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THE ECONOMY AT A GLANCE

ECONOMIC HIGHLIGHTS

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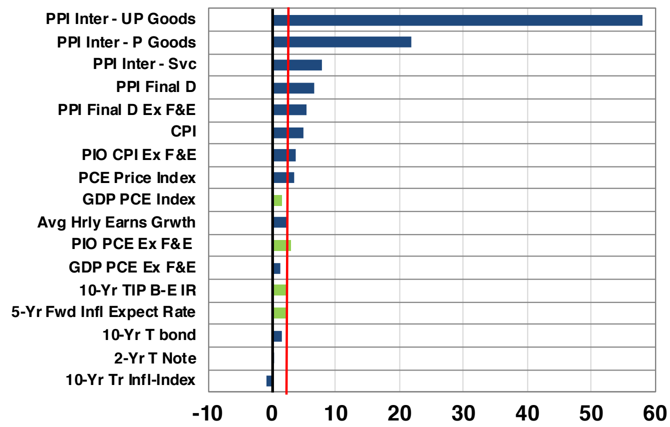
CORE INFLATION RISING

Pricing pressures are hot, primarily at the producer level. Mainstream measures of inflation are ticking higher as well. Still, we don't think the Federal Reserve is planning to change its approach to low interest rates, and 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 17 inflation measures on a monthly basis. On average, they indicate that prices are rising at an 8.2% rate, ahead of last month's 7.9%. But drilling down to core inflation, our reading is 3.0%, with the all-important five-year target rate at 2.1%. The Fed's inflation forecasts call for a core inflation reading of 3.4% in 2021 and 2.1% in 2022.

INFLATION MEASURES (% CHANGE Y/Y)



DOLLAR DOWN FROM PEAK

The dollar spiked early in the pandemic, as investors flocked to the security of assets denominated in greenbacks. But since peaking in April 2020, the greenback has drifted lower. On a real trade-weighted basis, the dollar is 8% above its average valuation over the past 20 years, down from a 17% overvaluation at the 2020 peak. We anticipate a trading range near current levels for the balance this year. While Congress has been aggressive with fiscal stimulus, traders may at some point become wary of the high level of U.S. debt relative to GDP. Lastly, the current valuation of the greenback implies that other currencies — and even gold or other commodities — are potentially undervalued, and traders can be expected to bid up those values over time.

U.S. DOLLAR TREND
REAL TRADE-WEIGHTED U.S. DOLLAR INDEX

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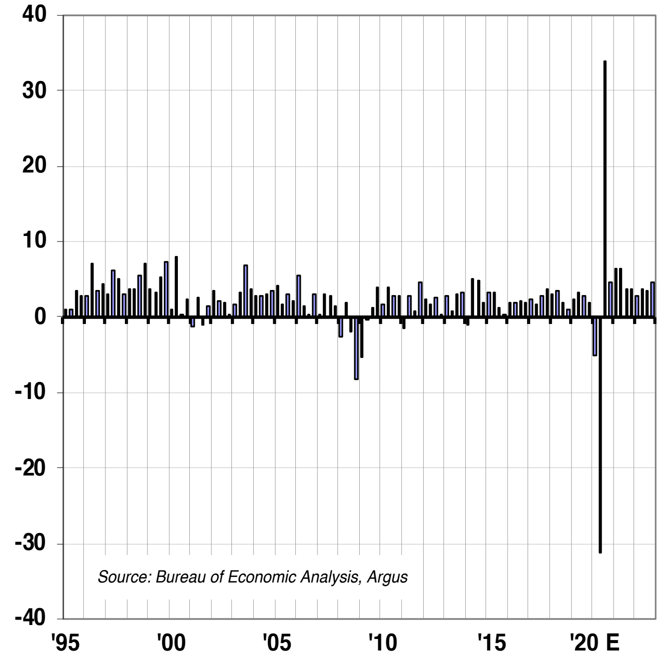
GDP EXPANDS 6.5% IN 2Q

U.S. GDP growth accelerated only slightly in 2Q21, to an annualized 6.5%. The consumer sector was the key driver, as personal consumption expenditures on goods rose at an 11.6% rate and expenditures on services rose at a 12% rate, offsetting a 3.5% decline in gross private domestic investment, a 1.5% dip in government spending, and a depletion of inventories. Within gross private domestic investment, spending on equipment increased at a 13.0% rate and spending on intellectual property products increased at a 10.7% rate. So there is strength in capital spending. Residential investment declined at a 9.8% rate, and investment in structures declined as well. After four quarters of recovery, current GDP of $19.4 trillion on an absolute basis is finally above pre-COVID levels. Indeed, earlier this month, the National Bureau of Economic Research said that the COVID-19 recession was over (and has been since the economy troughed in April 2020). We forecast solid above-trend GDP growth through 2023, and think the recently completed second quarter will represent the high mark for growth over the next 2-3 years.

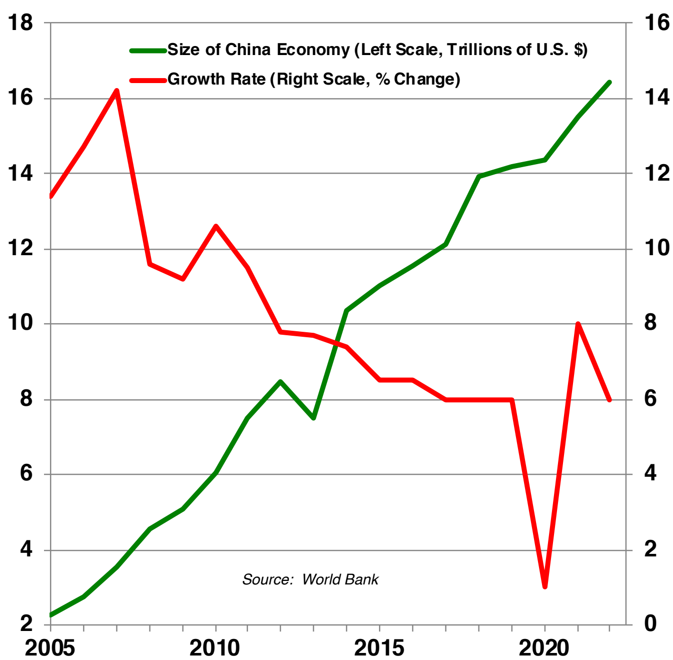
REAL GDP (% GROWTH/QTR)



CHINA 2021 GROWTH FORECAST AT 8%

Economic trends in China bear watching, and not just because the country appears to be a guiding light for others trying to emerge from the GDP-crushing grip of COVID-19. China is a $14 trillion economy and represents about 16% of the global economy. It is a critical contributor to global economic growth, even if it grows "only" 5%-6% per year. This year, forecasters are expecting a rebound to 8% growth — among the fastest rates in the world. Investors in Chinese stocks are not celebrating, however, as the Chinese market is down more than 25% from its high earlier this year. In part, the selloff is due to regulatory crackdowns in China and in the U.S. (where Chinese companies will soon have to submit to more rigorous financial audits). In addition, there is concern among investors about Chinese monetary policy, which has been loosened to support the economy. Over the long run, China is an important growth market, to which U.S. companies and investors want access on fair terms. We group China in the emerging markets segment of the equity asset class. In our asset-allocation models, we target 3%-5% exposure to the group. That can be achieved through regional ETFs, as well as through U.S.-based companies that depend on China for growth.

CHINESE ECONOMIC TRENDS

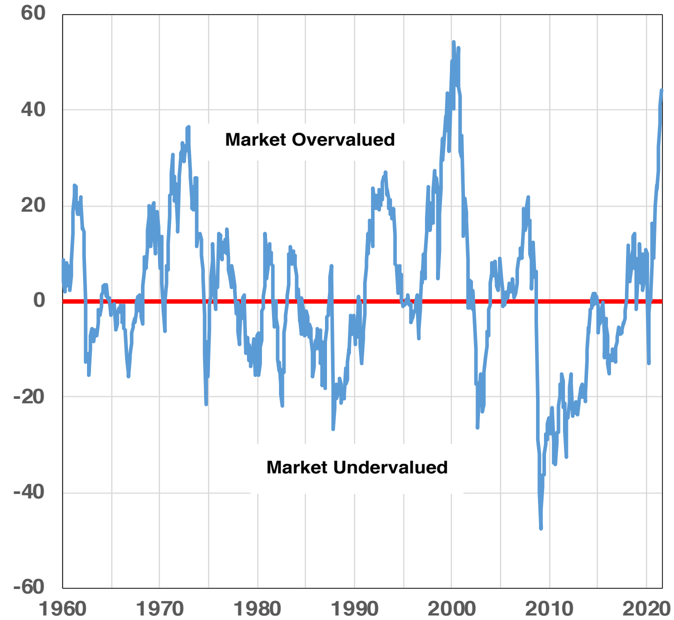


FINANCIAL MARKET HIGHLIGHTS

PULLBACKS SHOULD BE EXPECTED

Stock prices, as expressed by the S&P 500, are near all-time highs. Further, with earnings still recovering, the S&P is well above fair value, which our valuation model pegs near 3800. Our model takes into account factors such as stock prices, five-year normalized earnings (three historical years, two forward-looking), GDP, inflation, and T-bond and T-bill yields. We note that stocks rarely trade right at fair value. Since 1960, on average, the index has traded at a tight 2% above fair value, but the standard deviation to the mean is 16%. As such, we normally expect the S&P 500 to trade between 14% undervalued and 18% overvalued. At current prices, it is almost 30% above fair value, implying that investors are very optimistic about equities. Though we are still bullish on the economy, earnings, and market recoveries, we'd feel better about the long-term outlook for stocks if valuations were not so stretched. Several factors could improve valuations: a pullback in stock prices related to fears of inflation or COVID-19 variants; lower bond yields; or better earnings, which we do expect to see in the coming quarters.

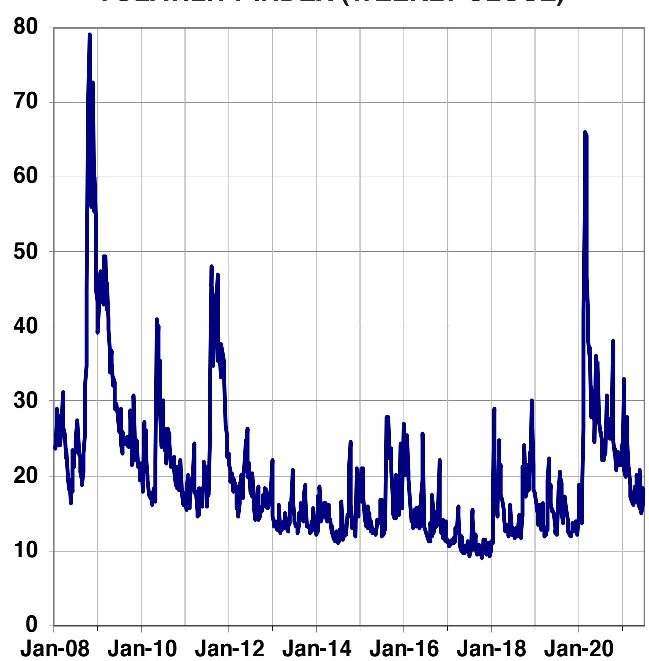
S&P 500 VALUATION MODEL (0% = FAIR VALUE)



VOLATILITY STILL HIGHER THAN 2019

The VIX Volatility Index posted average readings in the mid-teens for five years before spiking to an average of 29 in 2020. And, of course, that average masked the worst readings of 2020 (as high as 85 in March as the U.S. economy shut down in the first weeks of the pandemic). The VIX has been slowly moving back toward the mid-teens since late 2020, enduring speed bumps such as the divisive U.S. presidential election, fears of inflation, and new COVID variants. Indeed, the VIX recently jumped 40% in a single day due to concerns about inflation and new variants, and the DJIA dropped more than 700 points. While stocks have since recovered, 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. Using our S&P 500 valuation model, stocks are priced for perfection. In this environment, we recommend investors focus on high-quality companies, with strong balance sheets and experienced management teams.

VOLATILITY INDEX (WEEKLY CLOSE)



ECONOMIC CALENDAR

Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
2-Aug	ISM Manufacturing	July	60.6	61.0	60.6	NA
	Construction Spending	June	-0.3%	0.5%	0.4%	NA
3-Aug	Factory Orders	June	1.7%	1.5%	1.3%	NA
4-Aug	ISM Non-Manufacturing	July	60.1	61.2	61	NA
5-Aug	Trade Balance	June	-71.2 Bln.	-71.0 Bln.	-70.8 Bln.	NA
6-Aug	Wholesale Inventories	June	1.3%	1.5%	1.3%	NA
	Non-farm Payrolls	July	850 K	775 K	750 K	NA
	Average Weekly Hours	July	34.7	34.8	34.8	NA
	Average Hourly Earnings	July	0.3%	0.3%	0.3%	NA
	Unemployment Rate	July	5.9%	5.8%	5.7%	NA

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
17-Aug	Retail Sales	July	0.6%	NA	NA	NA
	Retail Sales; ex-autos	July	1.3%	NA	NA	NA
	Business Inventories	June	0.5%	NA	NA	NA
	Industrial Production	July	0.4%	NA	NA	NA
	Capacity Utilization	July	75.4%	NA	NA	NA
18-Aug	Housing Starts	July	1643 K	NA	NA	NA
19-Aug	Leading Economic Indicators	July	0.7%	NA	NA	NA