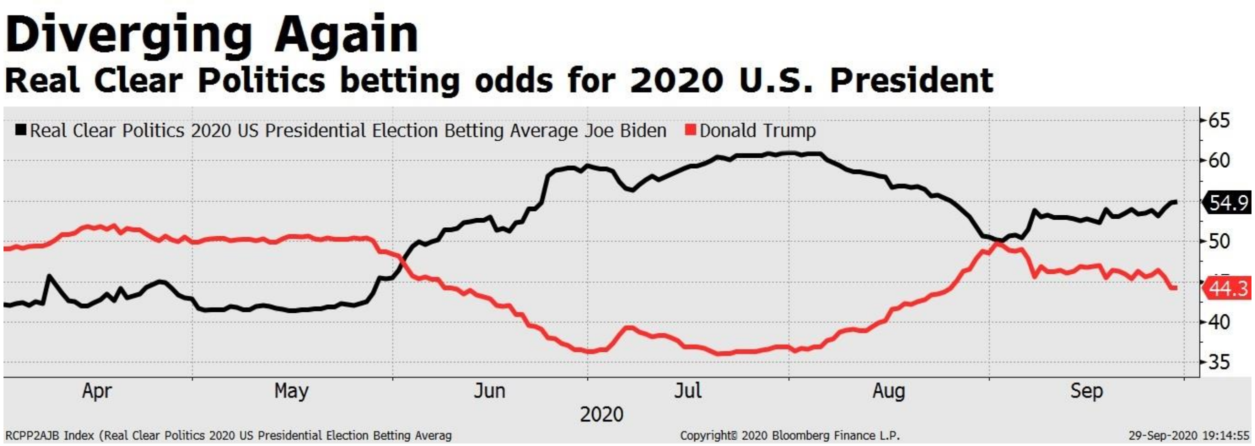
Courier Capital, LLC
Registered Investment Adviser
An affiliate of Five Star Bank

Economic and Market Update – ON HOLD (09/30/2020)

Latest Developments and Economics

As one of the most unusual summers the U.S. has experienced in recent times comes to an end we seem to be in between events and the four big issues determining our near and intermediate term future have us “on hold”. They are: the U.S. elections, fourth round of stimulus negotiations, progress on solving the virus and the U.K. Brexit situation.



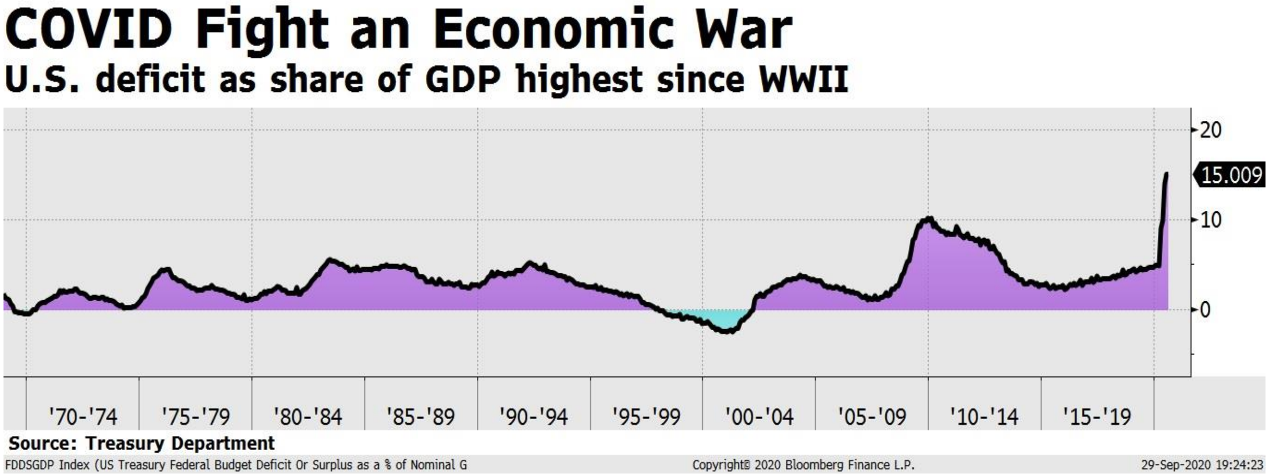
All eyes are finally on the election and it might seem like a shorter election cycle this time since the virus commanded our attention through the summer. The recent first presidential debate most likely did little to sway opinions as many voters had them already formed and there was more chaos than substance to change minds anyway (plus some states already started accepting votes by mail). National polls suggest that the Biden camp has put some distance between them and the Trump camp during September. Once again, what is more concerning with this election is the process of it as much as the result. The controversy around ballot collection and accurate count may not only delay the election results but there is an increased chance that the outcome would be challenged in court if results were not decisive. This has the potential to create significant uncertainty in markets.

Budgetary Composition of Hypothetical Phase Four Proposals ($bn)

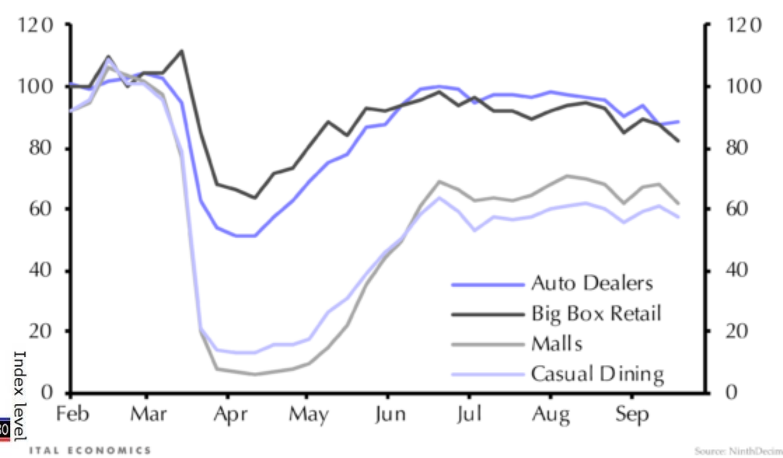
	Dem Sweep	Biden & GOP Senate	Status Quo
Unemployment Insurance	300	150	0
State & Local Relief	350	200	150
Temporary SALT Cap Relief	137	0	0
Schools	200	150	105
Paid Family & Medical Leave	165	25	0
Childcare	50	50	25
Workplace Tax Credit	50	50	50
Employee Retention Credit	100	50	0
SNAP	50	20	20
Refundable Credits	405	135	0
Housing Assistance	100	50	50
Public Health	200	150	100
PPP / Small Business Relief	100	100	100
COVID Liability Protections	n/a	*	*
Extend TCJA Biz Tax Cuts 3yrs	0	150	150
TOTAL	$2,207	$1,330	$750

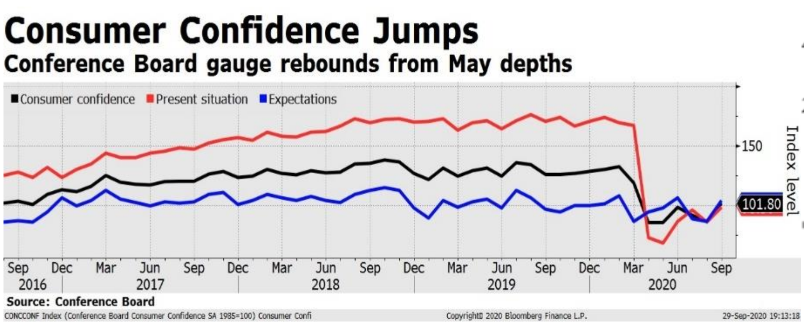
Source: CBO, JCT, and Cornerstone Macro.
Note: * means no cost. 0 means absent. Costs of the various line items are a combination of estimates from the Congressional Budget Office of House Dems HEROES Act or our own hypothetical figures that can reflect a variety of policy combinations.

The fourth round of stimulus talks have been ongoing since the end of the CARES Act in July. To recap where we are now, the House passed a $3.4 trillion HEROES Act in May, but it never had a chance in the Senate. The Senate stated back then that they wanted to see how the CARES Act impacted the recovery and how the recovery was progressing. In addition, the CARES Act, at almost $3 trillion was massive stimulus and that, combined with the extraordinary monetary policy, may be enough to jump start the economy. Later in the summer the Senate acknowledged the need for additional stimulus but, with signs of a recovery encouraging, the magnitude was much smaller than the House proposition. They floated the idea of $1.3 trillion. Since then both sides have moved. The House has recently considered a $2.2 trillion package which includes extension of the $600 unemployment supplement until January, a second round of $1,200 direct payments to individuals, $436 billion to state and local municipalities, $25 billion for airlines and monies for education, child care and rent or mortgage relief. The Senate has indicated that they would be willing to go up to $1.6 trillion. Fed chairman Jerome Powel also weighed in saying that additional stimulus is warranted. Treasury Secretary Steven Mnuchin and House Speaker Nancy Pelosi publicly say that talks are ongoing. At this point chances of something being passed before the election are rather slim. The Senate is concerned about the level of deficit adding to national debt. Currently, the deficit for this fiscal year is estimated to be $3.3 trillion – or approximately 15% of annual GDP (which includes the CARES Act) and that is without the fourth round of stimulus. The current national debt is approaching $27 trillion.

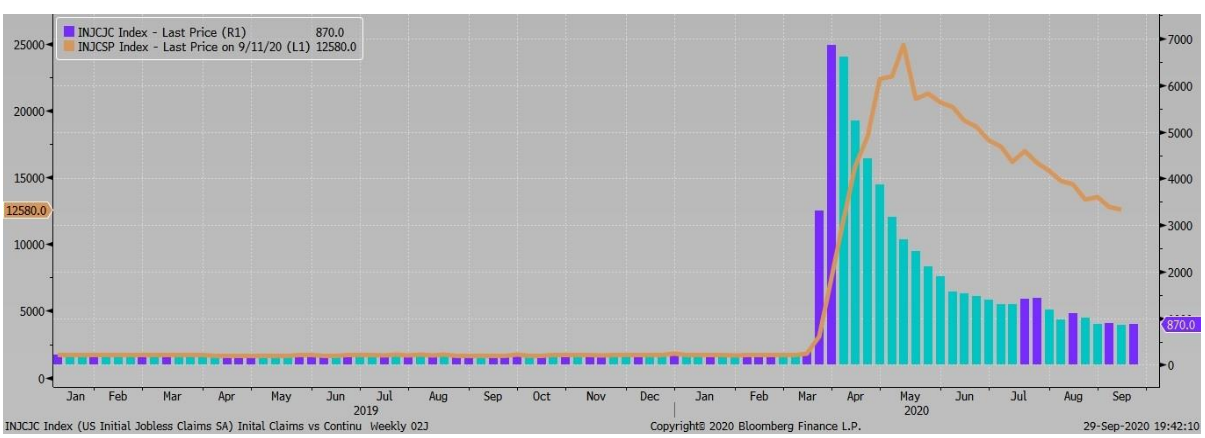


The view also was that the economic data was showing a rapid recovery from the first quarter (or what some have labeled a "V" shaped recovery). States were reopening, economic activity was increasing (see chart) PMI (new orders) were increasing and consumer confidence was recovering.



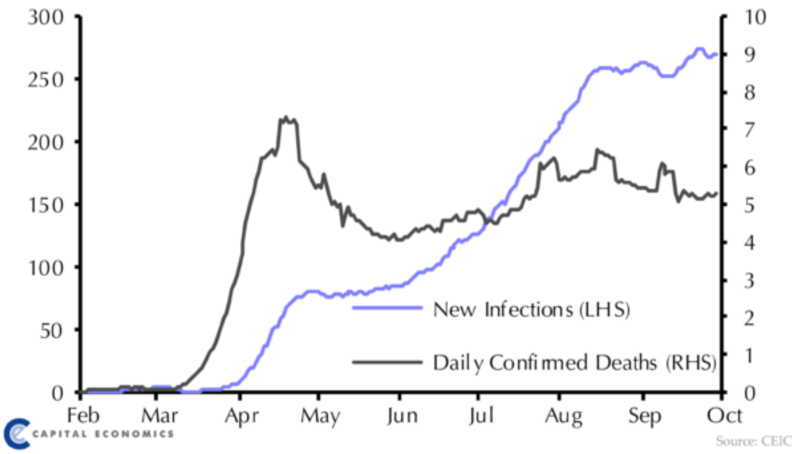


The employment situation was also stabilizing. By the end of August 11 million out of the 22 million jobs lost in Q1 were recovered and unemployment has dropped from 14.7% in April to 8.4% in August. The chart below shows the decline in the initial claims from their historic levels (bars) and the continuing unemployment claims dropping (line). What you see though is the initial claims have leveled off with no further improvement. In fact, economic readings towards the end of summer had changed with a marked decline in economic activity and jobs created. This coincided with the end of the unemployment supplement at the end of July. The "V' recovery has been interrupted and stalled. There are parts of the economy doing well (homes,



autos) but many virus-related industries still not recovering (airlines, cruises, hotels, theaters, restaurants, etc.). This can be seen in the recently announced job losses (American/United – 32,000; Disney – 28,000, Allstate 3,800, etc.). Essentially many industries are still "on hold" and will not fully recover until the virus situation is resolved.

This brings us to the third topic on the hold list – the virus. While the headlines are dominated with the number of pharmaceutical companies that are in late stage development of a vaccine the realization that the general populace most likely would not have a vaccine available before mid-2021 means that we still have several months where we will be dealing with the virus with the procedures and tools at hand. This has been a good news/bad news situation. New infection rates have increased worldwide (left chart) caused by a variety of factors as we enter Fall. The good news is that the advancement in treatments has substantially improved the survival rate. The chart on the left shows the death rate leveling off worldwide, even while cases increase. The chart below shows the same improved death rate in the U.S. as a percent of confirmed cases. Of course, the goal is to get this rate to as close to zero as possible. While there is concern about moving indoors with the colder weather, we are on hold until there is herd immunity, most likely through administration of a vaccine or through exposure of enough of the population.



U.S. Coronavirus Deaths per Confirmed Case

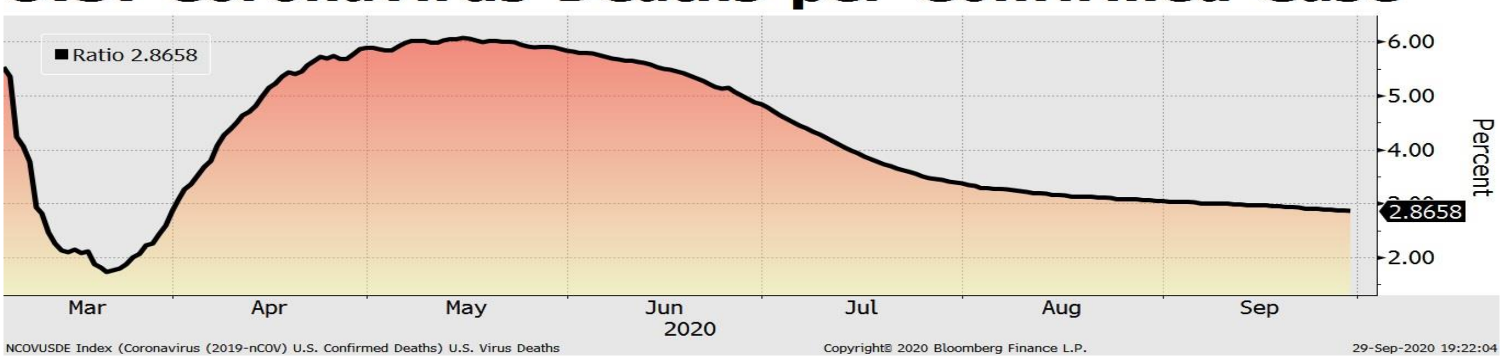
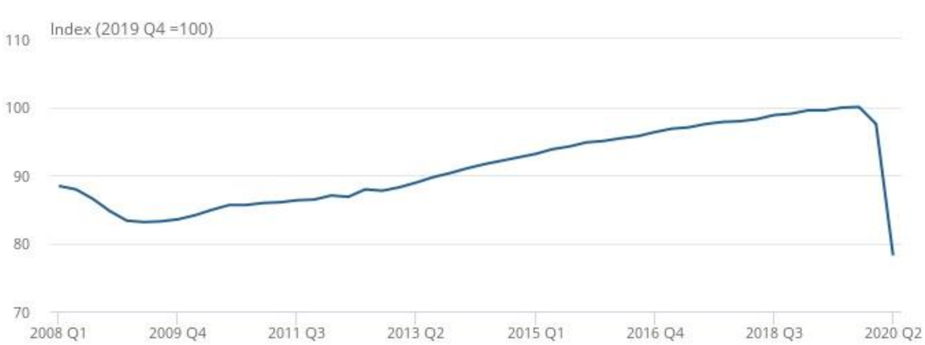


Figure 1: Real GDP fell by a revised 19.8% in Quarter 2 2020, the largest quarterly contraction on record

UK, Quarter 1 (Jan to Mar) 2008 to Quarter 2 (Apr to June) 2020



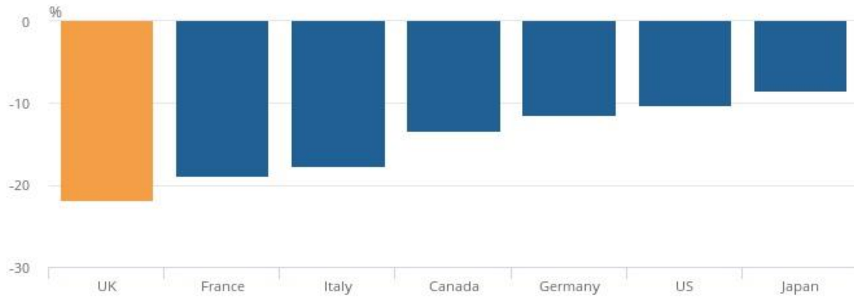
Source: Office for National Statistics – GDP quarterly national accounts

The United Kingdom is going through the same issues as the rest of the world with the virus and global recession, but they have Brexit to deal with as well. The UK economy contracted a real 19.8% in Q2, the largest decline since records started in 1955, and this followed a 2.5% decline in Q1. Comparing the UK performance against the other large developed economies of the world clearly shows that the UK turned in the worst decline in the first half of 2020 by far. The chart below shows the UK against 4 other European countries, 1 Asian country and 2 North American (U.S./Canada). The decline in GDP in the second quarter reflects widespread falls in output across the services, production and construction sectors. The Q3 numbers are showing some signs of recovery.

All of this while the deadline for the final exit from the EU is fast approaching. The UK left the EU on January 31, 2020 with a withdrawal agreement. This was basically a transitional agreement meant to be short-term while the final arrangements were made to be implemented on January 1, 2021. This agreement gave the UK full access to the EU countries during this 11-month period. There is currently still no final deal in place and the UK is in a weakened negotiating position due to the pandemic and the deep recession. In addition, the deadline for an extension has passed. If January 1 comes with no deal in place there is a potential for a great disruption in the UK economy and its supply chain. The EU is the destination for 43% of UK exports and they import about 26% of its food from EU suppliers.

Figure 2: UK GDP fell by a cumulative 21.8% in the first half of 2020

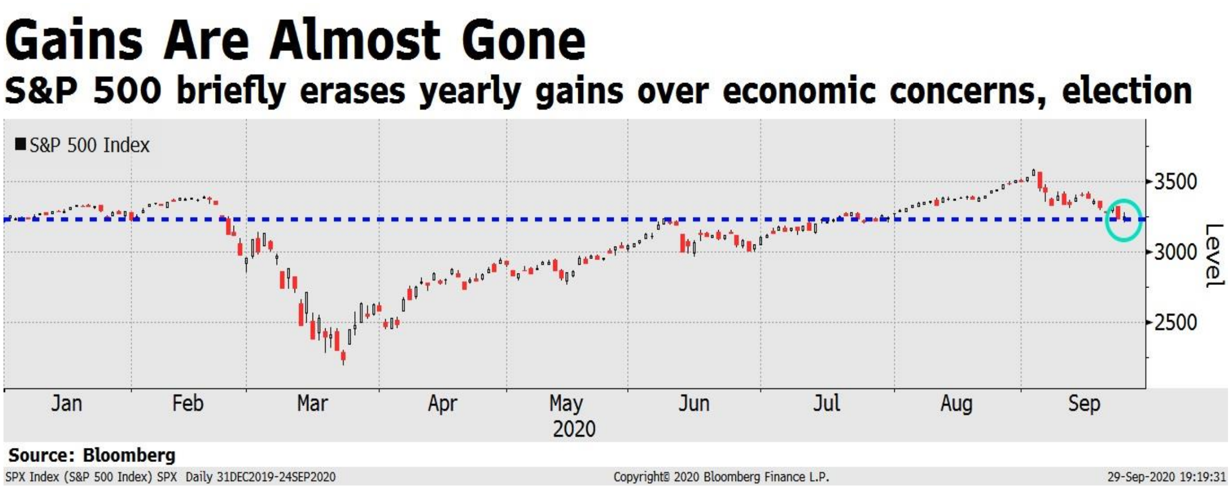
Quarter 4 (Oct to Dec) 2019 to Quarter 2 (Apr to June) 2020



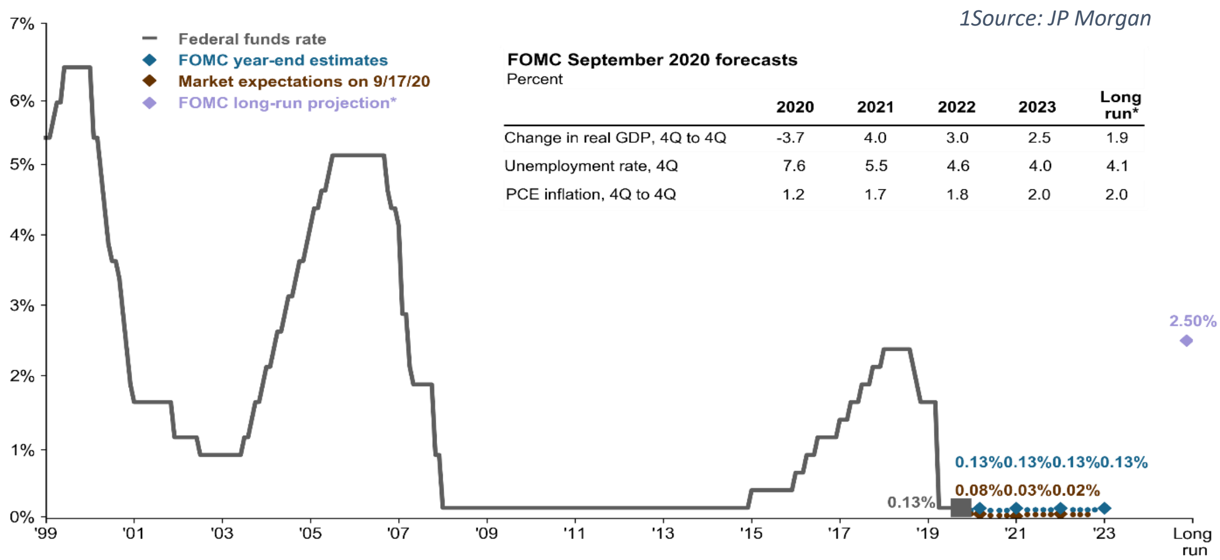
Source: Office for National Statistics, Organisation for Economic Co-operation and Development

The UK only accounts for 2% of GDP but its interactions with the EU impact 11% of global GDP. There is a summit with EU leaders scheduled for October 15 & 16. If there is a deal agreed upon and ratified by 12/31/20 then the implementation will begin 01/01/21. In the worst case, if there is no deal, trade checks and tariff conditions revert to standard World Trade Organization (WTO) rules. The additional delays and cost could impact the UK economy by an estimated 7.7% over the next 15 years. The situation is complicated, and we will be watching developments.

Financial Markets

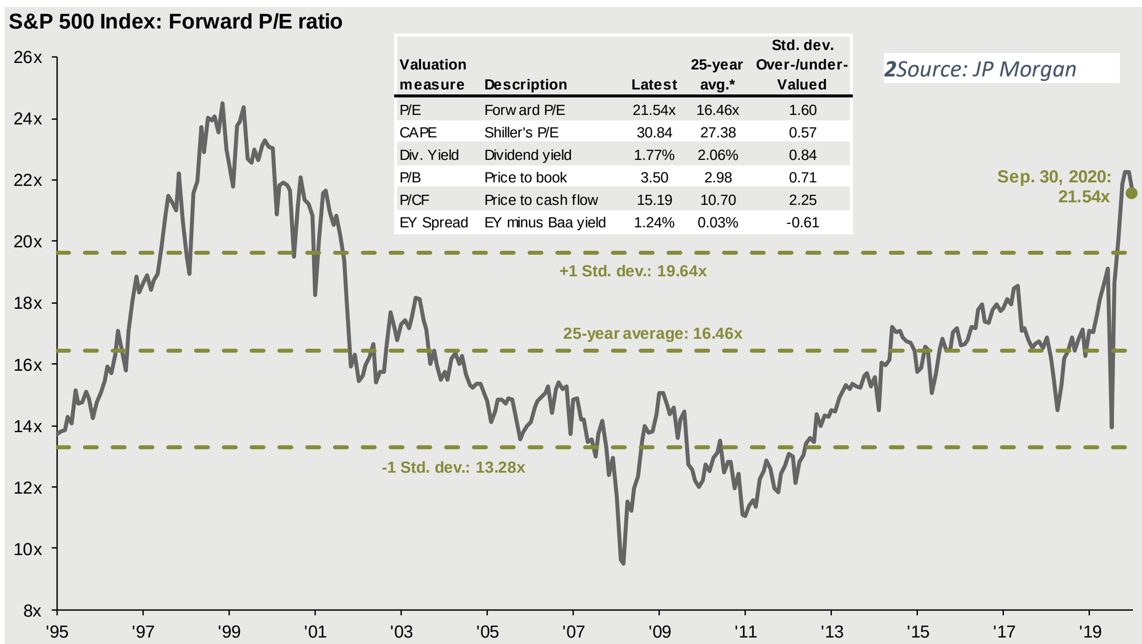


The markets have been rather volatile lately as it digests information about the virus, the economy and the elections. After a strong rebound during summer that produced a positive return for the S&P 500 in 2020 September reversed almost all those gains. By the end of September, the index was still able to manage approximately a 5.5% return YTD. Looking beneath the surface the growth returns that make this up are 20.6% for while value returns are -11.5%. Meanwhile other equity classes are still recovering YTD: U.S. mid cap is down over 8.00%; small cap down about 15% and developed international down about 7%. Surprisingly most of fixed income has performed the same or better than the S&P 500 due to the drop to zero interest rates in 2020. Of course, this doesn't make it any easier for savers. The zero-interest rate policy means that there is no yield to be had for many savers as the 10-year treasury rate has hovered around 0.70% lately and CDs are worse given the overcapitalization of banks and no appetite for more deposits. This situation does not look like it will change soon as the Federal Reserve has signaled their intention to keep rates near zero until sometime in 2023. The chart below shows future interest rate projections by the Fed (FOMC) and market expectations. Chairman Powell looks to have been successful in communicating his message as the two projections are as close as they have been in recent times – all near zero.



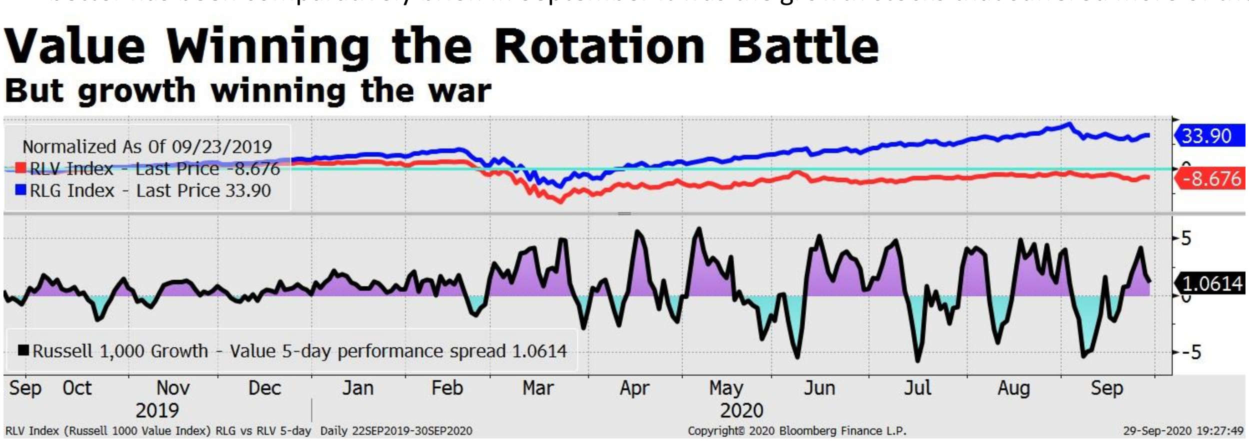
	2020	2021	2022	2023	Long run*
Change in real GDP, 4Q to 4Q	-3.7	4.0	3.0	2.5	1.9
Unemployment rate, 4Q	7.6	5.5	4.6	4.0	4.1
PCE inflation, 4Q to 4Q	1.2	1.7	1.8	2.0	2.0

The interest rate situation has led investors to increase their allocation to riskier assets (stocks) and caused an increase in valuations. In fact, valuation of the S&P 500 has increased well beyond 25-year averages as measured by the forward Price/Earnings ratio (i.e.: the S&P 500 is rather expensive).



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	21.54x	16.46x	1.60
CAPE	Shiller's P/E	30.84	27.38	0.57
Div. Yield	Dividend yield	1.77%	2.06%	0.84
P/B	Price to book	3.50	2.98	0.71
P/CF	Price to cash flow	15.19	10.70	2.25
EY Spread	EY minus Baa yield	1.24%	0.03%	-0.61

One other notable phenomenon this month has been the returns on styles. Growth continues to dominate returns on the S&P 500 for a historically long time (purple shade). The few times value has performed relatively better has been comparatively brief. In September it was the growth stocks that suffered more of the decline allowing value to perform almost at par. It is worth noting though that over the last year you would be much further ahead in Growth stocks (blue line) and you would still be underwater with Value (red line).



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