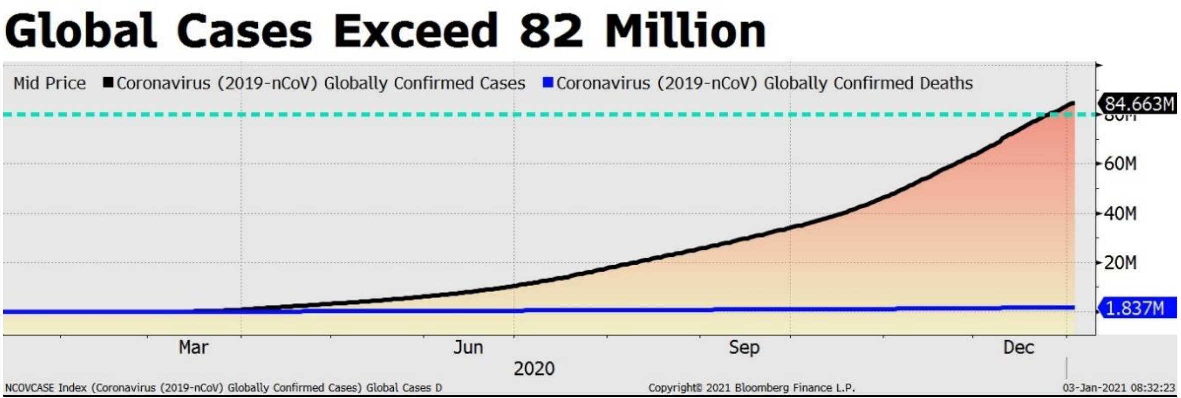
Courier Capital, LLC
Registered Investment Adviser
An affiliate of Five Star Bank

# Economic and Market Update – LOOKING FORWARD (12/31/2020)

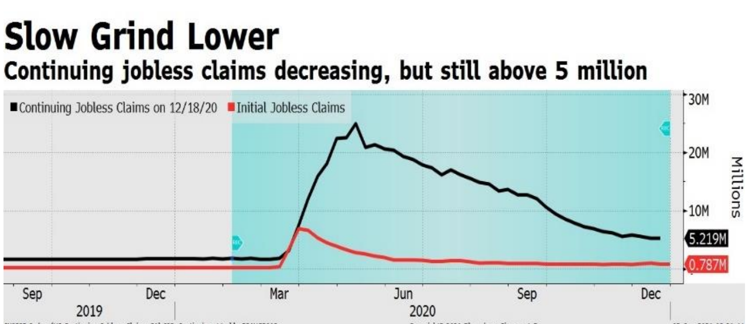
## Latest Developments and Economics

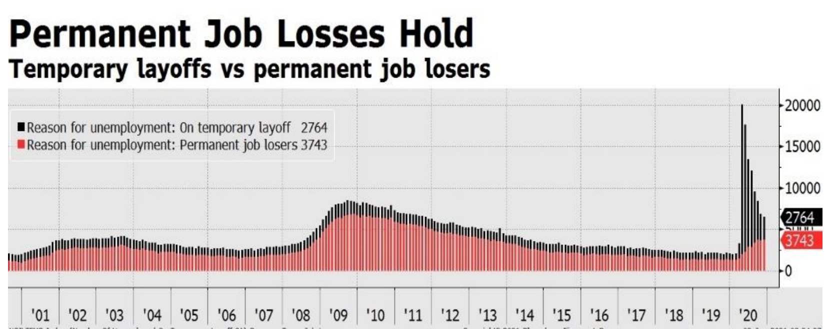
We hope that you enjoyed your holiday season as best as possible under the circumstances and wish you the best in 2021!

The new year always brings a retrospective of the prior year and, this year especially, we have all heard enough about how 2020 was unique and how it was 'a year like no other'. Rather than rehash reviews and comparisons we prefer to look forward. What will be interesting is how history will perceive 2020. Experiencing it personally has an outsized impact on us individually but, with the benefit of historical perspective, will 2020 be viewed as a significant marker in history (like GFC 2008, 9/11/01, WW II, etc.) or will it fade in collective memory (like the more lethal 1918 pandemic)? Only time will tell.

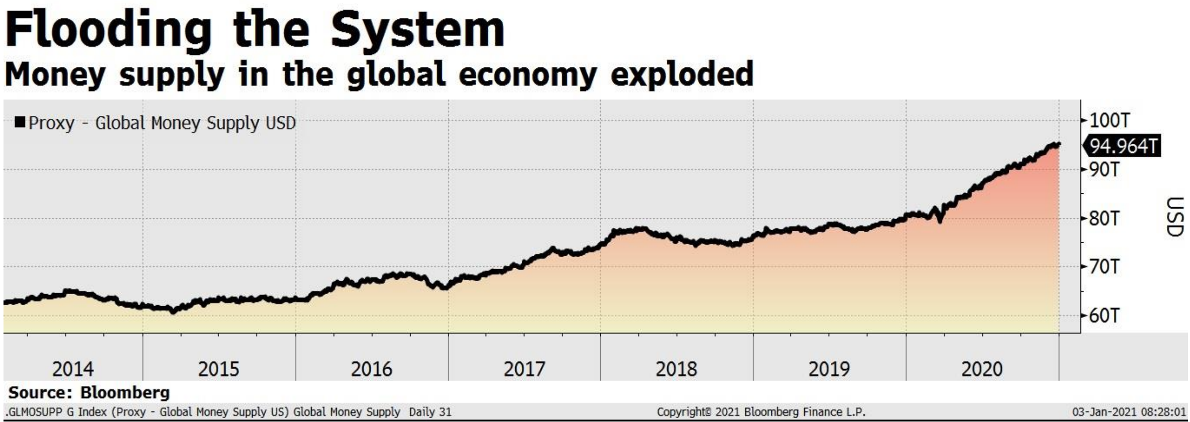



What we can focus on is where do we go from here. As it stands the virus situation leaves with hope but an ominous challenge (like the approaching climax of a suspense movie). The vaccines are currently being approved and distributed but, the post-holiday surge and the mutated, more communicable strain first discovered in the U.K. has the potential to add to cases in the short term. About 14 million doses of Pfizer and Moderna vaccines have been shipped but distributed to only about 3 million people in the U.S. As the process and infrastructure improve, hopefully the pace of vaccination means that everyone in the U.S. who desire a vaccine will have access to one by late Spring and the case load drops dramatically. With a new administration planning to begin on January 20 what has the pandemic left in its wake? First, one must look at the employment situation in the country. While the number of unemployed steadily decreases the make-up is skewing more towards permanent job loss rather than temporary. The longer the economy is shut down the more businesses, especially small businesses, will close.



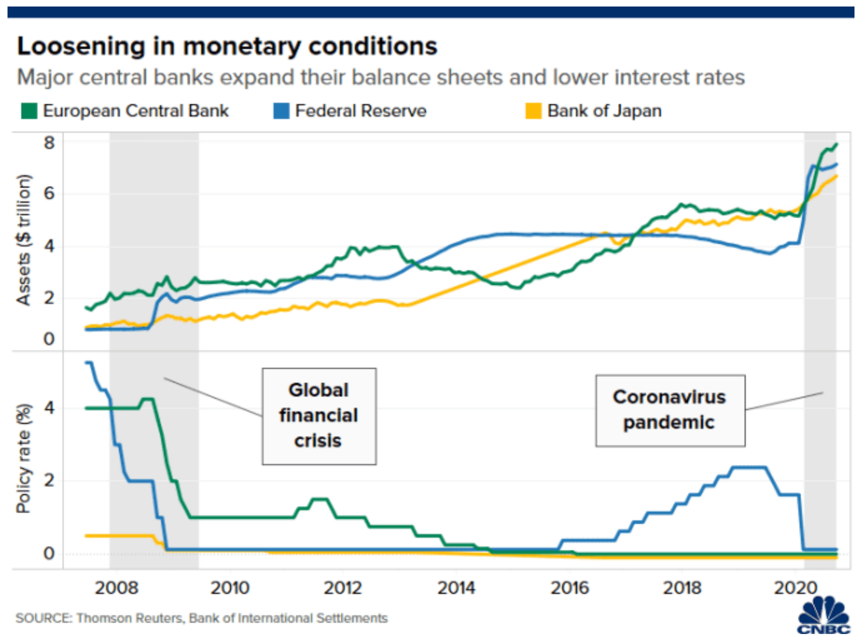



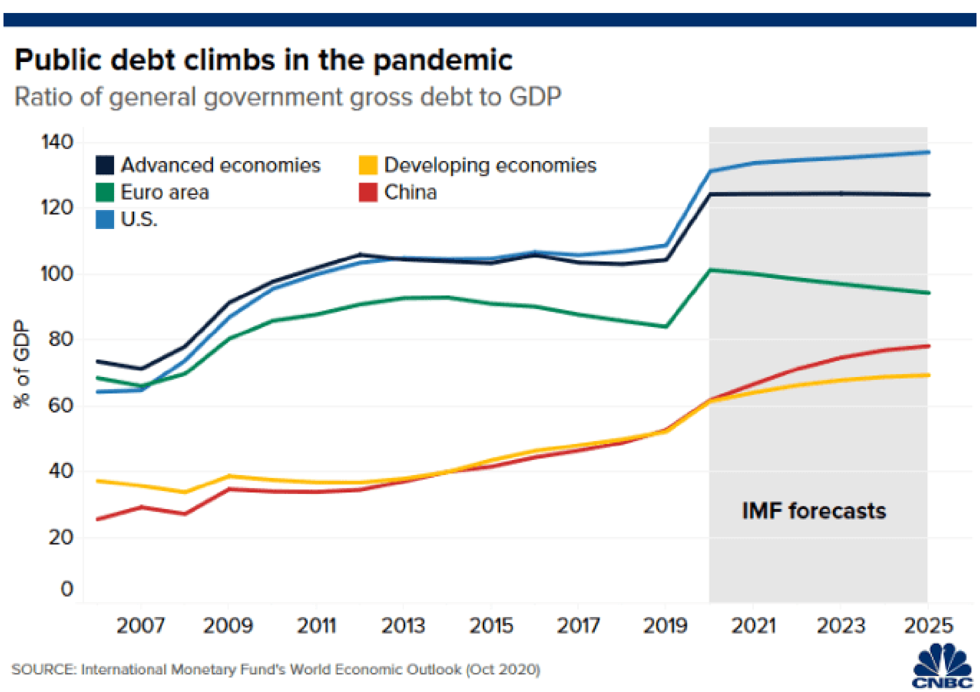

This situation finally prompted an agreement in Congress on a fifth stimulus package worth $900 Billion (4% of GDP and the second largest package in history). Only about 1/3 of this total is new spending and the rest is recycled, unused money from the original CARES act. This will include expanded unemployment benefits of $300/week for 11 weeks and direct payments of $600 to individuals making less the $75,000 and couples making less than $150,000. This was completed despite the drama created by the President's initial refusal to sign it and his proposal to include $2,000 direct payments instead of $600. Not to let the opportunity pass the House quickly took up a vote for the increase which now lays dormant in the Senate. The promise of additional stimulus has been floated by the incoming administration. The next stimulus, plus other new administration policy initiatives, will be shaped by the January 5 Georgia elections for two Senate seats. As a reminder the Republicans hold 50 seats and Democrats 48. A single win of the two seats will give Republicans a slight majority and is likely to result in more moderate policy to reach compromise and govern the country.



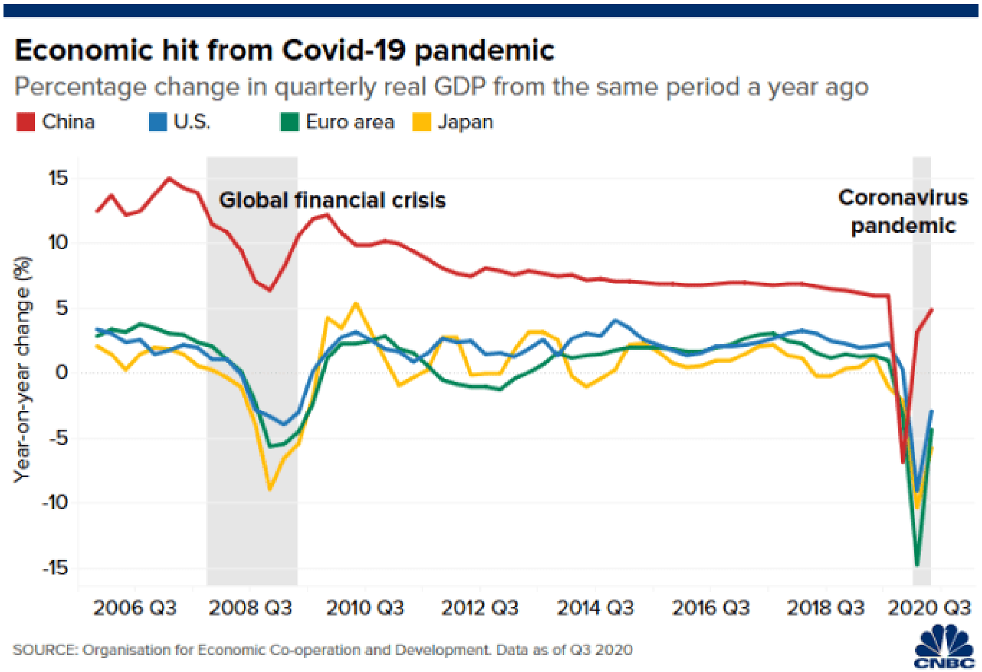

While the virus is expected to wane, what will endure economically will be with us for years. The massive monetary and fiscal response globally will stay as a reminder. The monetary response has left the world awash in liquidity as the money supply expanded dramatically.

Central banks around the world, and the Federal Reserve in the United States, have done their part to aid liquidity and support the fiscal and monetary response by increasing asset purchases and expanding balance sheets (the Federal Reserve buys treasury bonds issued by the U.S. Treasury Department). The Federal Reserve's balance sheet increased by over $3 trillion dollars in 2020. The Federal Reserve now holds over $7.4 trillion of treasury bonds – from less than $1 trillion in 2008. In December the Fed announced changes to its asset purchase program to continue to support recovery. Asset purchases will continue "until substantial further progress has been made toward the Committee's maximum employment and price stability goals."




The massive fiscal support, much through COVID relief packages, has caused the FY2020 deficit to come in at over $3.1 trillion and over $400 billion in the first two months of FY2021 (before the impact of the $900 billion stimulus package just reached). This results in total federal debt in the U.S. of over $27.5 trillion, approaching 130% of annual GDP with projections for more. Federal tax receipts will most likely be less temporarily given the number of unemployed people in 2020 and the suspension of required minimum distributions in 2020 coupled with additional spending. The rest of the world is embarking on the same fiscal support but the U.S. leads in debt levels among major world economies. The concern about this quantity of debt is its impact on future national economic growth, even when interest rates on debt are low as they are today.




All this monetary and fiscal stimulus has helped the world recover from the steep drop in GDP but, remains far below 2019 levels. Given that only a portion of the latest stimulus package is aimed at households the economic impact will most likely be muted. The additional lockdowns in parts of the country (like New York and California) will continue to keep the recovery subdued through the first quarter of 2021. Expectations for the U.S. economy in 2021 are rather high (at least temporarily) as the economy recovers from the virus after the vaccine distribution. U.S. GDP expectations range from 4-6% in 2021 (for a normal 2% economy) and will most likely occur in the second half of the year.

There have been other important developments that have been overshadowed by the virus. In the U.S. there was a major cyberattack, allegedly by Russian operatives. In what is known as a "supply chain" attack the hackers inserted malicious code into legitimate IT management software by SolarWinds, which is used by many federal agencies. The hack was discovered by security software firm FireEye in December but could have been in place since March. Many global organizations are estimated to have been affected including U.S. Departments of State, Energy, Homeland Security, Commerce and Treasury as well as firms like Microsoft and its customers. It will take a long time to determine the extent of damage and is an extremely significant breech of national security which exposed the weaknesses of the U.S. cyberattack defenses. The response to this significant threat will fall on the Biden administration.

A second Comprehensive Capital Analysis and Review (CCAR), also known as "stress tests", of U.S. banks was conducted for 2020. This normal annual review was done twice this year due to COVID. The initial review in June resulted in some restrictions on U.S. banks dividend payments and buybacks. The shock scenarios tested in December resulted in aggregate capital ratios declining from 12.2% to 9.6% - much higher than the 4.5% required minimum (i.e.: banks are healthy). The restrictions on dividend increases and share buybacks were not fully removed but modified for Q1 of 2021 so that both dividends and buybacks will be limited by the last 4 quarters of income. Still, a good sign for U.S. banks entering 2021.

The third item worth mentioning is that the U.K. and European Union (EU) have reached an agreement on post-Brexit relationship at the 11 ¾ hour. The deal allows for a smooth movement of goods between the U.K. and EU by employing a "zero tariff – zero quota" deal. The agreement still needs to be ratified by the respective parliaments but is expected to pass. The level-playing field agreement was held up by the major point of fishing rights. The agreement calls for a 5 ½ year transition period where EU fishing boats will still have access to U.K. waters.

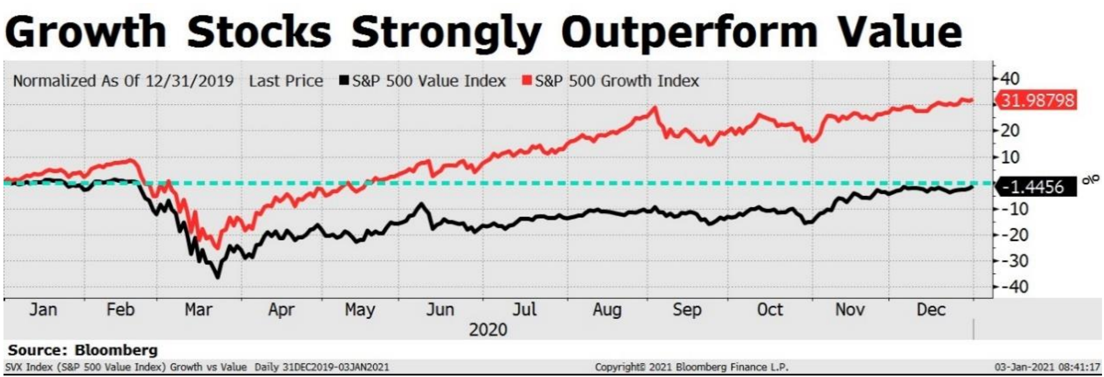
As we enter 2021 here are some of the known topics we are watching as far as having an impact on global economics and markets. Many times, though, it is what we cannot see which could also have a significant impact (ex: COVID).

- Vaccine distribution and take up among citizens. Current optimistic sentiment in the U.S. economy stems from a rapid rollout and most of the population taking the vaccine as soon as they are eligible.
- Unexpected interest rate increases and/or the reflating economy causing an unexpected rise in inflation.
- Limited ability of the central bank (Fed) to respond if there is an economic shock or downturn.
- Increasingly extreme monetary intervention employed to support economic growth. Along with this the level and direction of central bank debt – especially in developed economies.
- Direction of the U.S. dollar.
- U.S. policy direction of a Biden administration and make-up of the U.S. Senate after the Georgia elections.

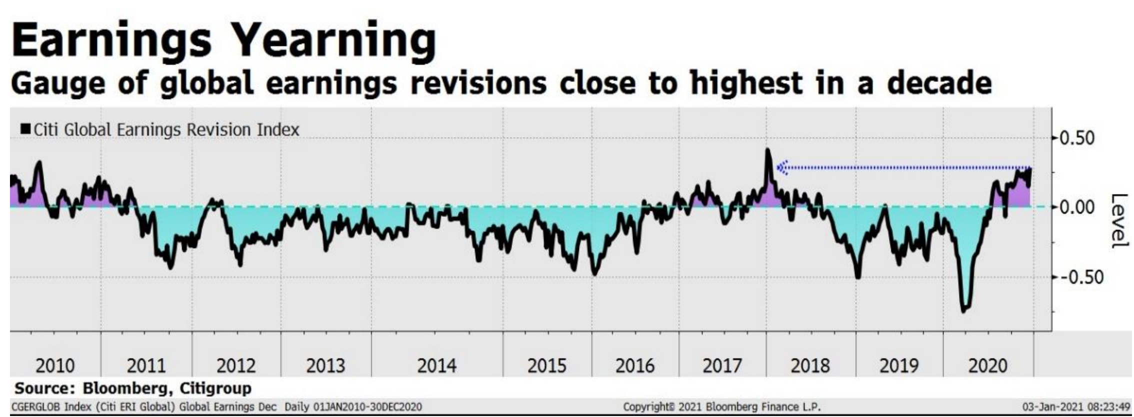
- Numerous geopolitical events including: China tensions (including trade); Iran and reentry to Obama nuclear deal; Russia subversion and cyberattacks.

## Financial Markets

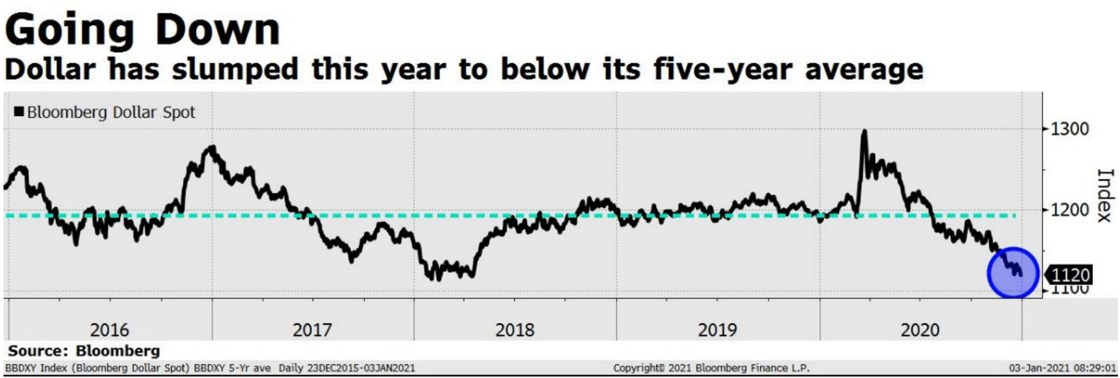
If you went to sleep on 12/31/19 and woke up on 12/31/20 things might have seemed a bit confusing in the US financial markets. The S&P 500 return would have suggested another strong year with a rise in the index of 16.26% and, together with dividends, a total return of 18.40%. A turn to interest rates though would have not seemed to support that story. We entered the year with the 10-year Treasury Bond yielding 2.25% and ending the year yielding 0.93%. Since rates usually fall in the presence of economic distress you may be tempted to look at other economic data and review the path of the S&P 500. GDP data would have shown unprecedented declines and the historic unemployment rate in the first quarter would have confirmed a significant economic event. The wild ride of the S&P would only become evident when looking at the index beginning the year at 3,230, dropping to 2,191 and then ending the near a few points shy of its all-time record (set a few days earlier) at 3,756 (A return of about 71% from market bottom). The relationship just described above would not be expected given market history and described in market theory. Looking underneath the surface the persistent performance divergence in growth stocks (technology, health care, etc.) has continued versus value-orientated companies (energy, financials, etc.). Much of this is driven by the winners and losers of the pandemic. As mentioned before in these letters the absence of travel and leisure activities have decimated companies in service industries. Less oil to drive or fly, less hotel stays, less tourism, less movie theaters and restaurant visits and less in person shopping has left not only individual companies but, whole industries struggling for survival. The extraordinary lock downs leaving work and play both at home had made us more dependent on technology than ever expected. So, companies like Zoom, Microsoft and Netflix are critical for work and play. Companies like Amazon and Peloton replaced our normal visits to malls and gyms. As a result, the top five companies ended the year with almost 25% of the value of the S&P 500 (with 495 companies representing the rest of the 75%). The return on those dominant companies was about 50% as well, propelling growth stocks over value. The addition of Tesla to the S&P 500 this past month also signifies the relevance of technology companies in the U.S. Tesla enters as the seventh largest company in the index with a weight of 1.52%.




This also set market valuations significantly above market averages. Due, in part, to the low interest rate environment but, just as much to the expectations of normalcy by the end of the 2021 and a significant increase in company earnings (many from a low 2020 base). Generally, earnings expectations of the S&P 500 for 2021 hover around $170 dollars, higher than the approximately $163 they ended with in 2019. This expected growth in earnings is a global phenomenon as well. What bears watching going forward is not only what the pace of the recovery will be in 2021 but what will be the impact? Does technology continue to rule the day and how do the industries so severely affected recover? Movies going direct to consumers through streaming is a threat to the movie theater industry. Work from home is a threat to commercial real estate and residential real estate in city centers. It is also a threat to miles driven



and gasoline, mass transit and automobile sales. There are about 32 million small businesses in the United States and about 6 million of them employ more than the sole proprietor. Many of those are restaurants who are trying to stay afloat, at minimal staff, until people are comfortable for indoor dining again.




The significant debt that governments and central banks are taking on will also need to be dealt with in the future. In the U.S. the debt levels are just one of the factors that impact the value of currency. Lately the dollar has been coming off recent highs in its value relative to other currencies, but it has been on a continuous slide for much of the year. This could be due to confidence in the U.S. economy waning or the relative improvement of other economies who have recovered from the pandemic quicker than the U.S. (ex: China, Taiwan, Vietnam) So, while we are hopefully in the end stages of the virus impact in 2021, some of the effects economically and from an expected market returns have yet to be determined.

**Should you have any questions please contact us.**

Image sources: Bloomberg and CNBC unless otherwise noted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