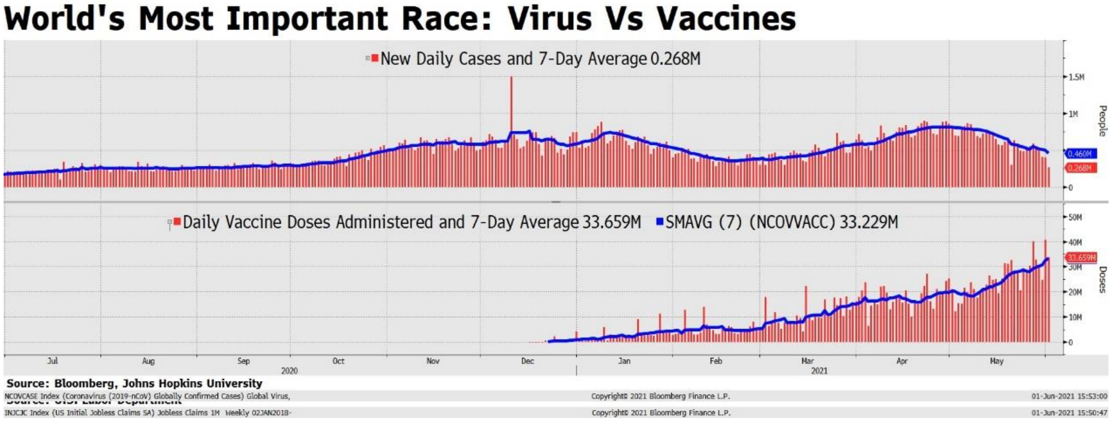
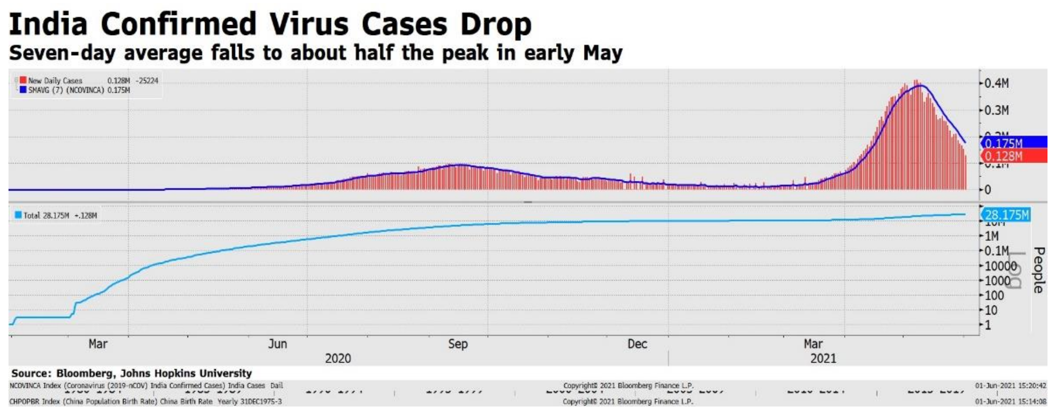
Courier Capital, LLC
Registered Investment Adviser
An affiliate of Five Star Bank

Economic and Market Update – A TRUE U.S. REOPENING (05/31/2021)

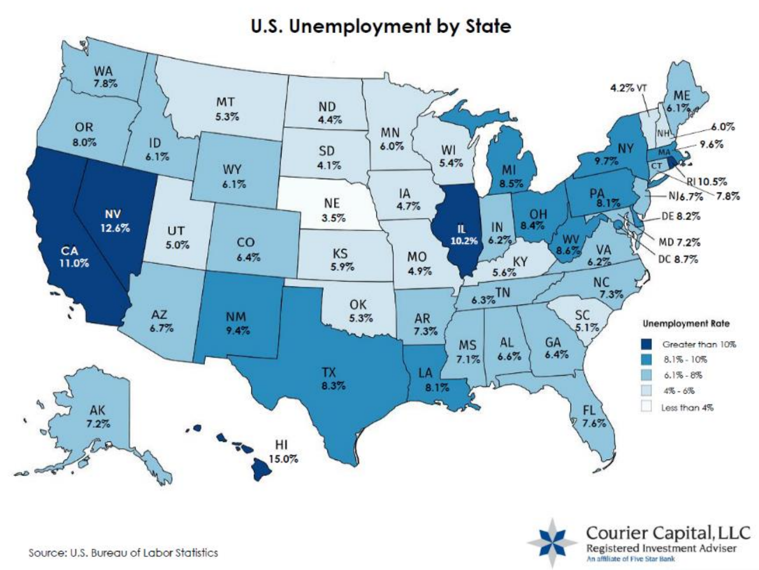
Latest Developments and Economics

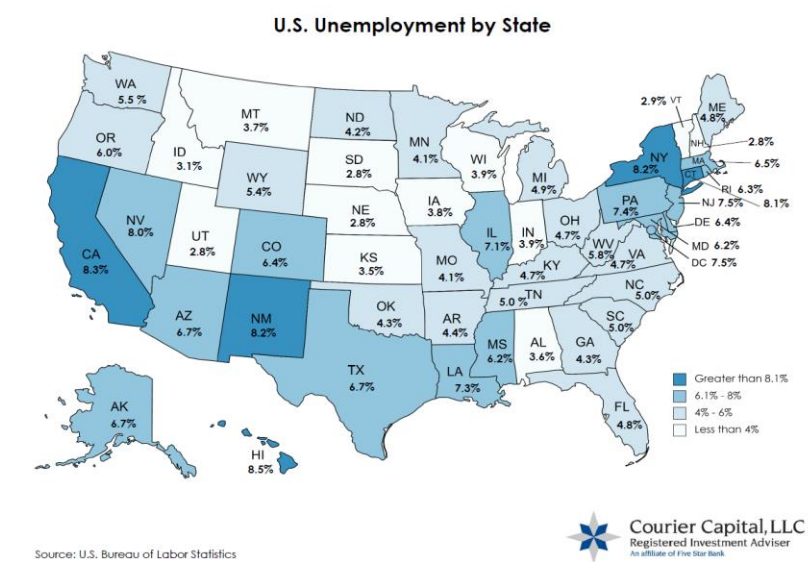


The good news in the U.S. is that the vaccination rate is over 50% and continues, albeit slower, and new cases and hospitalizations continue to fall. Against this backdrop most states are dropping mask requirements and fully reopening their public venues and events. The same is not true in all parts of the world. There are parts of the globe where vaccinations are still difficult to obtain, cases are still a problem and lockdowns continue. India was struggling as late as April and other parts of Asia are seeing variants originating from India. Japan is considering more restrictions on the Olympics (or cancellation) and even developed markets like Canada and Australia are still managing through restrictions and lockdowns.



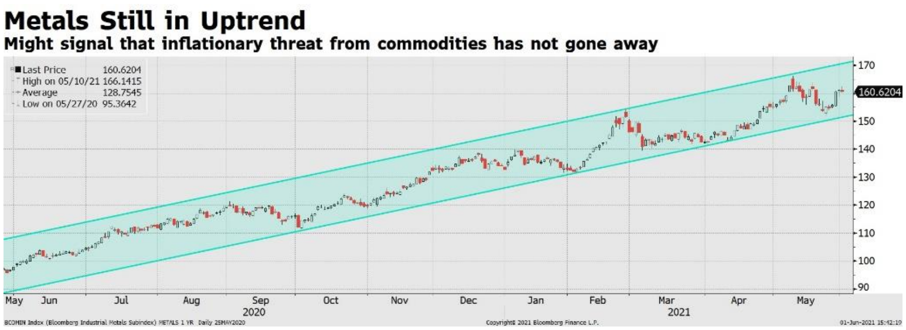
The reopening of the U.S. is expected to drive many positive economic growth activities and two are particularly important. The first would be employment in the United States and the latest readings provided a disappointing surprise. Total nonfarm payroll only rose by 266,000 in April versus expectations of 1,060,000. In addition, the 916,000 March report was revised lower to 770,000. This was surprising in that the number of open jobs in the U.S. rose to its highest level in over a

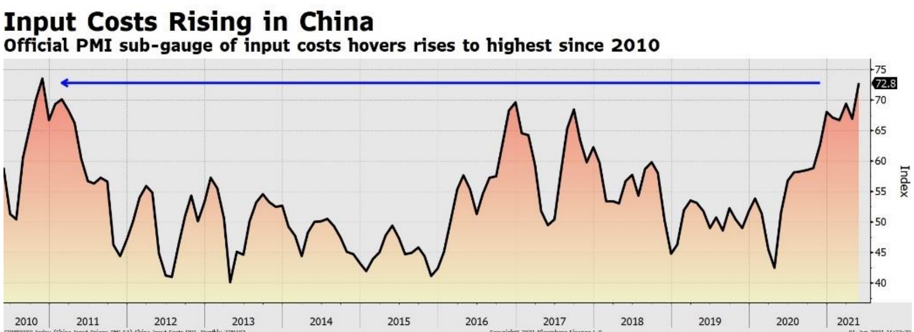


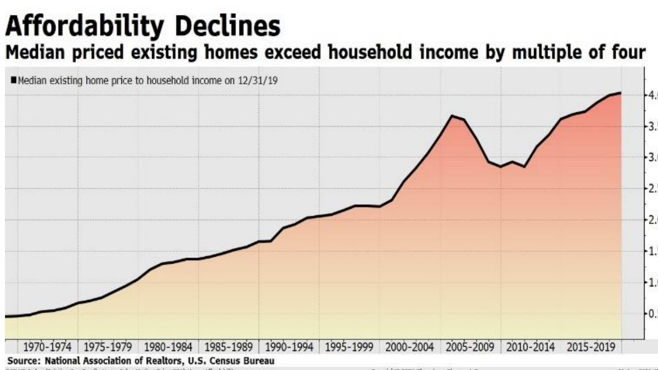


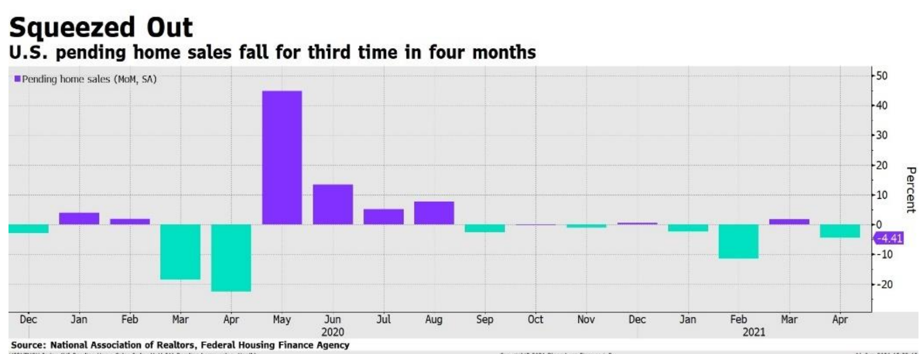
decade at 8.1 million jobs available. This has caused speculation as to the reason for such a low payroll number. A comparison of unemployment rates by state in the charts above from October 2020 (left) and April 2021 (right) show significant but uneven progress. Some believe that fear of the virus or lack of child care options are at the heart of individual reluctance to take jobs while others consider the supplemental unemployment benefits of $300 per week from the Federal government (through September) make the lower wage jobs unattractive. The current average state unemployment benefits, together with the supplement, are approximately equivalent to $16.00 per hour and has prompted governments in 24 states to no longer accept the Federal supplement.

This leads to the second economic implication of reopening and that is potential for inflation. As mentioned in last month's letter there is significant disagreement on whether the effects are temporary or true inflation. The labor issue mentioned above is one of items that will eventually decide the answer. Employers have been raising wages and adding bonuses to attract workers but a common theme in many diverse industries is that they cannot find enough workers to resume their businesses at full capacity. Strong demand from reopening and continued supply chain issues are adding to price increases – which businesses are passing on to the consumer. Oil prices hit $70 per barrel, a multi-year high, due to increasing demand and OPEC plans to increase output by 450,000 barrels per day. Industrial metals, such as copper, and lumber have recently continued significant increases and the chip shortage has not only caused a scarcity in new cars but has spilled over into used car prices as well (up about 10% YOY). While some of these affects do appear temporary some also have the potential to be permanent (i.e.: wages) as they are sticky – once granted they are difficult to remove.

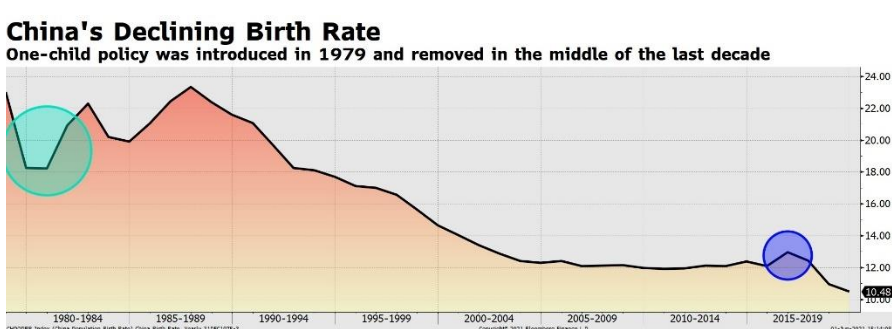




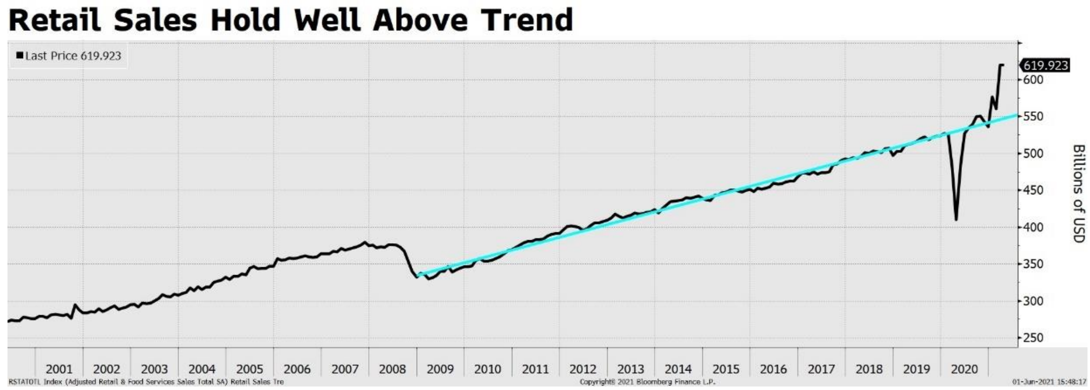




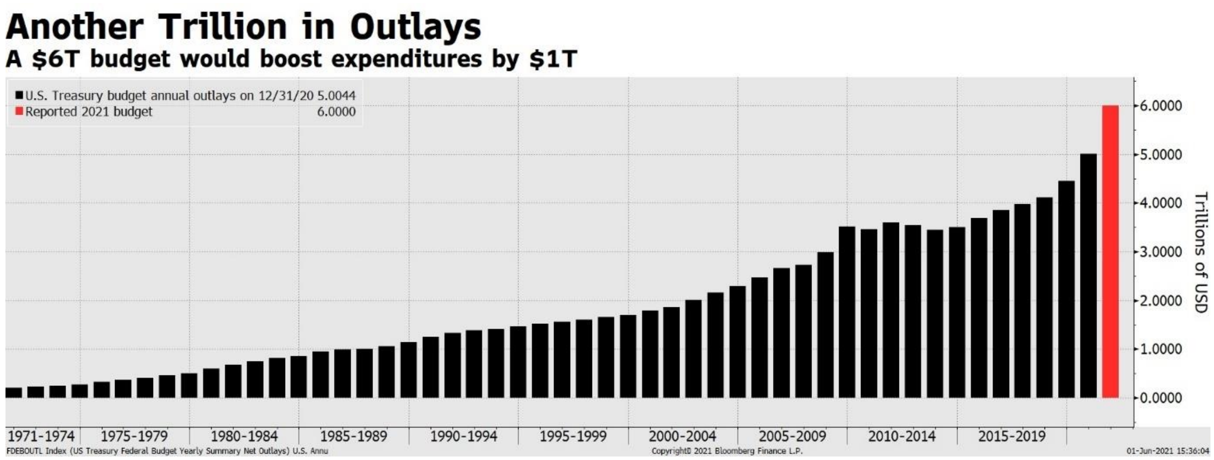
Inflation is also impacting asset prices. The U.S. equity markets have experienced significant increases and the same has been true of housing. Despite continued low mortgage rates the 13% increase in home prices over the last year has priced some out of the market. In addition, home affordability is an increasing challenge. The average home price in the U.S. is about 4 times the average wage in the U.S. Housing is a current problem, but one recent statistic has significant implications for future growth. The U.S. reported a birth rate of 1.64 children per couple (lowest since 1979). Aging demographics and low birth rates are phenomena that are occurring in many developed nations as well as China. Despite abandoning the one child policy the birth rate in China continues to fall.

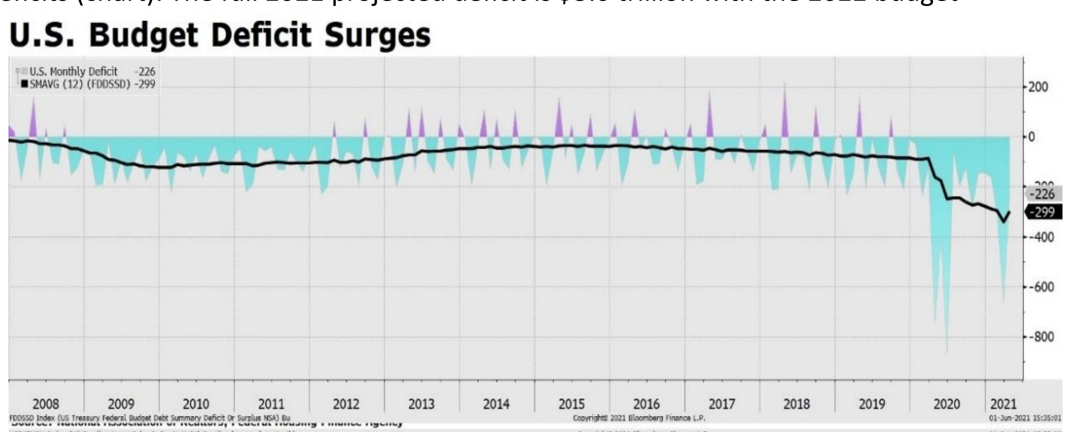


The U.S. consumer is starting to flex their financial muscle, armed with significant savings from the pandemic and ready to get back to some normality. The spending on goods as well as services continue to recover. Airplanes are filling up again and restaurants are seeing more demand. Movie theaters are open, and the warmer weather is bringing people back to amusement parks and resorts. Even malls, once considered near death, are seeing an increase in traffic and retail sales are well above long-term trend.

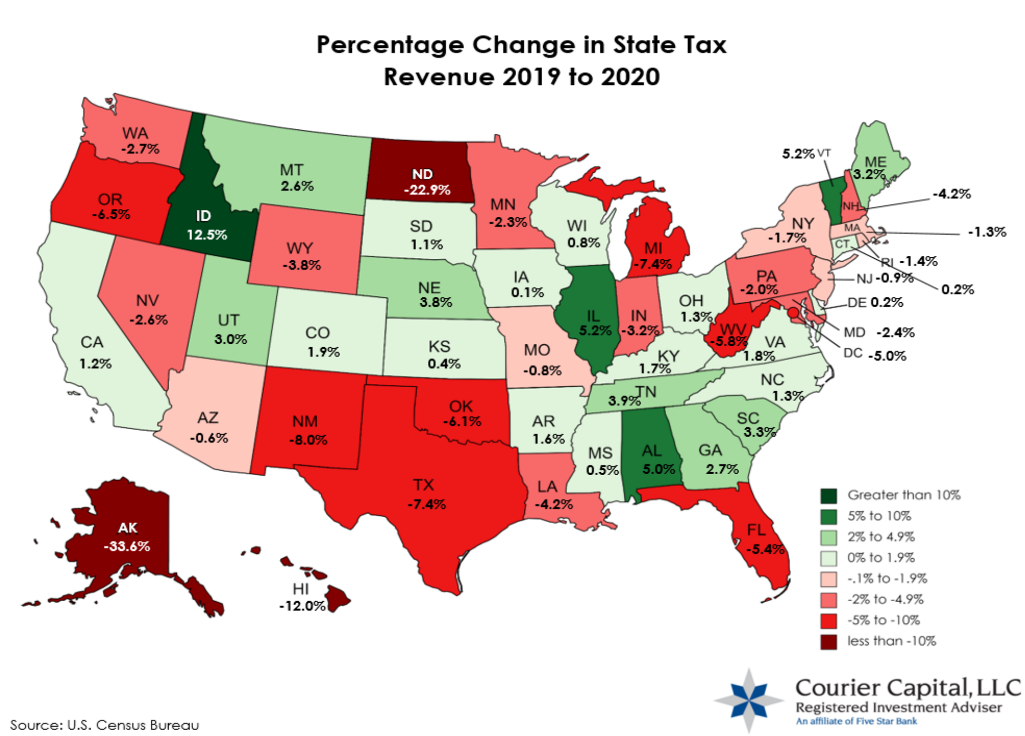


Speaking of spending, the current administration is not shy about getting into the act as well. The 2022 budget proposal was released by President Biden and includes $6 trillion in spending for FY2022. The spending is driven by the two administration proposals of the American Jobs Plan ($2.3 trillion) and American Families Plan ($1.8 trillion) as well as additional discretionary spending. The proposed spending, which needs approval from Congress, would represent a 50% increase in annual spending levels from as recent as 2019. The proposal includes tax increases of $3.6 trillion (largest relative to GDP since 1968) that would leave a net $0.8 trillion greater spending than receipts over the next 10 years and projects annual deficits of over $1 trillion for the remainder of this decade. In the proposal, high income earners would not only see their ordinary income top rates rise to 39.6% and the elimination of unlimited stepped up basis at death but a capital gains rate that increases from current 23.8% to 43.4% retroactive to April 28, 2021. There has never been a retroactive capital gains tax increase so that may face additional challenges. Corporate taxes also make up almost $1.4 of the $3.6 trillion. The last two years have already seen massive increases in monthly budget deficits (chart). The full 2021 projected deficit is $3.6 trillion with the 2022 budget proposal to add another $1.8 trillion next year (7.8% of GDP). The proposal assumes higher GDP growth for 2022 and 2023 followed by 2.0% annual growth through 2031. If adopted as presented, servicing the country's federal debt would be over 10% of federal spending by 2030 assuming interest rates do not rise significantly by then.





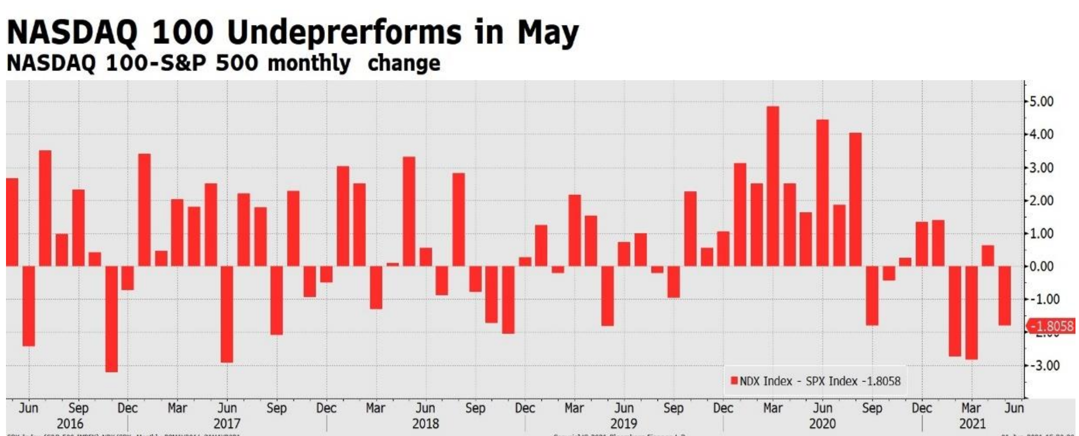
The aim is still for a bipartisan bill on infrastructure and the negotiation is continuing. The Biden administration came down to $1.7 billion and the Republicans have come up to $928 billion (from $568 billion) but the two sides are further apart than they appear. The Republican counteroffer maintains current program spending and using some of the $700 billion of unspent funds from prior COVID relief packages earmarked for state and local governments. Congressional Democrats are opposed to this reuse of funds and there is still a significant difference between the parties on what is defined as "Infrastructure".



Part of the state relief funds that were part of the prior COVID package were to mitigate lost state revenue due to the COVID lockdowns. There were several states that projected massive revenue declines from 2019 to 2020 due to significantly reduced economic activity. Nationally receipts were down about 1.0%. Once again, the results are rather uneven when looking at it on a state-by-state level with some of the states not faring as bad as feared and other states tax revenues up year-over-year. Several states have also suggested or already proposed state tax increases to help them cover the COVID-related deficits.

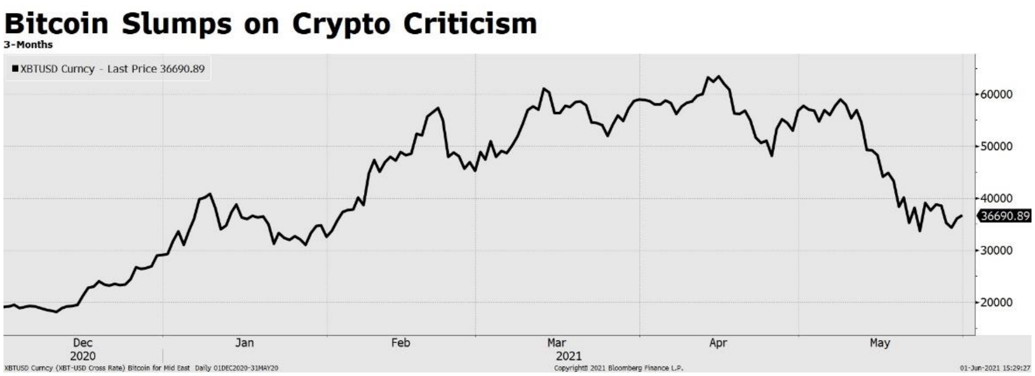
Financial Markets

The U.S. equity markets ended the month pretty much flat after the S&P 500 set record highs during the month. The month was a bit volatile as the specter of inflation and the weak jobs report weighed heavily on further increases. Despite the May performance the S&P 500 index is up over 12.6% YTD, but the story is in the makeup of the returns. The growth stocks that dominated in 2020 have fallen off and value has taken the lead. This rotation would have made a growth-orientated portfolio underperform so far in 2021. The S&P 500 Growth Index is up only 8.16% through May while S&P 500 Value stocks are up 17.68% during the same period. The tech-heavy NASDAQ also has fallen victim to this relative underperformance. Inflation and higher interest rates are usually not friendly to high growth stocks and this is when a well-diversified equity portfolio proves its worth.

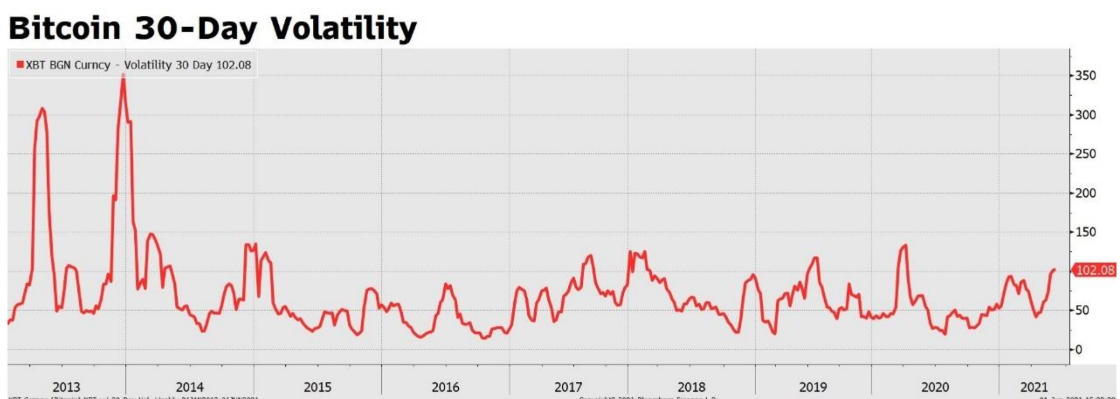


What is rather surprising is that the data on inflation has not impacted the fixed income markets yet. After rising quickly to 1.75% earlier this year the 10-year US Treasury rate has stayed between 1.50%-1.65% most of this quarter and ended May lower at 1.58%. The reason could be varied but certainly includes the $120 billion in monthly bond purchases by the Federal Reserve to keep rates low and encourage economic activity. The Fed finally hinted at starting to discuss a plan for tapering these purchases if the economy continues to gain momentum. While interest rate increases still look far off the tapering would be the first step in taking the economy off the monetary life support that was provided by the Fed in 2020. These developments will be something to watch during this summer as the current rate environment continues to favor borrowers and penalize savers.

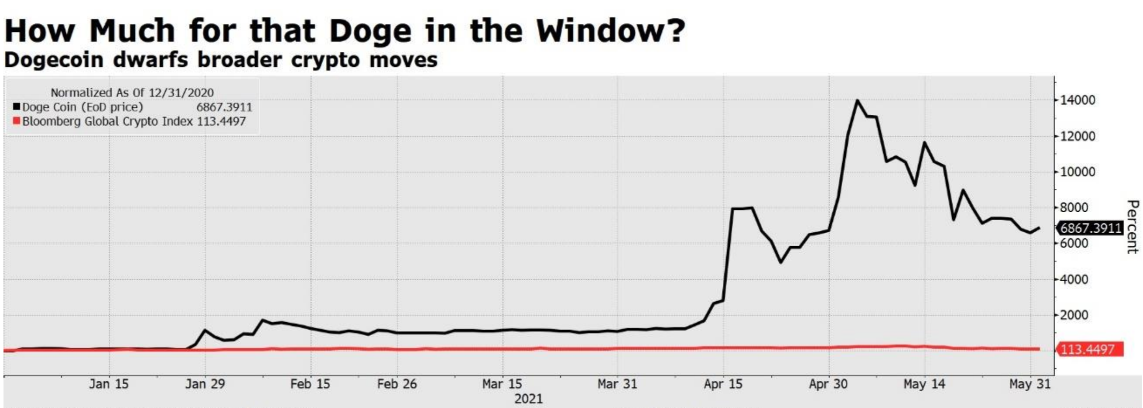
The most interesting news during May surrounded the recent topics of SPACS and Cryptocurrencies. Special Purpose Acquisition Companies (SPACs) are firms that raise cash through a sponsor, go public and then look for a private company to merge with, thus bypassing the IPO process. Often called ‘blank check’ companies investors give their money and may not know what they are getting in the end. The supposed advantage is speed and reduced fees in raising capital. A SPAC has a limited amount of time (usually 2 years) to find and make a deal. SPAC mergers that took place between January 2019 and June 2020 showed the value of the post-merger company dropped by 33% or more with a year of the deal according to Price Waterhouse Coopers. The companies purchased could be profitable or not and the shares of the company could become diluted making the investment less valuable. SPACs have recently gained significant attention, even though they have been around since 1993, but recent SEC guidance about restating SPAC financials could slow down this market.



The volatility of the cryptocurrencies has also been in the headlines recently, especially with the more retail-orientated Bitcoin. While the technology on which they are built, blockchain or distributed ledger, is real – there are literally dozens of cryptocurrencies on the market. Bitcoin, the most well-known had a terrible month. With no specific use or fundamental value Bitcoin has been very volatile and is subject to price movement based on headlines. Tesla’s announcement of acceptance of Bitcoin for a Tesla had an impact on its price, as did its subsequent withdrawal of that offer a short time later. Bitcoin was down 36% in May after reaching prices over $63,000 earlier this year. Critics also argue that, given the anonymous nature of Bitcoin, it invites criminal activity. In fact, many ransomware cyberattacks require payment in Bitcoin – such as the Colonial Pipeline attack this past month.

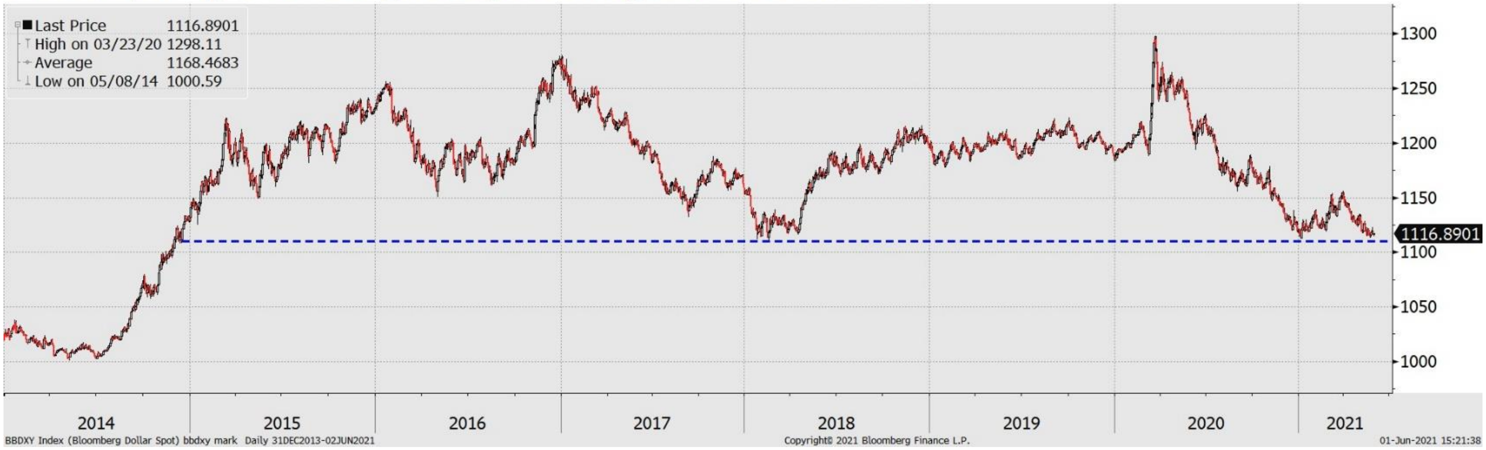


The best example of the crypto market is most likely the one involving Dogecoin. Dogecoin was started as a joke in 2013 by two software developers (one from IBM and one from Adobe). For most of its existence its value was far less than a penny. This year however saw amazing jumps in value – in January it went up over 800% overnight, reaching a price of $0.07 based on posts from REDDIT and by Elon Musk making a reference to it (and then another on Saturday Night Live). Other celebrities like Mark Cuban, Snoop Dogg and Gene Simmons have also brought attention to it. In May Dogecoin did hit $0.50 marking a 20,000% increase in one year. The cryptocurrencies will not disappear, but many compare it the modern-day Tulip Craze that ended in 1637. The future direction of digital currency may depend the Federal Reserve. Fed Governor Lael Brainard made positive comments about a Fed-backed cryptocurrency (essentially as a digital dollar) which could make many other cryptocurrencies obsolete.



Dollar Nears Six-Year Lows

However, many factors might be preventing a move even lower



Staying with the topic of currency brings us to the current widely-accepted official dollar – previous letters have mentioned its direction as something to watch going forward. The greenback continues to struggle against other major economic world currencies hitting a six year low in May. If it weren't for certain factors, like higher interest rates than much of the world, the US dollar could have slipped even further. The topics of inflation and budget deficits mentioned above could also pose a threat to the value of the dollar going forward. A declining dollar will make foreign goods more expensive for U.S. consumers and U.S. goods relatively cheaper to international consumers.

Should you have any questions please contact us.

Image sources: Bloomberg and CNBC unless otherwise noted

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