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THE ECONOMY AT A GLANCE

ECONOMIC HIGHLIGHTS

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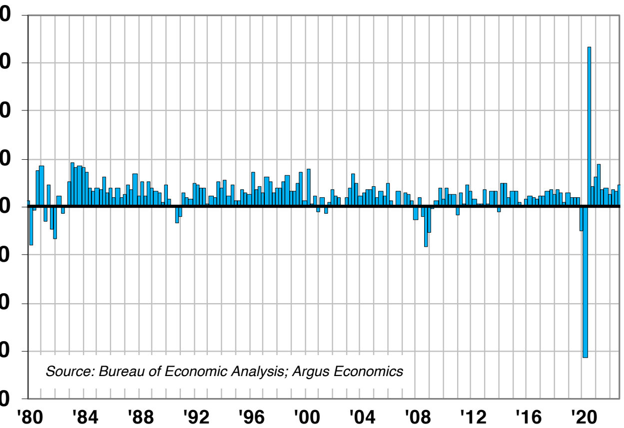
SECOND-QUARTER GDP FORECAST NOW 8.9%

The primary driver of GDP over the next few quarters is likely to be the country's physical health, as the nation recovers from COVID-19. Elsewhere, employment is in better shape than it was a year ago (though still far from strong) and consumer confidence is improving. We expect rising confidence will lead to growth in consumer spending. Auto sales have recovered and the housing market remains strong, even as interest rates tick higher. Businesses are expanding again. Our GDP model now calls for a 2.1% increase in absolute GDP in 2Q21 from 1Q21. That translates into an annualized gain of 8.9%. We expect further improvement into 2H21. On an annual basis, we look for overall GDP growth of approximately 5.7% in 2021 and 3.7% in 2022.

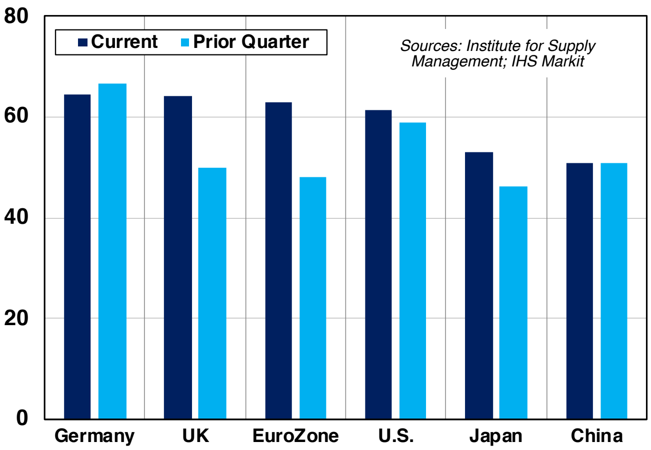
GDP TRENDS & OUTLOOK (% CHANGE)



MANUFACTURING IMPROVING IN U.S., UK, EUROPE

The outlook from purchasing managers is improving, benefitting from the positive news about COVID-19 vaccine development, approval, and distribution. The UK is leading the recovery, as its PMI has risen to 64.2 from sub-50 last quarter. The Eurozone is also surging. The non-German economies in Europe recorded a 63.1 PMI in May -- a sharp gain from 48.1 in the prior quarter. Nations that are less reliant on consumer services and have greater exposure to industrial activity, such as Germany and the U.S., have reported more consistent (and solid) PMI readings. China has pulled back a bit, due to a slowing in exports as the dollar has declined. Still, manufacturing trends in China are positive. Japan has finally moved into expansion phase, with a reading of 53.

PMI SURVEY RESULTS



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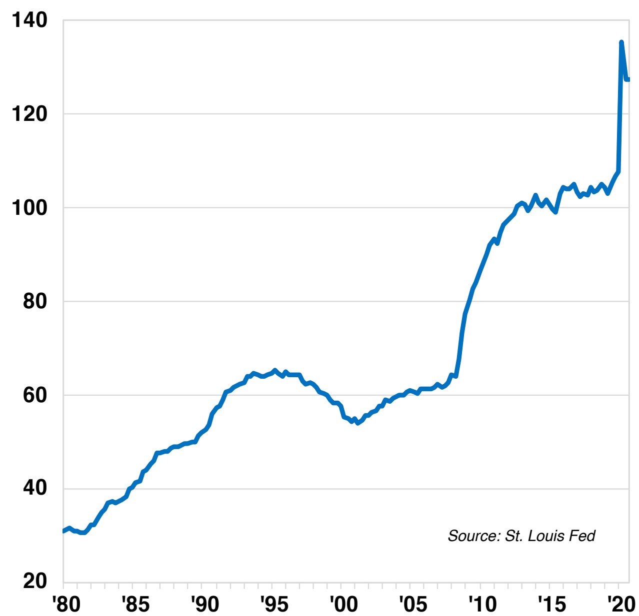
DEBT AND GDP`

U.S. debt levels have grown quietly and quickly over the past 10 years. Total U.S. debt is now more than 125% of GDP, according to the Office of Management & the Budget. That is the highest level since World War II. In the 1980s, the debt/GDP ratio was in the 40% range, and moved up toward the 60% level by 2000. The debt level soared around 2010, as the government spent aggressively to stop the recession and rekindle growth. According to Keynes, that's what the government is supposed to do. However, despite more than 10 years of economic growth prior to the pandemic, the debt level grew as a percentage of GDP. Now, in light of fiscal spending to fight the impact of COVID-19, debt levels have surged further. This is not a problem that has to be fixed today. After all, interest rates are low on an historical basis and policies to change the trajectory (less spending, more taxes) could push the economy into decline. But politicians should start to establish a plan to address the issue in the next 10-15 years. If the problem is not solved, it could result in hyperinflation or an inability for the government to address long-term problems, such as climate change.

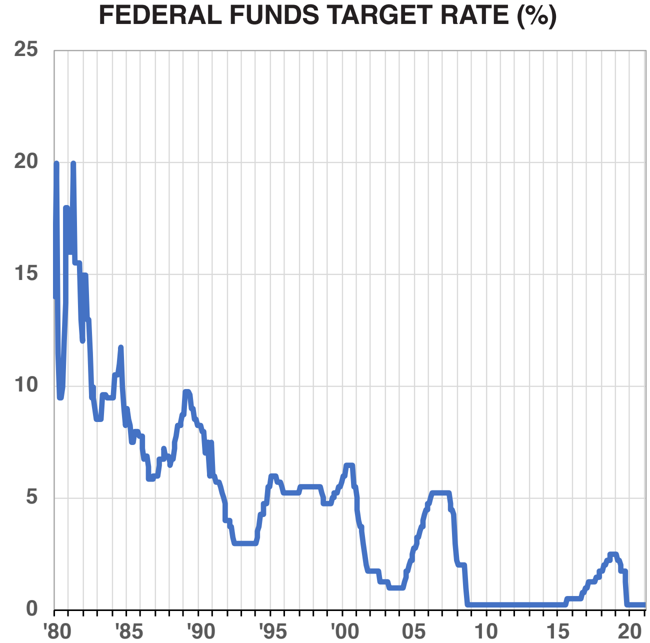
U.S. DEBT/GDP RATIO (%)



FED STARTS LOOKING AT HIGHER RATES

At its latest Open Market Committee meeting, the Federal Reserve decided to maintain the federal funds rate at 0.00%-0.25%. The action (or non-action) had been expected, given the current level of unemployment. But traders have been worried about rising inflation rates as the U.S. economy reopens. The vote to keep rates steady was unanimous -- for now. In an attempt to keep long-term rates under control, the Fed also is maintaining its $120 billion/month asset-purchasing program. Looking ahead, though, a majority of the bankers forecast the first change in the federal funds rate in 2023, with perhaps even two hikes that year. We note that inflation forecasts from the Fed have increased to a rate of 3.4% for 2021, compared to the March projection of 2.4%. Still, this bout of inflation is expected to be temporary and pricing pressures are forecast by the Fed to fall back to 2.1% next year. We expect to see inflation calm over the next year, leading to one rate hike by the Fed in 2023. We also look for the Fed to start tapering it asset-purchasing program slowly in the spring of 2022.

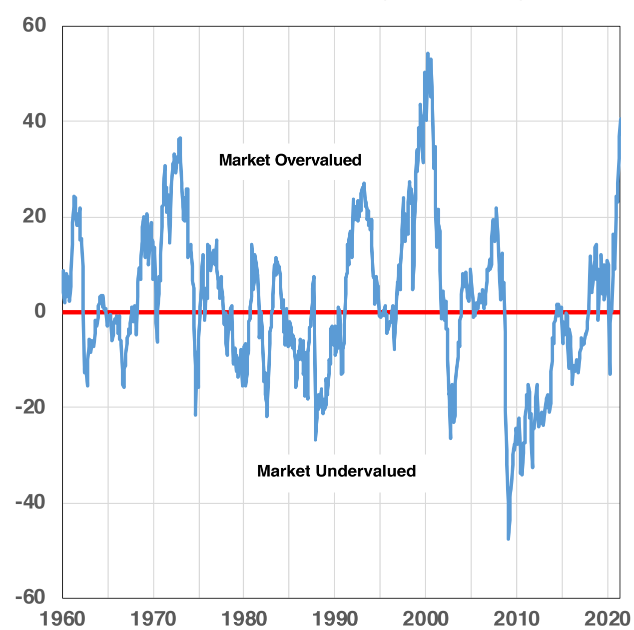
FEDERAL FUNDS TARGET RATE (%)



STOCKS PUSHING VALUE LIMITS

Stock prices, as expressed by the S&P 500, are near all-time highs and (on depressed earnings) are well above fair value, which our model pegs at around 3700 due to pandemic-weak-ened EPS in 2020. Our valuation 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, the stock market is almost 30% above fair value, implying that investors are quite optimistic about equities. Though we are still bullish on the economy and earnings, we'd feel better about the longer-term outlook for stocks if valuations were not so stretched. Several fac-tors could improve valuations: a pullback in stock prices, perhaps related to fears of inflation; lower bond yields; or better earnings (which we do expect in upcoming quarters).

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



ECONOMIC CALENDAR

Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
22-Jun	Existing Home Sales	May	5.85 Mil.	5.80 Mil.	5.73 Mil.	NA
23-Jun	New Home Sales	May	863 K	890 K	882 K	NA
24-Jun	Real GDP	1Q	6.4%	6.4%	6.4%	NA
	GDP Price Index	1Q	2.0%	3.5%	4.1%	NA
25-Jun	Personal Income	May	-13.1%	-2.5%	-3.0%	NA
	Personal Spending	May	0.5%	0.5%	0.4%	NA

Next Week's Releases

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