

Weekly Market Commentary May 31st, 2021

Five Takeaways From Earnings Season

Inflation fears subsided some last week, and the S&P 500 eked out a small gain in May, its fourth consecutive monthly rise. With few narrative-changing developments and the first-quarter earnings season largely complete, it is a good opportunity to conduct a gauge check on the health of the corporate sector. With most investors getting exposure to the stock market via mutual funds and ETFs that track major indexes, it is easy to forget that individual companies make up the market's backbone, and their collective earnings are the ones that drive investment returns over the long run. Below we provide five takeaways from the latest earnings season and debate what recent trends imply for the future.

1. Earnings rebound gains steam

- With 97% of the S&P 500 companies having already reported results, first-quarter earnings are set to rise by 50% from a year ago, the fastest pace since 2010¹. Not only have a larger share of companies topped projections (86% vs 74% historically), but actual results have also exceeded analyst estimates by a record 23%. As a result, analysts have continued to revise their numbers higher, with 2021 earnings now expected to grow 34% from 22% at the start of the year.

2. Profit margins reach new record

- Revenue growth handily exceeded expectations, but it was the surge in profit margins (how profitable companies are based on the revenue they earn) to a new record high that was the standout, in our view. The biggest improvement in margins took place in the consumer discretionary (led by automakers), financials and materials sectors.
- We attribute the strong recovery in profitability to:
 1. the benefit of rising sales driven by pent-up demand and government-income transfers;
 2. productivity gains with increased tech adoption and a lag in the pace of hiring;
 3. lower interest expense as companies took advantage of the record low rates;
 4. smaller credit losses than feared, benefiting bank earnings as reserves get released; and
 5. a lower U.S. dollar, which helps earnings of multinational companies.

3. Cyclical sectors have earnings momentum at their back

- Tech and growth companies continue to post stellar results even as some of the pandemic trends are starting to reverse. Yet, the biggest positive earnings surprises in first-quarter results came from cyclical sectors and value-style investments, including energy and financials, which are the top-two-performing sectors so far this year.

4. International earnings trying to catch up

- Because the vaccine rollout started more slowly in Europe and Japan, and fiscal support was not anywhere near as generous as in the U.S., the economic recovery in these regions has lagged. This is also reflected in the less robust corporate results in previous quarters. International developed-market earnings are expected to be 4% below their January 2020 level one year from now, while U.S. earnings are projected to be 11% above.

5. Peak growth and fast-rising expectations pose headwinds

- While the pace of blistering earnings growth is expected to continue as S&P 500 earnings are projected to grow double-digits for the remaining three quarters of 2021, we believe the second-quarter growth will likely mark the peak¹. We think that the expected deceleration in growth will simply reflect the return to a more normal, steady-state for the economy, rather than the end of the cycle. Still, a potential slowdown combined with elevated expectations could translate into muted short-term returns.

(source: oXYGen & Jones)

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	34,529	.94%
S&P 500 Index	4,204	1.16%
NASDAQ	13,748	2.06%
MSCI EAFE	2,325	.75%
10-yr Treasury Yield	1.61%	0%
Gold	\$1900	.98%
Bonds	\$114.54	.18%

Source: Wall Street Journal

What's In Joe Biden's 6 Trillion Dollar Plan

The Biden administration Friday released its budget for the fiscal year 2022 calling for increases in spending on education, healthcare, and renewable energy.

The president is proposing a \$6 trillion budget for the year beginning Oct. 1, including \$1.52 trillion in discretionary spending for the military and domestic programs. Excluding emergency measures last year tied to the coronavirus pandemic, the request would boost base discretionary spending by 8.4%, or \$118 billion, from the \$1.4 trillion authorized in fiscal 2021.

The document is a statement of the administration's priorities, with much haggling and input from Congress to come. The budget lays out how the president's plans for spending over the next decade on infrastructure and social programs, such as paid family leave and universal preschool, will affect federal debt and deficits.

Here is what is in the Biden administration's budget:

Taxes

Mr. Biden would sharply raise taxes on corporations and high-income households to pay for his plans. The corporate tax rate would rise to 28% from 21%, the top capital-gains rate would rise to 43.4% from 23.8% and unrealized capital gains would be taxed at death with a \$1 million per-person exemption. The administration is also proposing an expansion of the Internal Revenue Service that would double its staffing over a decade and is projected to yield \$700 billion in net savings from tougher tax enforcement.

The plan includes some tax cuts, such as an extension of the expanded child tax credit through 2025 and permanent extensions of expanded tax credits for health insurance, low-income workers, and parents who pay for child care. It is silent on individual tax breaks that are scheduled to lapse at the end of 2025, including the larger standard deduction. And it is silent on the \$10,000 cap on the state and local tax deduction, a limit opposed by many Democrats.

The budget outlines the tax-increase proposals the administration has already described, and it excludes other items—such as changes to estate taxes, payroll taxes, and a deduction for closely held businesses—that was part of the 2020 campaign but not part of the first wave of administration plans.

For the first time, the budget attaches official revenue estimates to some of the individual pieces. Limits on deductions for companies based in countries without minimum taxes would raise \$390 billion over a decade, for example. The capital-gains changes would yield \$322 billion.

Health

Mr. Biden's budget requests almost \$132 billion for the Department of Health and Human Services, a \$25 billion increase from fiscal 2021 that reflects priorities such as more spending on pandemic preparedness and programs to reduce racial disparities in healthcare.

The increase in the discretionary budget includes spending to enhance the U.S. Strategic National Stockpile to prepare for future pandemics, biomedical research, and funding on programs to reduce maternal mortality.

Mr. Biden is calling for empowering Medicare to negotiate for lower drug prices. In the budget request, he

calls for adding dental, vision, and hearing coverage to the health program for seniors and lowering the age of eligibility for Medicare from 65 to 60. He also supports a public option, which would be a government-run health insurance option that competes with private insurers, and a permanent expansion of subsidies to help reduce premiums for Affordable Care Act health plans.

The budget request would give \$8.7 billion to the Centers for Disease Control and Prevention, the biggest bump in nearly 20 years, and provide more than \$200 million largely aimed at reducing maternal mortality and morbidity.

The president wants \$10.7 billion, an increase of \$3.9 billion over 2021 enacted levels, for combating the opioid crisis. The budget also requests \$1.6 billion, more than double the 2021 enacted level, to expand access to mental health care, and a boost of \$2.2 billion to the Indian Health Service.

Mr. Biden is asking for \$6.5 billion to start a new agency called the Advanced Research Projects Agency for Health. The sum represents a big portion of the approximately \$9 billion requested budget increase, to \$51 billion, for the National Institutes of Health.

The Food and Drug Administration would get a requested budget amount of \$6.5 billion in fiscal 2022, up from the year-ago budget of \$6.05 billion. Much of the FDA's funding comes not from tax revenue but from user fees paid by industries such as those that produce pharmaceuticals, medical devices, and tobacco.

Abortion

The budget proposal doesn't include a ban on using federal dollars for abortions in most cases, known as the Hyde Amendment.

The 1976 Hyde Amendment bars federal funding for abortion with exceptions for victims of rape or incest or if the mother's life is in danger. Abortion opponents say it ensures federal tax dollars don't go to paying for the procedure, while supporters of abortion rights say it disproportionately affects low-income women and women of color who are Medicaid recipients.

Energy/Environment

The proposed budget calls for more than \$36 billion in investments to combat climate change. It deepens his pitch for how the U.S. can turn global emissions-reductions efforts into an economic opportunity that creates jobs for researchers, inventors, and blue-collar workers in charge of building the infrastructure needed for a cleaner energy sector.

The budget proposal links clean-energy spending to job growth, estimating \$2 billion for welders, electricians, and other workers on clean-energy projects. Another \$580 million would create 250,000 jobs to clean up abandoned mines and drilling wells, the proposal said.

A chunk of \$171 billion in federal research and development money would focus on technologies that could steer U.S. power needs away from fossil fuels and help the country's energy, transportation, and industrial sectors reach net-zero carbon emissions by 2050. More than \$10 billion—a nearly 30 percent increase over last year's budget—would fund clean-energy innovation across non-defense agencies. Part of that would upgrade the Energy Department's national labs to build out climate and clean-energy research programs.

The White House proposed to restore capacity at the U.S. Environmental Protection Agency, the primary agency for climate-change regulations that has strained under budget pressures. The agency is slated to get \$11.2 billion, a 21% increase from last year.

The budget also boosts spending for traditional programs, including water infrastructure improvements and cleanup money for contaminated neighborhoods, in line with President Biden's environmental justice push to aid historically disadvantaged communities.

Defense

The administration outlined a fiscal year 2022 budget of \$715 billion for the Pentagon. Officials said the budget reflected Mr. Biden's shifting priorities toward confronting China and Russia and reducing the emphasis on what Defense Secretary Lloyd Austin calls the "old wars" in places such as Afghanistan and in the Middle East.

Officials said the proposed budget, a 1.6% increase over last year, will fund the administration's focus on near-peer competitors, as well as modernization, investments in service members, and addressing climate change. The Army took a cut of about \$5 billion, while the Air Force and the Navy, which includes the Marine Corps, saw slight increases to help those services prepare to confront China.

The Army's cuts stem in part from the drawdown of all American troops from Afghanistan, which is expected to be complete by early summer.

Budget officials noted that for the first time in 20 years, the budget pays for war-operations costs, which since 2001 have been paid for through a separate account, in the base budget. They described the change as a bureaucratic signal that the U.S. role in conflicts in Iraq, Afghanistan, and elsewhere is over. Instead, the budget earmarks \$5.1 billion for the Pacific Deterrence Initiative, or PDI, which dedicates a funding stream for operations and other requirements in Pacific Asia, much of which will be used to fund

platforms and operations in the region against China.

Immigration

Mr. Biden set a goal of resettling up to 125,000 refugees in 2022, up from President Trump's cap of 15,000 for the current fiscal year. The \$4.3 billion request for refugee services includes a goal of providing better services for unaccompanied minors and expediting the process of uniting them with relatives and removing them from U.S. custody.

The request includes money for border security modernization to screen for human, drug, and weapons trafficking. It calls for no new funds for a border wall and requests the cancellation of any unused funds for the wall, but requests \$861 million to increase security and economic support for Central American nations. It also calls for \$891 million to hire more immigration judges and support staff to work through court backlogs.

Transportation

Many of the transit provisions in the budget are proposals from Mr. Biden's American Jobs Plan, including funds for upgrading 20,000 miles of highways and streets and a focus on repairing the 10 most economically significant bridges, many of which require reconstruction. It also will repair the worst 10,000 smaller bridges, providing critical linkages to communities.

It also provides funds for replacing buses and railcars, electrifying the federal fleet of vehicles—including Postal Service vehicles—and would extend and enhance tax credits for electric vehicles. Mr. Biden's budget also calls for a 35% increase in Amtrak funding and a new competitive grant program for local passenger rail.

Education

Mr. Biden's budget spells out his plans to have the government make four additional years of schooling—including preschool and two years of community college—free to families, with taxpayers covering the cost. It would also substantially boost federal funding for primary and secondary schools in high-poverty areas—so-called Title 1 schools.

The budget would give grants to states to provide universal preschool to all 3- and 4-year-olds, as well as funding to ensure workers at the schools earn \$15 an hour. Those two initiatives would cost \$3.5 billion in the fiscal year through September 2022. Providing free community college would cost about \$19 billion in the fiscal year. Those funds would go to states that agreed to put up matching funds—\$1 for every \$3 the federal government contributed—to cover tuition at community college.

The budget also calls for expanding a program that provides cash grants to students from poor and modest-income families to cover college tuition—including at four-year schools—and living expenses while in school. Under the proposal, eligible students would receive Pell grants of up to \$8,370 a year—some would receive less, depending on their incomes. That would be \$1,875 above the current maximum award. The grants, unlike student loans, don't have to be repaid. The budget would also boost funding to colleges that serve high shares of Black, Hispanic, and Native American students.

Agriculture

The Agriculture Department would see a 16% funding increase, with significant additional funding for priorities like rural broadband, improving rural water infrastructure, and improving forest management to prevent forest fires.

The budget would also allocate more money toward developing agricultural technologies to help farmers boost their output while also pursuing conservation initiatives and sequestering carbon on their land. The budget includes \$300 million in new conservation funds, including support for voluntary private lands conservation.

A major part of the Agriculture Department's budget goes to nutrition programs: Food stamps would receive \$6.7 billion under Mr. Biden's request, a \$1 billion increase from this year's enacted level.

Justice Department

Following last year's killing of George Floyd at the hands of Minneapolis police, the Justice Department under the Biden administration has made a priority of improving relationships between police and the communities they serve. The budget request asks for a 5.6% increase for the agency, including new funding to promote alternatives to prison and to support community programs to try to prevent violence before it happens.

It includes around \$400 million in new funds to improve relationships between law enforcement and the communities they work in; nearly \$700 million for efforts to reform the criminal justice system; and nearly \$500 million in new funding for the agency's office of violence against women. Much of that proposed funding would be used to provide grants to outside groups; the request translates to a 44% increase in the amount of funding for such grants. The budget request comes as the Justice Department and local law-enforcement agencies are anticipating increased violence this summer.

The budget also asks for another \$100 million to fight domestic terrorism, with most of the resources requested to be split between the Federal Bureau of Investigation and the U.S. attorney's offices around the country. It also asked for an additional \$4 million to research the root causes of domestic terrorism.

Cybersecurity

The budget requests a boost in cybersecurity funding the administration says is necessary to counter challenges posed by Russia and China.

The Cybersecurity and Infrastructure Security Agency would get an additional \$110 million, bringing its funding to \$2.1 billion. The bill provides \$20 million for a new Cyber Response and Recovery Fund. The blueprint also proposes \$500 million for the Technology Modernization Fund "to address urgent IT modernization challenges, bolster cybersecurity defenses, and improve the delivery of Covid-19 pandemic relief," and \$750 million to agencies "affected by recent, significant cyber incidents," such as the SolarWinds hack, to address gaps in security capabilities.

Officials say cyberattacks pose a growing threat to national security and public safety. Mr. Biden signed an executive order in March that sought to reorient the federal government's approach to cybersecurity around prevention rather than crisis response.

Space

The National Aeronautics and Space Administration would get a 6.3% funding bump to support human and robotic exploration of the moon and Mars. Mr. Biden also calls for additional funding for aeronautics research and climate science, including beefing up climate satellite monitoring programs.

(source: Wall Street Journal)

Market News, Corporate Earnings, and News & Notes

(source: CNBC)

Costco Is Seeing Inflation Bound And Here Are Products Being Impacted

Don't tell Costco executives that inflation is low.

The big-box club chain said it's been seeing accelerating prices across a range of products, including shipping containers, aluminum foil, and a 20% spike in meat prices over the past month.

"Inflationary factors abound," CFO Richard Galanti said on the company's fiscal third-quarter earnings call Thursday.

"These include higher labor costs, higher freight costs, higher transportation demand, along with the container shortage and port delays ... increased demand in various product categories some shortages, various shortages of everything from chips to oils and chemical supplies by facilities hit by the Gulf freeze and storms and, in some cases, higher commodity prices," he added.

Costco reported a profit of \$2.75 a share for the period, well above Wall Street estimates. It also saw revenues of \$45.3 billion that also beat the Street, which had been looking for \$43.6 billion. Beneath those numbers, though, was a story of how higher prices across the board impacted the chain.

On the plus side, there was a boost from gas inflation as prices at the pump have soared about 30% nationally this year. In other cases, it wasn't so simple.

Like other companies, Costco wrestled with passing costs onto customers. The firm expects there could be some margin pressures, though the degree remains to be seen and there haven't been any significant impacts so far.

Economists largely see the current spate of inflation — one closely followed gauge released Friday estimated the annual pace at 3.1% — as temporary. They list many of the same factors as Costco executives, mainly a string of supply chain issues that have caused spikes in products core to the U.S. economy and household consumption.

Galanti cited price increases as high as 8% and cited goods including pulp and paper, an assortment of plastic products as well as soda and cheese. Some apparel items saw price hikes of 3% to 10%. Overall, he said the company has gone from seeing inflation in the 1%-to-1.5% range in March to 2.5% to 3.5% today.

"Some items are up more and some items, the sale prices haven't yet changed. And some items are even down a little bit," Galanti said. "We think, again, we've done pretty well in terms of controlling that as best as we can, but the inflation pressures abound."

Costco has worked with its suppliers to keep a handle on price pressures. But Galanti conceded that “some of [inflation] has passed through.”

In the future, he said items like the warehouse’s \$4.99 rotisserie chicken and \$2.99 40-pack case of water could be impacted.

Source: (CNBC)

Earnings Highlights This Week

- **Salesforce-** Salesforce results exceeded estimates with quarterly results and higher full-year guidance. The company’s revenue growth accelerated as it lapped the quarter when the coronavirus pandemic hit the U.S.
- **Gap-** Gap’s fiscal first-quarter sales surpassed pre-pandemic levels. Shoppers turned to Old Navy and Athleta to refresh their wardrobes for summer, the company said. Gap’s namesake banner in North America showed early signs of improvement and e-commerce growth remained strong.
- **Best Buy-** Best Buy said sales grew 36% in the fiscal first quarter as shoppers’ stimulus-fueled spending spree included consumer electronics. The retailer raised its forecast for the year after seeing demand continue into the second quarter. CEO Corie Barry said the strong housing market has inspired consumers to invest in technology and appliances.
- **Petco-** Nvidia reported first-quarter results for its fiscal 2022 on Wednesday, with sales growing 84% compared to last year. Nvidia’s earnings come during a period of sustained, massive growth in its business amid a shortage of semiconductors worldwide. Nvidia said that the processors it sells specifically for cryptocurrency miners had sales of \$155 million.
- **Kohl’s-** Snowflake’s revenue beat estimates for the quarter as losses mounted. Goldman Sachs upgraded Snowflake stock to buy earlier this month as its performance trailed that of the Nasdaq

News and Notes:

What Is Revenge Spending?

- **What is revenge spending?**
 - Due to the coronavirus, many people have felt a loss of opportunity or felt deprived of having experiences.
 - Revenge spending - money you drop to make up for lost time.
 - There hasn’t been an opportunity to spend money on travel and entertainment, so it stands to reason people will spend with a vengeance over the next 12 to 18 months.
- **What are people splurging on right now?**
 - Looking Good: *Teeth Whitening Sales, Lip Gloss, Sunless Tanners, Jeans, and Champagne---all way up in sales*
 - Travel: *In the past week 1 out of 5 Americans made some type of travel booking*
 - Entertainment: People are beginning to dine out and buying sports and concert tickets in the droves.
- **How can you avoid revenge spending/post-pandemic splurging**
 - Ted’s Take: Make a post-pandemic budget (it may have been a while since you’ve done one).
 - Ted’s Take: Be careful of the FOMO trap (remember, people, don’t post their net worth on Instagram or Facebook).
 - Ted’s Take: Use your point programs (that rainy day has just come).

From the team at JM Brown Financial Partners

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