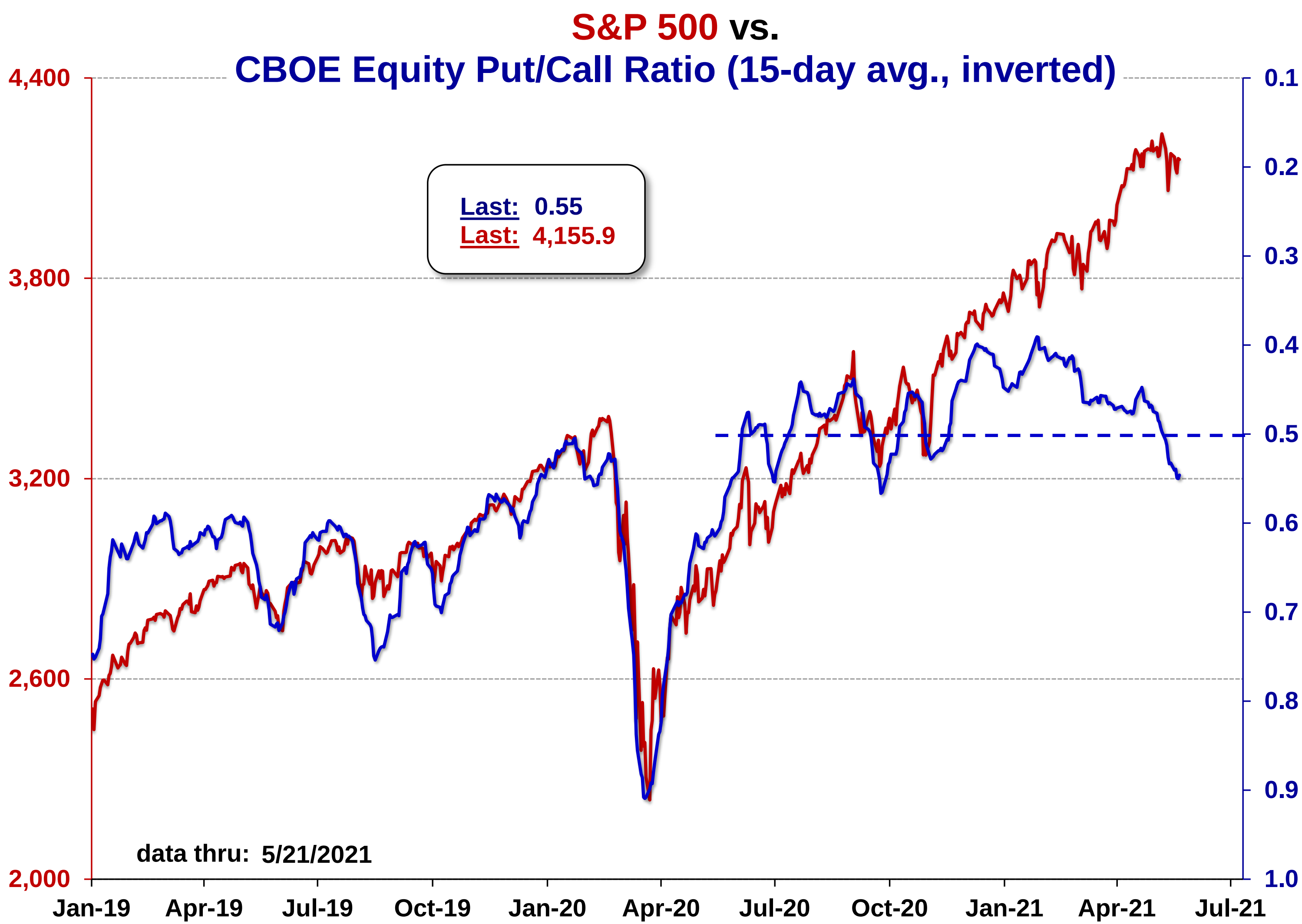
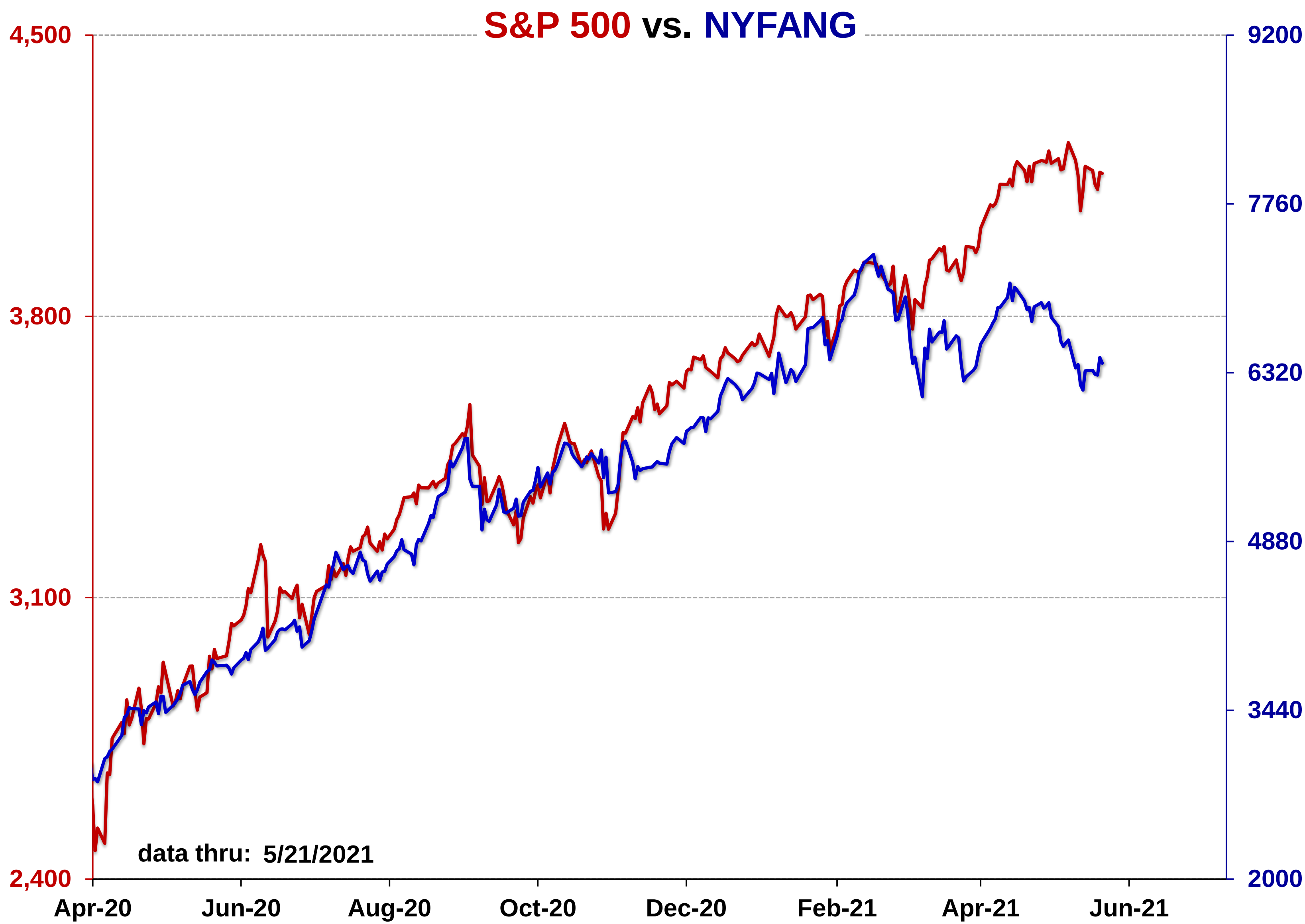
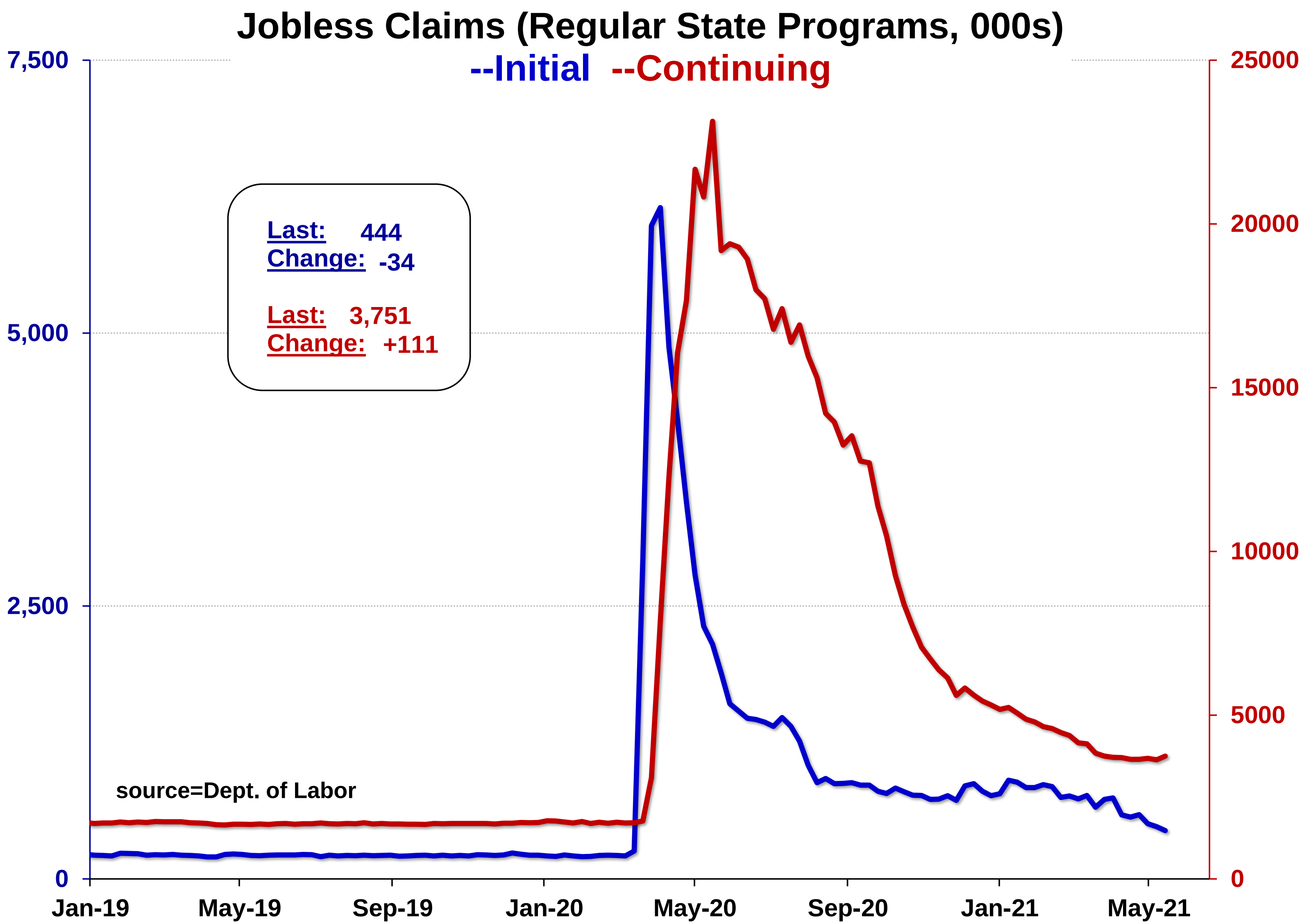
Caution Flags Remain: equity put/call ratio continues to rise, now above 0.5 for 10 straight days. The ratio had spent the better part of a year under 0.5, which has only occurred once before: during dot.com bubble.



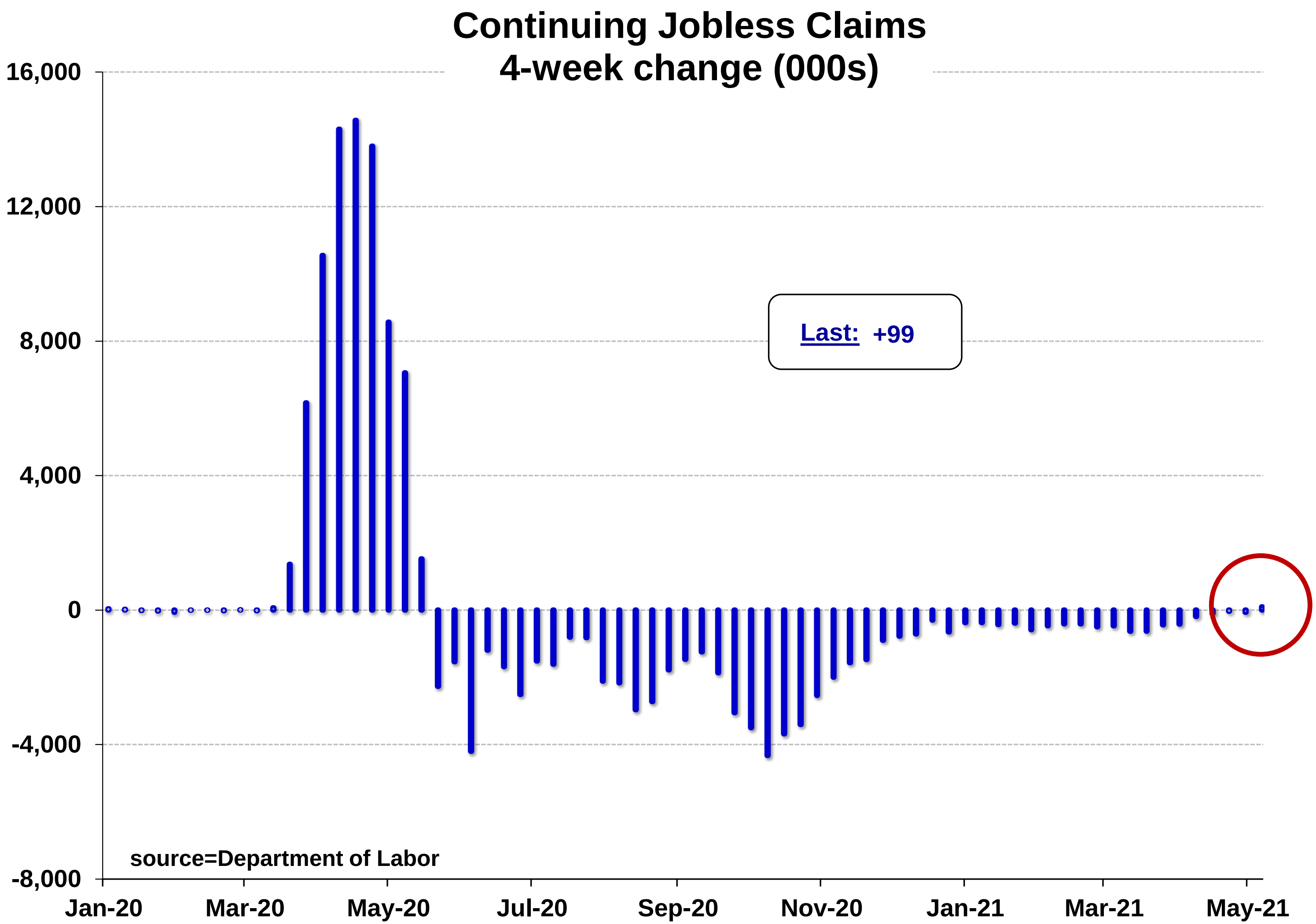
Stratospheric rise in Tech stocks looks to have stalled as Nasdaq, NYFANG indices part ways with the S&P 500.



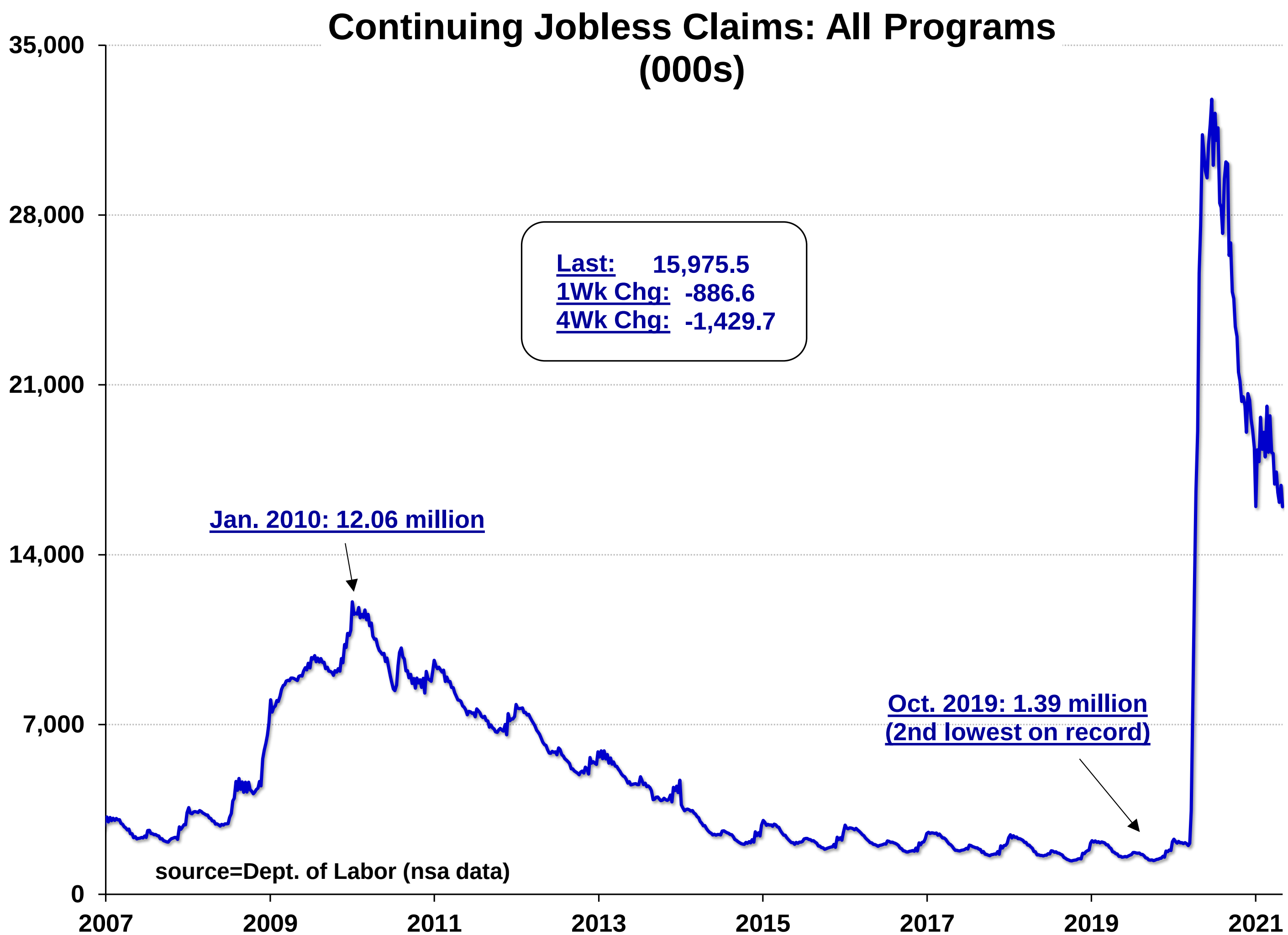
Good news: Initial Claims continue to fall, now at lowest since early 2020.
Bad news: Continuing Claims rise 111k to 3.75 million.



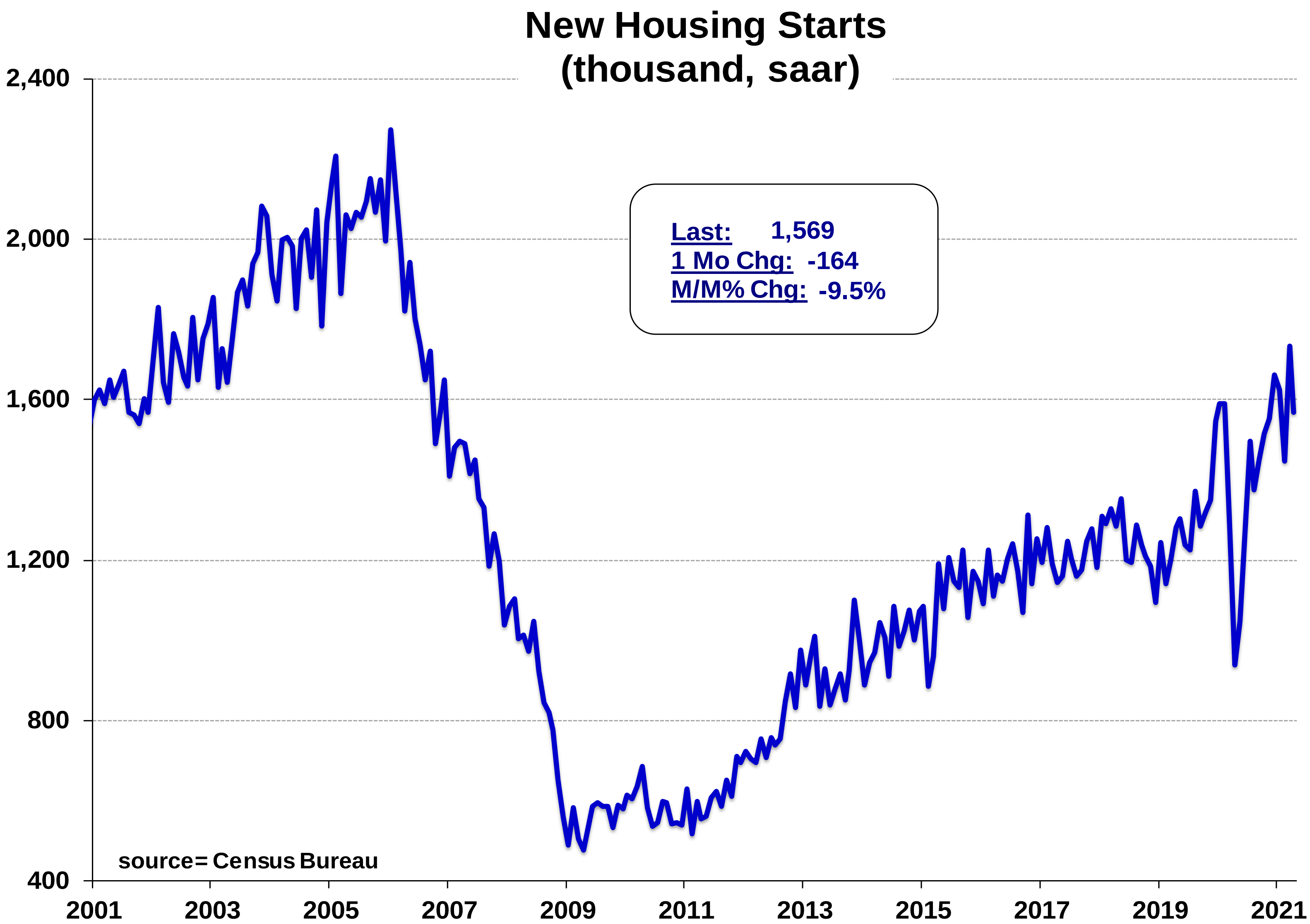
Moving in the wrong direction: **Continuing Jobless Claims see first 4-week rise since last March**. The fact that Continuing Claims seem to have hit a 'permanently high plateau' is troubling and suggests we may see disappointing employment reports ahead (or, lack of 'blockbuster' jobs numbers which we should otherwise expect). Elevated continuing claims may also be a warning of high level of permanent job losses. Should this be the case, all roads point toward additional stimulus programs.



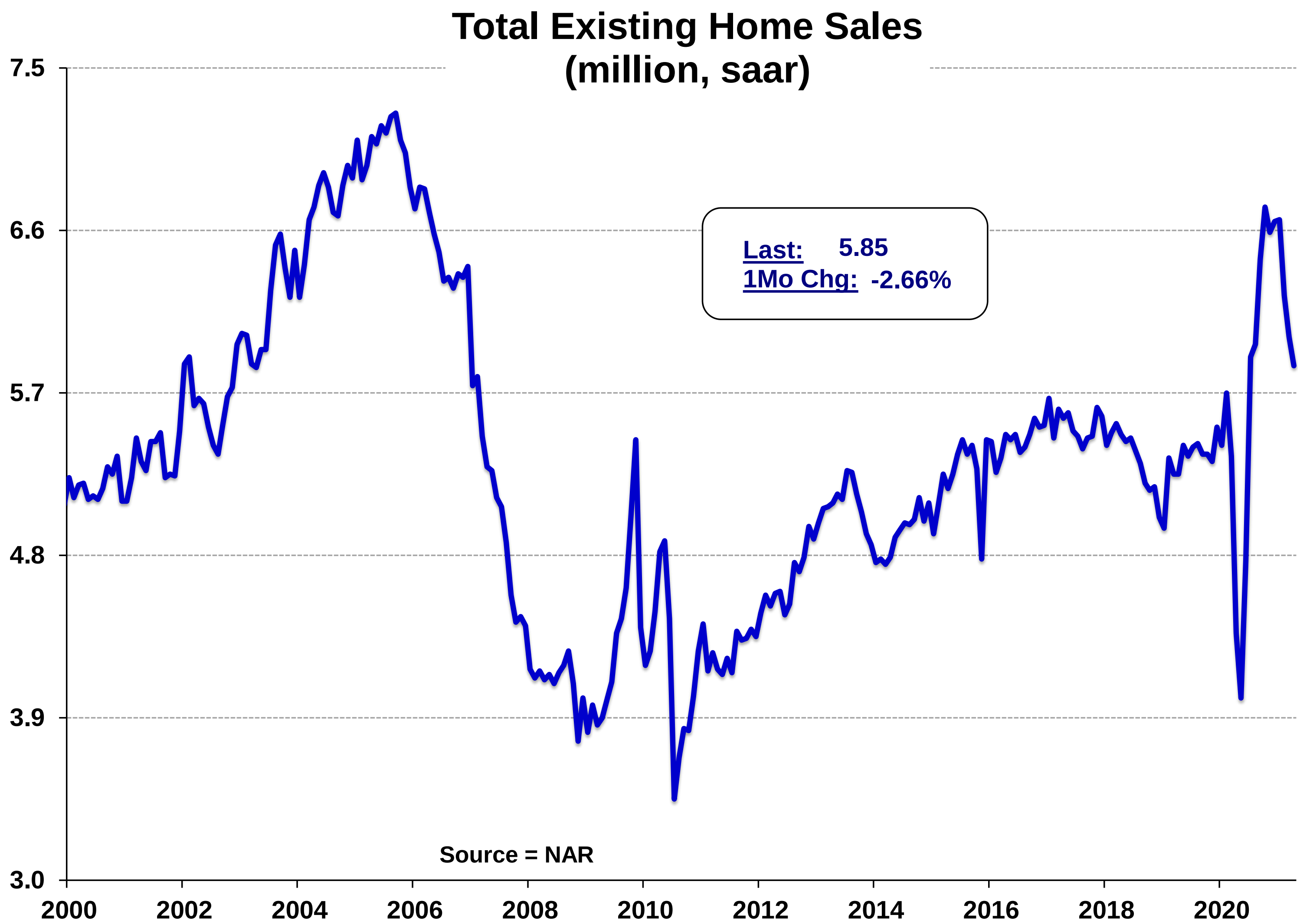
Total Continuing Claims (all programs) drop -887k to 15.9 million. Given that economic activity is heading back toward normal in most of the country and that many states have discontinued Covid-related unemployment claims programs, we should certainly see this number decline dramatically in the weeks ahead. This will indeed be good news, however the Continuing Claims number is what to watch going forward.



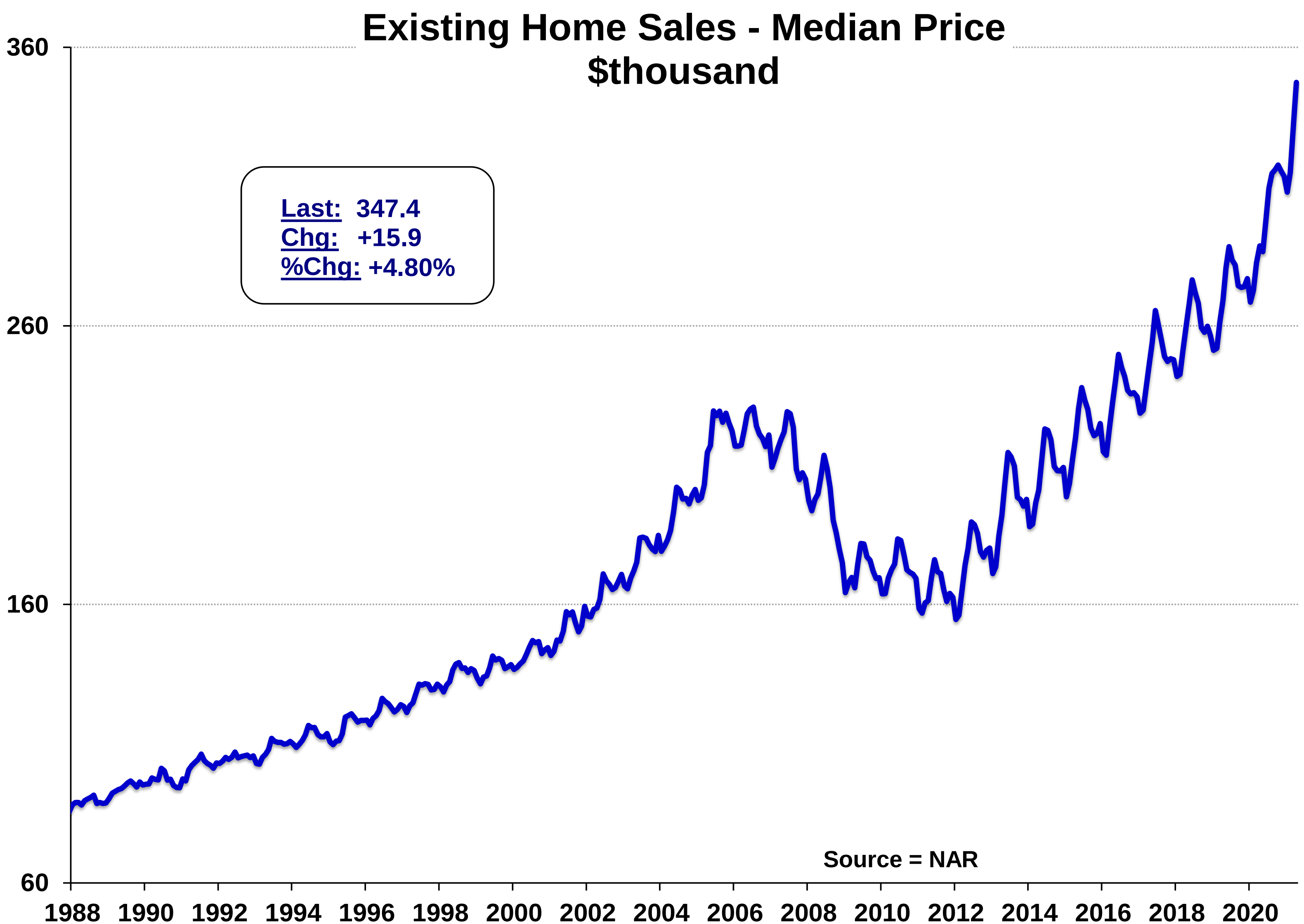
While the overall trend continues higher, Housing Starts & Building Permits slumped in April: Starts fell -9.5% vs. expectations of -2%.



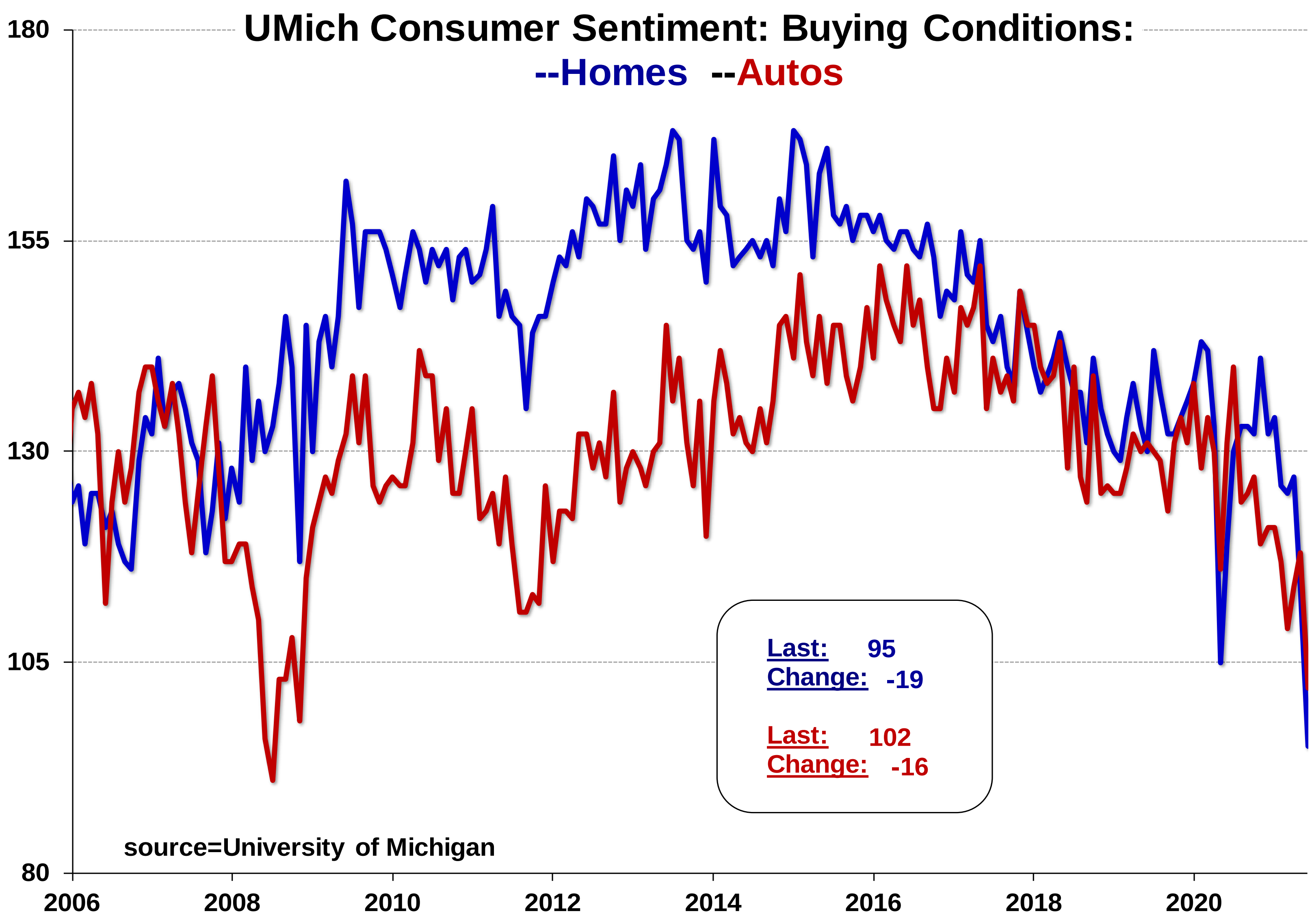
Has urban exodus come to an end? Following the disappointing Housing Starts data comes the third month in a row of Existing Home Sales declines. Sales fell -2.7% vs. expectations of a 1% rise and have been negative for last 4 of 6 months. As suggested in a number of our reports, home sales would inevitably soften once the urban exodus had run its course…and it seems this moment may have arrived.



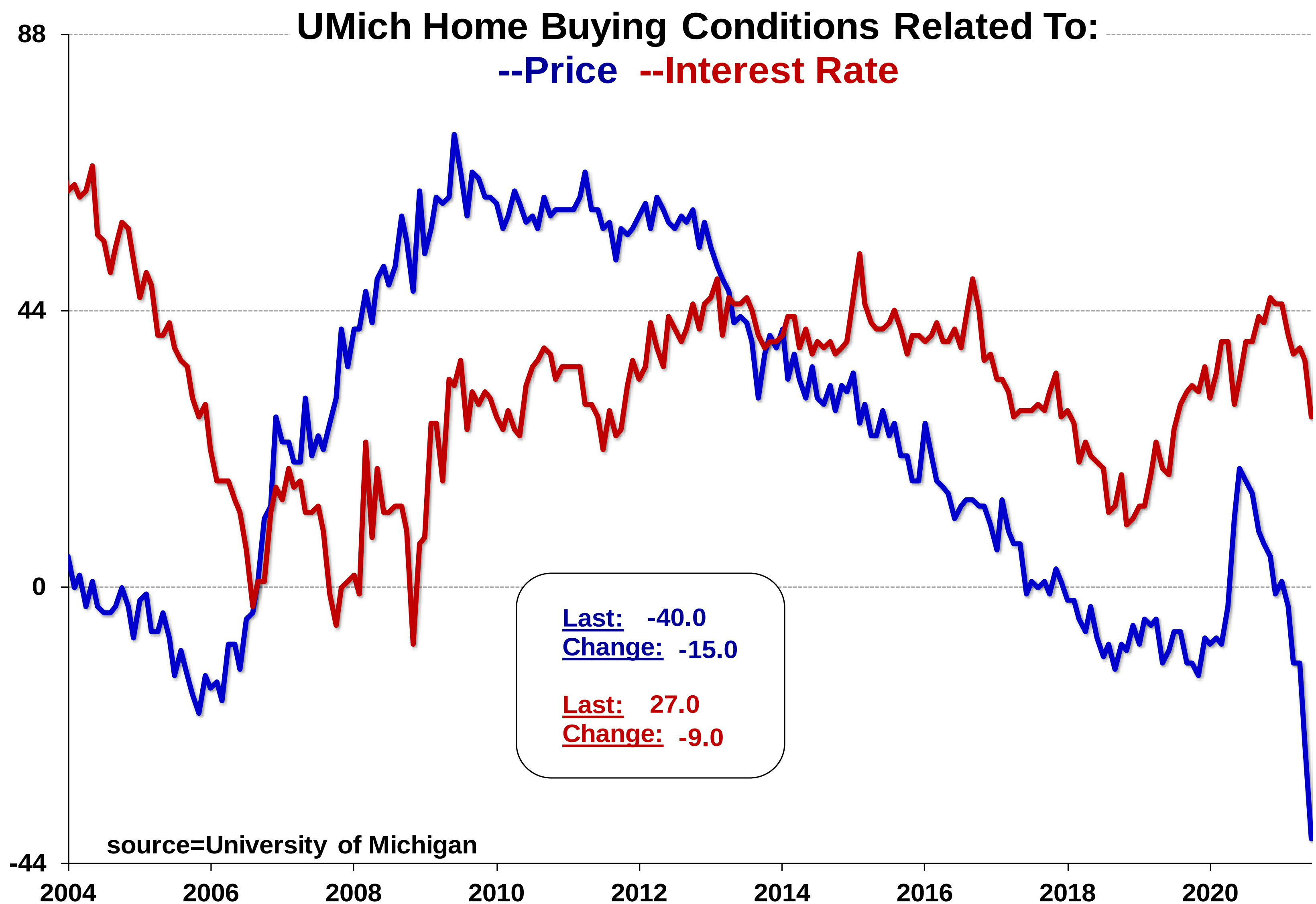
Meanwhile, median prices jump 4.8% to highest on record as inventory remains tight



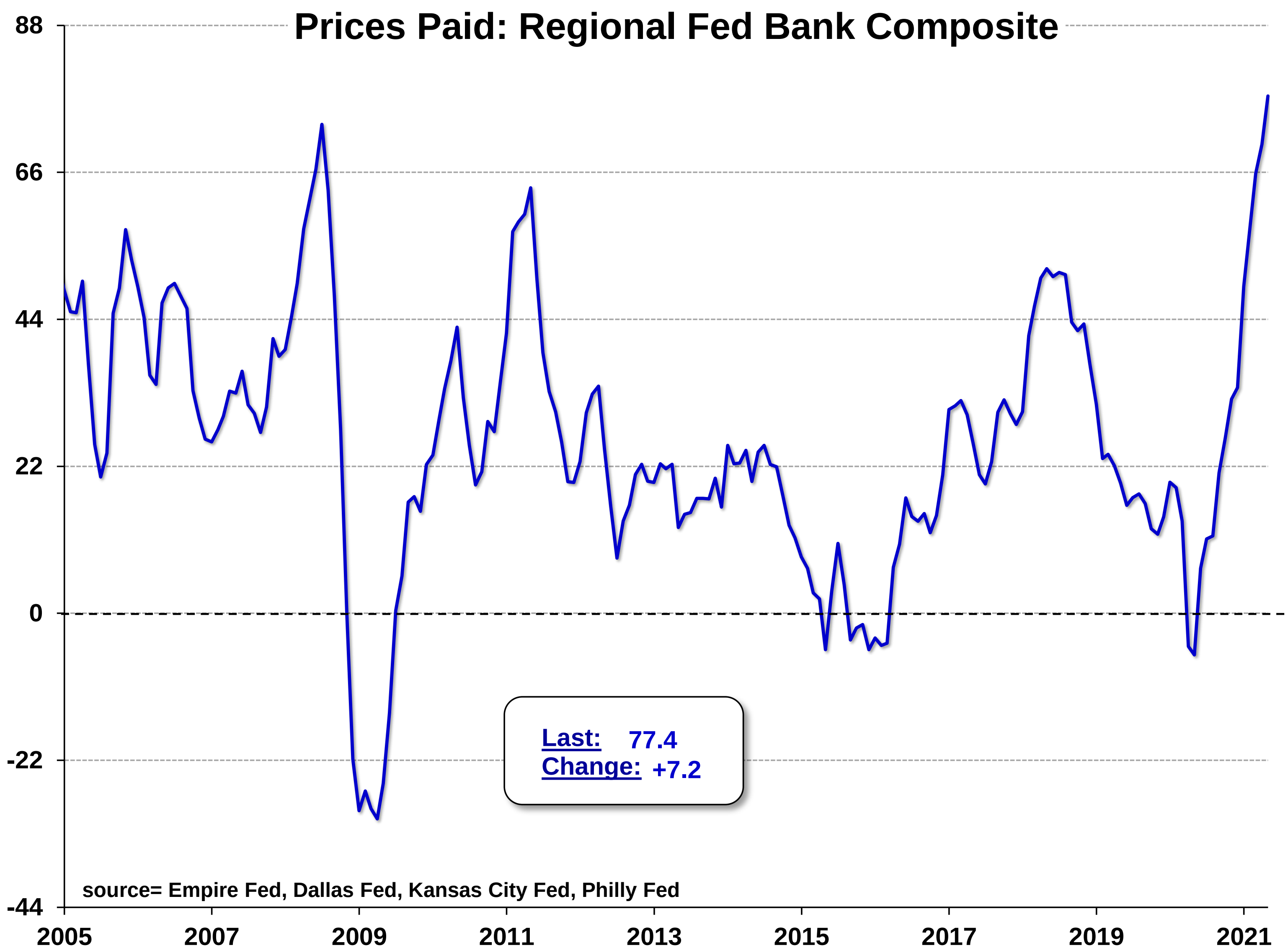
As noted last week, home buying conditions continued to sour even as interest rates remained favorable. Latest UMich survey shows Home Buying Conditions tumbling -19pts to 95 (lowest since 1983)…



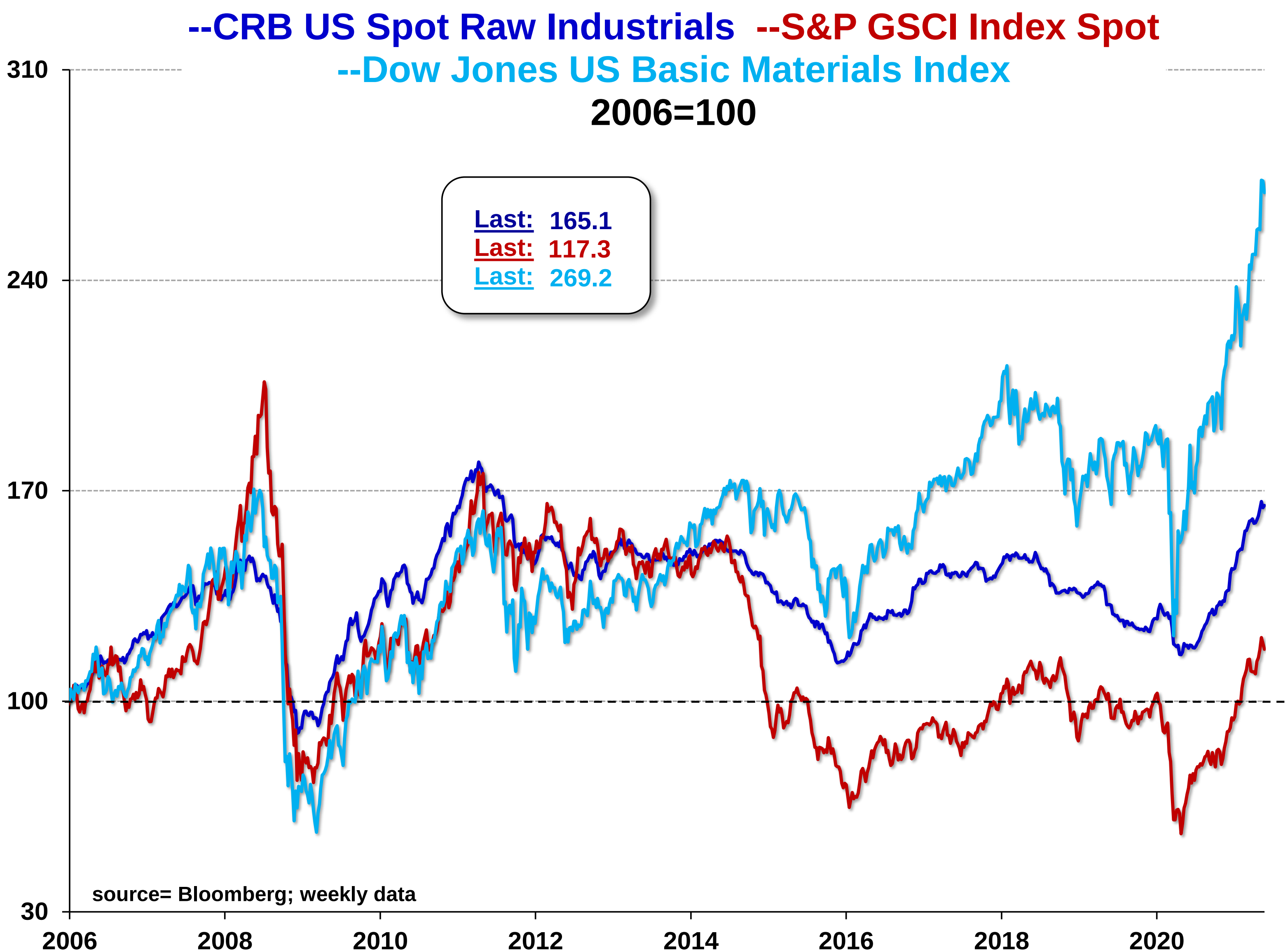
…with respondents pointing to soaring prices as the determining factor. **Chart: home buying conditions index (related to price) tumbles -15pts to record low -40**



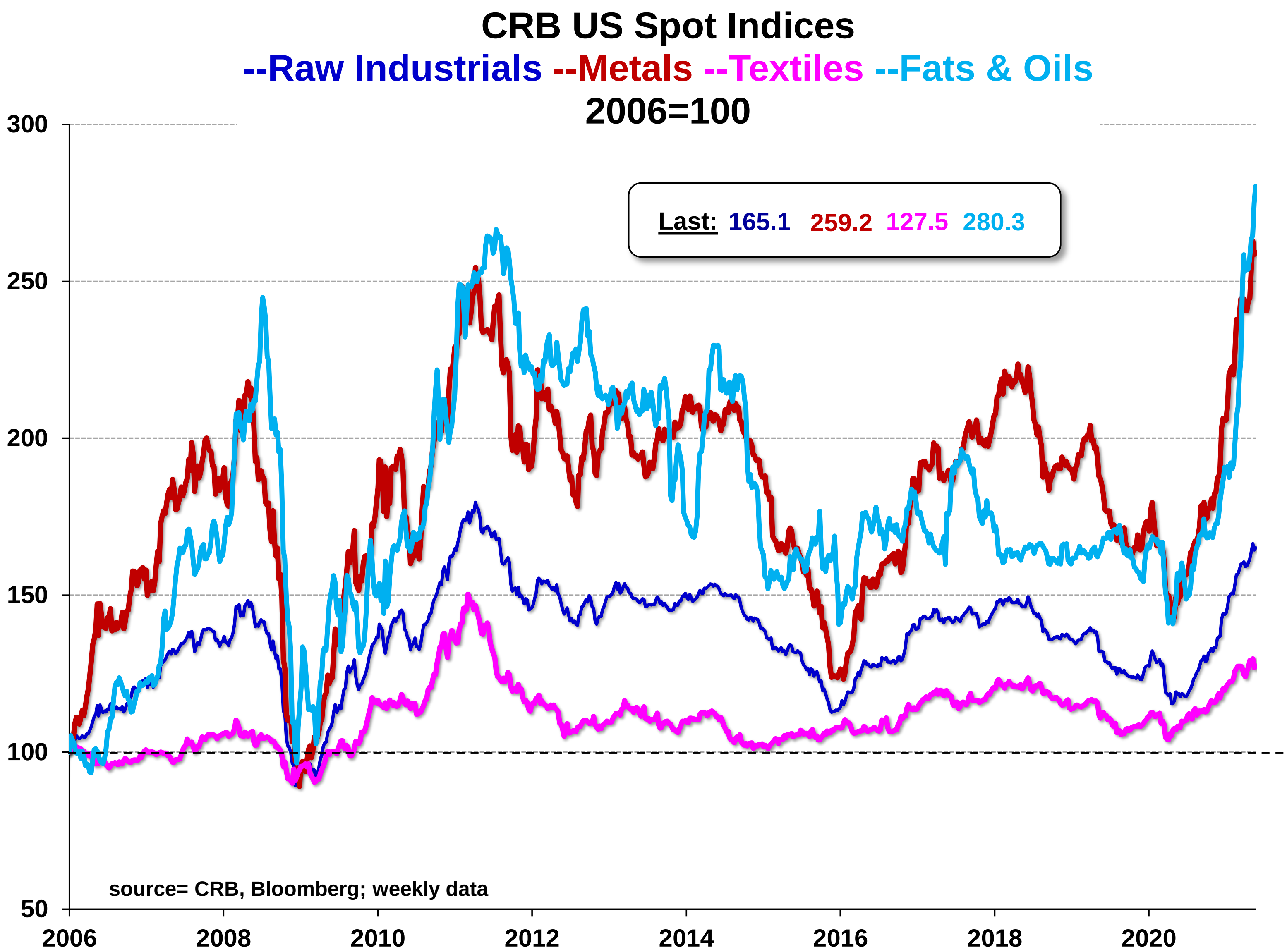
Meanwhile, inflation indicators continue to run hot: Prices Paid regional composite now at record high following Empire Fed (highest Prices Paid reading on record) and Philly Fed (highest PP since 1980) updates this week.



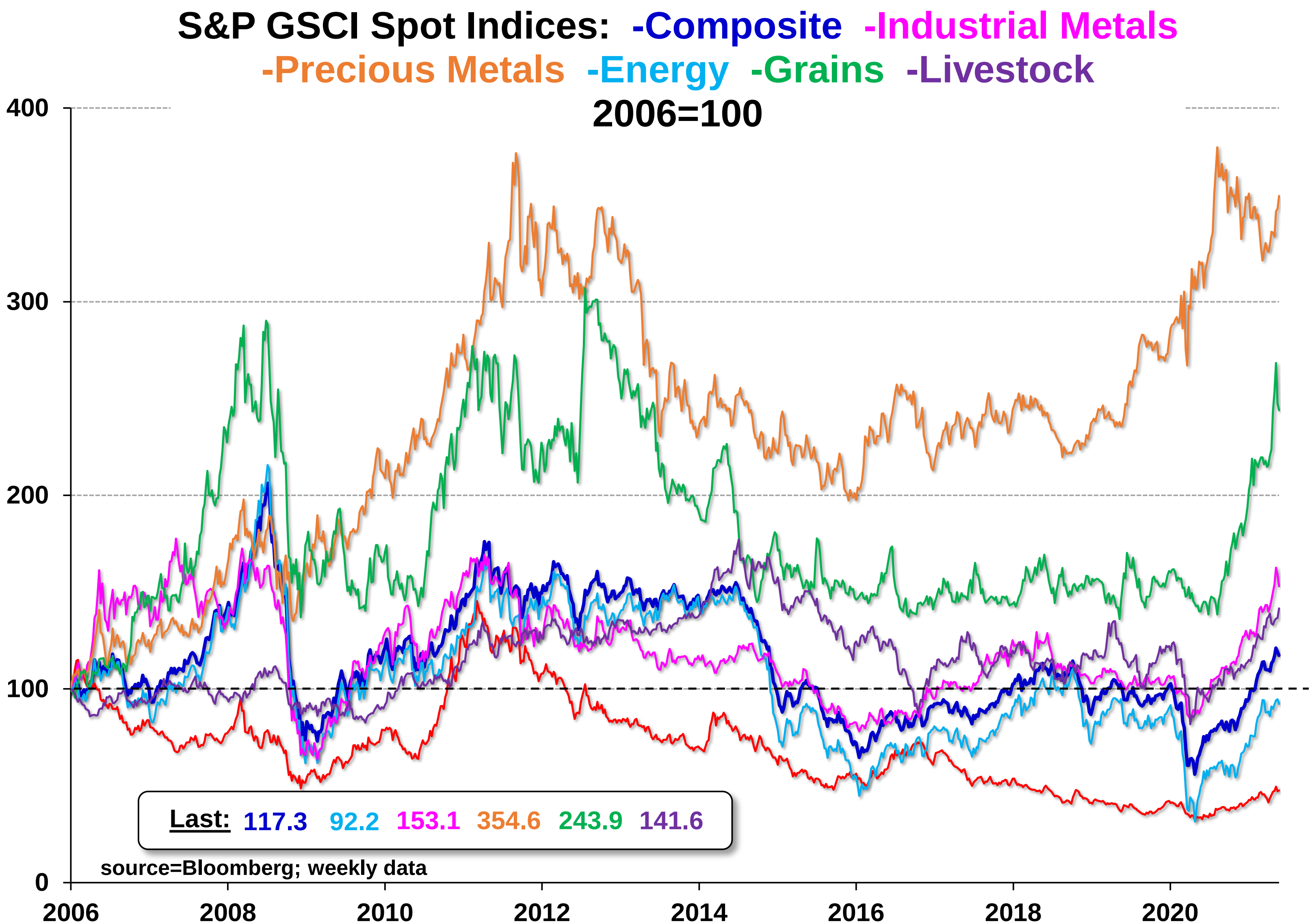
Inflation on the rise



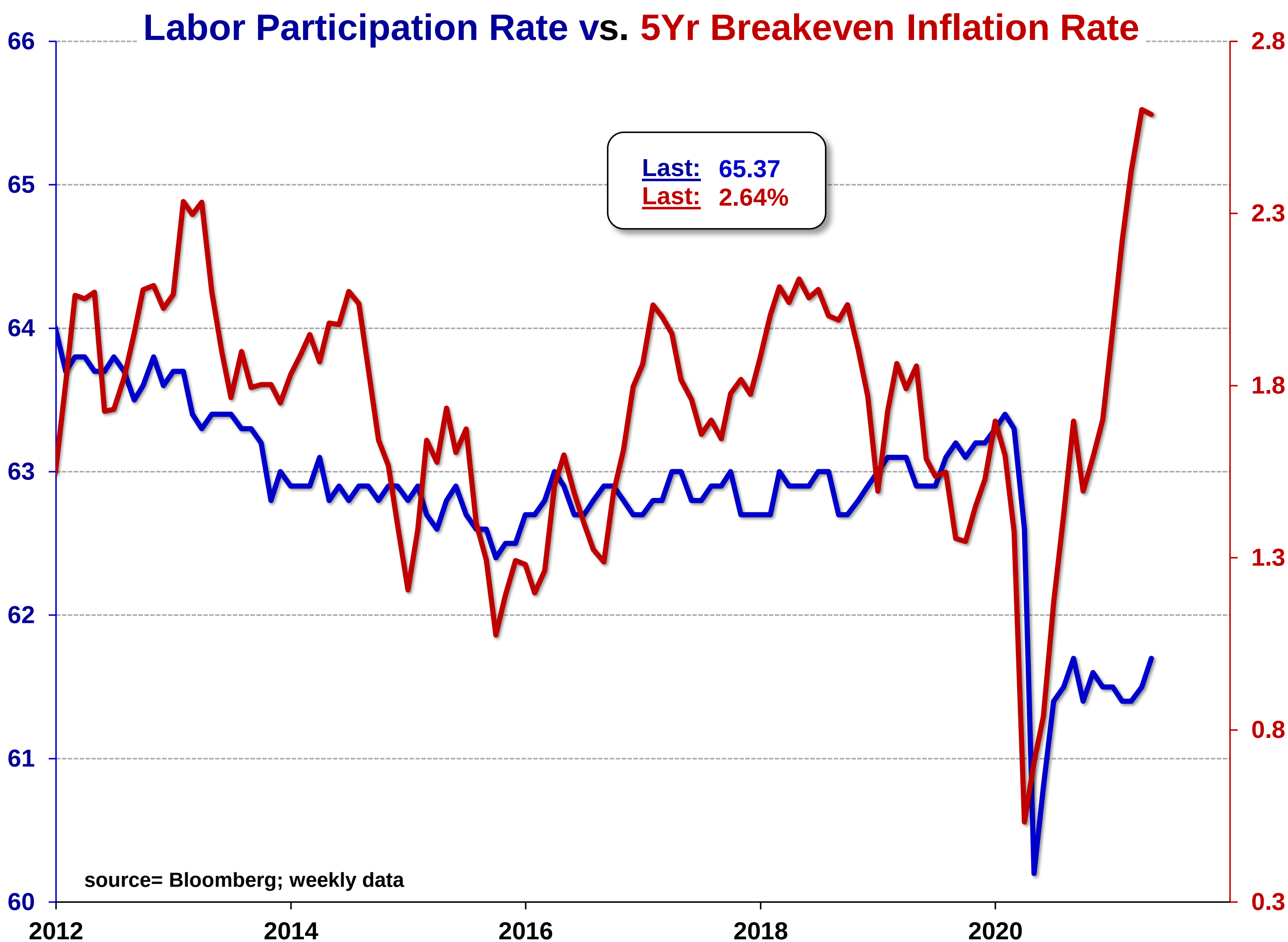
Inflation on the rise



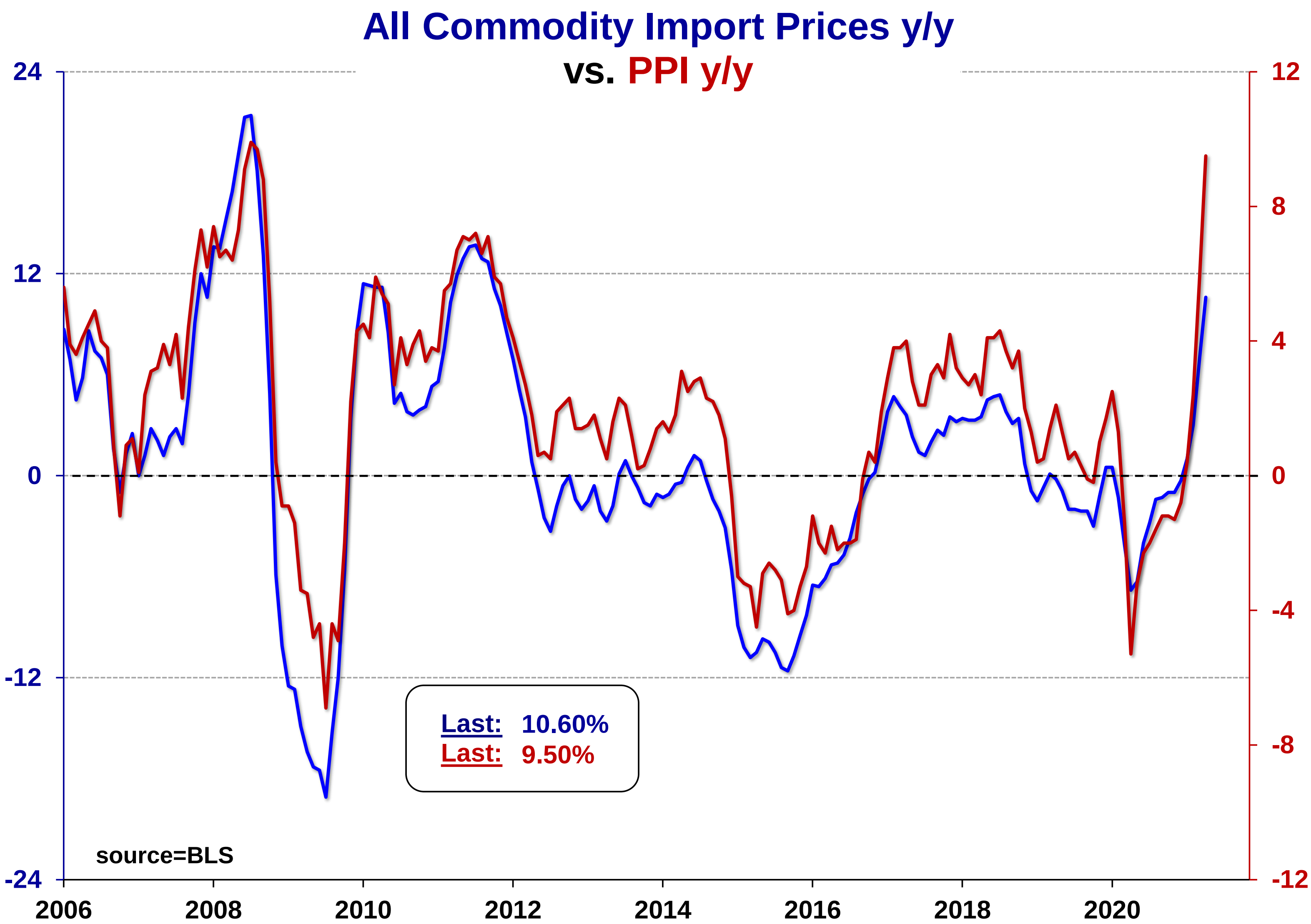
Inflation on the rise



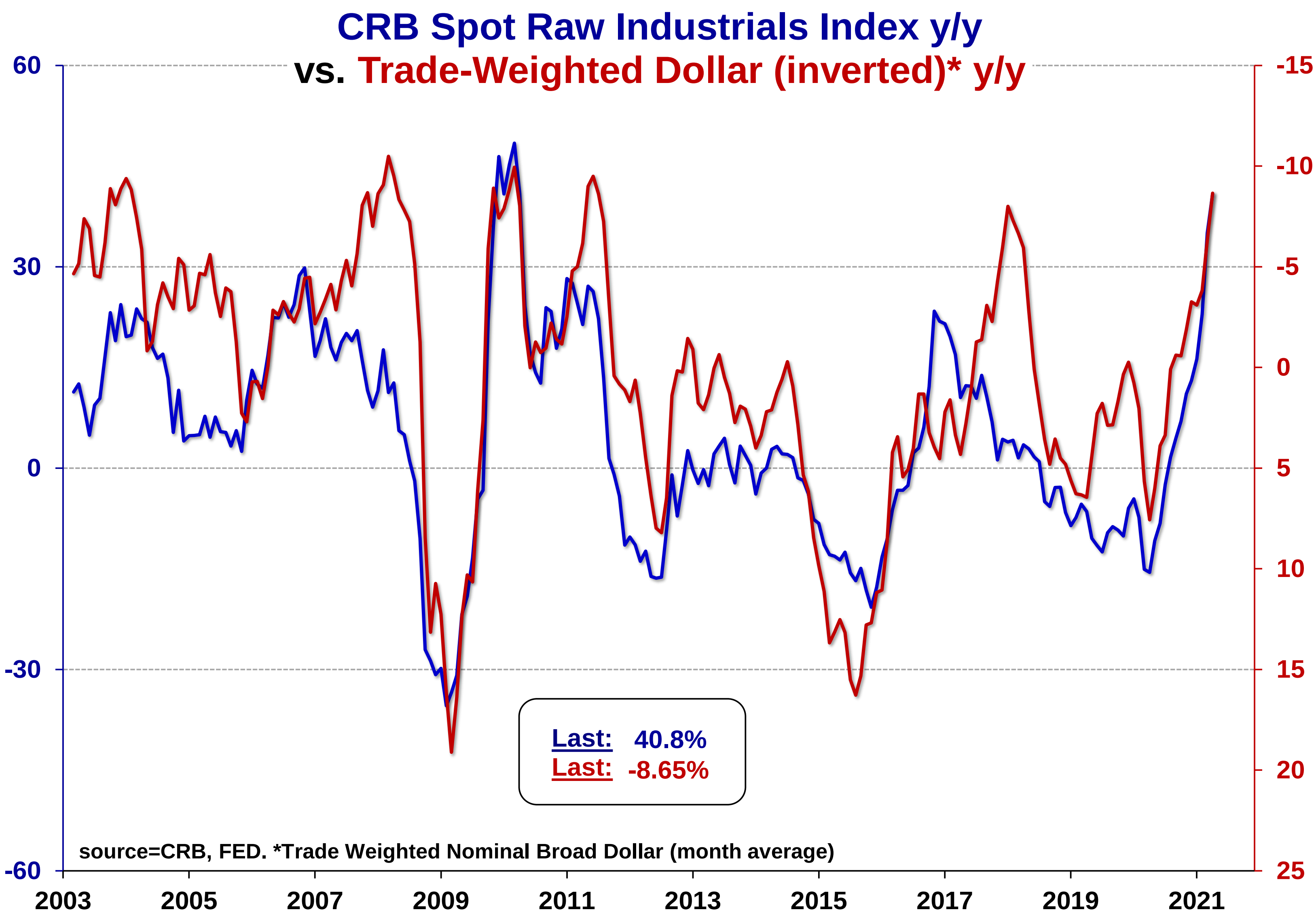
Record stimulus has created a massive disconnect between inflation expectations and labor market conditions.



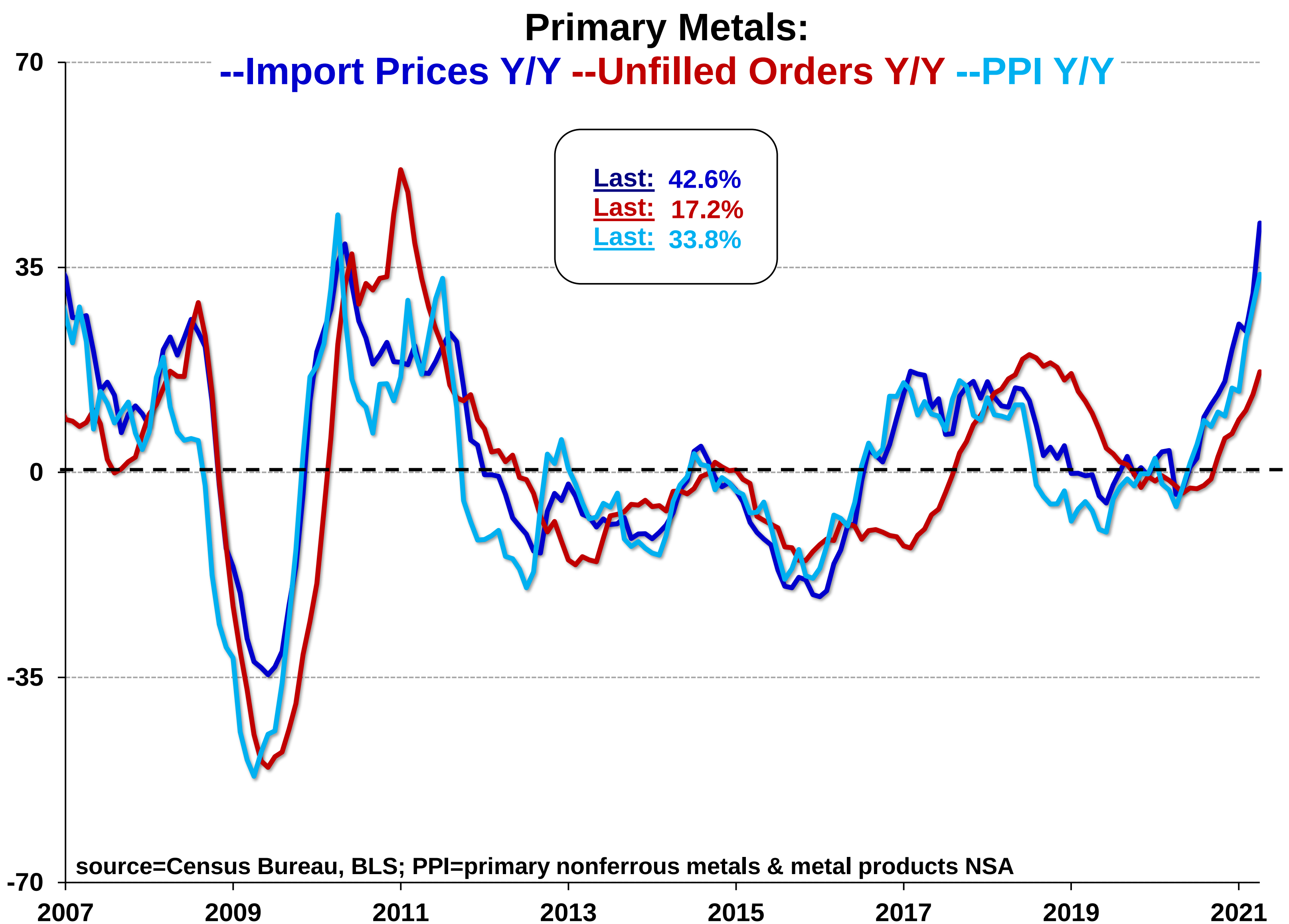
Rising import prices sending production/input costs soaring…



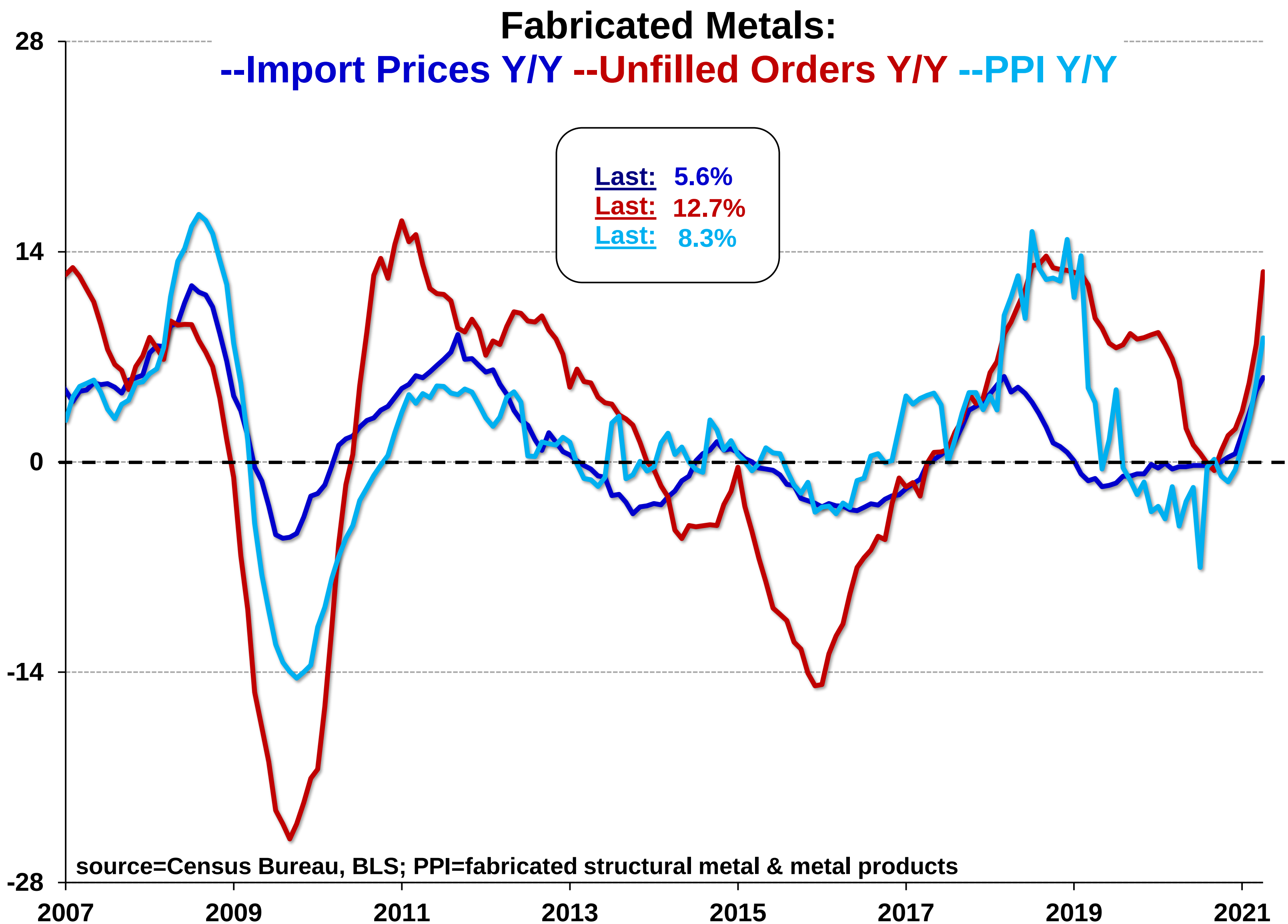
…and sending the dollar lower.



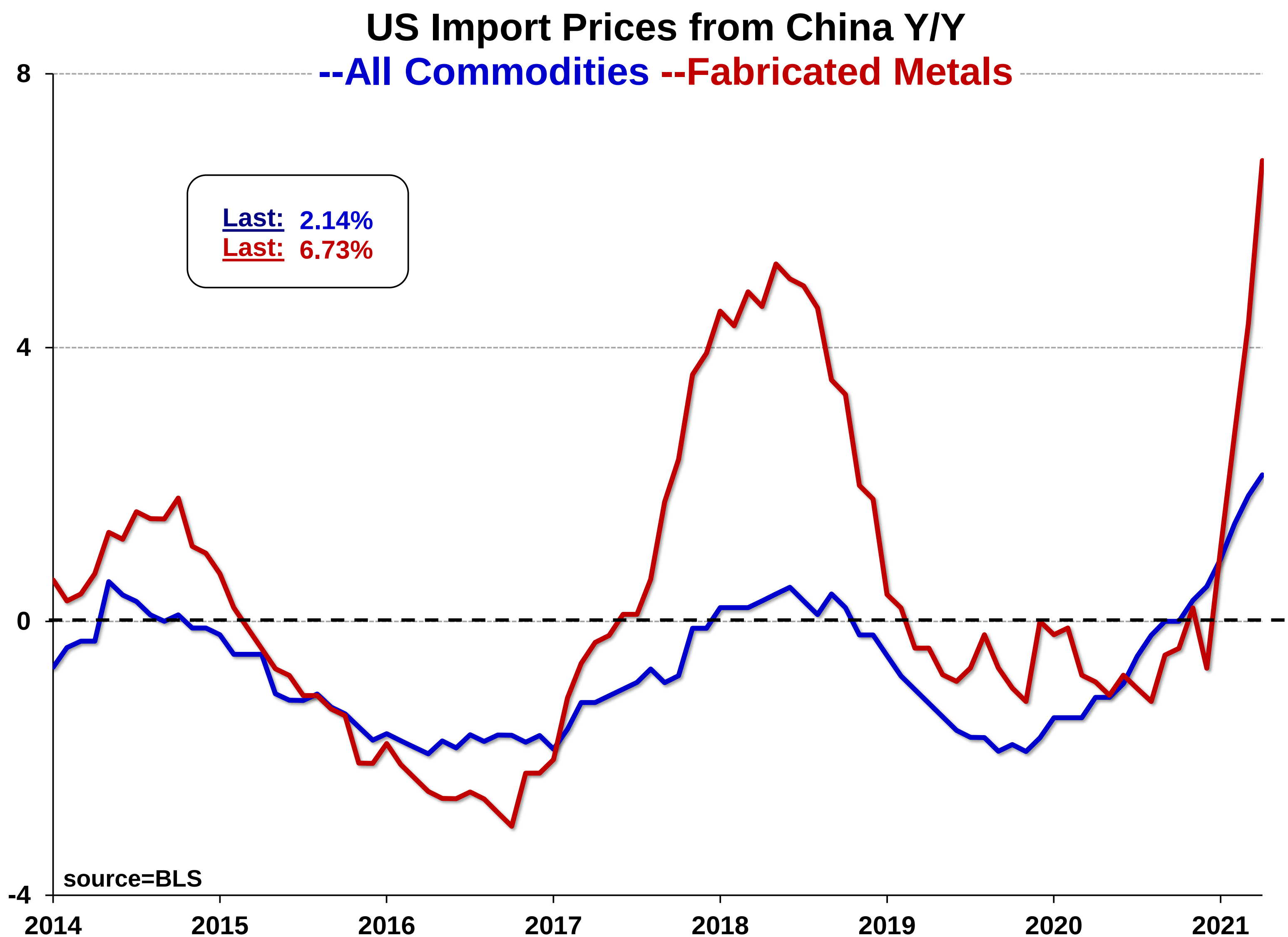
Primary Metals import prices up 43% y/y
Primary Metals PPI: +34% y/y



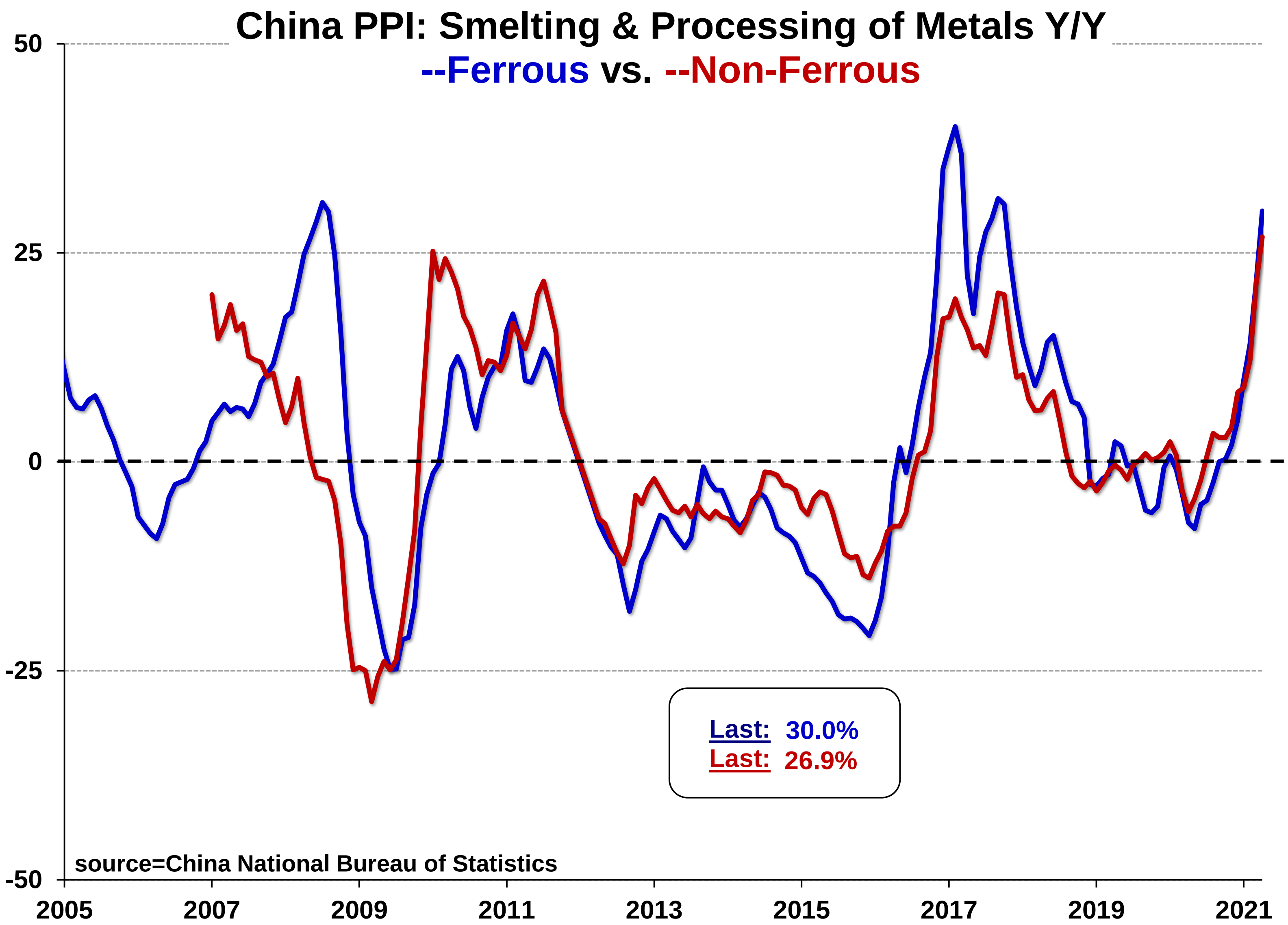
Fabricated Metal Import Prices and PPI also heading higher



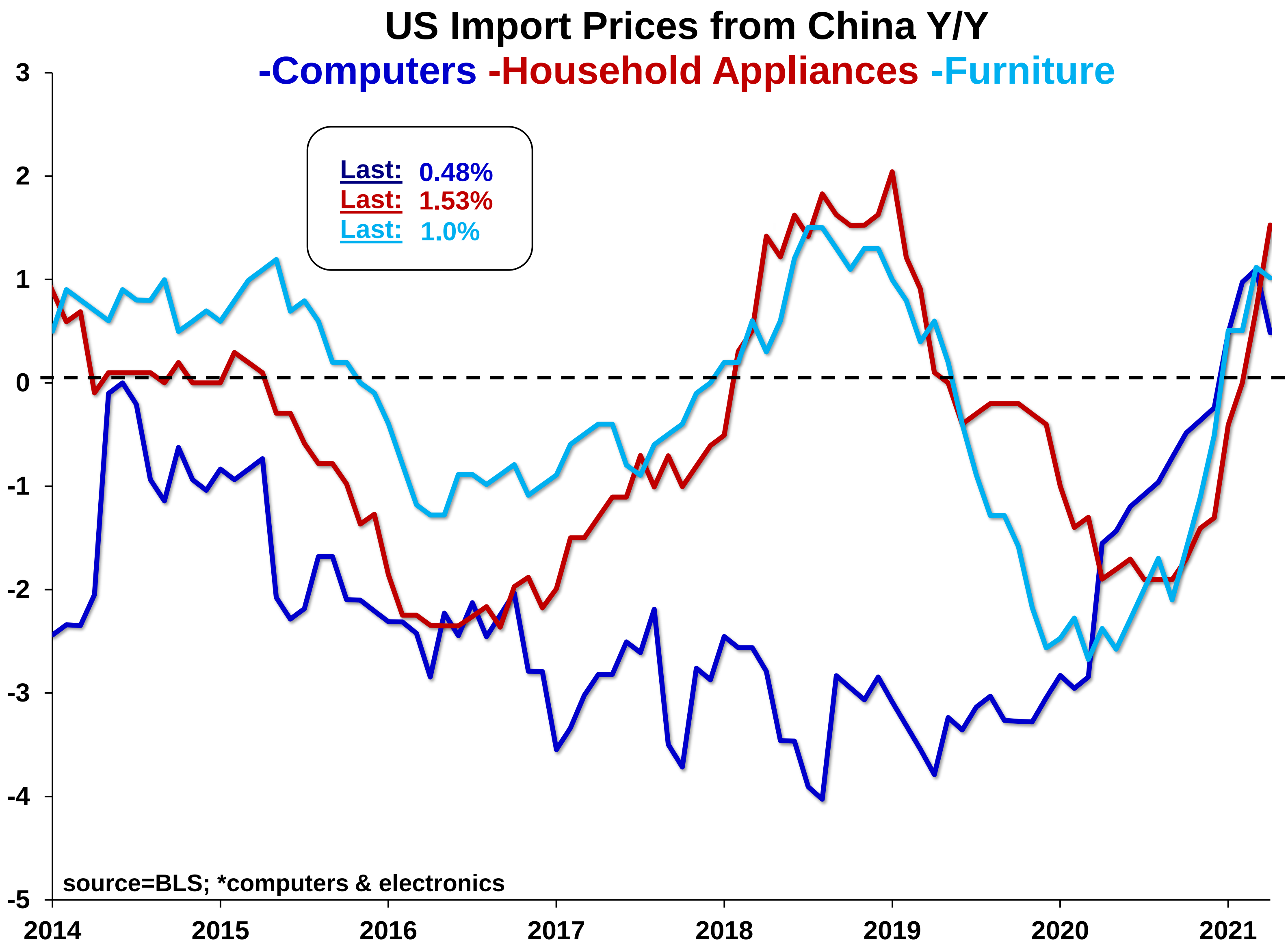
Import Prices from China are surging...



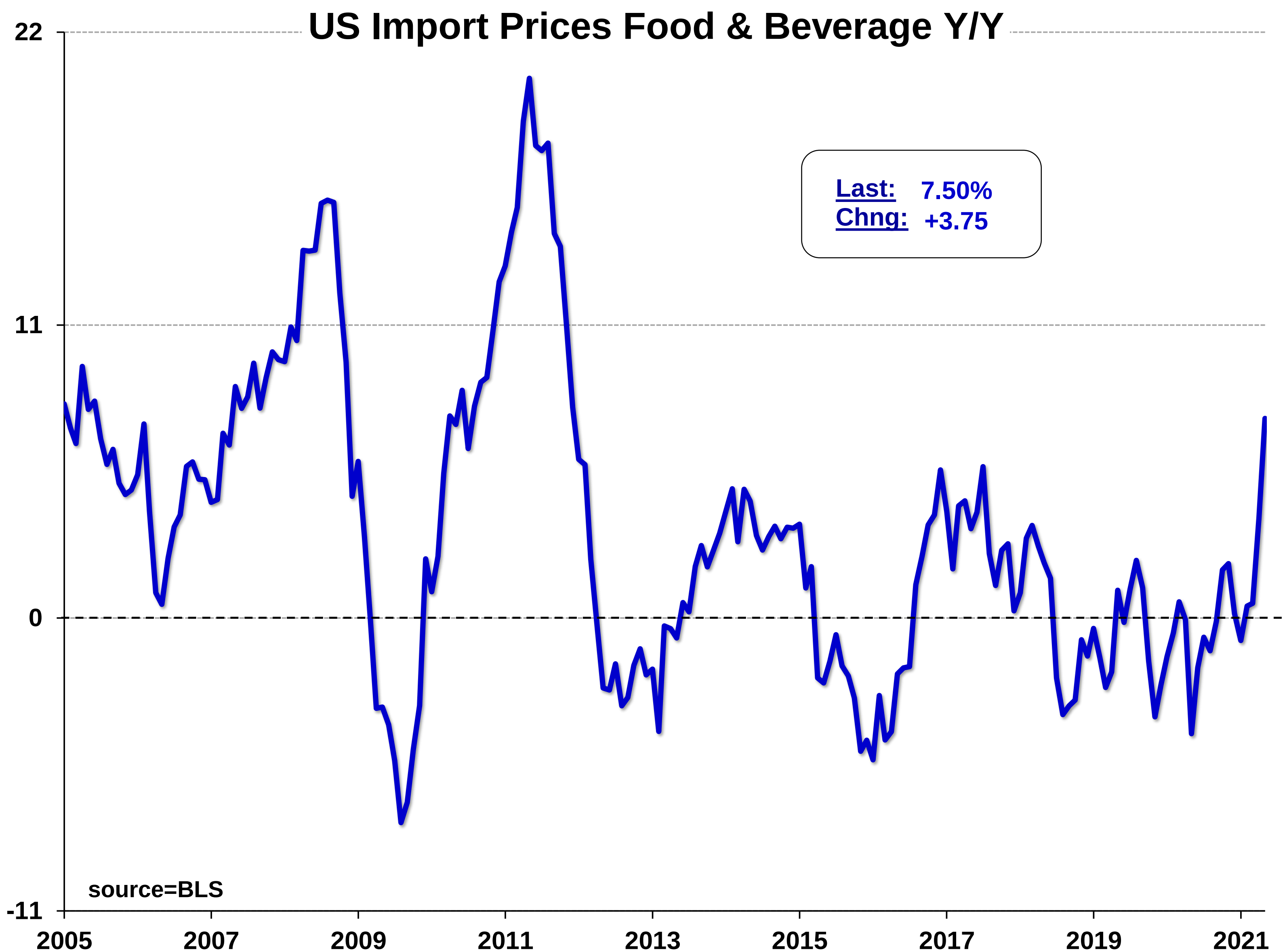
…this as China's metals smelting & processing inputs costs spike (along with China's broader PPI), exacerbating global inflation risks



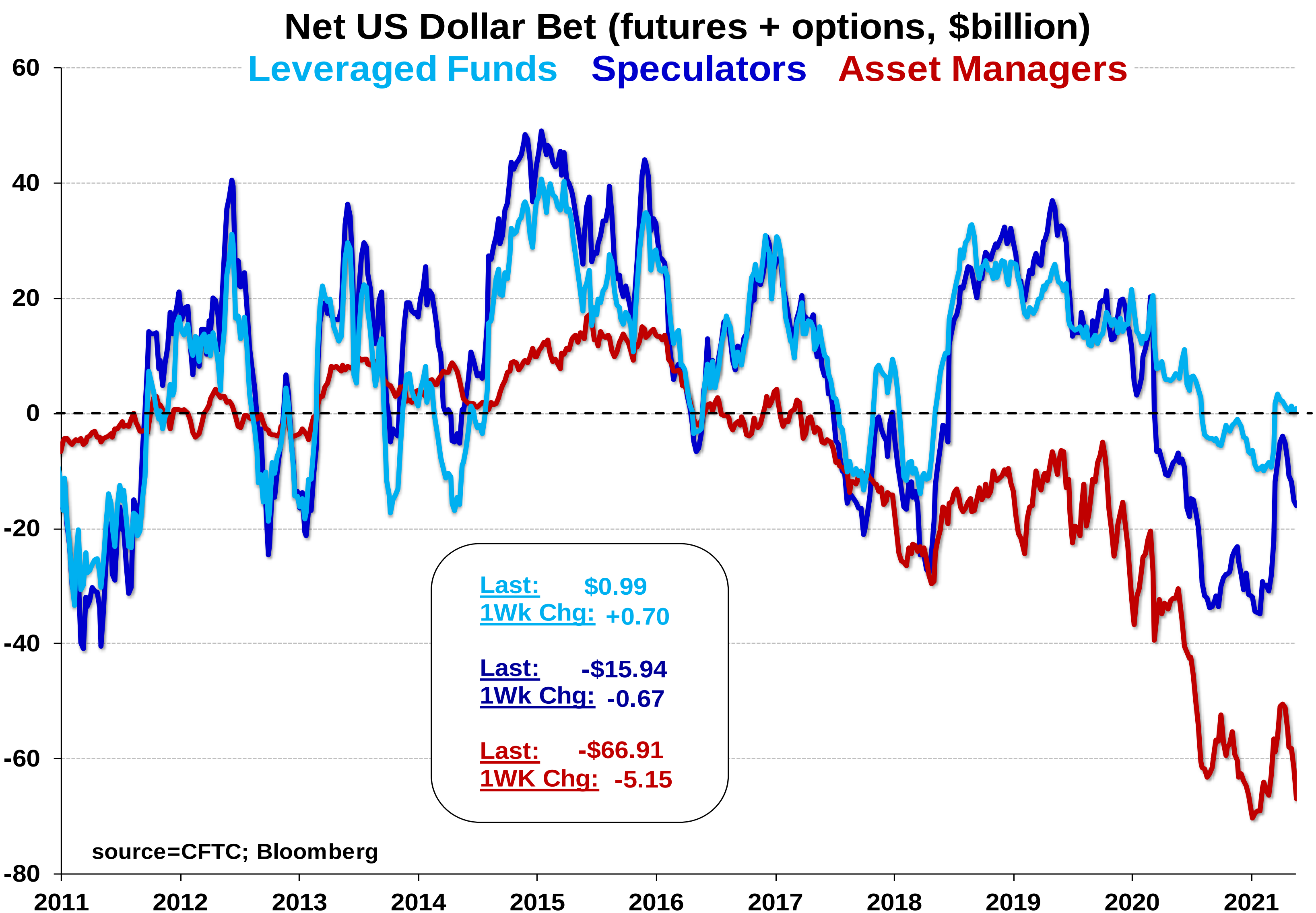
Consumer-goods-related import prices from China also turning higher…



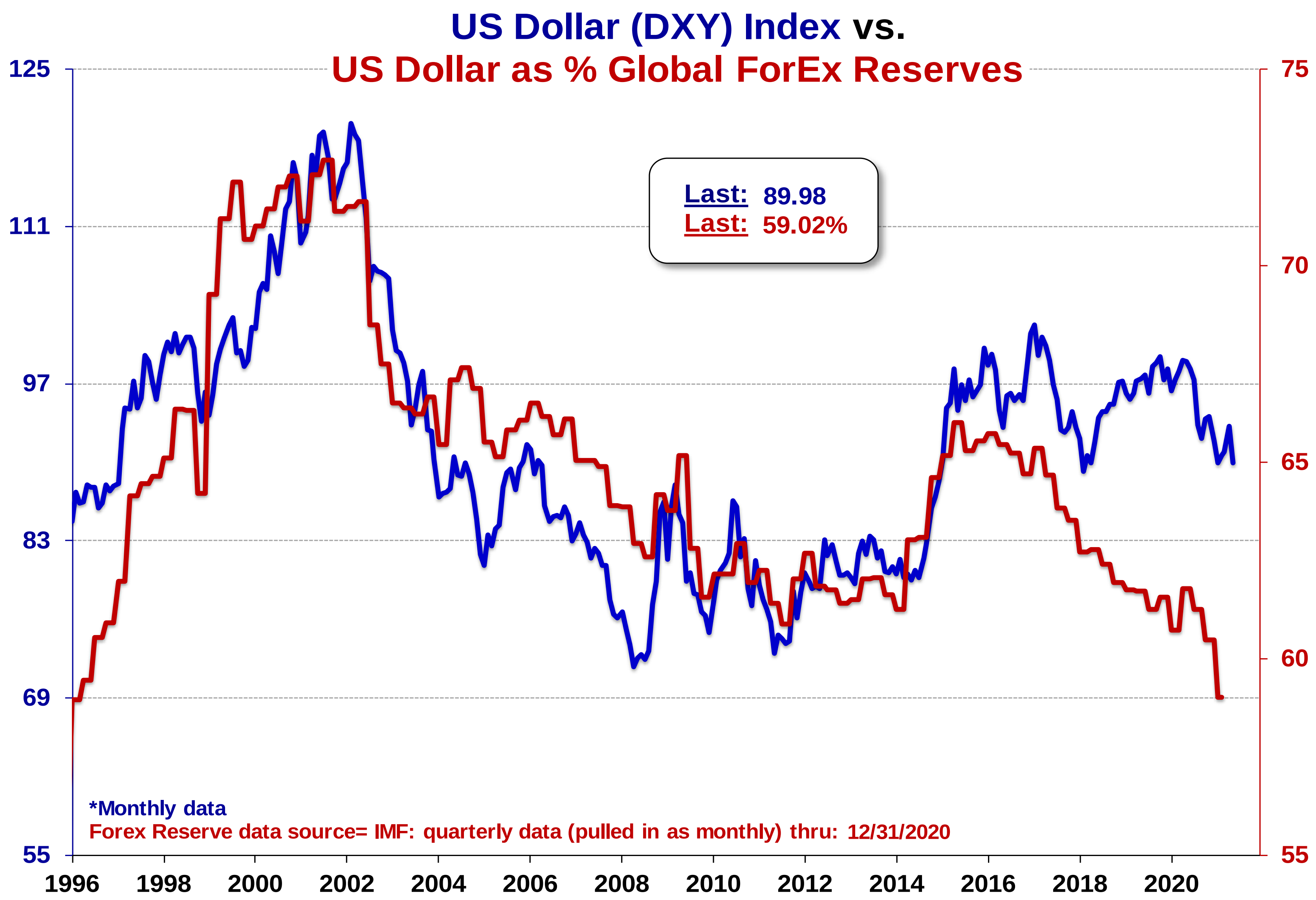
…as are food prices.



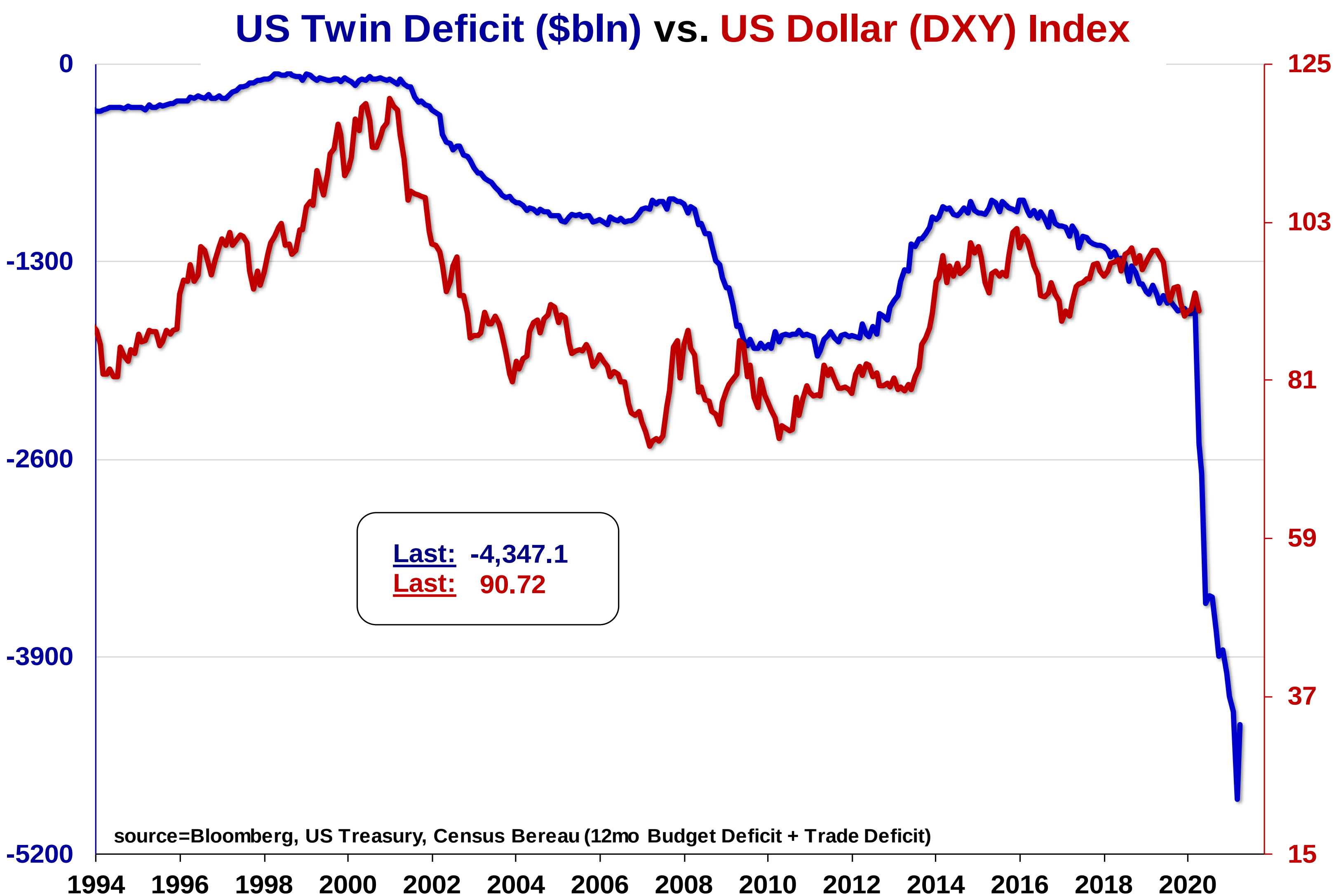
As record stimulus sets off inflation, dollar bets remain decidedly bearish: Speculators, Asset Managers increase net shorts for 6th and 5th week in a row respectively…with Asset Managers nearing record net short.



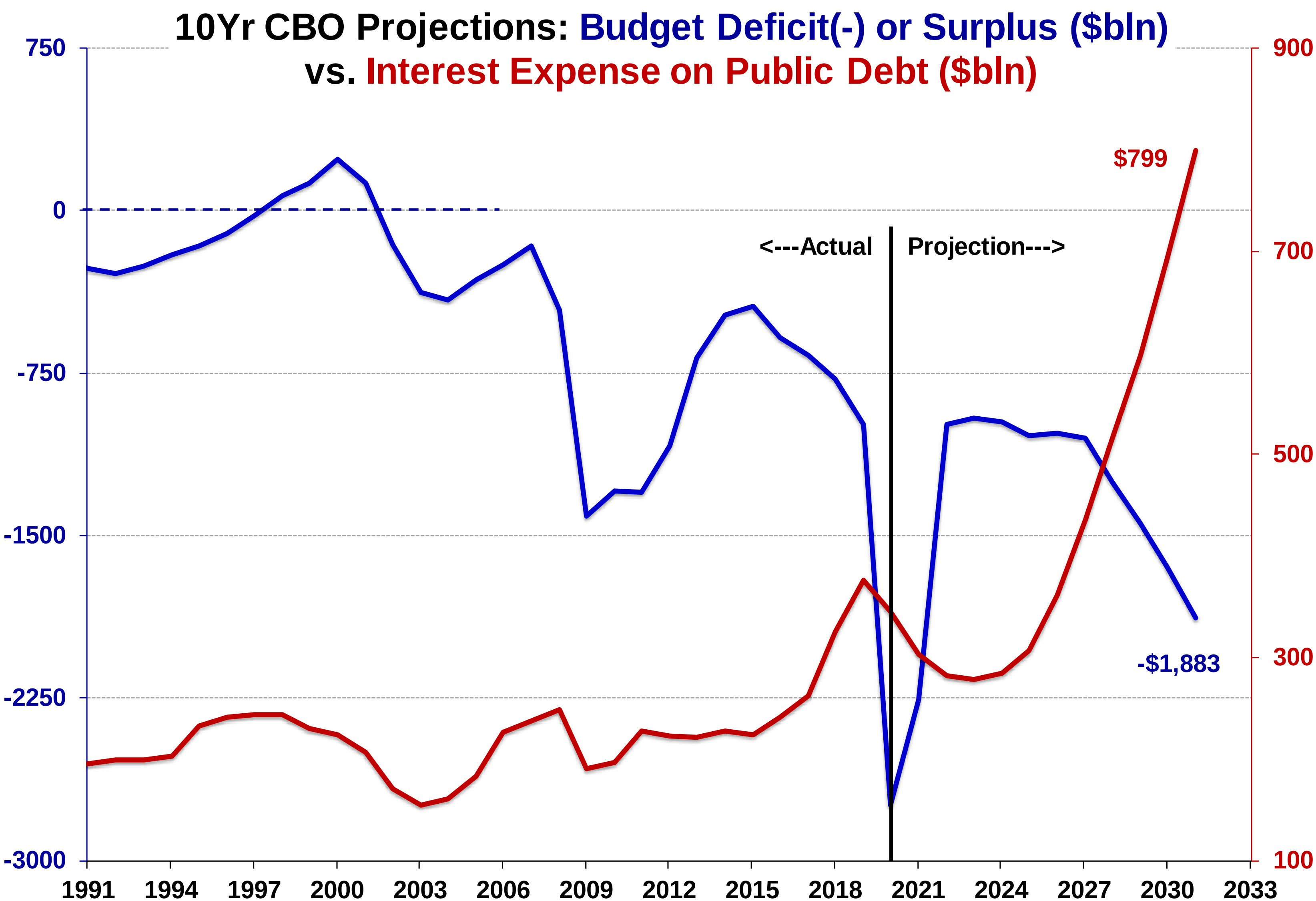
US Dollar as % Global Forex Reserves fell for 3 straight quarters thru end of 2020, and sure to continue lower...



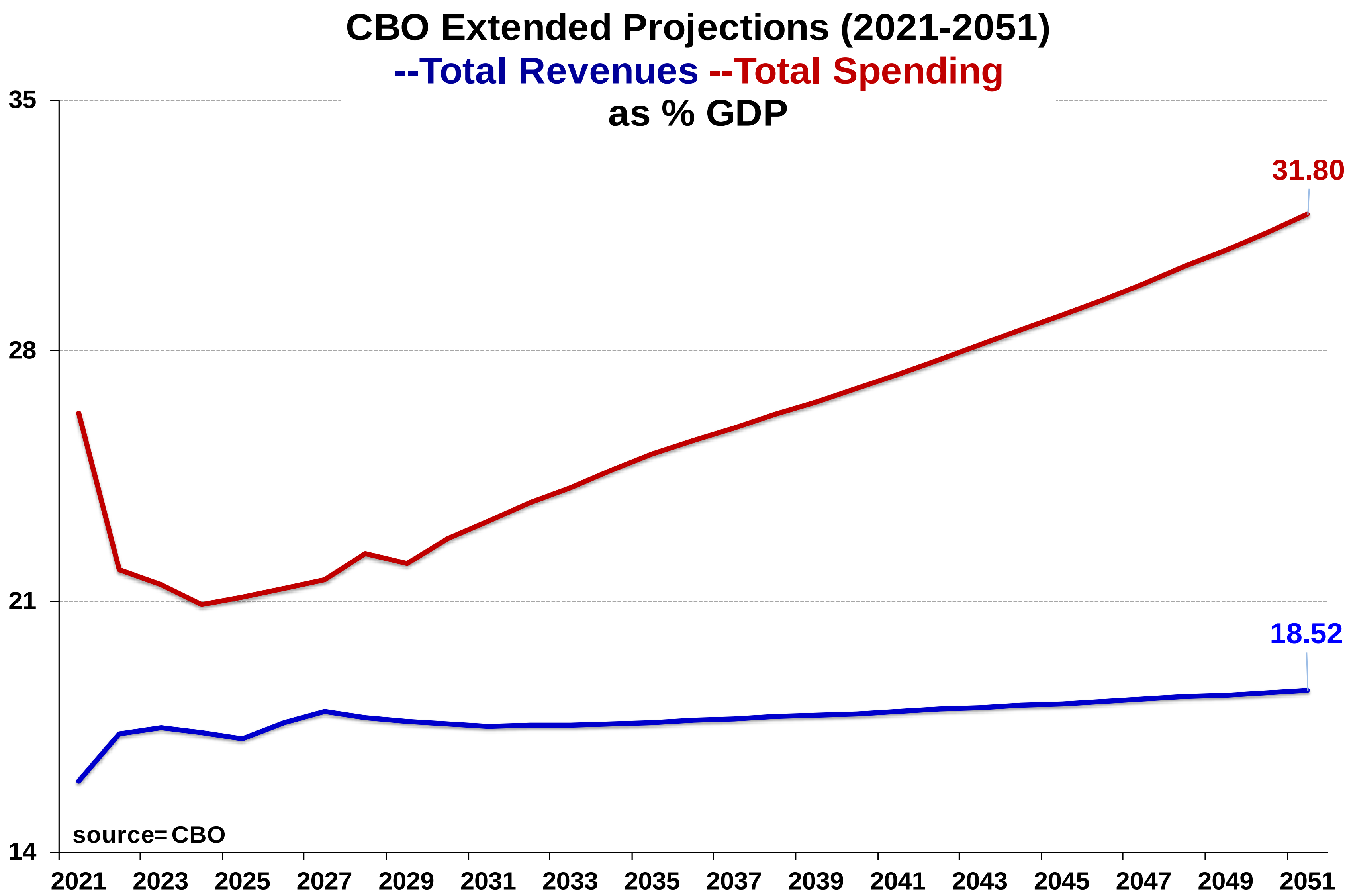
…as Deficit spending explodes, and likely to remain elevated as spending programs are sure to continue, with possibility of further rounds of stimulus checks (especially if permanent job loss numbers are as high as Continuing Claims seem to indicate).



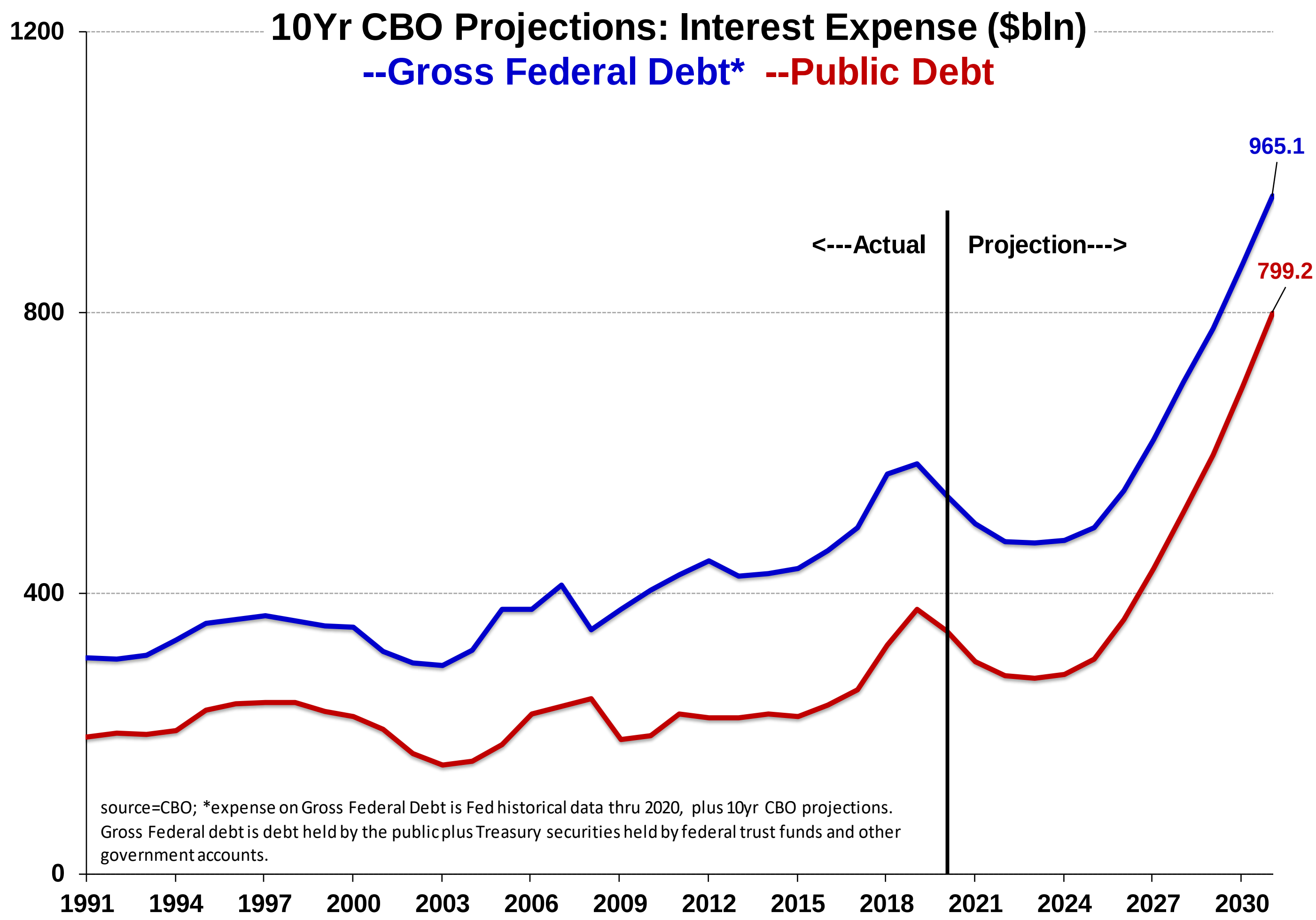
Expectations are for widening deficit over the next decade…



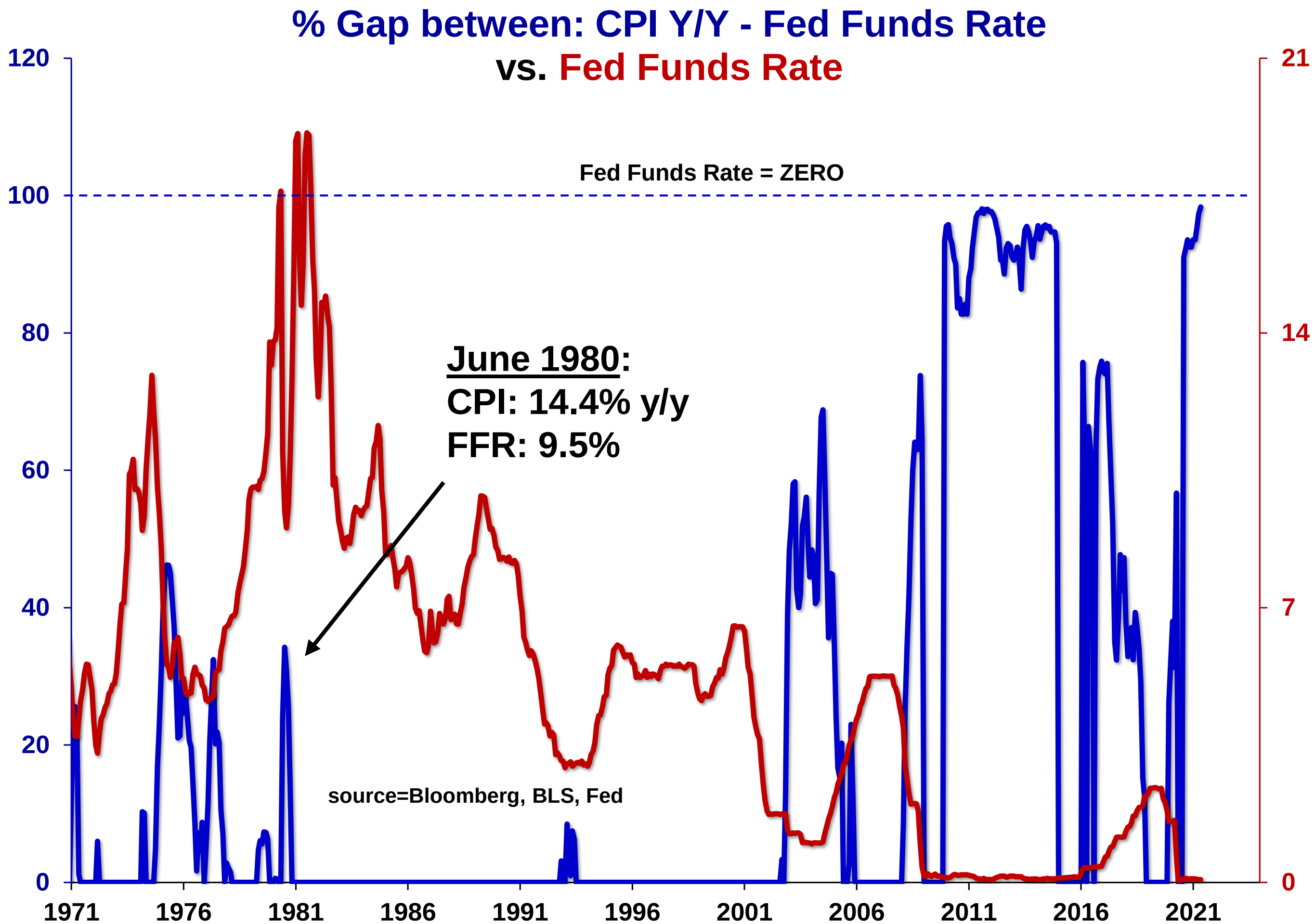
…and, further out, the situation is not expected to improve.



Indeed, the debt-fueled spending path we are on will be near impossible to break free from. In addition, raising rates in the current environment would create a massive negative feedback loop as it would slam the brakes on economic expansion and send interest expense exploding higher…which of course would lead to more stimulus and debt, in turn retarding growth. In astrophysics terms, we have effectively breached the debt *Event Horizon*…the point at which nothing can evade its inescapable and destructive grasp. <u>The organic growth necessary to escape this gravitational pull of endless debt-fueled spending simply is not there</u>.



Yes, the Fed is indeed trapped as debt levels are simply too enormous to consider raising rates. If the Fed were to state they plan to raise rates, say within the next 2-3 meetings, the market 'tantrum' would be seismic in our estimation. The Fed cannot allow a sustained bond market selloff either as rising interest rates would slam the brakes on the economy. Chart: Fed maintains 'lower for longer' even as CPI heats up. Note: Gap between CPI y/y and Fed Funds Rate (expressed as % difference; ie – gap is now a record 98.3% and would be 100% if Fed Funds were at zero instead of 0.07%). Prior largest gap where CPI was positive and Fed Funds was near zero was in August 2011 at 98% as European Sovereign Debt Crisis and US growth scare rocked global stock markets.

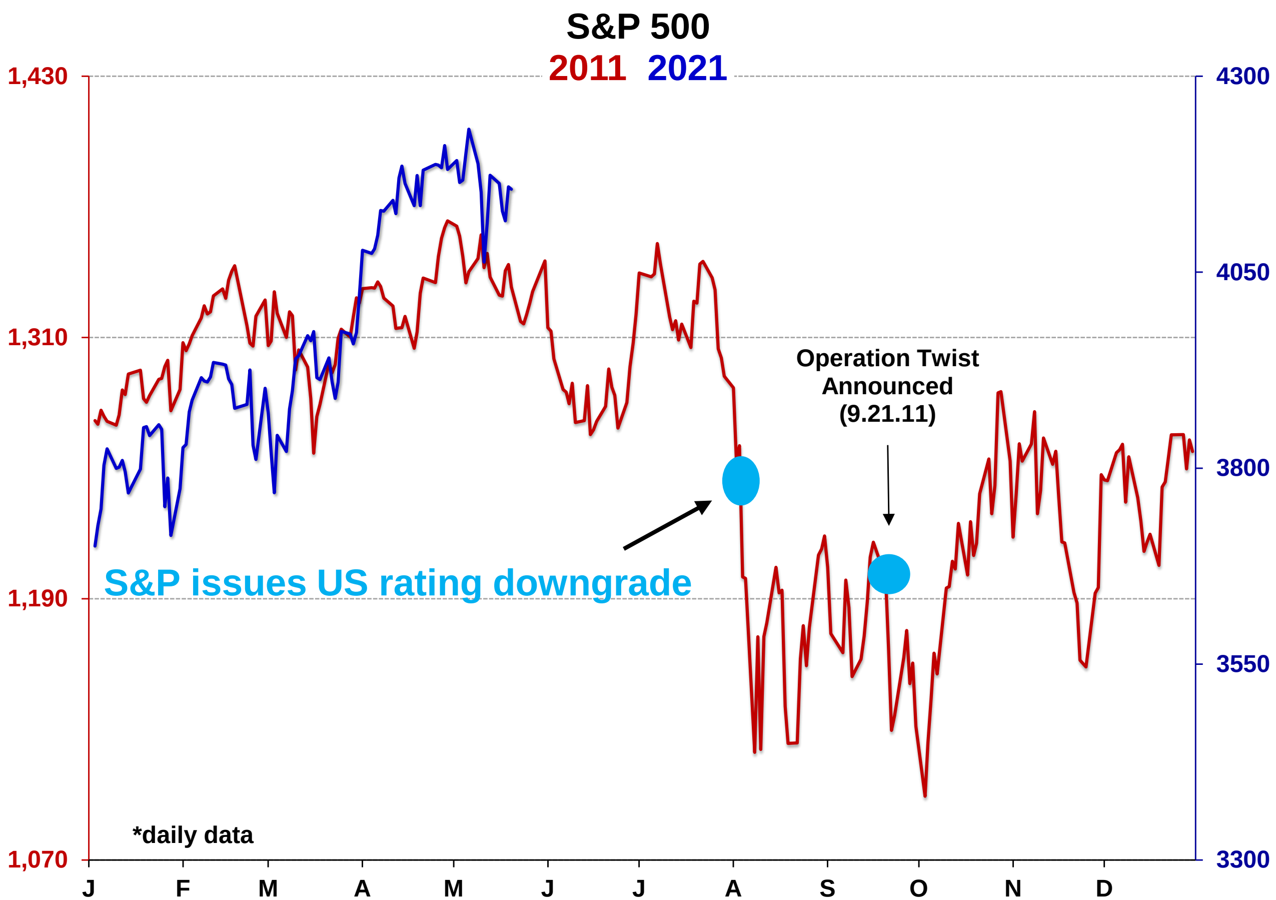


We wanted to point out something which has been conspicuously absent considering exploding deficit and debt, expectations for further spending programs, plus multiple warnings from the CBO regarding the unsustainable fiscal path we are on: a US credit rating downgrade. A shot across the bow came from Fitch Ratings in July of last year in which the agency affirmed United States' AAA rating, yet revised the outlook to Negative from Stable. Fitch noted that while the US benefited from issuing debt in the world's reserve currency, it also had the highest debt of any AAA-rated sovereign and had not presented a credible plan to address massive debt accumulation resulting from the economic shutdown. They also predicted Debt/GDP ratio would exceed 130% by end of 2021 (a marker which has already been hit in Q1 if we factor-in latest spending programs). Since Fitch's July 2020 report, the Budget Deficit has jumped \$2.25 trillion and we saw the 12mo deficit hit a record \$4.09 trillion in March. Should we see passage of additional (\$trillion+) spending programs (seems like a certainty) without a credible budgetary offset plan, it would only be logical the US would see a downgrade from one or more of the big 3 ratings agencies.

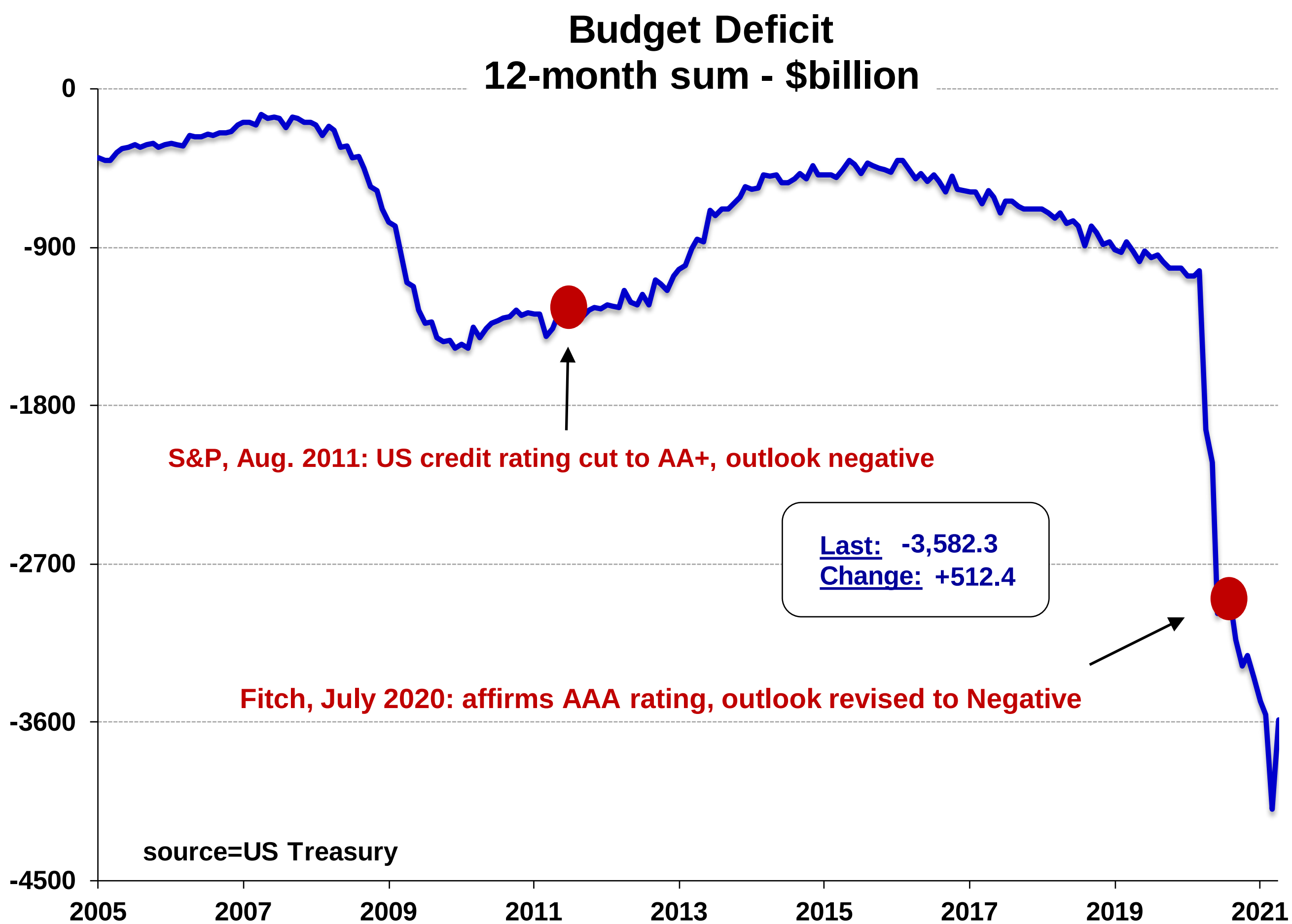
Earlier this year, Fitch again warned a downgrade may be warranted. From Fitch Ratings (March 9, 2021): "*The \$1.9 trillion American Rescue Plan (ARP) ….will deliver a strong economic boost but the scale of the package points to a delayed return to a fiscal stance consistent with stabilization of the government debt ratio, says Fitch Ratings. Consequently, the prospect of debt stabilization is further away than when Fitch placed the US Sovereign Rating of 'AAA' on Negative Outlook in July 2020, despite a stronger economic recovery demonstrated by improving data and supported by the ARP. At the time of the review of the US rating in July 2020 we said that we would assess what steps the new administration took toward deficit consolidation in the post-pandemic phase, noting that the rating could be downgraded in the absence of a credible commitment to address medium-term public spending and debt challenges. The future path of mandatory spending including Medicare and social security will remain an important driver of medium-term financing needs.*"

The report goes on to say: *"…without a fiscal anchor and in light of the ambitions of the administration, fiscal policy may be more expansionary, leading debt to rise more rapidly."* Translation: debt will rise *uncontrollably*.

A potential credit rating downgrade feeds right into the idea of a market correction ahead…much like the scenario seen in 2011. In August 2011, global markets reeled over fears of contagion from European Sovereign Debt Crisis, concerns over slowing US growth plus the shock of Standard & Poor's US credit rating downgrade to AA+ from AAA. Fast forward a decade to today, and it all sounds eerily familiar. Europe is still struggling (negative Eurozone GDP last 4 of 5 quarters, see addenda chart 3), Europe's debt pile has soared, US macro data is softening as stimulus check programs come to an end, and US Debt/GDP hits record highs. Could we be on the verge of a 2011 repeat as a double-whammy of growth fears (or stagflation fears) and credit ratings downgrades send markets reeling? Buckle up, volatility may soon be back in a big way.



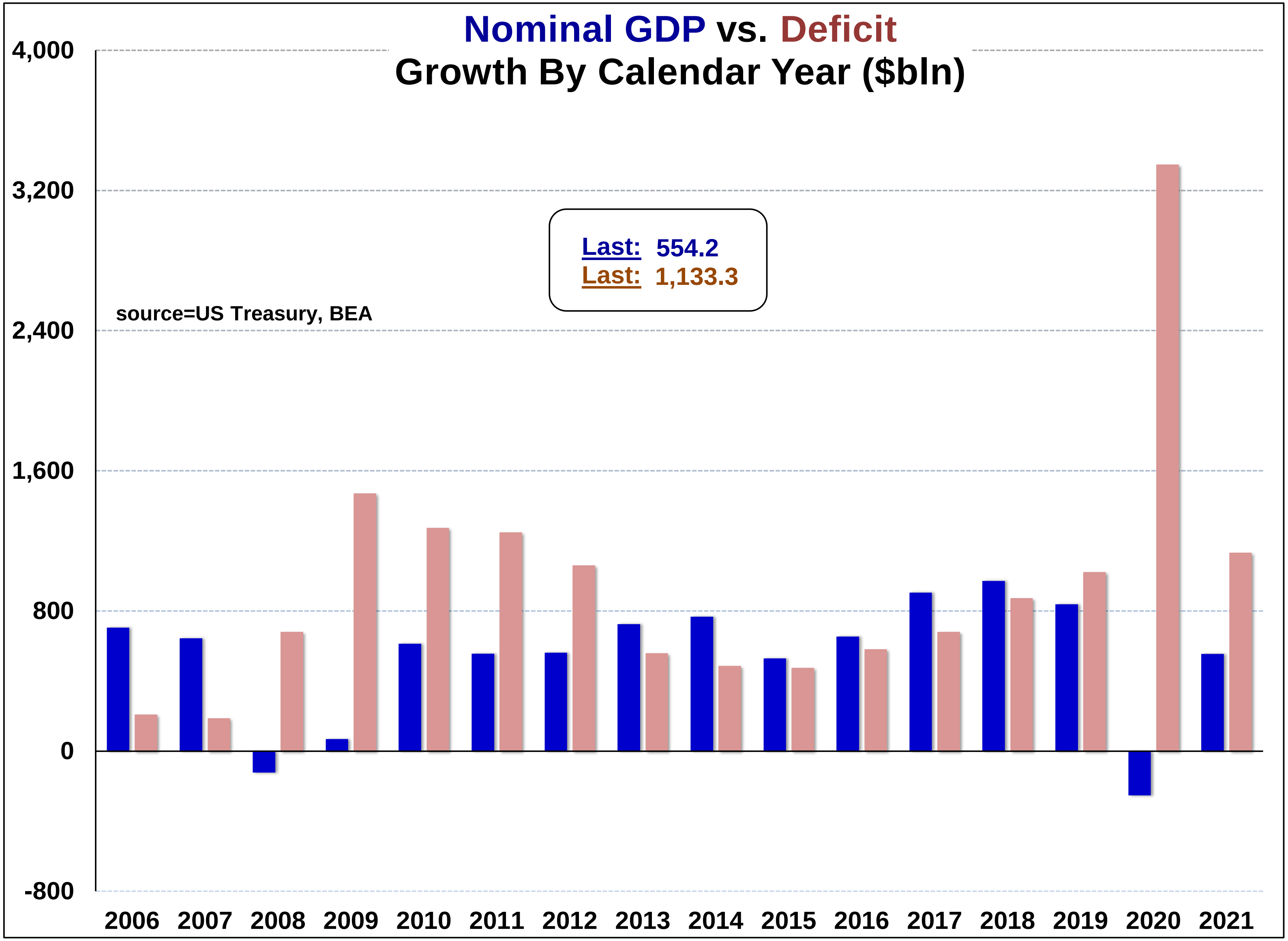
Oddly enough, S&P's August 2011 credit rating downgrade press release included the following: *We could lower the long-term rating to 'AA' within the next two years if we see that less reduction in spending than agreed to, higher interest rates, or new fiscal pressures during the period result in a higher general government debt trajectory than we currently assume in our base case.* It looks as if those targets (save higher interest rates) have easily been met, yet here we are a decade later…with 12-month deficit nearly 3x where it was in August 2011… and no movement from S&P. The Dollar is no doubt in the Fed's crosshairs as they attempt to reduce America's debt burden, so a credit rating downgrade could be just the ticket to accelerate the dollar's slide.



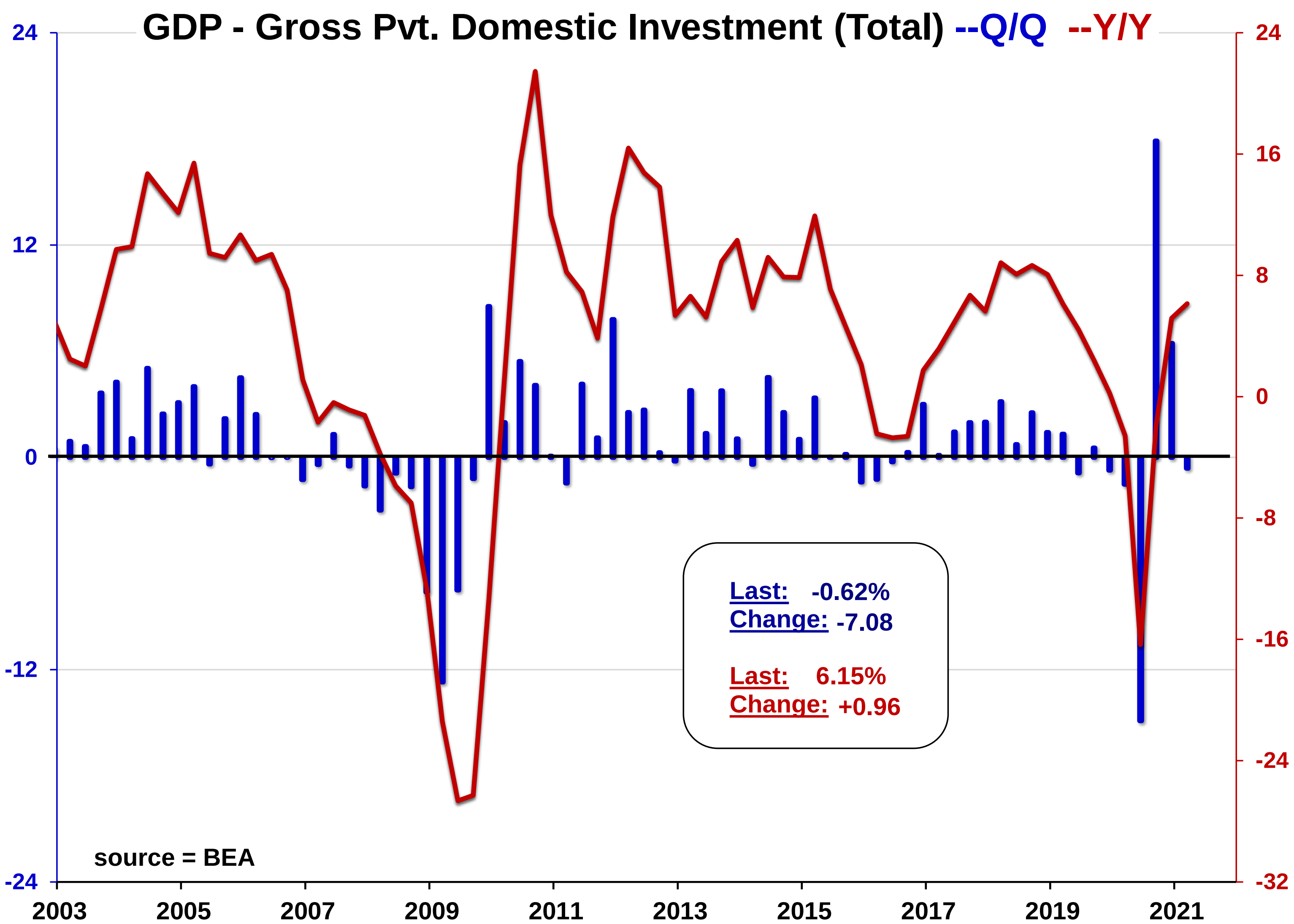
Should we see this scenario play out as it did in 2011, what will be the result? Why, additional fiscal and monetary stimulus of course. Whether it plays out this way or not, we believe the longer-term prospects for the dollar remain decidedly negative as debt accumulation has effectively entered autopilot mode.

Agency	Rating	Outlook	Date
Fitch	**AAA**	negative	Jul 31 2020
DBRS	**AAA**	stable	Apr 22 2014
Fitch	**AAA**	stable	Mar 21 2014
Fitch	**AAA**	negative watch	Oct 15 2013
DBRS	**AAA**	under review	Oct 09 2013
Moody's	**Aaa**	stable	Jul 18 2013
S&P	**AA+**	stable	Jun 10 2013
Fitch	**AAA**	negative	Nov 28 2011
DBRS	**AAA**	stable	Sep 08 2011
S&P	**AA+**	negative	Aug 05 2011
Moody's	**Aaa**	negative	Aug 02 2011
S&P	**AAA**	negative watch	Jul 14 2011
Moody's	**Aaa**	negative watch	Jul 13 2011
S&P	**AAA**	negative	Apr 18 2011
Fitch	**AAA**	stable	Sep 21 2000

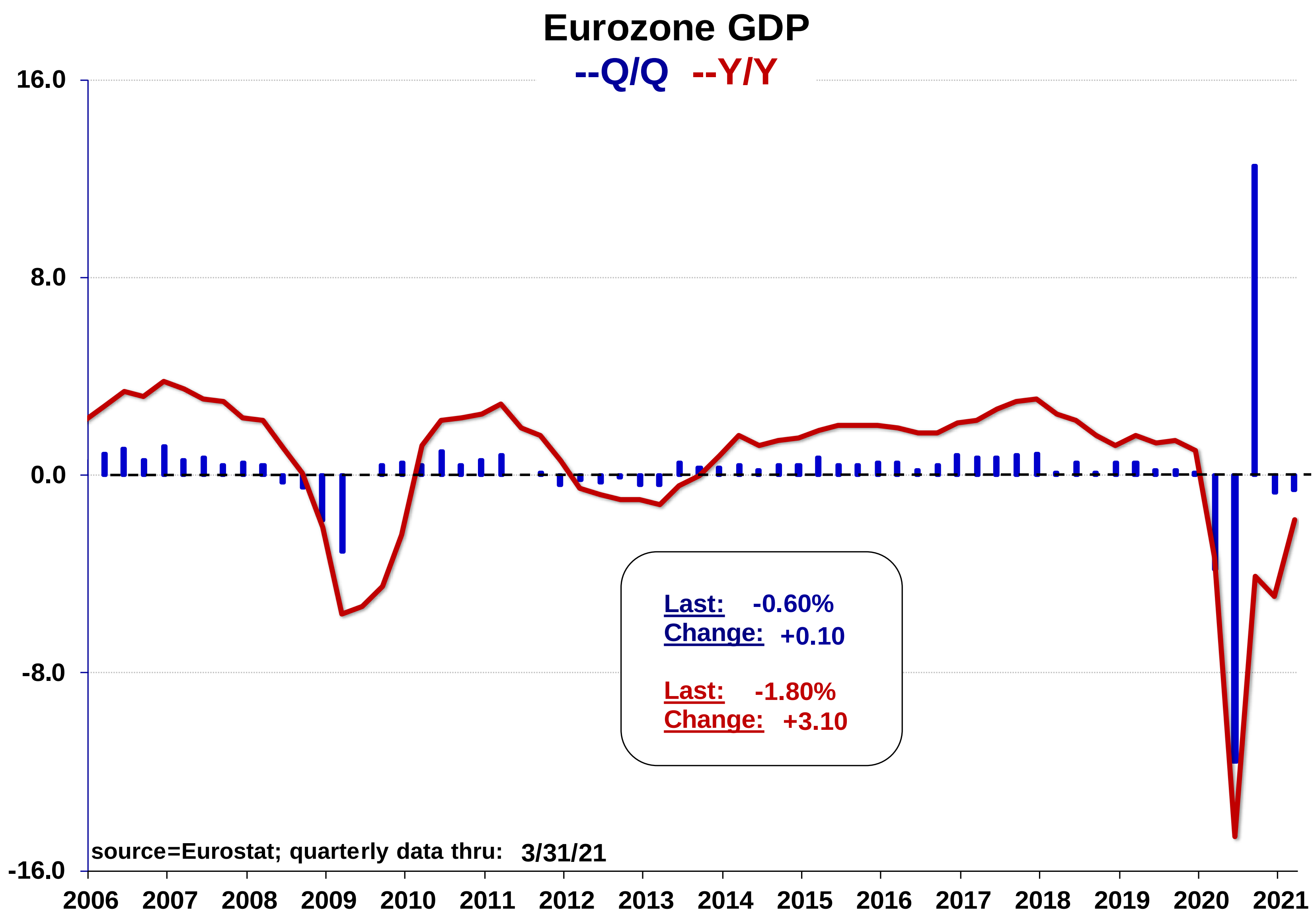
Addenda chart 1. Waiting for real growth to arrive: 2$ in deficit spending for every 1$ in growth so far in 2021



Addenda chart 2. US growth stalling? Gross Private Domestic Investment (Residential + Non-residential Investment + Change in inventories, *nominal) turns lower again, first negative print since Q2 of last year.



Addenda chart 3. Eurozone GDP negative for last 4 of 5 quarters thru Q1



Addenda chart 4. Eurozone Industrial Production remains firmly below 2008 highs; US Industrial Production is just above water over the same period.