number of people continuing to receive regular benefits also declined, the number of people receiving pandemic-related benefits rose sharply. All in all, 16.9 million people are still receiving benefits throughout all programs, which is an increase of 700,000 people from the previous week.

After jumping 10% in March (almost 11% with the revision), Retail Sales were flat in April. Taking out autos, gasoline, and building materials, sales were actually down 1.5%. This makes sense as the jump in March followed the latest stimulus package, and sales in April reflect an understandable pull back.

Lastly, Wednesday's 10-year Note and Thursday's 30-year Bond auctions also made headlines. Find out more about them below.

Consumer Inflation Blisteringly Hot

The Consumer Price Index (CPI), which measures inflation on the consumer level, rose by 0.8% in April. The year over year reading increased from 2.6% to 4.2%, which was a much larger jump than expected and the highest year over year increase in 13 years.

Core CPI, which strips out volatile food and energy prices, was up 0.9% in April, which is the highest month over month increase in 39 years! On a year over year basis Core CPI increased from 1.6% to 3.0%.

Within the report, it showed that rents are rising 2.0% across the US, which is up from 1.8% in the previous report.

And if we look even deeper into the numbers, while the 0.9% jump in Core CPI was big for the month of April, it was actually somewhat concentrated among airline fares (+10.2%), sporting events (+10.1%), used cars (+10%), hotels (+8.8%), and personal computers (+5.1%).

All of these were record highs and only represent 7% of the overall US economy. Many of these increases are explainable due to the shortage in semiconductor chips and the economy opening back up. The remaining 93% of the US economy was only up 0.3%, which is why some economists are arguing that the rise in inflation will be transient.

In addition, part of the reason for the increase in the annual comparisons is that readings for the more current months are replacing the readings from 2020 when much of the economy was shut down due to the pandemic. That's why inflation is expected to move higher still when May's readings are reported in June, as next month a -0.1% reading of the Core CPI from May 2020 will be replaced with data from May of this year.

Why is rising inflation significant?

Remember inflation erodes a Bond's fixed rate of return. In other words, rising inflation can cause Bonds to worsen or lose value. This includes Mortgage Bonds, to which home loan rates are inversely tied. When Mortgage Bonds move lower, be it due to rising inflation or other reasons, home loan rates move higher. Though many factors influence the markets, keeping an eye on inflation is always important.

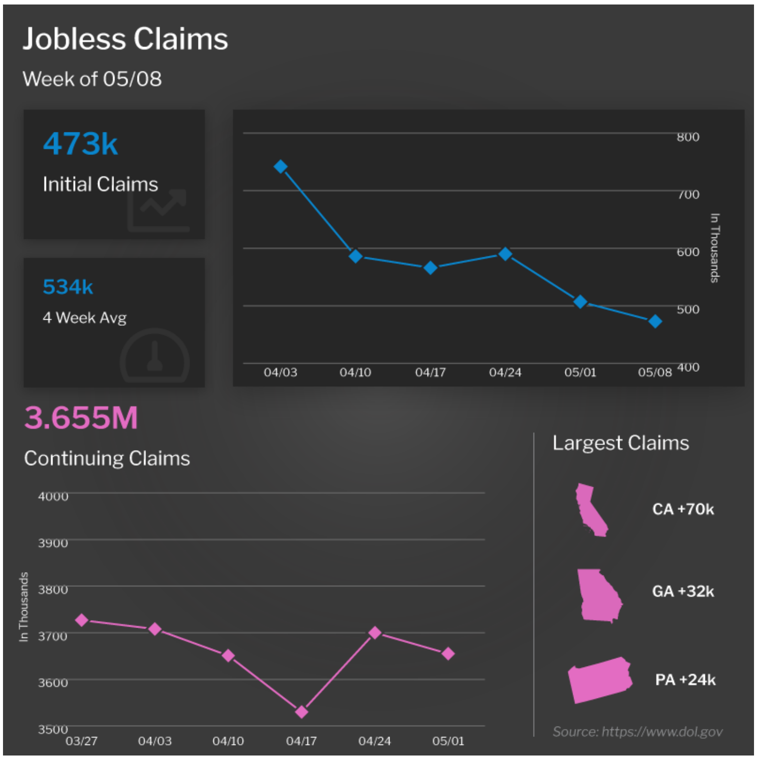
Wholesale Inflation Doubly Hot

The Producer Price Index (PPI), which measures wholesale inflation, rose 0.6% in April, which was twice as much as expected. Year over year, PPI rose from 4.2% to 6.2%, which is one of the hottest readings ever!

Core PPI, which again strips out volatile food and energy prices, rose 0.7% month over month and increased from 3.1% to 4.1% year over year.

Of note within the report, we saw price increases in things that affect housing. Steel was up 18%, furnishings wholesale was up 3.1%, flooring increased 3%, and household appliances rose 0.6%.

Initial Jobless Claims Fall in Latest Week



The number of people filing for benefits for the first time decreased by 34,000 from the previous revised report of 507,000 claims, as Initial Jobless Claims were reported at 473,000. This was just below expectations of 475,000 new claims.

Continuing Claims, which are filed by people who continue to receive regular benefits, fell by 45,000 to 3.66 million.

Pandemic Unemployment Assistance Claims (which provide benefits to people who would not usually qualify for them) and Pandemic Emergency Claims (which extends benefits after regular benefits expire) increased by more than 700,000 combined claims.

Despite the improvement in Initial Jobless Claims, all in all there are still 16.9 million people receiving benefits throughout all programs. This represents an increase of 700,000 people from the previous week.

Update on Auctions

Investors were closely monitoring the 10-year Note and 30-Year Bond auctions held on Wednesday and Thursday, respectively, to see the level of demand. High demand, which is reflected in the purchasing of Bonds and Treasuries, can push prices higher and yields or rates lower. Weak demand, on the other hand, can signal that investors think yields will continue to move higher, which can have a negative effect on rates.

While the 10-year Note auction showed strong demand, with the yield 1.684 versus a one-year average of 0.98 and direct and indirect bidders taking in 80.5% versus a one-year average of 76.1%, the hot inflation headlines had more of an impact on the markets Wednesday.

Thursday's 30-year Bond auction was met with below-average demand. The bid to cover of 2.22 was below the one-year average of 2.33. Direct and indirect bidders took 80% of the auction compared to 79.4% in the previous 12 months. However, Mortgage Bonds did not react to the weak auction.

Family Hack of the Week

National Pizza Party Day is this Friday, May 21. Making your own pizzas from scratch can be a fun activity for the whole family to enjoy together. These recipes from the Food Network can help.

For the dough, combine 3 1/2 cups bread flour, 1 teaspoon sugar, 1 envelope instant dry yeast and 2 teaspoons Kosher salt in the bowl of a stand mixer. While the mixer is running, add 1 1/2 cups water (lukewarm, approximately 110 degrees Fahrenheit) and 2 tablespoons of olive oil.

Beat until the dough forms into a ball. If the dough is sticky, add 1 tablespoon at a time of flour until the dough comes together in a solid ball. If the dough is dry, add 1 tablespoon at a time of water. Scrape the dough onto a lightly floured surface and gently knead into a smooth, firm ball.

Grease a large bowl with 2 teaspoons olive oil, add the dough, and cover the bowl with plastic wrap. Place in a warm area to let it double in size (approximately 1 hour). Turn the dough out onto a lightly floured surface and divide it into 2 equal pieces. Cover each with a clean kitchen towel or plastic wrap and let them rest for 10 minutes.

For the sauce, heat 2 tablespoons olive oil in a medium saucepan over medium-high heat. Add 1/2 teaspoon dried oregano, 3 cloves minced garlic and 1 pinch of red pepper flakes. Stir until the garlic is golden brown, 1 to 2 minutes. Add one 32-ounce can crushed tomatoes, 1 sprig of fresh basil and 1/2 teaspoon salt and bring to a simmer. Reduce the heat to medium and simmer, stirring occasionally until the sauce thickens, approximately 5 to 10 minutes. Remove the basil.

Once the sauce reaches room temperature, roll out the dough and top with sauce, a healthy layer of mozzarella cheese and your family's favorite toppings. You can also divide the dough into mini-pizzas to make a variety of favorite combinations.

What to Look for This Week

Reports on housing and manufacturing will highlight those sectors in the week ahead.

Housing news begins Monday with the National Association of Home Builders Housing Market Index for May, which will give us a real-time read on builder confidence. On Tuesday, we'll get an update on Housing Starts and Building Permits for April, while Friday brings the data on April's Existing Home Sales.

Manufacturing news will also be reported Monday with May's Empire State Index, which gives us an update on the New York region. May's Philadelphia Fed Index follows on Thursday.

Also of note, the minutes from the Fed's April meeting will be released on Wednesday while the latest Jobless Claims figures will be reported on Thursday, as usual.

Technical Picture

Mortgage Bonds are in the middle of a wide range between support at the 50-day Moving Average and overhead resistance at the 25-day Moving Average. Bonds are susceptible to large price swings when they are in a wide range like this, so it's important to be on guard.

The 10-year is trading at 1.63%, testing the 50-day Moving Average. Yields have several floors beneath present levels, which will make it hard to see an improvement lower. Conversely, there is room to the upside until the highs from two days ago at 1.70%, followed by 1.76%.