Capital Markets Group

Points to Ponder

July 16, 2021

The First Tee...

Paper Ceiling…**government debt ceiling is scheduled to be reinstated by the end of July:**

- The on-again, off-again limit on national debt incurred by the U.S. Treasury has evolved into more of a political pawn than a boundary to control excessive government spending:
  - Without an increase, extension or suspension of the debt ceiling the Treasury will be forced to reduce its cash balances by about $450 billion…reducing T-Bill supply in a market that is already tight due to all the excess liquidity looking to be invested
    - Treasury Secretary Yellen stated emergency government funding measures, to avoid breaching the debt ceiling, could be exhausted by August…many analysts believe the government could continue to operate until the end of October with some accounting manipulation.
- The debt ceiling was suspended again on August 2019 at $22 trillion…*(only activated when convenient)*:
  - **The current U.S. debt outstanding is $28.5** trillion *(and growing)*…in 2000, the U.S. debt was $5.2 trillion:
    - Since the turn of the century the debt ceiling has been Increased fourteen times and suspended five times.
- The Fed's decision last month to increase the rate on its reverse repurchase facility has increased the probability of additional cash searching for any kind of short-term return:
  - The reverse repo rate was increased from 0% to .05%...the Interest Rate on Excess Reserves was also increased 5 basis points to .15%:
    - The reinstatement of the debt-ceiling could intensify the shortage of collateral, pressuring rates even lower:
      - The Fed's ultra-accommodative monetary policy, combined with fiscal policy flooding the market with stimulus dollars, has pushed the rates on T-Bills, Agency discount notes, certificates of deposit, repurchase agreements, commercial paper and money market mutual funds to levels close to and below zero percent since the pandemic began over a year ago.
    - The monthly $120 billion bond purchases by the Federal Reserve continues to suck collateral out of the market:
      - It is estimated, there is a $1 trillion collateral shortage for money market funds…this gap is being plugged by the Fed's reverse repo facility.

Car Cost Cardiac Crash…the high price for buying an auto can create consumer heartburn:

- Demand for cars and trucks has been spiking as the economy reopens and a large number of consumers continue to avoid public transportation *(a not so perfect storm for car dealers)*:
  - Auto dealers are struggling with low inventories of vehicles and long wait times to receive new orders
    - Supply-chain issues continue to hamper auto manufacturing, especially the shortage of semiconductors.
- **Getting a raw deal**…besides demand, car prices are rising due to surging raw materials prices:
  - Costs for the primary metals made to manufacture vehicles, such as copper, steel, and aluminum, have been trading close to record highs this year…metal prices are up 21% since the start of the year:
    - Steel, needed to build chassis, engines, and wheels, has increased in price by 231% over the past twelve months:
      - Steel hit an all-time high at the end of June at $1816 per ton…China, who is the world's largest steel producer, has also curbed output.
    - Copper, a key component for electric vehicles, has risen in price by 54% over the past year…electric vehicles take three-and-a-half time more copper to manufacture (versus gasoline combustion powered vehicles) due to the large amount of wiring required.
    - The price of lithium, cobalt and nickel, metals used to build car battery cells, have risen 47% since last summer:
      - Some car manufacturers are investing in new technology that does not require these metals for batteries…the cost savings for power pack costs using the new technology could reduce the price as much a ten-fold *(electric energy economization!)*
    - Analyst estimate the price for an automobile's raw materials has risen 83% for the year through March…raw materials typically make-up 10% of the cost of building a vehicle (labor is the largest cost, which has also increased price pressures due to rising wages)
      - A vehicle with a price-tag of $40k would need to increase an additional 8.3% to cover the additional raw materials cost.
- Let's make a deal…with such strong consumer demand, the environment is persuasive for passing along production, supple-chain, and inflation costs to consumers *(it is definitely what can be defined as a "sellers" market!)*:
  - New vehicle prices are over 5% higher from year ago levels, but with the low availability of new cars the demand for used vehicles has skyrocketed, pushing their price up over 45% versus a year ago:
    - The surge in used-car prices has comprised over 30% of the gains seen in CPI inflation during the past few months.
    - Due to the shortage of new vehicles, car rental companies have had to resort to purchasing used vehicles at auction.

At the turn...

The Back Nine...

Slow Boat from China...the cost to ship goods from China to the U.S. have escalated:

- Strong consumer and business pandemic recovery demand from the U.S., combined with a shortage of containers, has created expanding profit potential for shipping companies:
  - The spot-rate for a 40-foot container from Shanghai to Los Angeles (the largest U.S. port) has increased to $9631, up 229% from a year ago...a composite index of eight major trading routes has rose to $8,796, a 333% price surge from a year ago:
    - From 2011 to 2020, the average shipping rate from Shanghai to Los Angeles was less than $1800 per container.
  - U.S. importers are dealing with growing difficulties absorbing the rising shipping costs:
    - Companies are having to make the difficult decision to either narrow profit margins, or pass along the higher shipping costs to customers...the monthly U.S. trade deficits in February through May were the highest on record.

High Water Mark...stock prices rise with the tide as values float with excess liquidity:

- Data format: July 1, 2020 / January 1, 2021 / April 1, 2021 / July 1,2021:

Equities

Dow: 25812 / 30606 / 32981 / 34502
S&P 500: 3100 / 3756 / 3972 / 4297
NASDAQ: 10058 / 12888 / 13246 / 14503
Russell 2000: 1441 / 1974 / 2223 / 2311

Commodities

CRB: 137 / 167 / 184 / 213
Oil: $39.27 / $48.52 / $59.16 / $73.47
Gold: $1780 / $1898 / $1707 / $1770
Copper: $271 / $351 / $399 / $429
Natural Gas: $1.75 / $2.53 / $2.60 / $3.68
Bitcoin: $9147 / $28996 / $58960 / $34585

Borrowing Benchmarks

Libor:
1mo: .178% / .143% / .111% / .100%
3mo: .307% / .238% / .194% / .144%
SOFR: **(U.S Secured Overnight Financing Rate)**
1day: .08% / .07% / .01% / .05%

Treasuries Issues

3mo: .16% / .09% / -.005% / .04%
6mo: .18% / .09% / .01% / .04%
1yr: .16% / .10% / .05% / .06%
2yr: .16% / .12% / .15% / .24%
3yr: .18% / .17% / .33% / .45%
5yr: .29% / .36% / .93% / .87%
7yr: .49% / .65% / 1.40% / 1.21%
10yr: .66% / .93% / 1.73% / 1.44%
20yr: 1.18% / 1.45% / 2.31% / 1.99%
30yr: 1.41% / 1.65% / 2.40% / 2.05%

Currencies

Euro: 1.123 / 1.221 / 1.173 / 1.185
Yen: 107.93 / 103.25 / 110.72 / 111.09
Peso: 22.992 / 19.914 / 20.432 / 19.938
Canadian $: 1.357 / 1.272 / 1.256 / 1.239
Yuan: 7.065 / 6.527 / 6.552 / 6.457

Grain Futures

Corn: $3.41 / $4.84 / $5.64 / $5.85
Soybeans: $8.38 / $13.11 / $14.36 / $13.93
Wheat: $4.92 / $6.40 / $6.18 / $6.80
Random Lumber: $384 / $642 / $1009 / $748

Job / Inflation Indicators

Unemployment: 11.1% / 6.7% / 6.0% / 5.9%
Consumer Price Index: .6% / 1.4% / 2.6% / 5.4%
Core PCE Index: 1.0% / 1.4% / 1.4% / 3.4%

Federal Funds Open: .08% / .08% / .07% / .05%
Prime Rate: 3.25% / 3.25% / 3.25% / 3.25%

19th Hole...

Always and never are two words you should always remember never to use.

Wendell Johnson

Ross Elford, First Vice President

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