Bahl&Gaynor
Investment Counsel

A letter from
Bahl & Gaynor

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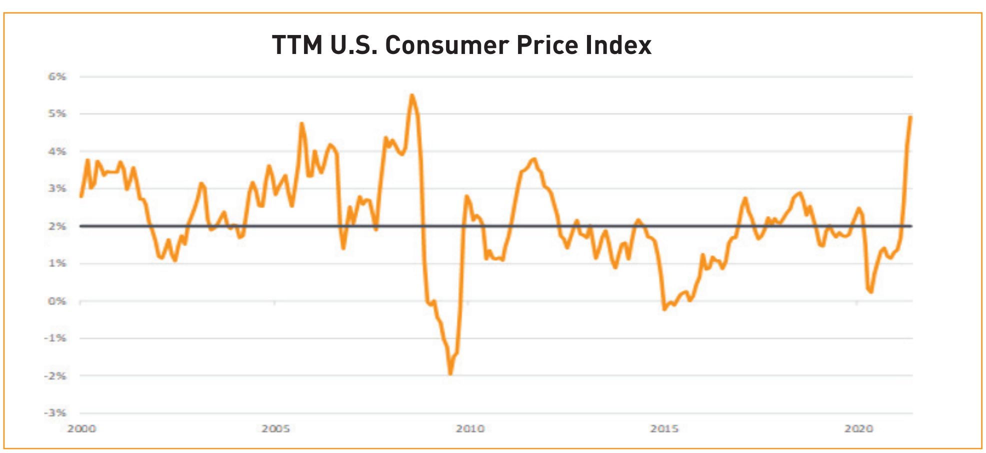
Outlasting the Bugs

We fully anticipated this, it was just a matter of time and degree. No, not the cicadas... rather, the long-awaited post-pandemic rebound.

Halfway through 2021, most people are again publicly emerging (Thankfully, the cicadas are all but gone.) as restaurants and airline seats fill and traffic returns to stores and highways. Spring was a solid period for spending in general and there are signs there is room to grow this summer. Some forecasters (i.e. Oxford Economics) believe spending could grow as much as 9%, the highest rate since 1946.[1]

Inflation Pressures

Yet consumers, enticed to buy, may think twice when confronted with higher prices. Inflation is the talk of every town and with reason: prices in May were 5% higher, as measured by the CPI, than they were one year ago, the largest increase since 2008. However, when compared to the pre-pandemic May 2019 readings, inflation is increasing at a more moderate 2.5%. Low inventories, transportation issues and sharply higher demand create what Fed chair Jerome Powell calls "the perfect storm" for price pressures.[2] He maintains those pressures will ease on their own as we continue to emerge from recession. While that is certainly possible, many economists question the degree and speed with which we will recover. Inflationary readings and trends will receive a high degree of attention; elevated prices are a negative for many financial assets, including most equities and fixed income securities.



Source: FactSet, 2021

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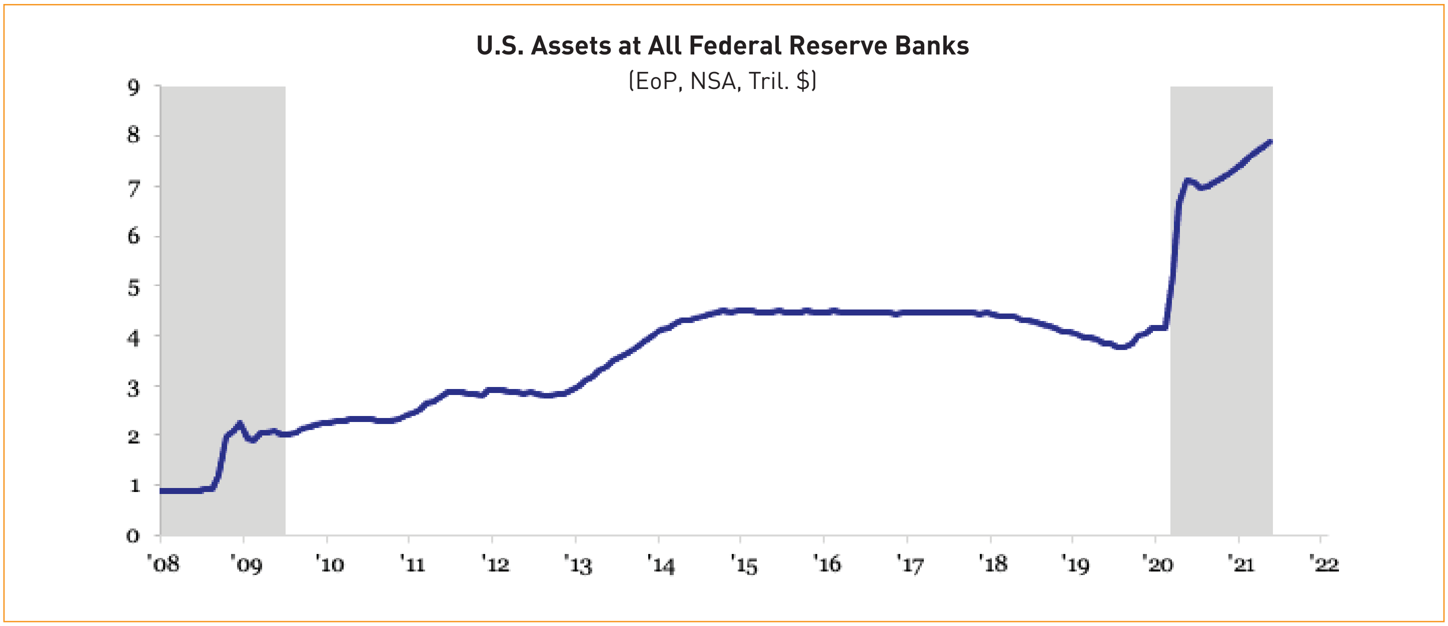
Big Decisions Ahead

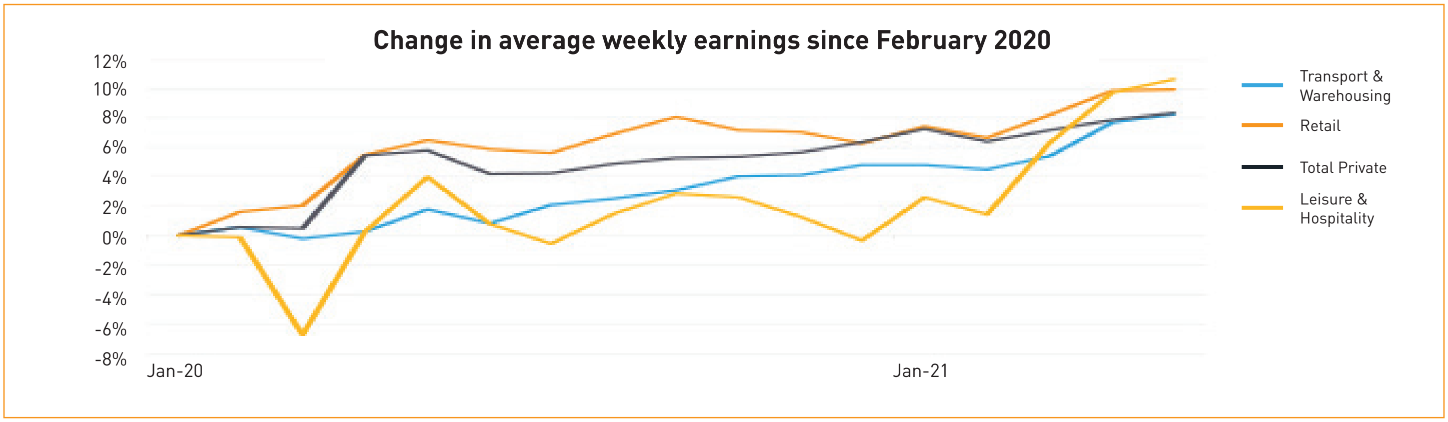
There is concern the Federal Reserve is falling behind the inflation curve. The low interest rates and higher liquidity generated by the stimulus packages and enlarged Fed balance sheet (pictured below) were effective in stabilizing our economy but are now likely contributing to the uncomfortably high inflation readings and may no longer be appropriate. Clearly, we are reaching a crossroads as the Fed begins to consider a normalization process to reduce economic stimulus in the months ahead. The pace with which that occurs will be closely monitored by capital markets around the world.



Source: ISI International, 2021.

Workers in the Drivers Seat

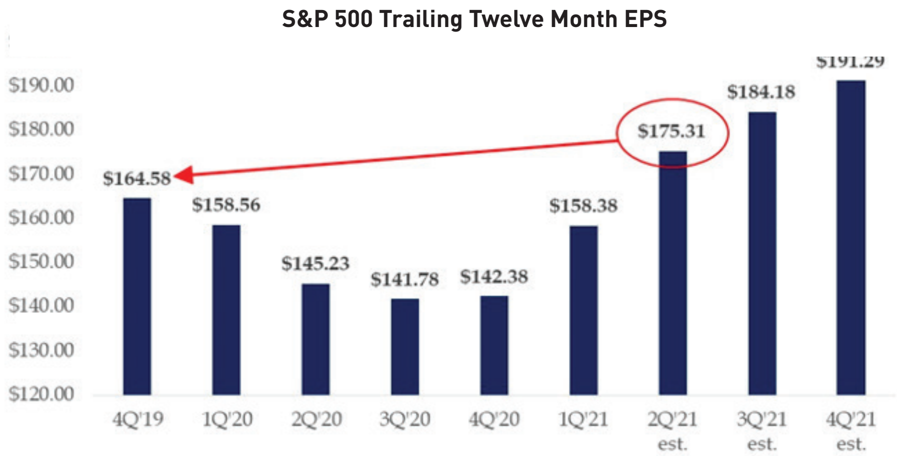
Sudden and higher-than-anticipated demand for goods and services combines with a variety of other factors to create labor shortages across industries. As a result, we can now add higher wages to the growing list of inflationary ingredients (see average weekly earnings trend below). The latest jobs report is encouraging, with 850,000 people reentering the workforce in June (the biggest gain in 10 months).[3] Still, employers continue to compete for a limited pool of workers, especially in the hospitality and leisure industries. May 2021 wages registered their highest two-month gain since 1983. Layoff activity is currently at an all-time low. It is possible, once stimulus checks are spent and unemployment benefits expire, labor issues will ease in late 2021. Labor costs are a larger and more enduring portion of the inflation equation; it's easier to raise prices on consumer goods than it is to reduce a worker's paycheck. Higher prices *and* higher wages create a spiral the capital markets would not be anxious to see; once that fuse is lit, it has historically been difficult to stop the inflationary fire that results.



Source: Bureau of Labor Statistics, 2021.

Stronger for Longer

Corporate earnings are surging (pictured below) with readings reflecting growth well above expectations as measured by 1Q data and anticipated 2Q data. It is possible we will reach year over year percentage earnings gains in 2Q representing the peak for this economic cycle. All of the S&P 500's economic sectors are participating. Increasingly, we anticipate companies in both the service and capital goods sectors will experience accelerated growth. With share prices near all-time high levels, the number of acquisitions and companies going public is likely to remain at the top end of historic ranges. Cash balances and profitability also remain high, so we can anticipate corporate announcements of capacity expansions, dividend increases, and share repurchases to be almost as plentiful as the Cicada population.



Source: Refinitiv, Strategas, 2021.

We foresee a constructive environment for elevated capital return to shareholders extending into 2022. The current inflationary trend may well be transitory, but while it remains a risk to the market, we believe the best hedge is investment in dividend growth stocks. That should be no surprise; at Bahl & Gaynor, we've maintained a risk-conscious dividend growth philosophy for more than 30 years. We remain committed to it and our mission: to deliver exceptional service to our clients while seeking a growing stream of income remains especially relevant in today's unpredictable markets.

Sources

[1] *http://blog.oxfordeconomics.com/content/here-comes-record-breaking-consumer-spending-growth*

[2] *https://www.reuters.com/business/us-lawmakers-likely-press-powell-feds-hawkish-turn-2021-06-22/*

[3] *https://www.bls.gov/news.release/pdf/empsit.pdf*

Disclosure: