Courier Capital, LLC
Registered Investment Adviser
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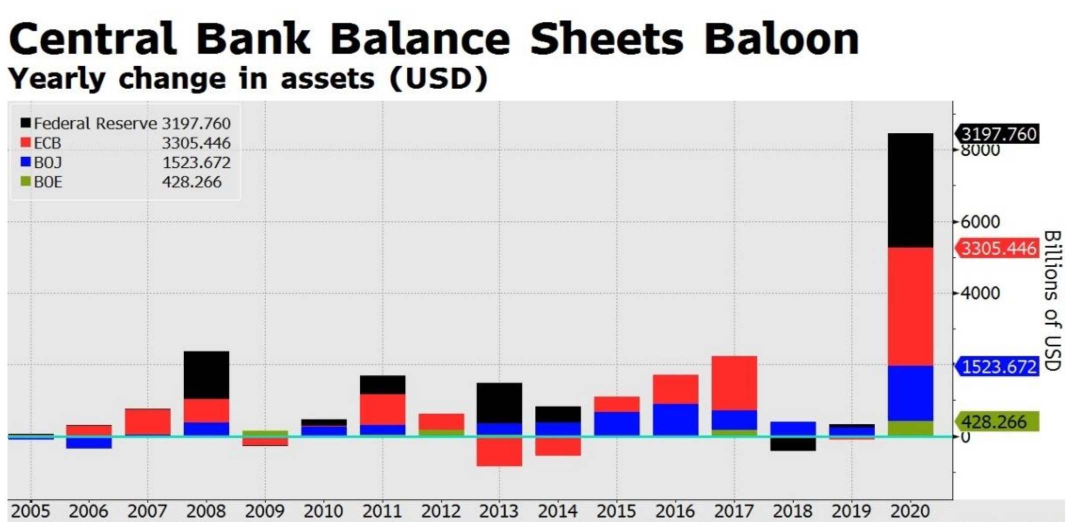
Economic and Market Update – A DIFFERENT DIRECTION (01/31/2021)

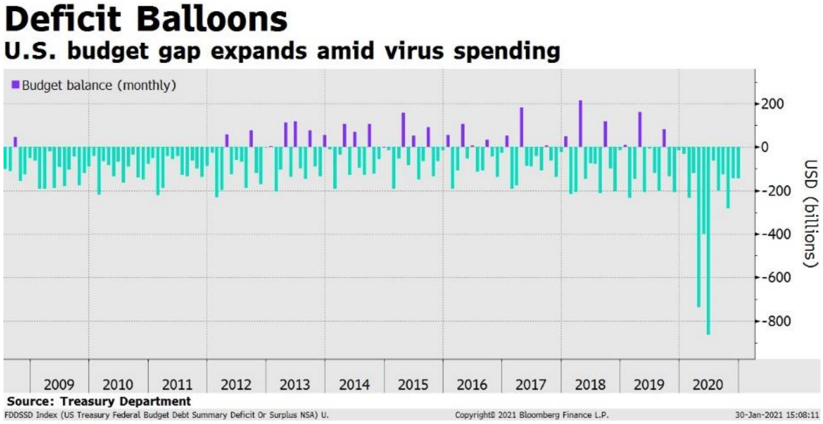
Latest Developments and Economics

On January 20 Joe Biden became the 46th President of the United States in an uneventful (fortunately) transition with promises to put the country on a different course. By the time of his inauguration the last major part of the 2020 election had been decided. The two Georgia Senate seats went to the Democratic candidates which makes Congress and the Presidency technically in control of the Democrats (though a much slimmer margin in the House and a 50/50 split in the Senate with the Vice-President as the tie breaker if necessary). Nancy Pelosi hung on to Speaker of the House with Chuck Schumer and Mitch McConnell agreeing to share power in the Senate. In this case moderates are going to play a more prominent role in the Senate as they can tip the balance in one direction or another. Biden didn't waste any time in moving on his agenda as he signed 39 executive orders in his first 10 days in office. Many were on social matters and COVID response, but others were more directly economic. In a major theme of climate change several were aimed at the oil and gas industry (including cancelling the Keystone pipeline bringing gas from Canada and suspending any new oil and gas leases on public lands). Another major proposal is his "American Rescue Plan" a $1.9 trillion proposal which would be the second largest fiscal spending package in history at roughly 9% of GDP (the largest was last year's CARES act). This proposal, which comes on the heels of the $900 billion package that was passed in late December, includes the following:

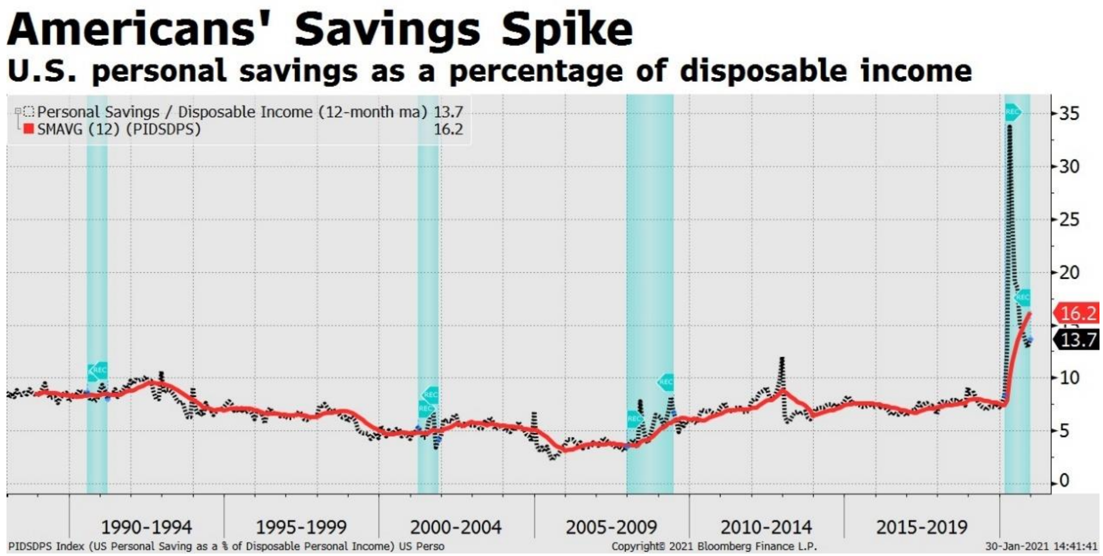
ITEM	EST COST ($BN)
$1,400 Rebates (to top off the $600 from Dec)	465
$400 Unemployment Supplement thru Sep	350
State and Local Government	350
Schools/Colleges	170
Vaccines, Testing, etc.	160
Child Tax Credit and Child Care	160
Small Business, Housing, Public Transport	95
Paid Leave	150

There are other parts of this proposal as well which include an extension of the student loan and eviction moratorium and a national $15 per hour minimum wage. The cost of the plan, as the December package ink is not yet dry, has some legislators looking to pare this down. As of today, Pelosi and Schumer are planning to move forward with passing this, as is, through the budget reconciliation process (whereby they can evade opposition) but it may not be able to cover all the items on the list. At this point the fiscal (and monetary) stabilization efforts are without precedent, not only in the U.S. but globally as well. The budget deficit in the U.S. (the amount we add to debt each year) in FY 2020 was $3.1 trillion dollars after deficits of $666 billion, $779 billion and $984 billion in 2017, 2018 and 2019 respectively. The deficit for the first quarter of FY2021 was $572 billion and current projection is for a potential deficit nearing $4.0 trillion if all stimulus measures are enacted. The Federal Reserve has been funding these deficits through purchases of U.S. treasury bonds (buying $3.197 trillion in FY2020 per chart above) and now holds $7.4 trillion dollars (from $3.8 trillion in 2019) of U.S. debt.

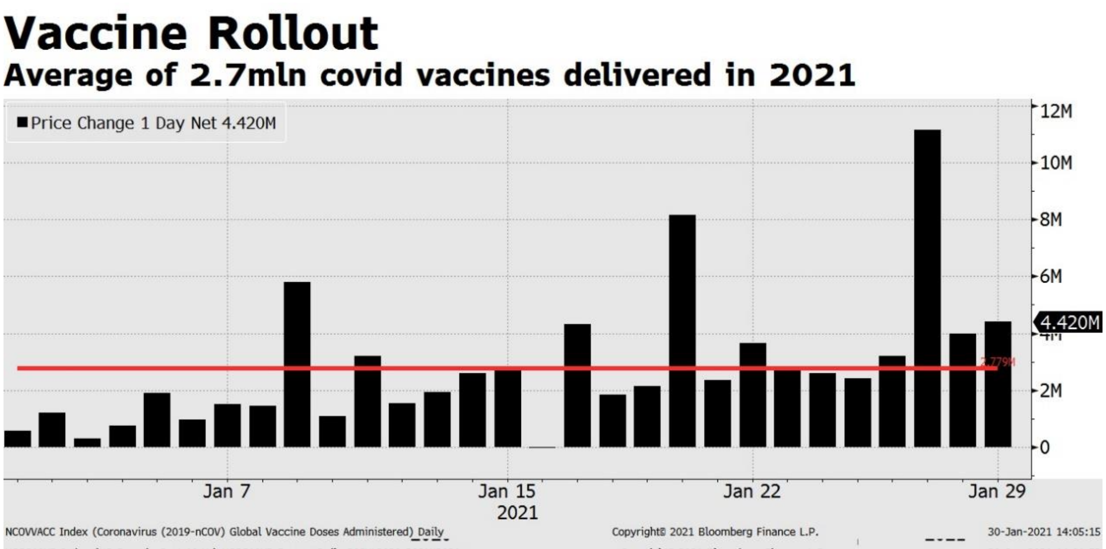




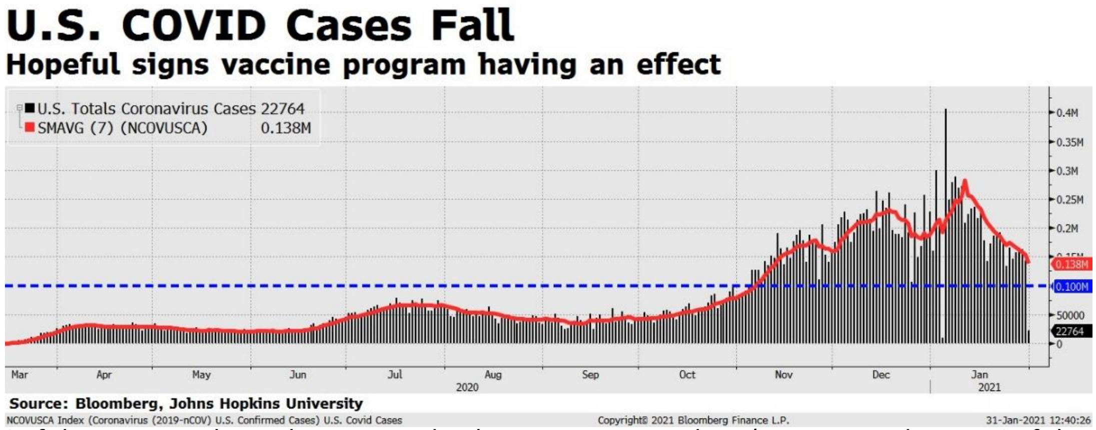
The increased spending in developed economies around the world is facilitated by the historically low interest environment that has been in place generally since 2008. Rates in the U.S. increased from December 2016 - December 2018 but were lowered to essentially zero again in March 2020. The average interest rate on federal debt is less than 2.5%. In fact, the dollar value of negative yielding debt has continued to increase to record levels (about 16.8 trillion dollars globally).



Legislators arguing against the current $1.9 trillion proposal aren't just concerned about the additional spending but mainly that it isn't targeted well enough to those in need. Looking at the last round of direct payments to citizens, many who were still working, saw them adding to savings or paying off debt. Contributing to this was the fact that the shutdowns prevented many from spending the extra funds even if they were so inclined. As you can see by the chart the savings rate spiked in relation to their income.

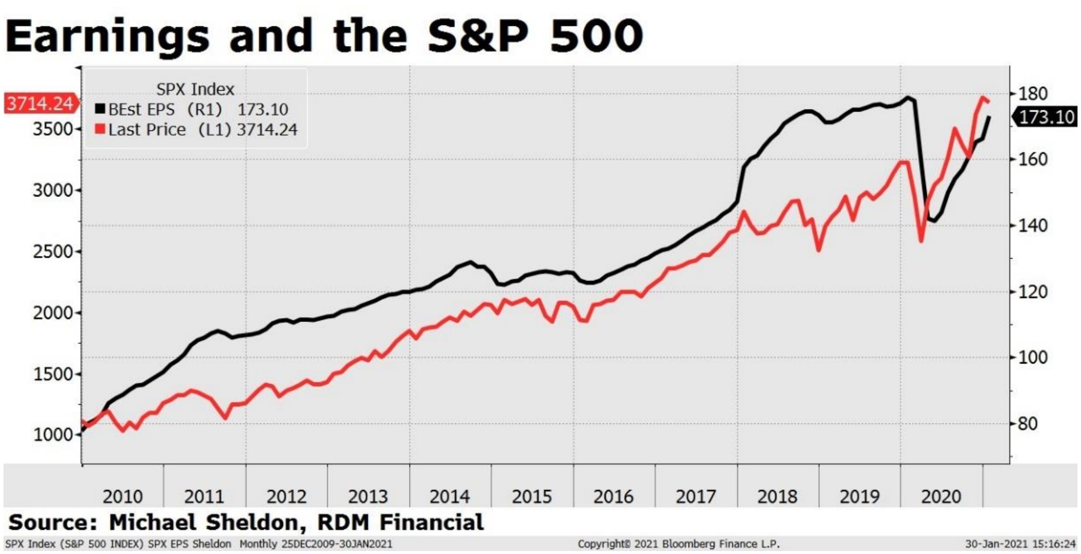


The pent-up demand from lockdowns plus the added extra spendable funds from savings could create a powerful impetus for the economy to experience a significant boost once we return to a more normal way of living. GDP estimates for 2021 range from 4.0-5.0% vs. a decline of 3.5% in 2020. This, of course, all depends on the pace of vaccine rollout in the U.S. and globally. While the good news is that the Pfizer and Moderna vaccines are being distributed, the production and distribution has been slow and uneven by state. The rollout development has improved with the January distribution averaging about 2.7 million doses per day worldwide. This has prompted the Biden administration to promise to deliver 100 million doses in the U.S. in 100 days. While we focus on the vaccine distribution the challenge of virus variants from the U.K., South Africa and Brazil have been discovered in the United States. These variants are thought to be more contagious and some evidence points to a bit more severe as well. Fortunately, the Johnson and Johnson and Novarax had promising new vaccine news with the Johnson and Johnson product about to be approved for emergency usage, which will provide another significant source of vaccine production. Preliminary research provides evidence that all three of these vaccines have proven effective, even if less so, against the variants.

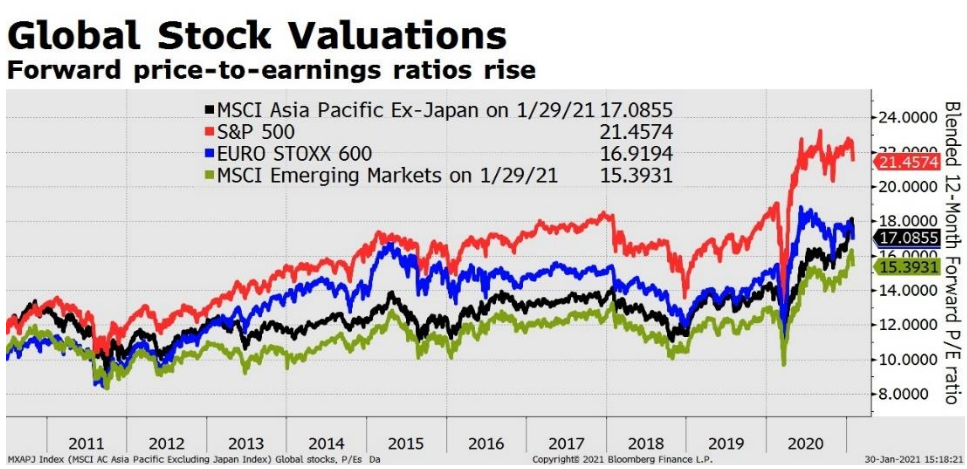


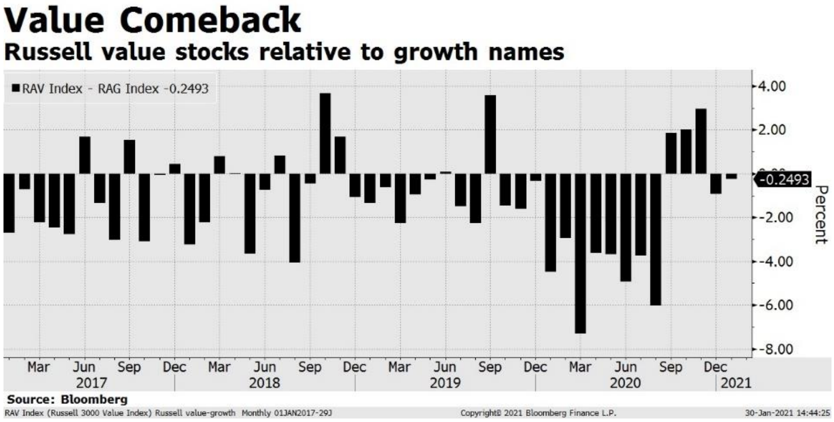
By the end of January about 6.5% of the U.S. population has received at least one vaccine dose (as compared to 1.7% of the European Union, 10.7% of the U.K. and 31.0% of Israel). The combination of: vaccine distribution, at least 7.0% of the population that had contracted the virus and recovered, passing of the holidays and more widespread mitigation efforts (ie: masks) have hopefully had an impact as the daily cases and seven-day average look to be falling (the new variants have not had an impact so far). This data helps to provide some optimism that we are on track for more restrictions to be lifted and a progression towards a more normal lifestyle. The sooner the better as the Federal Reserve even noted in their comments after the most recent Fed meeting last week that the virus resurgence has impacted the recovery: “The pace of the recovery in economic activity and employment has moderated in recent months”. Weekly new unemployment claims were still in the 800-900 thousand range in January.

Financial Markets

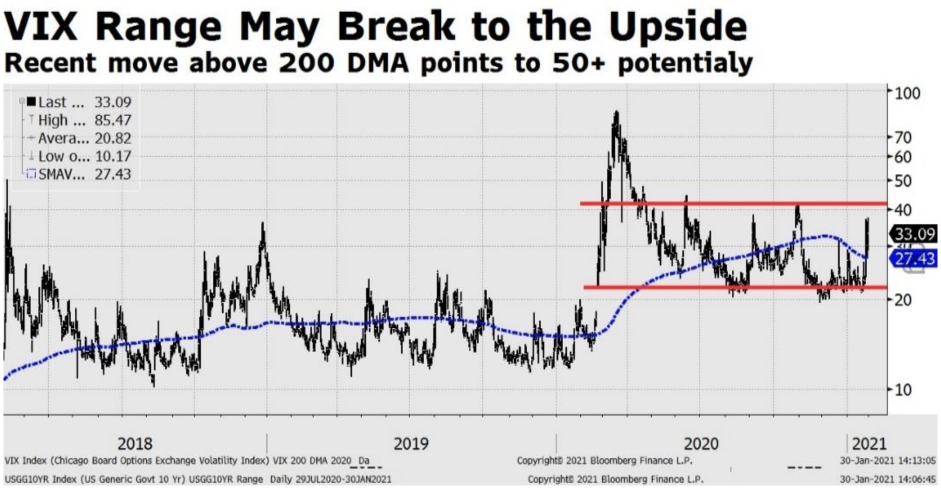


The financial markets have also been anticipating an economic recovery and, with it, a significant increase in corporate profits. The recovery in the U.S. equity markets have outpaced the recovery in earnings but, estimated earnings have turned decidedly positive (black line). Up to this point most of the market returns have been driven by multiple expansion rather than corporate earnings growth. A return to normal life (and economic activity) would certainly allow corporate earnings to catch up to where the market currently has forecast. In the meantime, the low interest rate environment and the anticipation of an economic recovery has resulted in historically high equity valuations (as measured by forward P/E). As you can see in the chart conditions are the same throughout the world but no one region as historically high as the United States (with a forward P/E of almost 21.5 – red line).





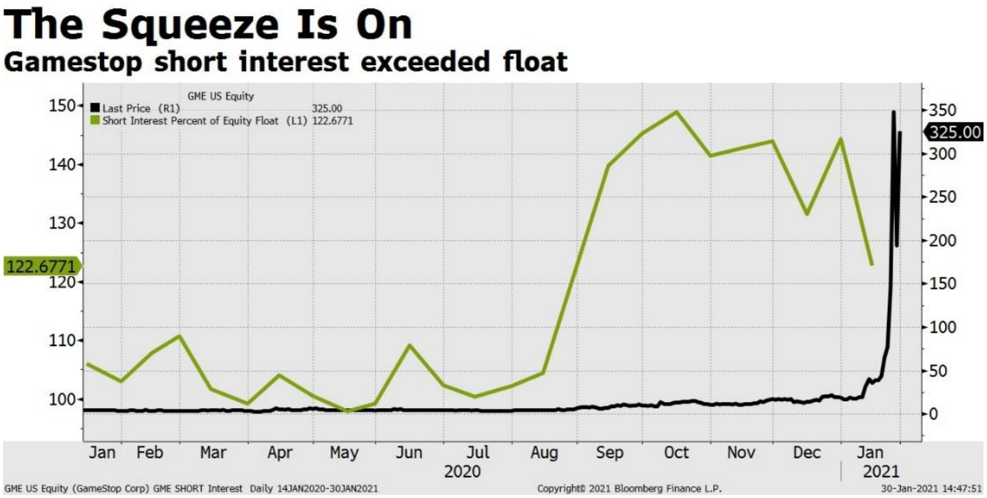
The fourth quarter of 2020 saw a double digit return on the S&P 500, but the new story was which stocks gained. In what is often deemed a 'rotation', investors seemed to put money in sectors and stocks that would benefit from a return to more normal economic activity. The group of sectors and stocks considered value companies started to outperform growth companies in the fourth quarter. This is welcome as it creates a more broad-based market increase rather than the handful of stocks that have dominated the S&P 500 returns throughout 2020.

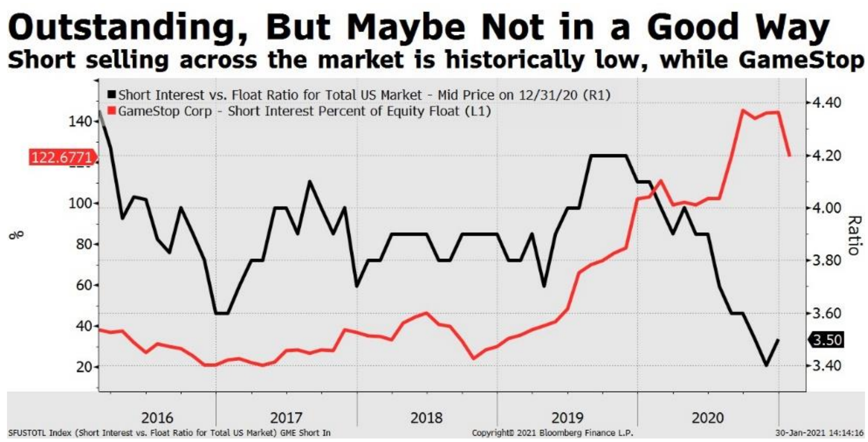


Even though the broad-based return was good news, the virus, plus other factors, created significant uncertainty as measured by the volatility index (VIX) which is often called the 'fear gage'. The VIX ran up to historical levels early in 2020 but then eased back down and is now at the upper end of its recent range. This may explain some of the volatility markets experienced in January. The S&P 500 ended January with the sharpest losses since October but down only about 1% for the month.

This uncertainty, along with the latest fiscal proposal, likely contributed to the rise in yields that has accelerated in January. The yield on the 10-year treasuries were 0.50% in late July. Since that time, they had been on a steady climb (blue line) for the remainder of 2020 crossing 1.00% in January 2021 and staying above that level most of the month. While it doesn't sound like much, going from 0.50% to 1.00% is a doubling of the yield which would cause a 10-year bond purchased in July to lose about 5% in price. The low rate environment has affected other assets in addition to financial. The increase in value in hard assets such as gold, cryptocurrencies and housing (up 9.5% year-over-year) were the result.

The equity markets seized headlines as of late with the news about the "short squeeze" of the retail company GameStop (GME) as well as AMC, Dillard and other targeted stocks. In what can be described as a "David vs. Goliath" event social media played a role in small retail investors banding together to go against large hedge funds. Essentially GameStop was a company targeted by hedge funds for short selling (when one sells a stock they do not own with the expectation of purchasing it later at a lower price). For most of 2020 GameStop stock sold for less than $20 and on 12/31/19 was valued at $19.26. In January the social media site Reddit, through one of its forums entitled WallStreetBets began to recommend taking the other side of that position (much of it through Robinhood). GameStop was ripe for this battle for a couple of reasons: it was a small cap stock with a thin “float” (shares available in the market) and it had a very high degree of short sellers. In fact, the amount of share sold short exceeded the float approaching 150% (green line in chart). The Reddit group has approximately 3 million subscribers and, when acting in a coordinated way, can be a significant influence on such a stock. As they continued to purchase shares the price rose and closed as high as $350 (and even higher intraday) – a significant increase of its $20 price in the beginning of January. The dramatic rise in price is detrimental to the short sellers as they need to cover their positions – one such hedge fund, Melvin Capital, estimates it lost 50% in January on the short selling and up to $19.5 billion lost in total by hedge funds. As for the individual investors, on paper many have made significant profit but, it is an aggressive tactic on both sides. The individual investors have already experienced significant volatility and, once the short sellers are covered, the stock could fall back towards its pre-January price as quickly as it rose. The reaction of limiting trading in GME has some calling for an investigation. Others are concerned about market credibility but, on the surface, this seems more like an isolated incident as short selling generally has been on the decline.





Should you have any questions please contact us.

Image sources: Bloomberg and CNBC unless otherwise noted

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