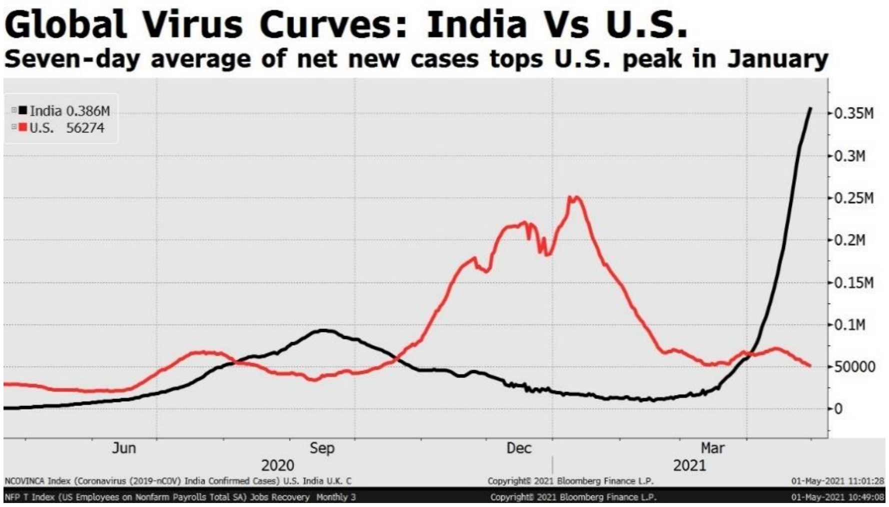
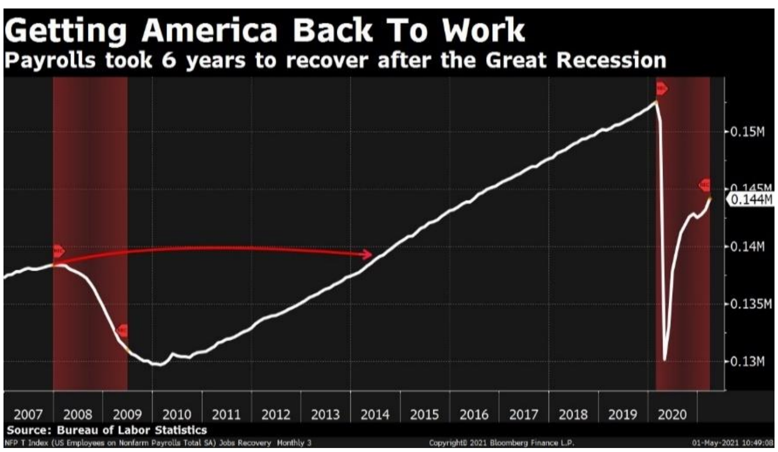
Courier Capital, LLC
Registered Investment Adviser
An affiliate of Five Star Bank

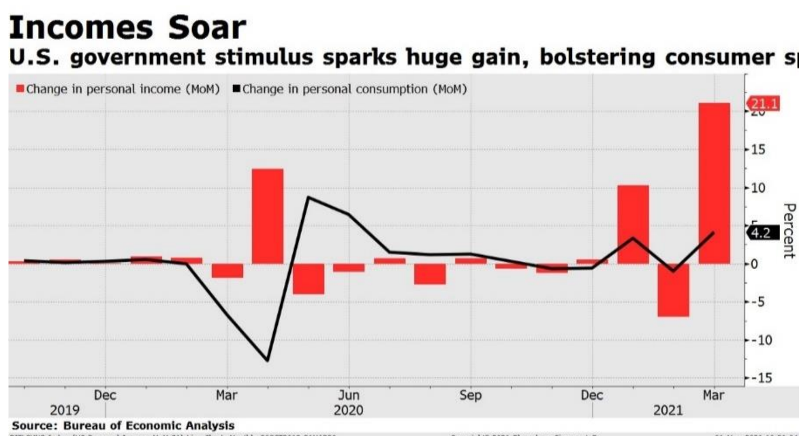
Economic and Market Update – THE BIG WAVE (04/30/2021)

Latest Developments and Economics

Recent data supports the assumption that the U.S. economy is about to experience a significant wave of growth driven by a continuation of a return to normal as well as the massive fiscal stimulus that has been delivered in recent months. The reopening can be credited to the swift vaccination of citizens, which now stands at over 30% of the population and natural immunity which may result in about two thirds of the population having virus protection. This includes about 82% of those over 65 – generally considered most vulnerable. The concern now is a slowing rate of vaccination in the country. This is in sharp contrast to other parts of the world. Brazil and India are the most troubling spots in the world currently. The lack of available vaccine in India means only about 1.8% of the population is vaccinated and new cases are increasing significantly. Even developed countries like Canada are still progressing much slower than hoped.

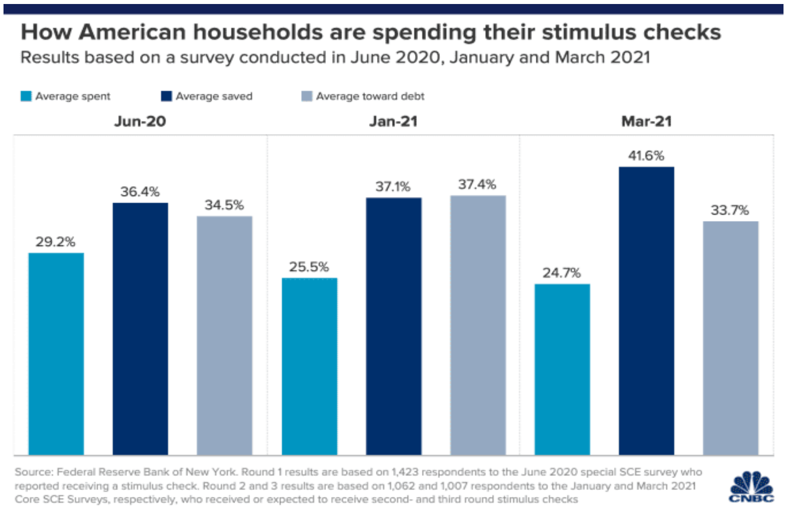






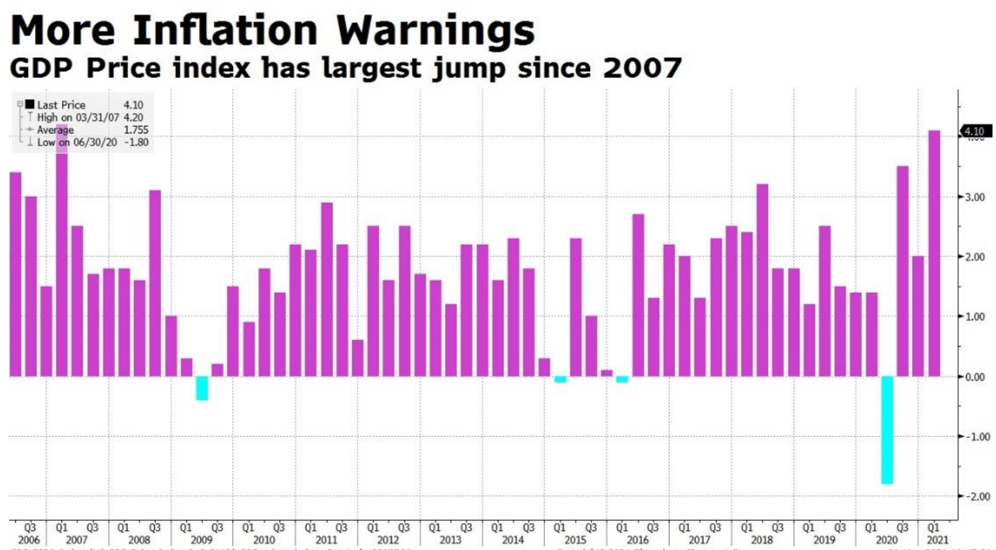
The recovery in U.S. jobs has been remarkably fast by historical standards – it took 6 years for total non-farm employment to return to pre-crisis level after 2008 (chart). The unemployment rate is now at 6.0% and first-time unemployment claims fell to 553,000 – lowest since pandemic. During March 916,000 jobs were added with expectations of 800,000-1,000,000 jobs possible in April. Many of these job gains are expected to come in the leisure and services industries. Even with these gains we are still 8 million jobs short of pre-pandemic levels and the participation rate (people employment as a percent of all eligible workers) stands at only 61.5%. In addition, there are currently over 7.3 million jobs open per the latest Job Opening and Labor Turnover (JOLTS) report. This represents either people unwilling to work or people not possessing the skills for available positions. The job situation encourages confidence for consumers to spend as does cash in pocket.

The second chart above shows the change in consumer personal income. This comes not only from salaries but also from the federal government's direct payments to consumers. The chart shows the three direct payments of $1,200 in April 2020, the $600 in January 2021 and the $1,400 in March – which resulted in a historic 21% increase in income from the

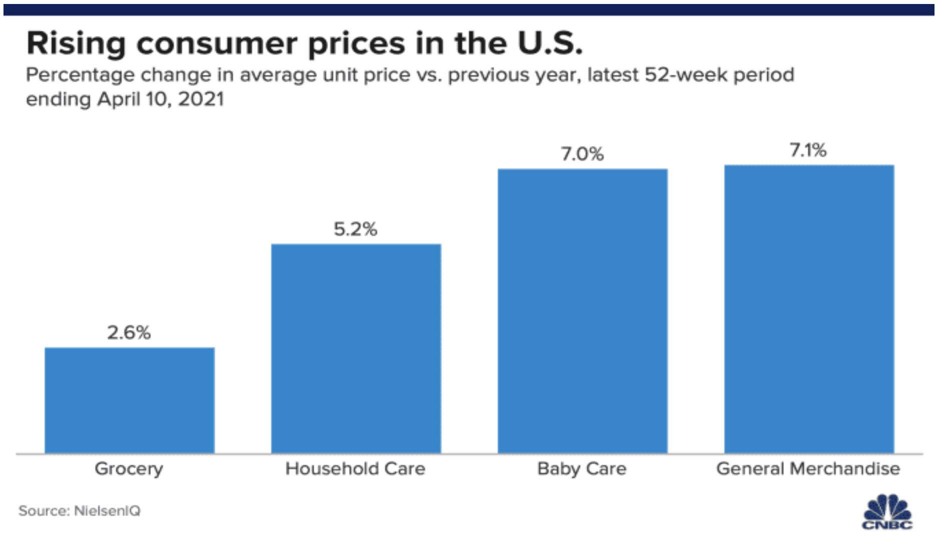


month prior. This has supported the consumer in terms of spending (black line) as the change in personal consumption (buying) increased by 4.2% in April. The spending has mainly still been in goods rather than services but, the make-up should change as people shift their spending to leisure activities of travel and restaurant dining. The chart to the left also shows that with each successive stimulus payment there has been a marginal decrease in propensity to spend and increases in savings and debt reduction. This partially explains why a 21% increase in income only resulted in a 4.2% increase in spending but, the consumer is generally in good shape and primed for continued spending in the short term.

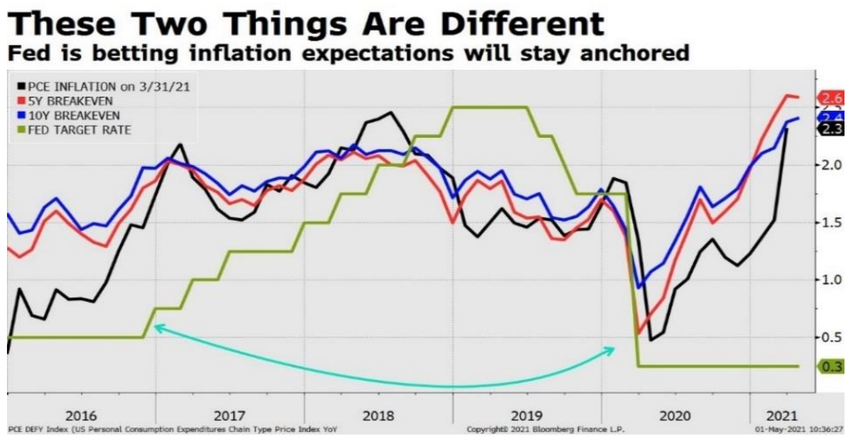
In what may be considered the beginning of the coming wave of economic activity, the first read on Q1 GDP was a 6.4% annual rate fueled by a 10.7% jump in consumer consumption. There are many indicators pointing to continued strong economic activity in the near term (ex: retail sales and consumer confidence) and annual GDP estimates still range from 6.0-8.0% (albeit from a small 2020 base) for the year. Moreover, the initial read was slightly below expectations and a look under the hood shows rather disappointing growth in housing (most likely due to inventory shortage and price increases) as well as business investment. The strength of consumer spending also resulted in a drawdown in inventories (which is a positive for Q2 GDP) and is a sign leading to the other potential concern in the near term – inflation.



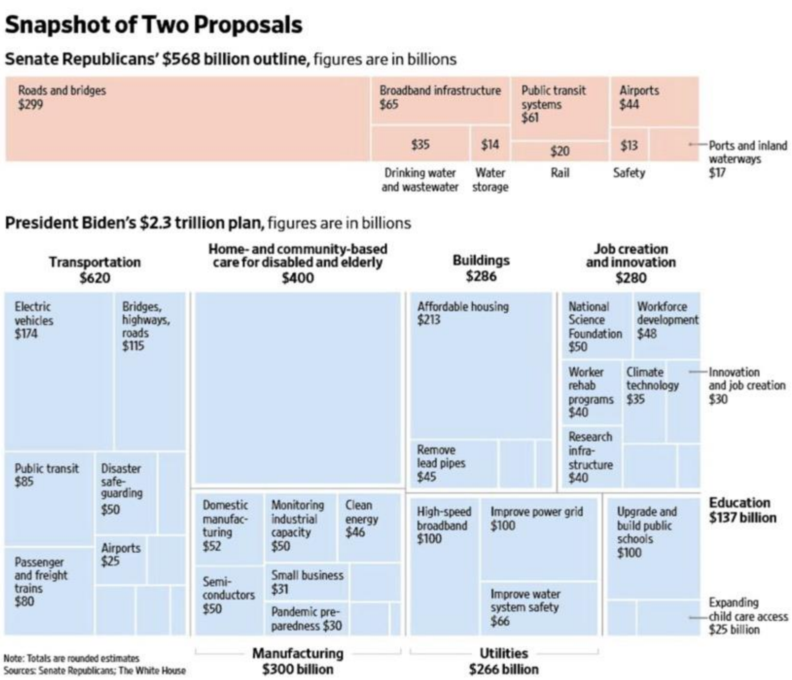
The GDP report came with a larger than expected 4.1% increase in the GDP Deflator (one measure of inflation that does not get much attention) while the Fed's preferred indicator (PCE) was a more muted 2.3%. As mentioned in a previous letter we are watching to see if the expected price gains are a result of temporary price shocks as consumers spend or if signs point to true inflation. The factors working against more lasting inflation are the same powerful ones that existed before the virus – demographics, technology and globalization. However, there are indications of increasing price levels in many different parts of the economy and in the Q1 corporate earnings calls input costs and inflation were significantly mentioned as it related to increased costs. Even at the consumer level many have experienced the noteworthy increases in food, energy and commodities. The acknowledgement of asset price increases (housing, stocks, etc.) may now be followed by price level changes. One example is the broad commodity index tracked by Bloomberg which shows increases during most of 2020-21 after the initial decline from the pandemic. Lumber is up 232% since the pandemic started, corn just hit a 7-year high in prices and there is a reported shortage of chickens. The increase in prices has also affected



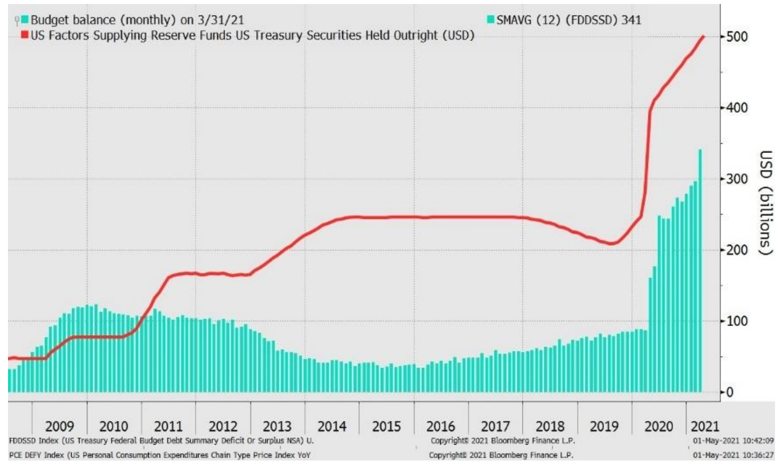
labor with many job openings remaining unfilled at starting wages higher than the currently deliberated $15 per hour national minimum wage. Consumers have already noticed rising gasoline prices (and potential shortage due to lack of truck divers). In addition, many consumer-orientated companies like Proctor and Gamble, Coca-Cola, Kimberly Clark, General Mills, J.M Smucker and others are announcing price hikes to consumers given their pricing power. The increases may not come as direct price hikes but could be in the form of different packaging and smaller sizes as well as price increases coupled with temporary promotions. The Federal Reserve has signaled that they are willing to accept higher inflation for a time to focus on getting more people back to work. They believe that the price increases are 'transitory' and will not become permanent. This has led to their decision to keep interest rates low for the foreseeable future despite signs and market expectations of increased price levels. The chart to the right shows the difference between the Fed target interest rates and the market expectations for inflation 5 and 10 years out as well as current PCE mentioned above.



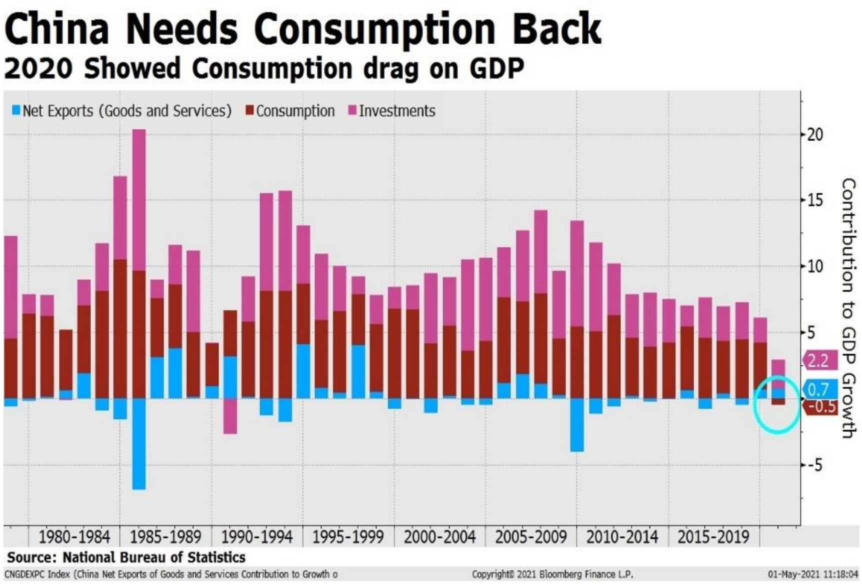
In the midst of what is currently happening in the economy there is also quite of bit of news on the political front. President Biden recently conducted his first address to a joint session of Congress and laid out plans for near term objectives on the economy. On the heels of the $1.9 trillion stimulus package his administration has proposed 2 new spending plans worth a total of an additional $4 trillion as laid out (almost 100% of annual federal budget). The American Jobs Plan (aka Infrastructure bill) totals $2.3 trillion and is aimed at traditional infrastructure (physical transportation) but also includes items like clean energy, home health care and buildings in a broadly expanded definition of 'infrastructure'.



The administration also proposed a $1.8 trillion America Families Plan which extends the $3,600/$3,000 per child tax credit through 2025, covers universal pre-k, free community college and child care/paid medical and family leave. The proposal is to partially pay for these initiatives with tax increases on wealthy individuals and corporations (the rest would be deficit spending). Corporations would face increases on income to 28% (from current 21%) and a minimum tax on "book" profits. On the personal side increased tax enforcement makes up the majority together with an increase of capital gains tax on wealthy individuals to ordinary income rates, which would also be increased to 39.6%. This would bring capital gain top rates to 43.4% at the federal level. Republicans and some Democrats are concerned about the total price tag and imposing tax increases on corporations (making them less competitive internationally) and individuals at this time. The Senate Republican's did assemble their own infrastructure bill, worth about $600 billion, and focusing mainly on the traditional physical elements. Many expect a toning down of Biden's proposed initiatives (both spending and tax) through negotiation with some Democrats who are uncomfortable and Republicans. Should that not prove fruitful the Democrats still have the reconciliation process to try to get all that they propose without going through Republicans but, this means that tax increases will need to stay (and possibly raised) to pay for the entirety of the packages. Another concern is the level of deficits and debt. So far in fiscal 2021 the federal government accumulated $1.7 trillion in receipts and spent $3.4 trillion in outlays. The deficit has been financed through borrowings with debt purchased by the Federal Reserve, which has over $7 trillion of U.S Treasury bonds on its balance sheet.

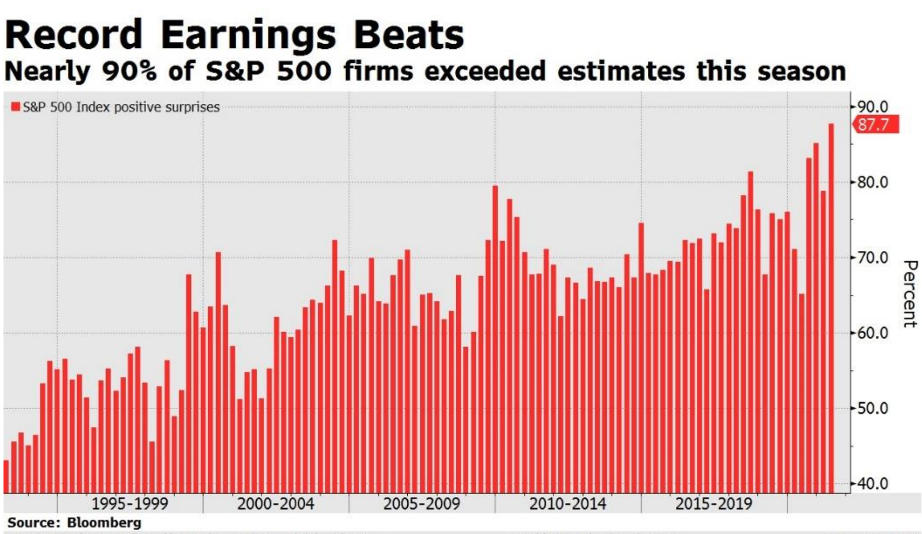


Turning our attention internationally the focus is on the second largest global economy – China. Recent reported growth in the first quarter was 6.1% on an economy worth about $14.7 trillion. Many project that continued growth at that rate the Chinese economy could overtake the U.S. economy somewhere between 2026-2030. Looking at 2020 (chart) China was the only major economy with positive growth at 2.3% since they were the first in the pandemic and quickly the first out. However, looking a little deeper, the economy is currently in transition towards a consumer-based economy. Last year was the first year that Chinese consumers were a drag on economic performance. In addition, the U.S. still retains certain advantages in the composition of the economy – such as dominance in technology and innovation.



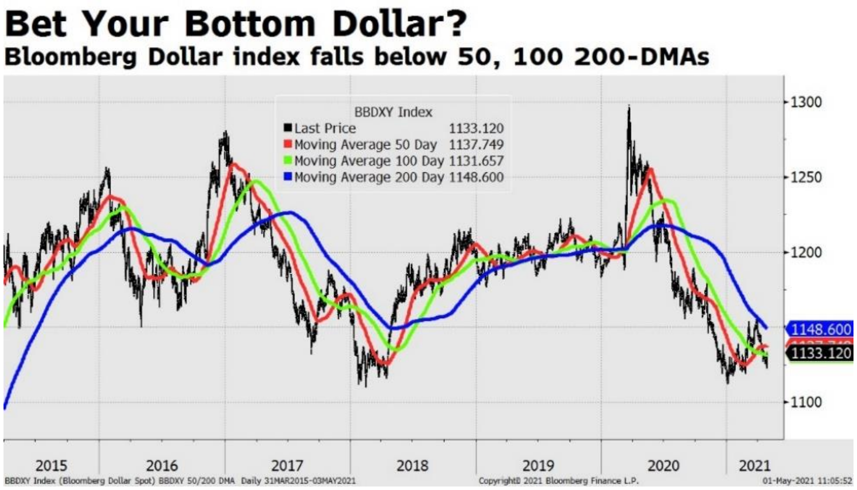
Financial Markets

Even with a weak finish the S&P 500 ended April gaining over 5%. This leaves the S&P 500 up 11.84% in 2021 but finds itself looking up at the mid cap stocks (18.58%) and small cap stocks (20.65%) year-to-date. April was an important month as S&P 500 companies were reporting Q1 earnings results. With over 60% of the companies reporting so far about 87% have beaten relatively high earnings expectations (more than the 5-year average of 74%). In addition, earnings are about 22.8% above expectations according to Factset which is significantly above the five-year average of 6.9%. Revenues are also higher than estimates for 78% of the companies reporting. This signals that recent increases in the level of the S&P 500 are supported by growth in company earnings. However, the fact that the market has not increased more with such large beats may be an indicator that much of this was baked into current stock prices already.



We continue to watch the pace and progress of the recovery not only in the U.S. but around the world since pandemic difficulties can still impact the U.S. from an economic perspective given our global economy and a resurgent case load.

The focus on inflation mentioned above is critical to the future of interest rates and the U.S. dollar. Unexpected increases in inflation beyond what the Federal Reserve expects in terms of degree or length could impact U.S. interest rate markets and even cause the Fed to raise rates earlier than they expect. After rising to over 1.74% recently and looking to go higher the 10-year treasury rates had settled back to the 1.55-1.60% range. This wave of economic activity in the coming several months due to reopening, coupled with supply chain shortages, create this inflation potential. A significant increase in interest rates also could very well have a spillover effect in equity markets. If the U.S. equity market, which is anticipating a strong recovery for the next several quarters, must digest corporate, individual and payroll tax increases coupled with interest rate increases, it may be more than can be absorbed in the short-term.



Finally, increased federal spending and resulting deficits have a negative impact on the dollar. Higher inflation (which the Fed has indicated it will tolerate) usually detracts from value of the currency. There is also a focus away from the U.S. towards the next region to recover (i.e. Europe) which would cause that currency to appreciate. The U.S. dollar gained significant strength in 2020 at the height of the pandemic. However, the dollar has been sliding since mid-2020 against a trade-weighted basket of currencies and some individual currencies, like the Euro, have been gaining against the dollar. This could also explain some of the rise in the price of commodities, which are quoted in dollar terms. Rising interest rates in the U.S. could support the dollar but only if it comes from real economic growth and not inflation. Dollar weakness however, is usually a positive factor for emerging market economies.

Should you have any questions please contact us.

Image sources: Bloomberg and CNBC unless otherwise noted

Buffalo Office

1114 Delaware Ave.

Buffalo, New York 14209

PHONE: 716-883-9595

Jamestown Office

214 West Fifth Street

Jamestown, New York 14701

PHONE: 716-484-2402