OLD POINT TRUST

Investment Commentary **October 2021**

A Sticky Bag of Treats?

The great debate in the world of the Economy these days is about the surging and undeniable inflation that is gripping the cost of just about everything. Is this Inflation transitory, as the Federal Reserve has been suggesting? Or are the increased prices Sticky and likely to persist through time? As with many great debates, time will tell.

I tend to think many of the increases will be sticky, particularly in the realm of increased wages & employment costs and in the increase in shelter costs.

Employment Cost Index (ECI)

According to Labor Department data released October 29th, employment costs rose at the fastest pace on record during the third quarter. The Employment Cost Index (ECI) rose 1.3% from the second quarter and has increased 3.7% on a twelve-month basis. Total compensation readings are composed of both wages and benefit costs. Within the ECI, wages rose 1.5% quarter-over-quarter and 4.2% year-over-year. Benefit costs rose 0.9% quarter-over-quarter and were up 2.5% year-over-year.

The total compensation increase suggests that labor cost growth is the fastest in more than two decades. Compensation gains were seen across all sectors of the economy as well as in every region of the nation.

Within the private sector, wages and salaries for civilian workers rose at a record pace in the third quarter, gaining 1.5%. Quarterly gains in the private sector included the following gains in sub-sectors: Credit Intermediation up 7.7%, Finance and Insurance wages up 3.0%, Leisure and Hospitality wages rose 2.6%, Nursing and Care facility wages were up 2.1% and general service industries wages were up 1.7%.

These employment cost increases tend to be some of the stickiest forms of inflation. You can see the Department of Labor's full 20-page report on the ECI at: https://www.dol.gov/newsroom/economicdata/eci_10292021.pdf

Monetary Stimulus

Since March of 2020, the Federal Reserve has added over $4.4 Trillion worth of artificial stimulation to the economy. That $4.4 Trillion increase amounts to more than a doubling of the assets on the Federal Reserve's balance sheet, which now stands at $8.605 Trillion as of October 27th, 2021.

The Federal Reserve continues to pump $120 billion of monetary stimulus into the economy each month, although there are now signs that suggest a tapering of this artificial stimulation might start within the next month or two. On Wednesday November 3rd, the Federal Open Market Committee (FOMC) of the Federal Reserve is expected to make an official announcement regarding the beginning of their tapering process, including some details on the amounts, pace and timing of the reduction in their asset purchases.

It's important to remember that even if the Federal Reserve begins to taper their artificial stimulation that they are not flipping off the easy money switch. The central expectation is that they will reduce the monthly purchases of Treasuries and Mortgage-backed securities to $105 billion a month, down from the current $120 billion per month. There will still be plenty of stimulus "Punch" in the bowl.

Consumer Price Index (CPI) and Inflation

Prices paid by consumers increased more than anticipated in September. The CPI rose 0.412% from August and 5.4% from a year ago. This increase matches the largest annual gain since 2008, according to data released by the Labor Department on October 13th. The pickup in prices last month were seen most clearly in higher food, energy and shelter costs. Excluding the food and energy components, "Core" CPI rose 0.243% for the month.

I have always wondered about the appropriateness of excluding food and energy price increases. The rationale for it is that the prices on these goods are highly variable. Does that mean they are somehow less important? I often joke – "How many Fasting Bicyclists do you know?"

So there was a steep increase in the cost of energy in the month of September. Energy prices increased 19.3% in the third quarter. On a year-over-year basis, Energy costs are up 24.8%. Within that number, the price of Gasoline is up 42.1% on a year-over-year basis. Following is a table of some specific energy price increases for the month of September:

CPI for Fuel Oil	+ 3.9%
CPI for Propane, Kerosene and Firewood	+ 3.8%
CPI for Utility Gas Service	+ 2.7%
CPI for Motor Fuel	+ 1.2%
CPI for Gasoline (all grades)	+ 1.2%
CPI for Energy Services	+ 1.2%
CPI for Electricity	+ 0.8%

The cost of Food and Beverages rose 0.9% in September. For the third quarter, food prices increased 7.8%.

Higher home prices are also starting to show up in the data, with the rent of primary residence component of the CPI jumping 0.5%. This was the biggest monthly increase since 2001. The Homeowners' Equivalent Rent component also rose. That increase was the most in five years. Shelter costs are a more structural element of the CPI and they account for about a third of the overall Index, so persistently higher shelter costs would certainly add to the "stickiness" of inflation.

Consumers have also been hit with higher costs for other goods such as new vehicles and household furnishings, which increased by a record 1.3% for the month.

Home Sales Data

In September, sales of new homes jumped 14% to an annual rate of 800,000 units, well above the anticipated increase of 2.2%, and the highest level since March. A report produced by the U.S. Census Bureau and the Department of Housing and Urban Development released on October 26th showed that the median price of a new home has rocketed up 18.7% from a year ago. The median price of a new home now stands at a record $408,800. Sales grew in three of the four regions of the country, led by sharp gains in the Northeast and the South. You can see the report at: http://www.census.gov/newhomesales

In general, the pace of both new and previously owned sales is being dictated by the supply of homes available. Builders point to shortages of key materials and skilled labor as obstacles to faster construction. Separate data out last week showed that sales of previously owned homes jumped the most in a year during September. Previously owned homes comprise the majority of the Home Sales market, nearly 90% of it in fact. The median selling price of an existing house rose 13.3% in September from a year ago, to $352,800.

GDP

The economy grew at 2.0% in the third quarter of 2021, after rising 6.7% in Q2 and 6.3% in Q1. Although this reading was a touch below the anticipated GDP growth for the quarter, it was still a strong reading historically. According to data issued by the Commerce Department's Bureau of Economic Analysis on October 28th, Personal Consumption, which is the biggest part of the economy, grew at an annualized rate of just 1.6%.

"The third quarter increase in real GDP reflected increases in inventory investment, consumer spending, state and local government spending, and business investment that were partly offset by decreases in housing investment, federal government spending, and exports." See: https://www.bea.gov

Leading Economic Index (LEI)

The Conference Board's Leading Economic Index (LEI) for the U.S. increased by 0.2% in September, to 117.5. This followed a 0.8% increase in August and a 0.9% increase in July. The six-month annualized LEI rose 11.1%. The biggest contributor to the Index, for the second month in a row, was the Institute of Supply Management's reading for New Orders, which added 0.23%. The biggest negative contributor was in building permits, which subtracted 0.23%. Following is a table illustrating the ten components of the LEI and how they have fared over the third quarter:

	September	**August**	**July**
Leading Index	117.5	117.3	116.4
Average workweek	-0.07%	0.00%	0.07%
Building permits	-0.23%	0.16%	0.06%
Jobless claims	0.11%	0.33%	0.02%
Stock prices	-0.01%	0.08%	0.11%
ISM New orders	0.23%	0.23%	0.19%
Interest rate spread	0.14%	0.13%	0.14%
Non def. Cap goods orders	0.01%	0.00%	-0.02%
Consumer goods orders	0.01%	-0.11%	0.05%
Leading credit	0.09%	0.19%	0.21%
Ave. Consumer expectations	-0.09%	-0.10%	0.08%

"The U.S. LEI rose again in September, though at a slower rate, suggesting the economy remains on a more moderate growth trajectory compared to the first half of the year," said Ataman Ozyildirim, Senior Director of Economic Research at The Conference Board. "The Delta variant, rising inflation fears, and supply chain disruptions are all creating headwinds for the US economy. Despite the LEI's slower growth in recent months, the strengths among the components remain widespread. Indeed, The Conference Board continues to forecast strong growth ahead: 5.7% year-over-year for 2021 and 3.8% for 2022."

Corporate Earnings for the Third Quarter

According to Bloomberg, as of October 29th, 272 of the S&P 500 companies have reported earnings for the third quarter. Of those that have reported, 83% have beaten analyst Earnings per Share (EPS) estimates. Companies in the Communications, Healthcare, Technology and Financial sectors have been among the biggest winners. Companies have also topped analysts' revenue estimates for the third quarter 59% of the time.

As more companies beat estimates, the S&P 500 is now trading at a price-to-earnings ratio of 26.07 vs. a P/E ratio of 28.81 a year ago, and the price-to-sales ratio is 3.12 vs. 2.67, according to Bloomberg.

U.S. Debt

If you are getting curious about the amount of government debt that has been added in the last year and a half, I would direct you to the following website: https://www.usdebtclock.org/ (**Warning** Cover your eyes if you are frightened by large and dizzying numbers as this website shows them in rolling real-time estimations that are moving very quickly.)

As I write this Commentary on Sunday October 31st, 2021, the U.S. National Debt stands at $28,933,155,478,285 and is quickly growing larger by the second. That works out to $86,911 of debt per citizen and $229,705 of debt per actual taxpayer.

A history of the U.S. Federal Debt to GDP ratio shows that in 1960 debt to GDP was 52.27%. In 1980 the ratio was 34.68%. In the year 2000, the ratio was 55.81%.
At this current point in time the U.S. Federal Debt to GDP ratio stands at 125.96%.

The current U.S. Gross Domestic Product is estimated to be $22,971,151,911,444.

COLA

The Social Security cost-of-living adjustment for 2022 will be 5.9%. The annual increase will be the highest increase since 1982. In 2021, the cost-of-living adjustment was 1.3%. The last time the annual adjustment came close to the 2022 figure was in 2009, when beneficiaries saw a 5.8% increase. The average COLA in the past decade was just 1.65%, while in three of the past 12 years, the adjustment was zero.

Following is a table of the historic COLA increases:

2022	5.9%	2011	0.0%
2021	1.3%	2010	0.0%
2020	1.6%	2009	5.8%
2019	2.8%	2008	2.3%
2018	2.0%	2007	3.3%
2017	0.3%	2006	4.1%
2016	0.0%	2005	2.7%
2015	1.7%	2004	2.1%
2014	1.5%	2003	1.4%
2013	1.7%	2002	2.6%
2012	3.6%	2001	3.5%

Beneficiaries will see the boosts to their monthly checks starting in January. Meanwhile, about 8 million Supplemental Security Income, or SSI, beneficiaries will see the increase starting Dec. 30. The estimated average monthly benefit for all retired workers will rise to $1,657, up from $1,565.

In addition, the Social Security Administration also announced that the maximum earnings subject to Social Security taxes will be $147,000 in 2022, up from $142,800 in 2021.

Social Security's benefits are adjusted annually using a specific set of consumer price index data, the Consumer Price Index for Urban Wage Earners and Clerical Workers, or CPI-W.

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