

THE ECONOMY AT A GLANCE

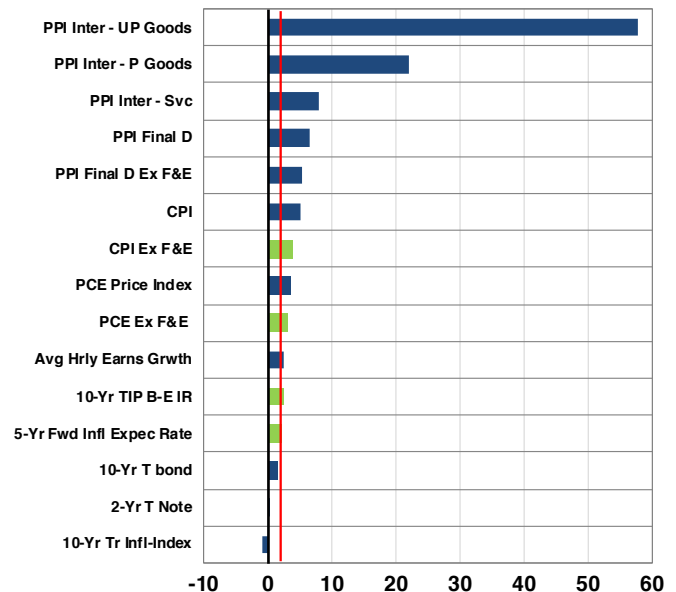
ECONOMIC HIGHLIGHTS

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CORE INFLATION HEATS UP

Pricing pressures are hot, primarily at the producer level. After months of below-target inflation readings, mainstream measures of inflation are also ticking higher compared to the deflationary lows during the pandemic. Still, we don't think the Federal Reserve is planning to change its approach to low interest rates. Chairman Powell has said that the central bank is willing to let inflation rise above its 2% target in exchange for a continued decline in unemployment. We track 15 inflation measures on a monthly basis. On average, they indicate that prices are rising at an 8.9% rate, ahead of last month's reading of 8.4%. But drilling down to core inflation, our reading is 2.9%, with the five-year target rate at 2.3%. The big increases in recent months have come at the producer level, as the PPI for intermediate unprocessed goods, for example, is now 58%, and the PPI for intermediate processed goods is 13%. Much of this price activity is the result of a recovery in commodity prices, including oil (which has more than tripled year-over-year). The Fed's inflation forecasts call for core inflation readings of 3.4% in 2021 and 2.1% in 2022.

INFLATION MEASURES (% CHANGE Y/Y)

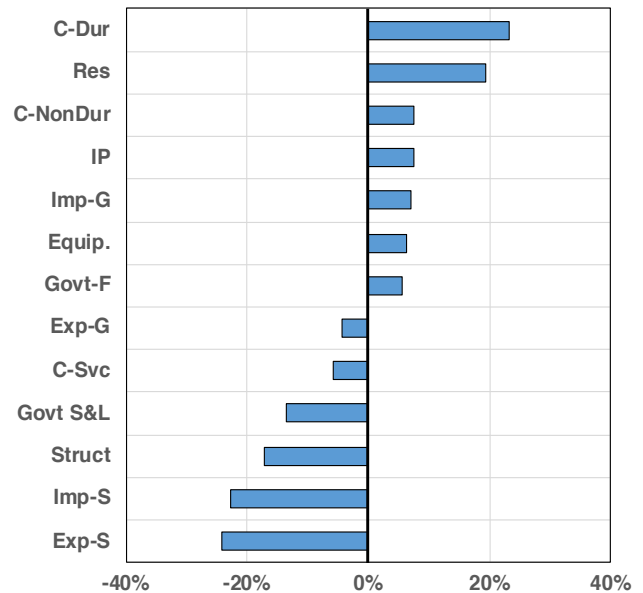


ECONOMIC HIGHLIGHTS (CONTINUED)

FINAL 1Q GDP READING: +6.4%

The U.S. Department of Commerce announced that its third estimate of 1Q21 GDP growth was 6.4%. This was in line with previous estimates and the consensus outlook, and represents a robust recovery. The report also includes an inflation gauge, the PCE price index. This index, excluding food and energy, rose at a 2.5% pace, well ahead of the Federal Reserve's inflation target of 2.0% (though the Fed has said that it will allow inflation to run hot for a while before raising short-term interest rates). We expect above-trend GDP growth for the next few quarters. But there may be bumps along the way. Some segments of the economy are back to, or above, pre-pandemic highs. These include consumer spending on durable and nondurable goods as well as investment in residential and intellectual property products. Other segments continue to lag, such as consumer spending on services, investment into structures, and exports.

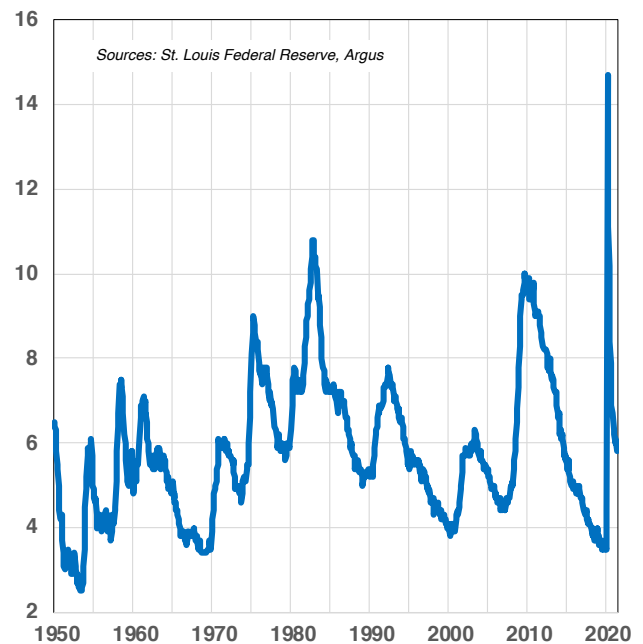
HOW GDP HAS CHANGED DURING PANDEMIC
(% CHANGE IN GDP CATEGORY SINCE START OF PANDEMIC)



FINALLY, AN UPSIDE PAYROLLS SURPRISE

The U.S. economy added 850,000 jobs in June, up from the tepid average of 426,000 in the previous two months. The unemployment rate ticked higher to 5.9%. The re-opening trend was prominent, as job gains were led by sectors such as leisure and hospitality (+343K) and local government education (+155K). Industries including professional and business services, as well as retail, also added jobs. Manufacturing and construction were little changed. The labor market continues to reflect the impact of the pandemic, as the shape and character of the workforce is changing as the economy recovers. The current number of jobs is approximately 6.7 million lower than the pre-COVID February 2020 level, according to Automatic Data Processing. The labor force participation rate remains a low 61.6%, below the historical average of 65%. Last month, 14% of employed persons teleworked because of the pandemic. Pre-pandemic, that reading was 3.0%. The Labor Department recently reported that 364,000 people filed initial weekly unemployment claims, down from 385,000 a month earlier. Though trending in the right direction, the data indicates that the employment environment is still under stress. We expect the unemployment rate to remain high, above 5.0%, and thus look for the Fed to keep interest rates low, into 2022.

U.S. UNEMPLOYMENT RATE (%)

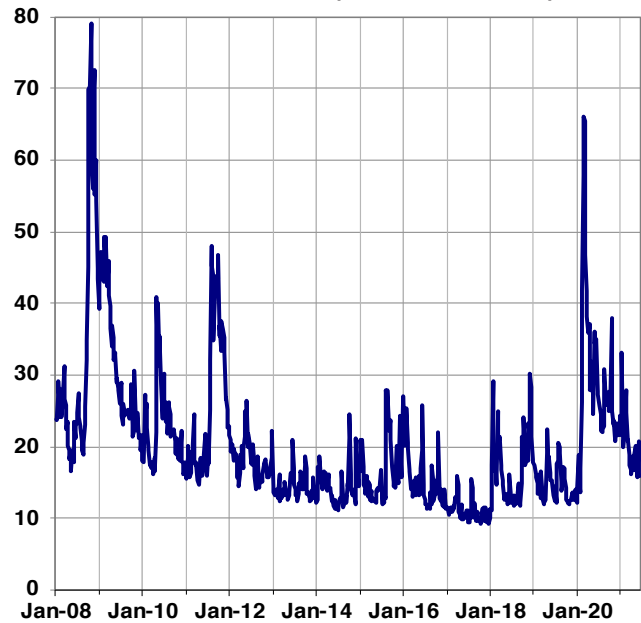


FINANCIAL MARKET HIGHLIGHTS

VOLATILITY CALMING

The VIX Volatility Index averaged in the mid-teens for five years before spiking to an average of 29 in 2020. That average masked the worst readings of last year (as high as 85 in March as the U.S. economy shut down in response to the pandemic). The VIX has been pushing down toward those mid-teen readings in recent months, enduring speed bumps along the way such as a recession, second and third waves of COVID-19, an extraordinarily divisive U.S. presidential election, and fears of inflation. After an impressive rally that lifted the major market averages to all-time highs, the VIX recently dropped below 16 for the first time since February 2020. Investors have endured challenging quarters of earnings, and are now enjoying easier comparisons. But investors should remain alert. Since 1920, the S&P 500 has recorded a 5% pullback three times a year on average and a 10% correction once every year and a half. Based on our S&P 500 valuation model, stocks are priced for perfection. We recommend that investors focus on high-quality companies, with strong balance sheets and experienced management teams.

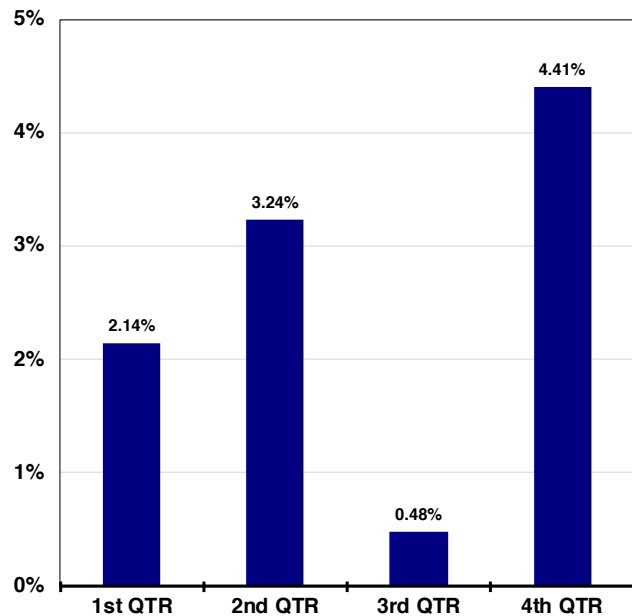
VOLATILITY INDEX (WEEKLY CLOSE)



INVESTORS BEWARE, 3Q IS HERE

Investors have enjoyed a buoyant first half, but should note that the markets are entering the poorest-performing quarter of the year. By our calculations, 3Q performance has been underwhelming compared to 1Q, 2Q, and 4Q returns. We analyzed data collected on S&P 500 performance in 1980-2018. The strongest quarter has been 4Q, which has generated average gains of 4.4%. Returns in 1Q and 2Q have averaged 2.1% and 3.2%, respectively. On the other hand, 3Q is barely positive, with an average return of 0.5%. Not every 3Q is a disaster. In fact, the “win percentage” for the quarter is 63%, which means markets deliver positive returns in the quarter more than three-fifths of the time. But the actual quarters that are negative can really hurt: -12% in 1981, -15% in 1990, -15% in 2000, -18% in 2001, -14% in 2008, and -14% in 2011. Some of the events that occurred in these quarters are random: the September 11 attacks in 2001, the Lehman bankruptcy in 2008, and the S&P U.S. Treasury downgrade in 2011. But 3Q is also when companies start to know if they are going to meet their estimates for the year. In addition, the Fed can be active. We think the current fundamentals are positive for stocks as 3Q21 begins, but will be watching closely for emerging risks, especially after the 8.1% return for stocks in 2Q21.

AVERAGE QUARTERLY STOCK MARKET APPRECIATION



ECONOMIC CALENDAR

Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
6-Jul	ISM Non-Manufacturing	June	64.0	64.0	63.5	NA
9-Jul	Wholesale Inventories	May	0.8%	1.0%	1.1%	NA

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
20-Jul	Housing Starts	June	1572 K	NA	NA	NA
22-Jul	Leading Economic Indicators	June	1.3%	NA	NA	NA
	Existing Home Sales	June	5.80 mln.	NA	NA	NA

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