CS

COOK
STREET
CONSULTING

# 2021 | Q2 Market Brief

**Cook Street Consulting, Inc.** *5299 DTC Boulevard, Suite 1000 | Greenwood Village, Colorado 80111 USA* **TEL** *303.333.7770 | 1.800.318.7770 |* **FAX** *303.333.7771 | cookstreetconsulting.com*

**DISCLOSURE**

This document is intended for educational purposes only and should not be construed as investment advice. This document may contain forward-looking statements within the meaning of the federal securities laws. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. Actual results could and likely will differ, sometimes materially, from those projected or anticipated. Cook Street is not undertaking any obligation to update or revise any forward looking statements whether as a result of new information, future events or otherwise. You should not take any statements regarding past trends as a representation those trends or activities will continue in the future. Accordingly, you should not put undue reliance on these statements.

Past performance is no guarantee of future results and every investment may lose money. No guarantees or assurances are or can be made as to performance. Different types of investments involve varying degrees of risk. The investment return and principal value of securities will fluctuate based on a variety of factors, including, but not limited to, the type of investment, the amount and timing of the investment, changing market conditions, currency exchange rates, stability of financial and other markets, and diversification. There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment. No investment strategy can guarantee profit or protection against loss in periods of declining values. No assurance can be given that capital market assumptions will prove to be correct, and the difference between assumptions and actual conditions could vary materially.

This document contains data obtained from sources believed to be reliable, but such data is not guaranteed as to its accuracy and does not purport to be complete. Please be advised that any numbers referenced in this document, whether provided herein or verbally, are subject to revision. Cook Street is not responsible for updating those figures that have changed. Cook Street accepts no liability for loss arising from the use of the material presented in this report. This document should not be relied on in substitution for the exercise of independent judgment.

# I – DOMESTIC MARKETS OVERVIEW

## U.S. Equities Extend Gains

### Equity Market Recovery Continues for Fifth Consecutive Quarter

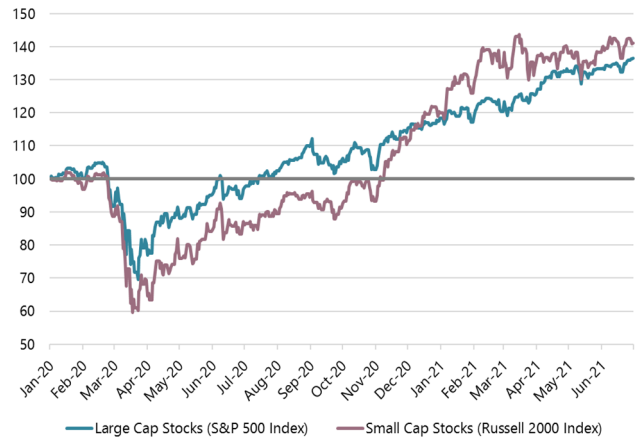
U.S. equity markets powered through to record levels over the second quarter of 2021, marking a fifth consecutive quarter of growth (Exhibit A). Stock markets advanced amidst the relatively strong vaccine rollout in the U.S. and continued policy support from the U.S. government and Federal Reserve (Fed). In addition, U.S. companies have experienced a very strong earnings recovery, which has lessened concerns over the relatively high valuations exhibited at the beginning of the year. U.S. large cap stocks (S&P 500 **+8.5%**) posted another quarter of greater than 5% growth, capping a 15-month period where the Index has gained nearly 70% in value. With the exception of the Utilities sector (S&P 500 Utilities **-0.4%**), all S&P 500 sectors experienced positive returns, with the Real Estate (S&P 500 Real Estate **+13.1%**), Energy (S&P 500 Energy **+11.3%**), and Tech (S&P 500 Information Technology **+11.6%**) sectors outperforming. More defensive sectors, including Utilities and Consumer Staples (S&P 500 Consumer Staples **+3.8%**) underperformed as markets continued to rally. Small cap stocks also performed well over the quarter (Russell 2000 **+4.3%**), despite not fully keeping pace with larger cap companies. Since the market nadir in March 2020, small cap stocks have advanced by over 100% (Exhibit B).

Exhibit A: **Trailing Asset Class Returns** *Source: Morningstar*
(Select Indices; through 6/30/2021)

| Index | 3-Month | YTD | 12-Month | 3-Year | 5-Year |
|---|---|---|---|---|---|
| **Capital Preservation** (US 3-Month T-Bill Index) | 0.01 | 0.02 | 0.07 | 1.23 | 1.15 |
| **U.S. Fixed Income** (Barclays US Agg Bond Index) | 1.83 | (1.60) | (0.33) | 5.34 | 3.03 |
| **U.S. Large Cap Equity** (S&P 500 Index) | 8.55 | 15.25 | 40.79 | 18.67 | 17.65 |
| **U.S. Small Cap Equity** (Russell 2000 Index) | 4.29 | 17.54 | 62.03 | 13.52 | 16.47 |
| **International Equity** (MSCI ACWI Ex USA Index) | 5.48 | 9.16 | 35.72 | 9.38 | 11.08 |
| **Global Real Estate** (FTSE EPRA/NAREIT Developed Index) | 9.17 | 15.50 | 33.55 | 6.39 | 4.98 |

### Bond Markets Stabilize as Treasury Yield Curve Flattens

Exhibit B: **Equity Market Recovery** *Source: Morningstar*
(Performance Jan. 2020 – June 2021)




After experiencing a sharp increase in Treasury yields over the first three months of the year, bond markets stabilized over the second quarter. Returns for the broad market were modest (Bloomberg Barclays U.S. Aggregate Bond Index **+1.8%**), as the Treasury yield curve flattened over the month of June, and credit spreads narrowed. Amidst the strong equity market rally, credit markets outperformed (Bloomberg Barclays U.S. Credit Index **+3.3%**; ICE BofA US High Yield Index **+2.8%**). As actual inflation increased and inflation expectations continued to rise, inflation-linked bonds also outperformed the broader fixed income market (Bloomberg Barclays US Treasury US TIPS Index **+3.2%**). Higher risk fixed income asset classes performed relatively well, including convertible bonds and emerging market debt. The Treasury yield curve flattening provided a boost to longer duration assets, while asset-backed securities and mortgages underperformed.

## I – DOMESTIC MARKETS OVERVIEW (Cont.)

### Fiscal and Monetary Policy Remain Accommodative as Economic Recovery Accelerates

#### Despite Inflationary Concerns Fed Policy Unchanged

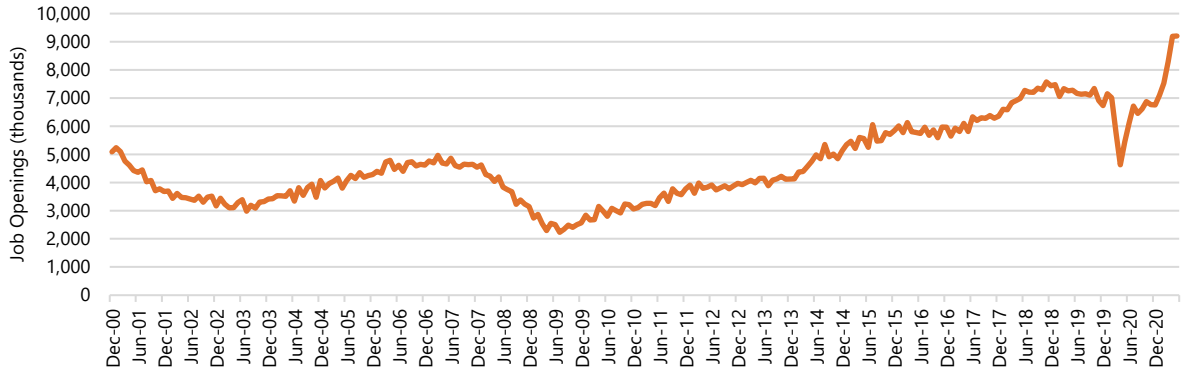
In June, the U.S. Federal Reserve kept in place its policies of quantitative easing while maintaining its interest rate policy positioning, despite acknowledging recent increases in inflation and the broader economic recovery. The Fed (in a unanimous vote) kept its key Federal Funds Rate anchored at 0.00%-0.25% and indicated it would continue to pursue policies of quantitative easing (i.e., Treasury and mortgage bond buying program of at least $80 billion and $40 billion per month, respectively). Although the FOMC also does not expect to begin raising interest rates until 2023, they more explicitly targeted 2023 as the year they expect interest rates to increase in new policy guidance. Additionally, the Fed maintained its guidance on inflation, indicating they would attempt to achieve near-term inflation higher than the long-term target of 2%. The Fed acknowledged while current inflation was running higher than those near-term targets, the expected impact and duration were transitory, driven in part by anomalies from the 2020 downturn and shorter-term impacts from supply chain disruptions in COVID-affected international markets.

#### U.S. Economic Recovery Takes Hold

Accommodative monetary policy, coinciding with the March stimulus and relief package, boosted a broadening economic recovery driven by the vaccine rollout. First quarter GDP was estimated to be 6.4% on an annualized basis, with the Fed recently increasing their expectation for 2021 GDP growth to 7% (from 6.5% in March). While resilient consumer demand continued to underline the recovery, increases in business investment and government spending have also positively contributed to the uptick in economic growth. The buoyant housing market has been additive to growth, as well.

Labor markets continued to improve in recent months as the U.S. economy reopened. Headline unemployment fell slightly to 5.9% over the quarter, while measures of underemployment (June U-6 Rate; 9.8%) improved more meaningfully. Continued labor market gains have been hampered by a persistently low and stagnant labor force participation rate. This comes as the number of job openings increased significantly in recent months, with companies across the country struggling to find skilled candidates for openings (Exhibit C). With the eventual reduction and conclusion of direct stimulus measures to households, investors will be closely watching the extent to which these programs have temporarily slowed further improvement to the labor market.

Exhibit C: **Job Openings: Total Nonfarm Listings** *Source: Bureau of Labor Statistics*



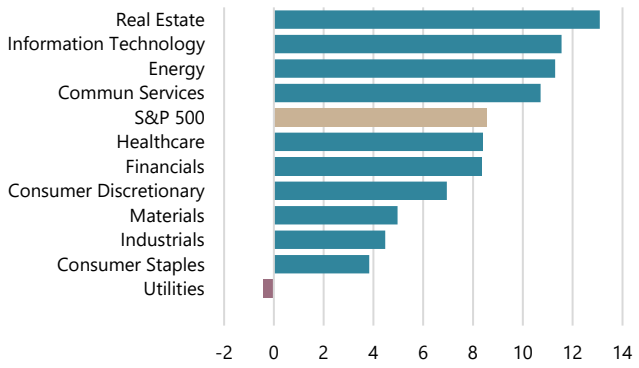
## I – DOMESTIC MARKETS OVERVIEW (Cont.)

### Market Contributors

#### Real Estate and Technology Stocks Lead Market Higher

Equity markets continued to advance, with all but the utilities sector appreciating over the second quarter of 2021, as the country continued to rebound due to the lifting of COVID-19 restrictions. This helped propel the market forward, and for the first time in years, investors began to worry about inflation. Rising prices, along with declining interest rates, aided the real estate sector, which had the strongest returns over the quarter. Self-storage real estate companies, like Public Storage, did particularly well. The self-storage industry benefitted from an increased number of moves and relocations. Additionally, for those who stayed put, a desire to have more space in their homes because of remote learning and working has spurred demand for increased storage space.

Exhibit D: **Q2 S&P 500 Sector Returns (%)** *Source: Morningstar*



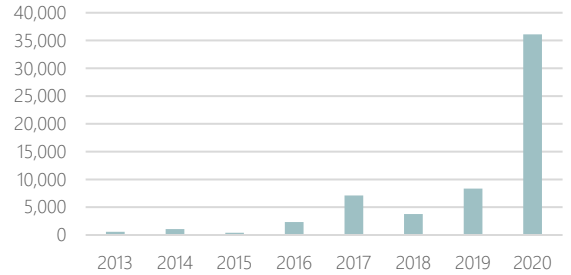

Technology companies also performed well in the second quarter. Semiconductor giant NVIDIA gained almost 50% and was the best performing stock in the S&P 500 over the period, as demand for microchips remains high around the world, leading to short supply and high prices for the company's products. Cybersecurity companies Fortinet and NortonLifeLock were also strong performers. Investors expect this trend to continue following the surging number of data breaches and high-profile ransomware attacks, such as the Colonial Pipeline attack in May.

The technology and communication giants also delivered strong returns over the quarter and helped propel the broader market forward. At the end of June, a federal judge dismissed an antitrust case against Facebook brought by the Federal Trade Commission and 47 state attorney generals, saying the plaintiffs had not pled enough allegations to support monopolization claims against the company. Post announcement, Facebook's market capitalization surpassed $1 trillion for the first time. This ruling was encouraging for Apple and Google, who are also facing antitrust litigation and saw their share prices rise following the dismissal.

The energy sector delivered double digit returns over the quarter, as WTI oil prices surged from $59 to $73 on demand from the U.S. and other developed economies.

In fixed income markets, declining long-term interest rates led longer-dated bonds to outperform. Optimism in the economic expansion aided high yield and investment grade credit, as spreads tightened. Higher inflation expectations (and realized inflation) aided TIPS.

Exhibit E: **Data Records (in millions) Lost in Cybersecurity breaches through 3Q:2020** *Source: RiskBased*

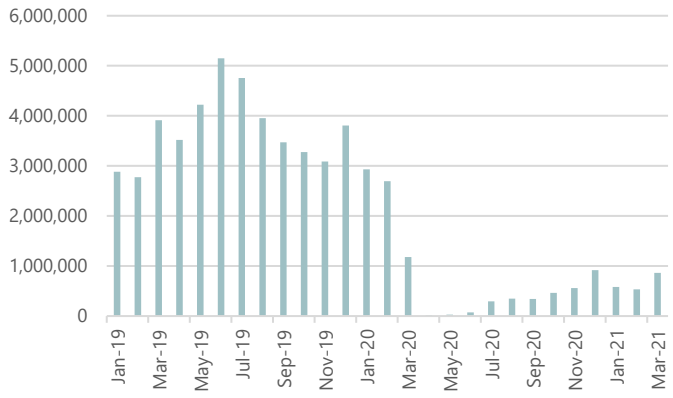


## I – DOMESTIC MARKETS OVERVIEW (Cont.)

### Market Detractors

#### Traditionally Defensive Sectors Underperform Alongside Travel-Related Industries

Exhibit F: **U.S. Citizen Travel to International Regions**
*Source: Department of Commerce*




Consistent with experience during historical equity market rallies, the utilities sector and other defensive stocks underperformed the broader market in the second quarter. Despite all other sectors advancing, some industries were notable exceptions.

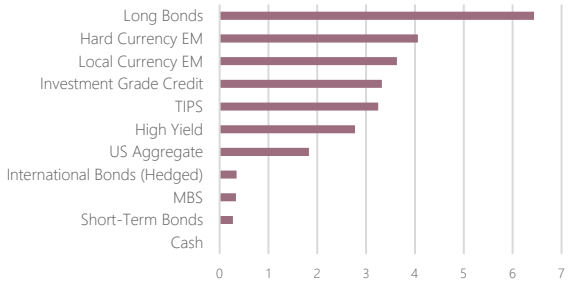
Despite air travel rebounding to around pre-pandemic levels, airlines lost value over the quarter. Airlines are still struggling financially, because although domestic leisure travel has rebounded, business travel and long-haul flights are still well below 2019 levels, and these travelers are significantly more profitable. Rising oil prices have also been a headwind for the industry. Global hoteliers like Hilton and Marriott lost value over the period as well. Similarly, despite leisure travel picking up in the U.S., especially at beach and other resort destinations, the industry has suffered from increased travel restrictions due to COVID-19 resurgence, especially the Delta variant, in Europe and the Asia Pacific regions.

Although the industrials sector generated positive returns, it underperformed the broad market over the quarter. The sector declined immediately following the Federal Reserve's announcement that it now expects two rate hikes in 2023 instead of zero. This negatively impacted economically sensitive stocks such as heavy machinery maker Caterpillar, despite posting generally strong financial results.

Walgreens Boots Alliance was another underperformer this quarter. The company posted strong financial results for the previous quarter, but it appears its administration of COVID-19 vaccines peaked last quarter, and analysts expect it to continue to face increased competition for everyday retail items like toothpaste and shampoo from online retailers such as Amazon.

In a reversal from recent quarters, higher quality stocks outperformed lower quality ones. This negatively impacted heavily indebted companies, like Discovery Inc., which will be inheriting significant debt as part of its announced merger with Warner Media, and Penn National Gaming.

Exhibit G: **Fixed Income Returns Q2:2021 (%)** *Source: Morningstar*




Fixed income markets were positive for the quarter, but because rates declined, shorter-duration bonds and cash underperformed. Mortgage-backed securities also lagged, as the Federal Reserve's announcement that it is beginning to consider when it will reduce its bond purchasing program weighed on the sector.

# II – INTERNATIONAL MARKETS OVERVIEW

## World View

### Global Markets See Mixed Recovery

In general, global equity markets continued their recovery from the COVID-19 pandemic during the second quarter (Exhibit H; MSCI World Index +6.2%). However, momentum slowed as inflationary concerns began to more heavily weigh on global investors and policy makers (Exhibit I). The combination of pent-up demand, droughts, logistical issues, and a semiconductor shortage have all continued to put pricing pressure on consumer goods. Energy prices also surged during the quarter on increased demand and over a disagreement over oil output between OPEC and its allies. The Delta variant of the virus also raised fresh concerns about the trajectory of the economic recovery in certain regions. Asia Pacific markets (MSCI Asia Pacific Index +1.1%) underperformed relative to other regions as countries imposed fresh lockdowns as a result of a resurgence in COVID-19 cases. Within the region, Japan was the worst performing market during the quarter (MSCI Japan Index -1.8%) as their economy continued to struggle to recover. The country has seen a persistent rise in COVID-19 cases and has struggled with the implementation of their vaccine campaign. This has led the country to implement fresh lockdowns, including the cancelation of spectators at the Olympics, which continues to hinder business activity and consumer spending. Chinese markets also underperformed global markets during the quarter (MSCI China Index +0.8%). While the country's economy has largely rebounded to its pre-pandemic levels (driven by the export sector) economic momentum slowed as COVID-19 outbreaks rose, and port delays continued to pressure trading. Chinese equity markets also lagged during the quarter in part due to increased regulation on technology companies.

Exhibit H: **Global Equity Returns (%)**

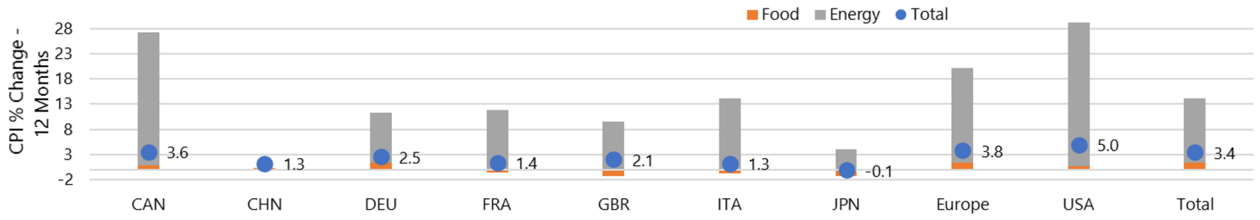
Select Countries and Regions, Q2 2021. Source: Morningstar. Currency: USD.

| Global Equity Returns | | |
|---|---|---|
| Region / Country | Q2:21 | Trailing 1-Year |
| MSCI Argentina | 4.2% | 16.9% |
| MSCI Australia | 5.3% | 27.0% |
| MSCI Canada | 8.4% | 32.6% |
| MSCI China | 0.8% | 15.8% |
| MSCI France | 7.5% | 28.1% |
| MSCI Germany | 3.2% | 19.8% |
| MSCI Italy | 2.1% | 24.2% |
| MSCI Japan | -1.8% | 13.5% |
| MSCI United Kingdom | 4.4% | 19.4% |
| MSCI USA | 7.2% | 29.0% |
| MSCI ACWI Ex USA | 4.7% | 30.0% |
| MSCI EAFE | 3.6% | 20.3% |
| MSCI EM | 3.5% | 28.1% |
| MSCI Asia Ex Japan | 2.1% | 27.0% |
| MSCI Asia Pacific | 1.1% | 22.1% |
| MSCI Europe | 5.8% | 22.8% |
| MSCI North America | 7.2% | 29.2% |
| MSCI World | 6.2% | 26.4% |

Fueled by an efficient vaccine campaign, Canadian markets (MSCI Canada Index +8.4%) outpaced global markets during the second quarter. The country's economy, which is largely dependent on oil exports, also got a boost from an increase in oil demand and the surge in WTI prices during the quarter. Additionally, after lockdowns eased in June, labor markets and consumer spending returned to normal more quickly than anticipated. European markets (MSCI Europe Index +5.8%) also continued to recover during the second quarter. The region's vaccine campaign gathered pace, and restrictions eased increasing investor optimism and helping to fuel business activity and consumer spending.

Exhibit I: **Inflation-CPI (%)**

Select Countries and Regions, Q2 2021. Source: OECD. Currency: USD.



## II – INTERNATIONAL MARKETS OVERVIEW (cont.)

### World View (Cont.)

While generally underperforming the U.S. equity market, global equity markets saw positive growth in almost all sectors throughout the second quarter of 2021 (Exhibit J). Healthcare and energy were the best performing sectors in the second quarter (MSCI ACWI ex USA Healthcare Index +9.9%, MSCI ACWI ex USA Energy Index +8.2%). Over half of the global health care sector is composed of companies in the pharmaceutical industry, which have benefitted from the global COVID-19 vaccine campaign. The two largest contributors to the Index over the quarter were Roche Holdings (partnered with Moderna) and Novartis (partnered with Pfizer). The energy sector, which took the greatest hit during the pandemic-induced lockdowns of 2020, has continued to have a remarkable recovery. Energy stocks were aided during the quarter by strong consumer demand as travel restrictions eased, and households sought to resume at least some level of travel activity. WTI oil prices surged during the quarter, from $59 to $73 per barrel, also aiding the sector. Similar to domestic markets, the utilities sector was the worst performing sector and the only sector with a negative return during the second quarter of 2021 (MSCI ACWI ex USA Utilities Index -0.3%).

Exhibit J: **Global Equity Sector Returns (%)**
Select Sectors, Q2 2021. Source: Morningstar

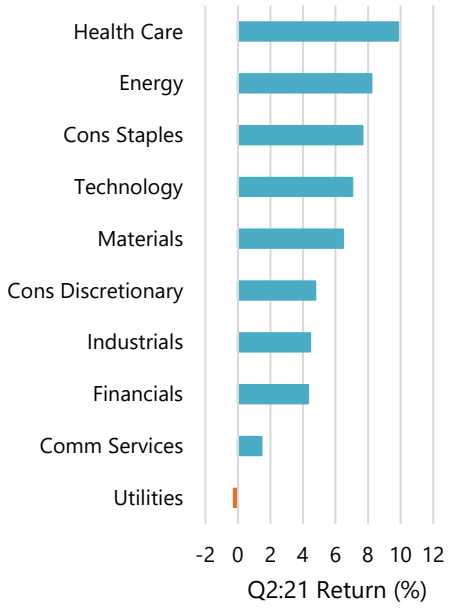
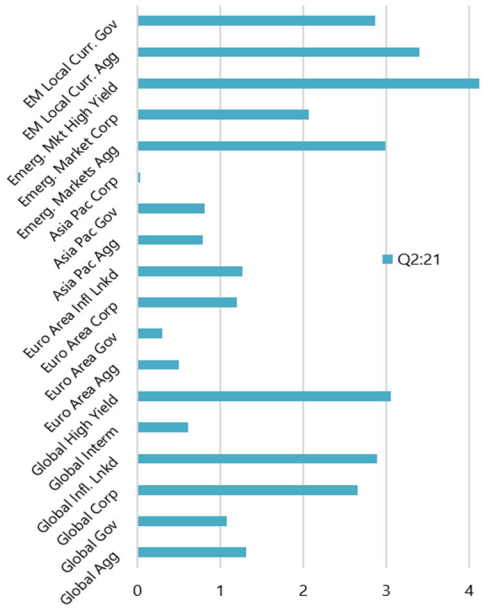



Exhibit K: **Global Fixed Income Returns (%)**
Select Regions and Sectors, Q2 2021. Source: Morningstar



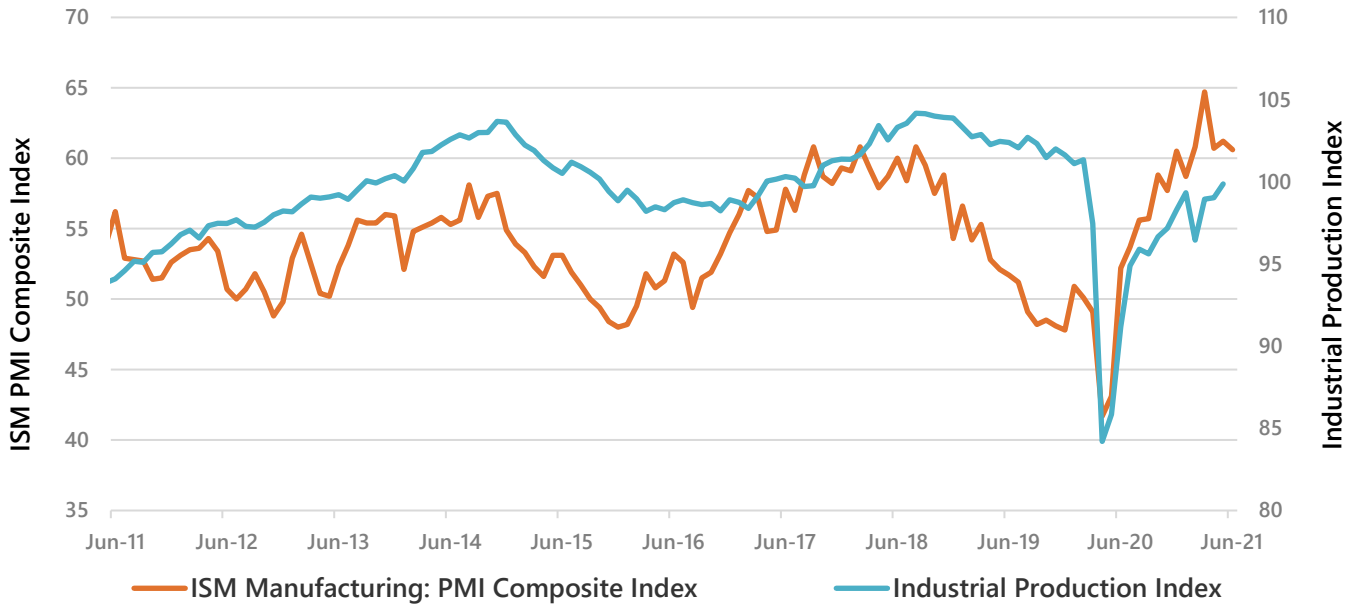

Returns for global fixed income were modest during the quarter and generally underperformed the U.S. (Exhibit K; Bloomberg Barclays Global Aggregate Bond Index 1.3%, Bloomberg Barclays U.S. Aggregate Bond Index 1.8%). Inflationary concerns aided the performance of inflation-linked bonds (Bloomberg Barclays Global Infl. Linked Index 2.9%). Despite these concerns, investor sentiment shifted to 'risk-on' during the quarter as countries successfully implemented aggressive vaccine rollouts leading to more speculative areas of the fixed income market to outperform during the quarter (Bloomberg Barclay Global High Yield Bond Index 3.1%). Emerging market bonds also had a strong quarter, led by high yield and currency performance as the U.S. dollar held steady during the quarter (Bloomberg Barclays Emerging Markets Aggregate Index 3.0%; Bloomberg Barclays Emerging Markets High Yield Index 4.13%; Bloomberg Barclays Local Curr. Index 3.4%). Eurozone and European peripheral bonds generally underperformed as investor optimism increased about the region's recovery (Bloomberg Barclay Euro Aggregate Bond Index 0.5%).

## III – LEADING ECONOMIC INDICATORS

### Manufacturing and Industrial Output

Exhibit L: **Industrial Production and ISM PMI Indexes**
(Trailing 10-year)

*Source: The Federal Reserve, Institute of Supply Management*




**ISM PMI Composite Index (U.S.) –** The Institute for Supply Management (ISM) Purchasing Managers Index (PMI) combines five manufacturing indicators (new orders, production, employment, deliveries, and inventories) to create a composite view of national manufacturing activity. A PMI reading above 50 generally indicates manufacturing expansion.

**Industrial Production Index (U.S.) –** Calculated by the Federal Reserve, the Industrial Production Index measures real output for all facilities located in United States, including manufacturing, mining, electric utilities, and gas utilities.

#### Manufacturing Outlook Remains Positive while Winter Storm Uri Disrupts Industrial Production

The ISM PMI Composite Index extended its streak of expansionary readings in Q2:21. While the Index retreated from a thirty-eight year high in March 2021, it continues to signal strong growth in manufacturing activity, a trend that has persisted for thirteen consecutive months. Manufacturing industries are broadly experiencing strength in demand throughout the COVID-19 recovery with the Customers' Inventories Index remaining low, Backlog of Orders Index remaining high, and New Orders Index expanding. Survey contributors report record-long raw material lead times, rising commodities prices, labor shortages, and transportation delays as major headwinds for meeting potential growth, though sentiment remains positive due to strong demand.

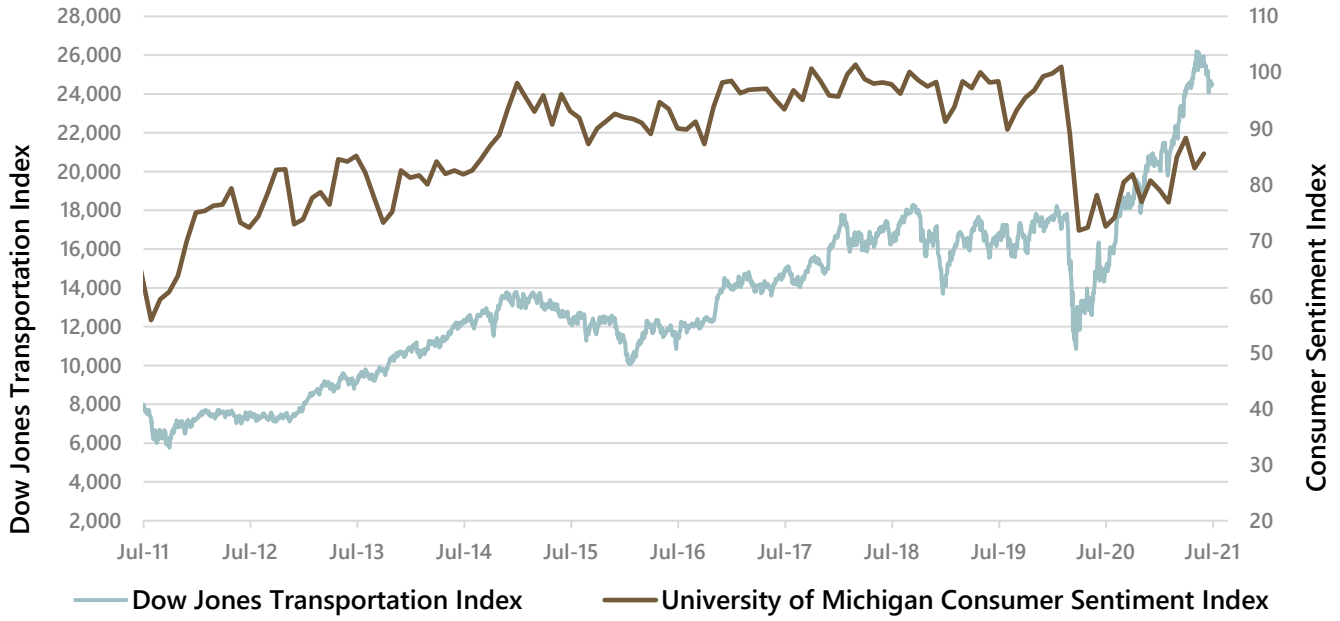
The Industrial Production Index sits at 99.9% as of May 2021, 1.4% below its pre-pandemic reading of 101.3% in February 2020. Recovery from the pandemic resumed following a dip in February 2021 that was primarily attributable to damaged petrochemical facilities during Winter Storm Uri. Recent progress has been driven, in part, by the reopening of those facilities, as well as a large gain in motor vehicle assembly, which saw an increase of approximately one million units (annualized) in May, despite the ongoing semiconductor shortage.

## III - LEADING ECONOMIC INDICATORS (Cont.)

### Commercial Activity

Exhibit M: **Transportation Index and Consumer Sentiment**
(Trailing 10-year)

*Source: Morningstar, Thomson Reuters/University of Michigan*




**The Dow Jones Transportation Index –** The Dow Jones Transportation Index represents the stock price movement of 20 of the nation's largest transportation firms, including trucking, airlines, and railroads. It is commonly used as a forward indicator for future commercial and industrial activity.

**Consumer Sentiment Index –** Conducted by the Survey Research Center under direction from the University of Michigan, this index reflects the personal and overall economic outlook of respondents. The survey is widely used as a proxy for future consumer spending expectations.

#### Transportation Index Posts Modest Gains; Inflation Concerns Dim Consumer Sentiment

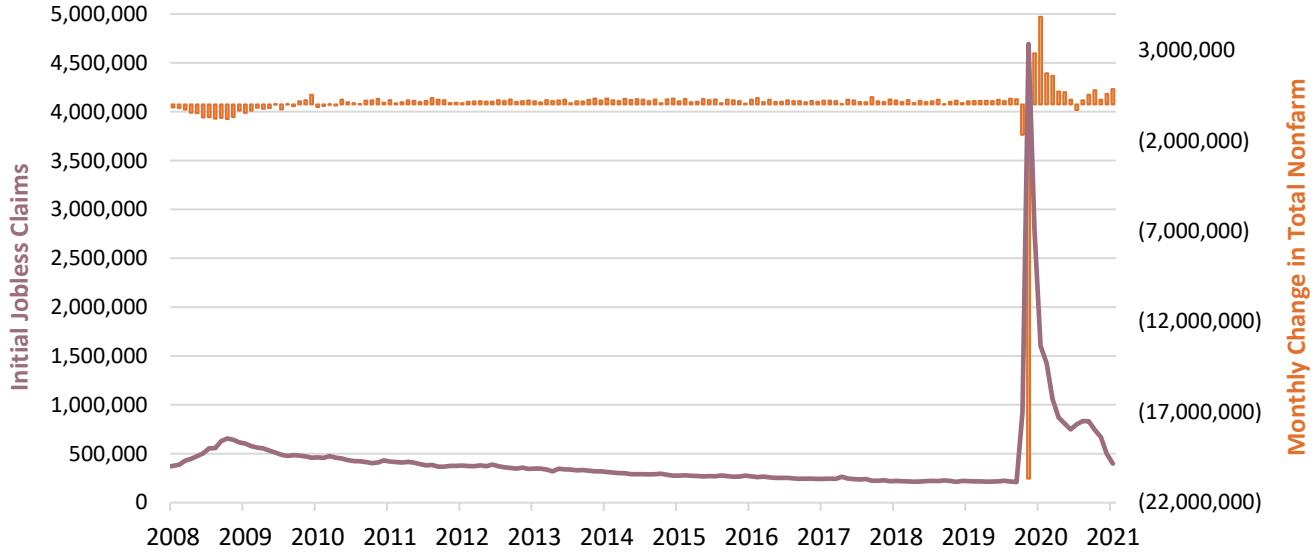
The Dow Jones Transportation Average Index continued to push higher, modestly gaining 2.0% over the second quarter of the year. Positive news regarding COVID-19 vaccination rates and distribution helped the Index reach all-time highs in early May. Logistics and shipping companies (+6.0%) led Index constituents over the quarter as relentless demand continued to fill company backlogs. Index gains were however offset by a pullback among airline companies (-12.0%). Airline stocks trimmed outsized Q1 gains as capacity cuts in August and September may signal softer demand as the summer travel bounce eases.

The Consumer Sentiment Index settled at 85.5 in June after reaching its highest level in over a year during April (88.3). The Index slipped during May (-6.1%) due to concerns over rising prices as inflation expectations rose to 4.6%, the largest it's been over the past 10 years. Over June, the Index rose 3.1% as future economic prospects continued to increase coming out of the pandemic, especially among households with an income over $100,000. Inflation, unemployment, and interest rates remain the three factors that consumers said they are paying close attention to.

## III - LEADING ECONOMIC INDICATORS (Cont.)

### Labor Markets

Exhibit N: **Initial Jobless Claims and Total Nonfarm Payroll** *Source: Federal Reserve Bank of St. Louis, BLS*
(monthly, seasonally adjusted, 2008-current)



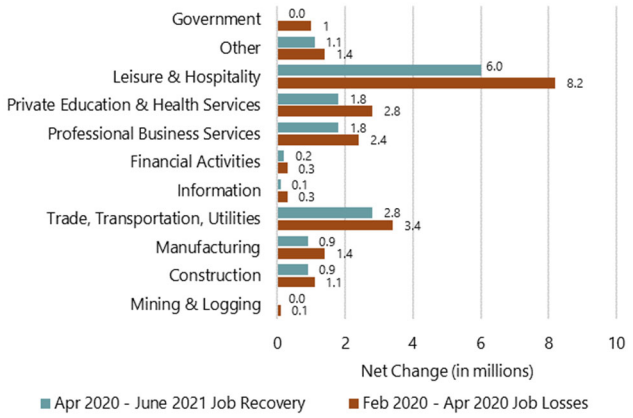

**Total U.S. Nonfarm Payrolls** – U.S. Bureau of Labor Statistics statistical measure representing the total number of paid U.S. workers of any business, excluding: government employees, private household employees, employees of some nonprofit organizations, and farm employees.

**Initial Jobless Claims (4-week moving average)** – Initial Jobless Claims readings are issued by the U.S. Department of Labor. This indicator measures the number of unemployed who are filing for initial unemployment benefits. To smooth volatility, a 4-week moving average is utilized.

### Reopening and Rehiring Continues to Take Hold

The economy gained 850,000 jobs in June, the largest monthly gain in almost a year, bringing the total number of jobs recovered since the COVID-19 pandemic to 15.6 million (about 70% of the 22.4 million jobs that were lost). The 4-week average of initial jobless claims has continued to drop to a level of around 400,000 (down from 800,000 in March 2021, but still above the 2019 level of 220,000). Although the total number of non-farm payrolls increased in June, the unemployment rate also slightly increased from 5.8% in May to 5.9% in June due to an increase in people looking for work. The majority (over 40%) of the June payroll gains can be attributed to the Leisure and Hospitality sector (+343,000). This was the sector most impacted by the pandemic and still has the most ground to make up, having gained back only 6 million of the 8.2 million jobs lost from February to April 2020. Local and state government education added payrolls in June as well (+230,000) as in-person learning and other school activities have returned.

Exhibit O: **Employment Changes by Industry** *Source: BLS*

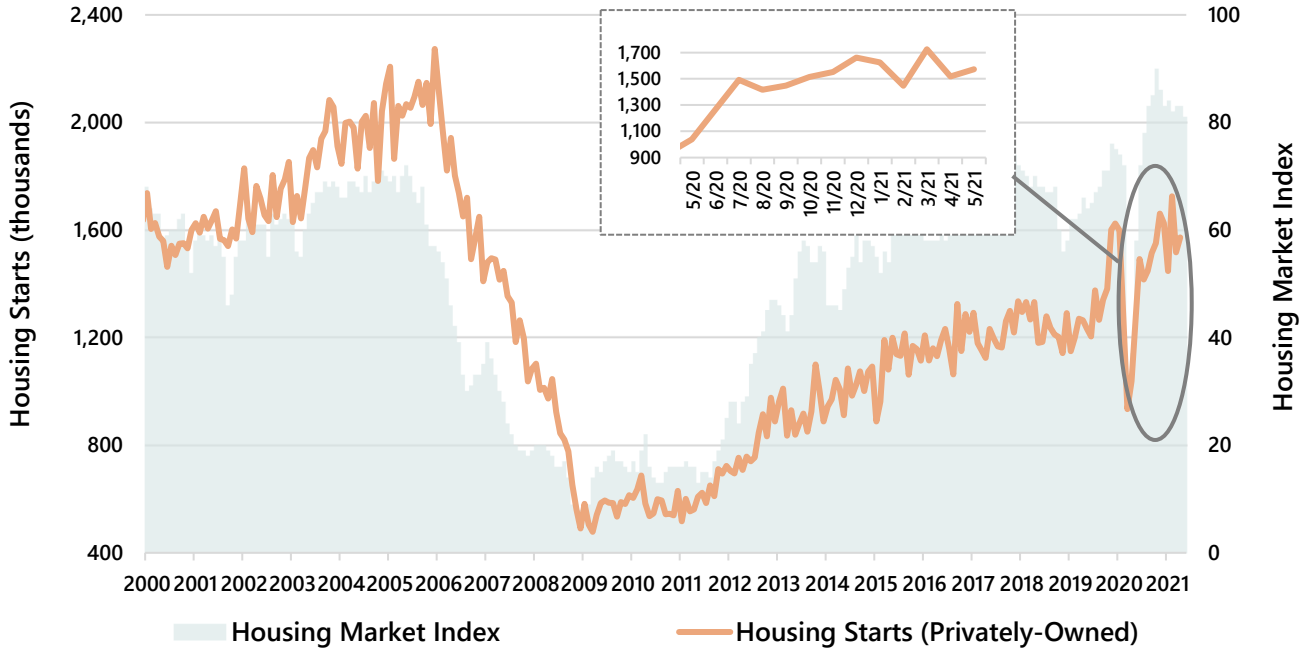


## III - LEADING ECONOMIC INDICATORS (Cont.)

### Housing

Exhibit P: **Housing Starts, Housing Market Index**
(2000 – current)

*Source: Federal Reserve Bank of St. Louis, National Association of Home Builders, U.S. Department of Housing and Urban Development*




**Housing Market Index –** Data compiled by National Association of Home Builders (NAHB) based on a monthly survey with a focus on single-family housing. The index is a weighted average of ratings from home builder surveys on market conditions for current and forecasted new home sales. The index ranges from 0 to 100, and a reading of 50 generally indicates positive sentiment in builders.

### Builder Confidence Holds Steady, and Housing Starts Struggle to Meet Demand

After the NAHB Housing Market Index fluctuated slightly in Q1 of 2021, the Index remained relatively steady in Q2. The March reading of 82 persisted into April and May, and increased slightly to 83 in June. This quarter's readings indicate that there is still positive sentiment amongst builders, although it has decreased slightly since the Index's high of 90 in November 2020. However, these readings are still among the highest readings in the Index's history.

Privately-owned housing starts decreased 12.1% from an annualized rate of 1,725,000 in March, a 15-year high, to 1,517,000 in April. Housing starts rebounded slightly and increased 3.6% to 1,572,000 in May. Housing starts missed expectations in both April and May due to increases in material costs, specifically lumber, and a shortage of skilled labor. May housing starts for multi-family housing increased 4% month-over-month, while single-family housing starts had a slightly higher increase of 4.2%. Housing starts increased in every area of the country in May, except for the Northeast where housing starts decreased 22.4%. The largest increase was in the Midwest with housing starts rising by 29.9%, indicating more demand for housing in that region. The Midwest was followed by the South, with an increase of 3.8%, and the West, with an increase of 1%.

## For more information, please contact our Research Department:

800.318.7770
research@cookstreetconsulting.com

## Or visit us online at:

cookstreetconsulting.com


COOK STREET
CONSULTING
EST. 1999