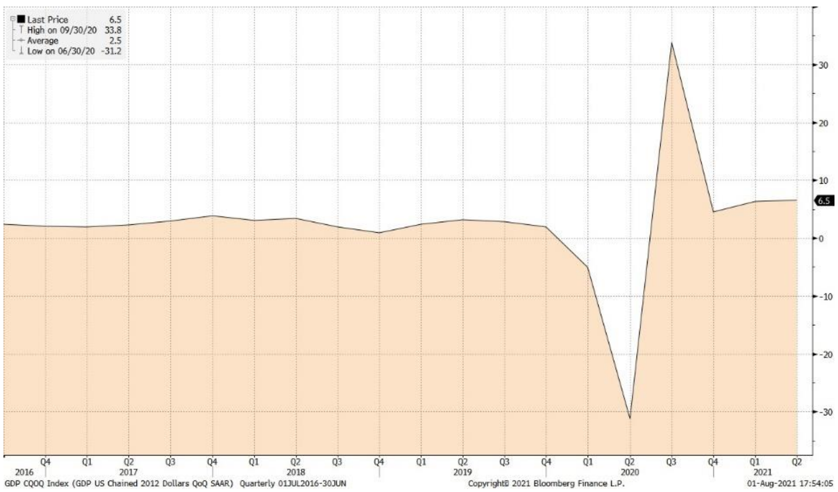
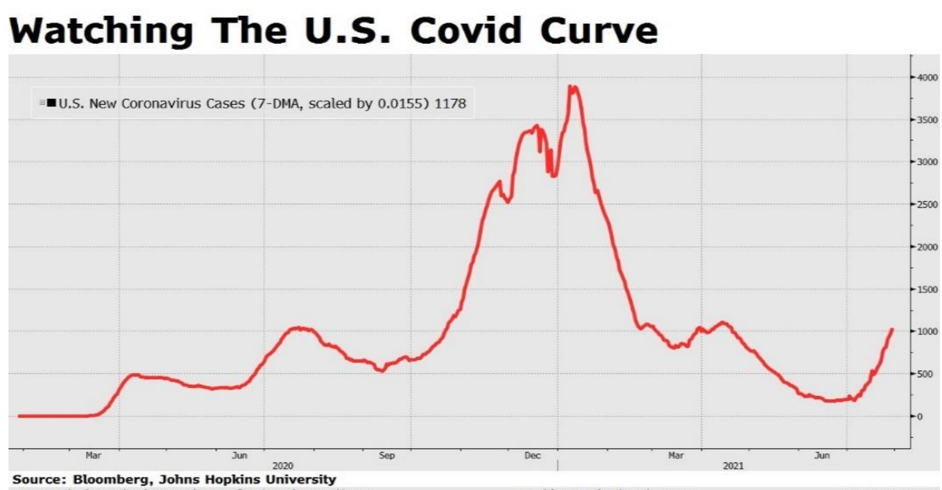
Courier Capital, LLC
Registered Investment Adviser
An affiliate of Five Star Bank

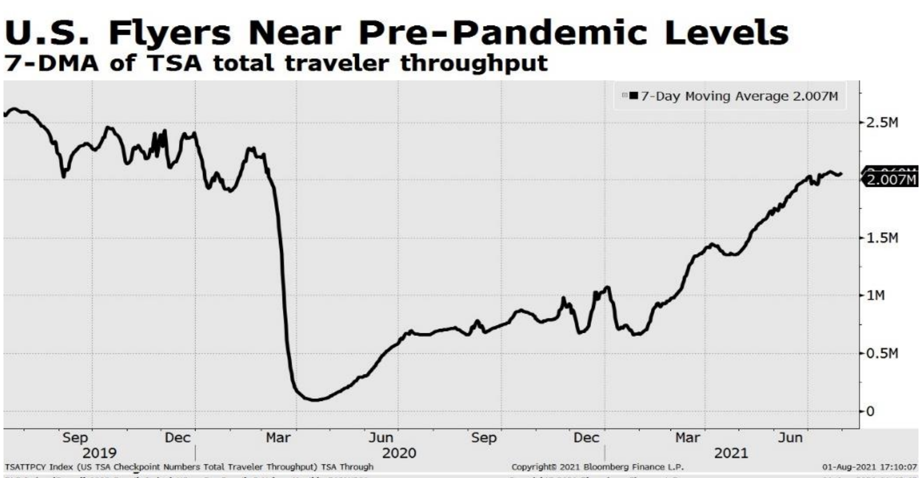
Economic and Market Update – PEAK GROWTH? (07/31/2021)

Latest Developments and Economics

The question of near-term peak economic growth rates has been sneaking into conversations lately. After a rapid 31% decline in 2020 Q1 GDP and subsequent rebound of 33% in 2020 Q3 we see economic growth leveling off towards the trend we have been accustomed to since the Great Financial Crisis in 2008. This year GDP readings have come in at 6.4% and, most recently, 6.5% where estimates were in the 8.0 - 10.0% range. Normally anything above 3.0% would be an outstanding reading but with the massive fiscal stimulus and pent up demand from the economic reopening it was rather disappointing. One now looks for signs that this disappointment could be temporary or a bit more entrenched. On the supply side the labor shortage and supply chain disruptions (i.e.: microchips, lumber, etc.) could be limiting our economic output. Evidence of this came from the latest GDP reading which showed that inventory levels are down for the second straight quarter. This could indicate that production is not able to keep up with demand. Demand may slip also because of a slower reopening with the Delta variant of the COVID virus creating another wave of infections across the country. There are specific hotspots, but the incidents are up in almost every state. The fact that about 50% of the country was vaccinated creates greater risk for the unvaccinated and may be causing hesitancy in a full reopening. While mask requirements (even for vaccinated) are in discussion there are no lockdowns like last year, but this could be creating a psychological retrenchment in the minds of consumers. So far, no evidence of this yet as consumer confidence remains high and consumption in Q2 GDP was up 11.8%. In fact, one of the most vulnerable industries would be travel and July saw the return of air travelers nearing prepandemic volume as measured by people going through TSA checkpoints around the country. So, it may be possible that the recovery continues but will be elongated in time rather than as quick as previously expected.

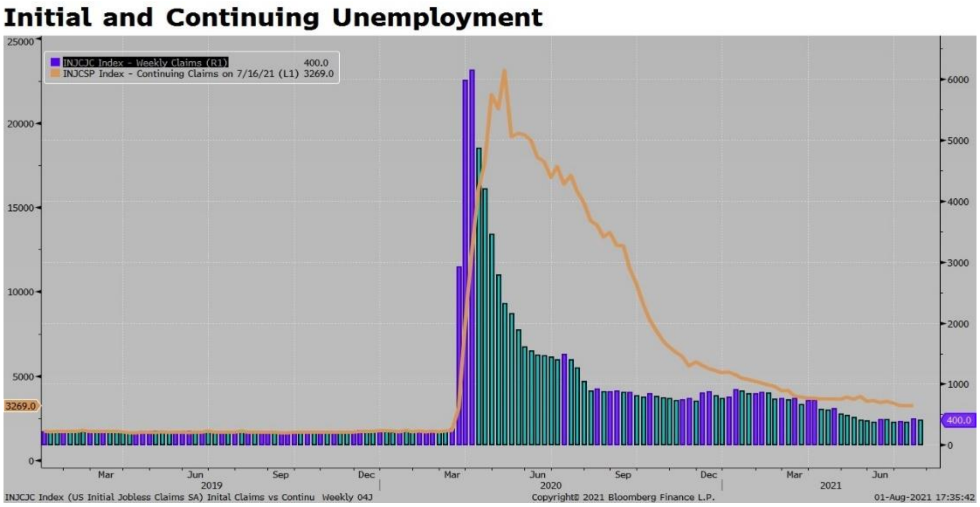






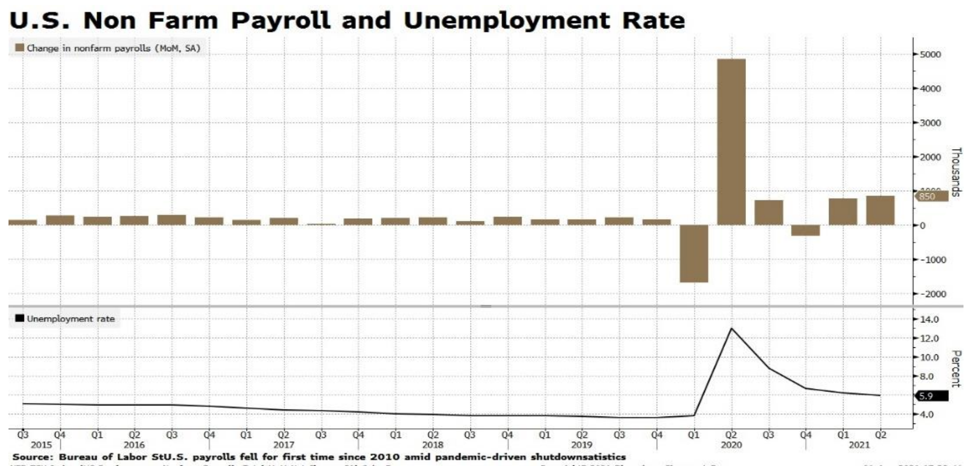
Turning to another big driver of economic recovery is the progress on employment. The

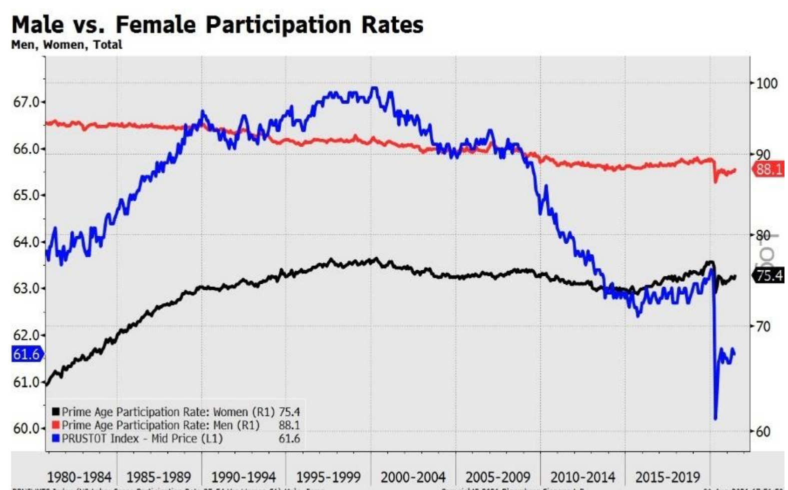
Federal Reserve has prioritized recovering jobs lost during the pandemic. The following four charts tell the current story.



The first is initial and continuing unemployment situation. Are people in current jobs keeping those jobs? In general, the answer is yes, although that rate of decline in unemployment claims has slowed and there has been a small uptick in initial claims (400,000 at last reading). Moreover, the initial and continuing claims are still high relative to history. There may be some impact on these numbers after September when the Federal supplement to unemployment ends in all states.

The second chart is U.S. payrolls and the unemployment rate. The economy gained 850,000 jobs in June (up from 583,000 the prior month). Job gains occurred primarily in areas affected by the pandemic: leisure and hospitality, public and private education, retail trade and other service-related industries. This puts the U.S. down still about 6.8 million jobs from the pre-pandemic levels of February 2020. The unemployment rate rose slightly to 5.9%.

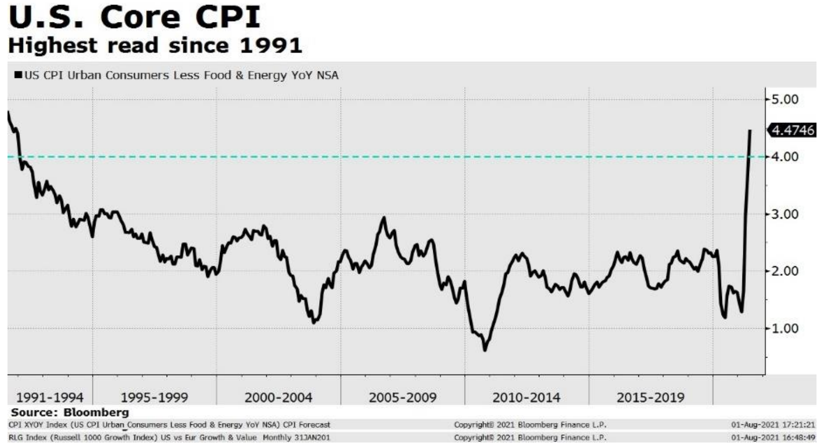


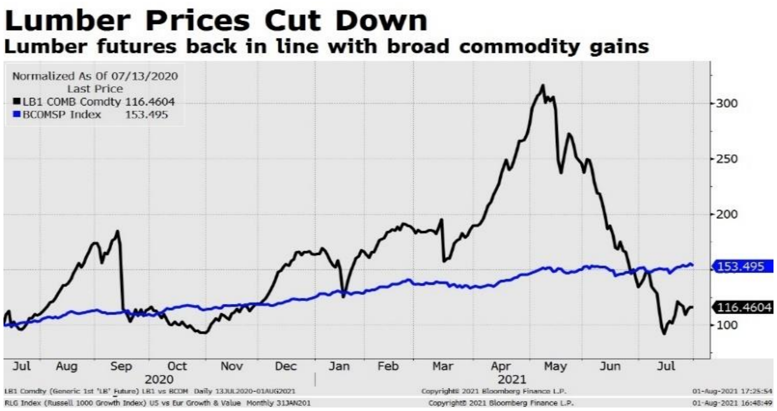


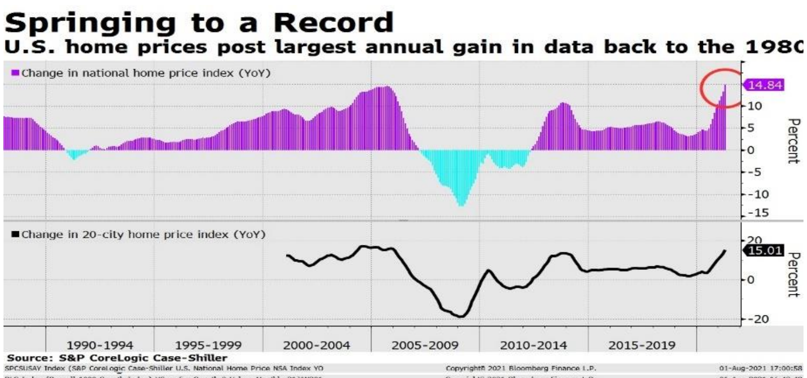
Finally, looking at available jobs there are approximately 9.2 million jobs open – more than the U.S. workers seeking employment. This results in a labor force participation rate (% of people in labor force/working age population) of 61.6% - about 1.7% below February 2020 and far off its turn of the century levels of near 67.0%. The labor shortage has also impacted labor costs as wages were up an annualized 3.6%.

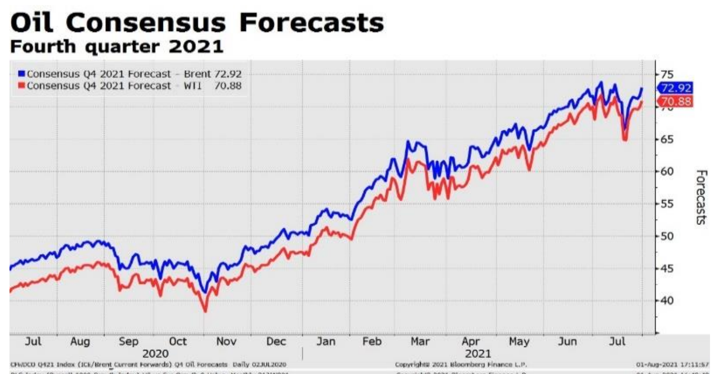
Factors such as the monetary and fiscal stimulus, along with the rapid return of economic activity and employment data has caused this recession to officially be declared the shortest in recorded U.S. history at 2 months (February-March 2020).

The other big conversation has been around inflation. This is still developing with the Federal Reserve sticking by the story that it is 'transitory' – even with the latest read of inflation at a 5.4% annualized rate as measured by CPI. Even removing volatile food and energy, core CPI came in at almost 4.5%. There has been no indication of how temporary they believe inflation to be but are resting on factors such as base effects from last year, supply chain issues that will be resolved (i.e.: chip shortage) and labor shortages which should subside. They also see inflation as rather narrow with a few categories (such as used cars) causing most of the impact on the reading. There are indications that some of the often-cited categories are starting to come down. Lumber, for example, seems to have peaked and come back in line with other commodities but there are other elements of price increases which seem a little more enduring. The labor costs mentioned above tends to be persistent and, looking at the two charts below, oil and housing which make up a significant portion of consumer budgets seem to remain elevated at this time. The good news on oil is an OPEC+ agreement to increase production after an impasse between Saudi Arabia and UAE was resolved.



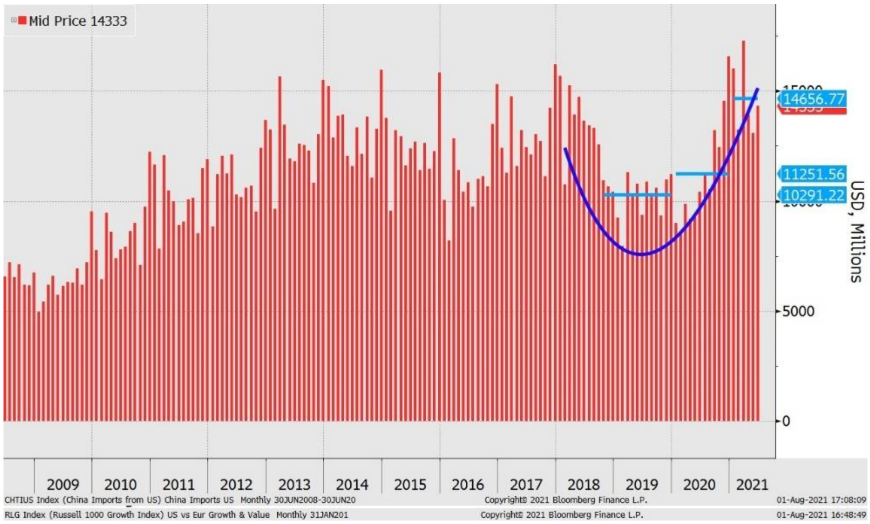




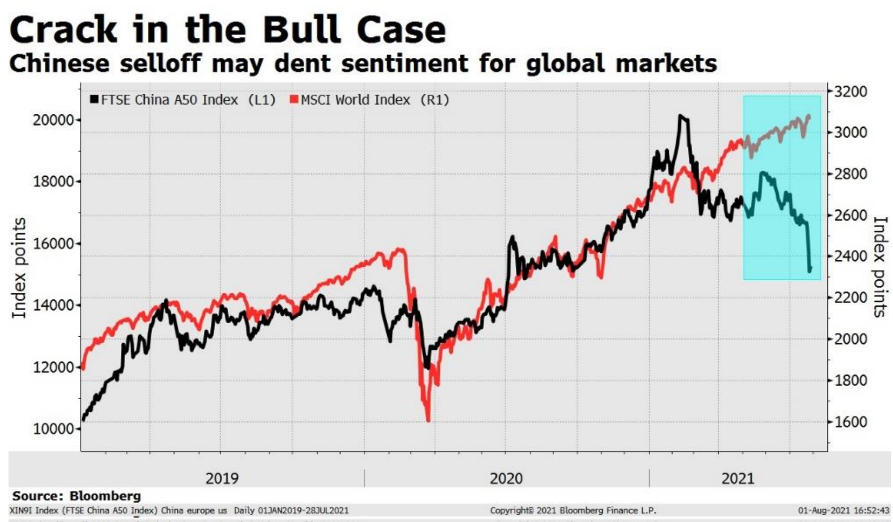


The final domestic development to cover is the progress on the political front. In a rare bipartisan achievement, a deal was reached on traditional infrastructure in the Senate. The deal involves a total spending of about $1 trillion with $550 billion of it as additional spending. Of the $550 billion a good portion goes to roads, bridges, rail, public transit, power grid and water. Most of the funding will come from appropriated but unspent COVID relief funds, 5G band auctions and better tax enforcement. The odds of full passage have increased significantly but still faces challenges. Speaker Pelosi prefers it tied to the $3.5 trillion social bill proposed by the Biden administration and the upcoming federal debt ceiling issue is outstanding and could be used as a political bargaining chip as well.

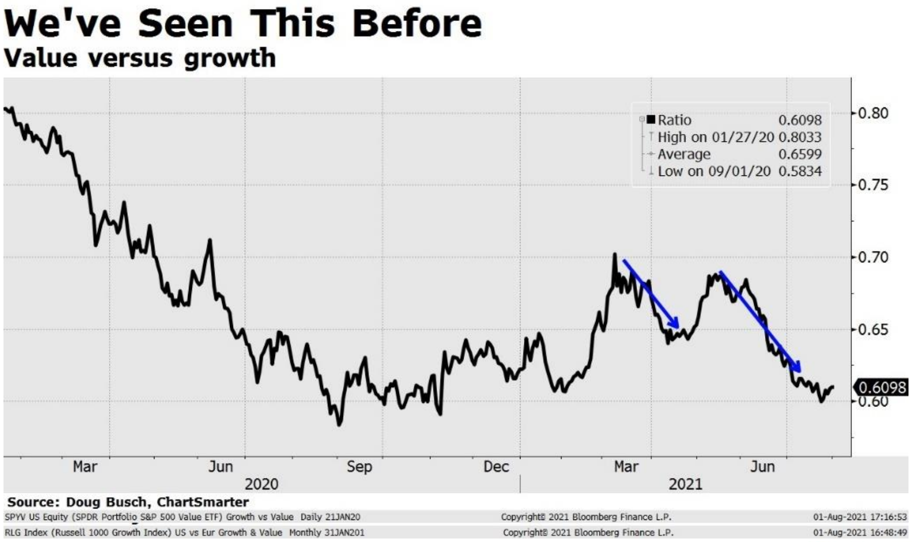
Internationally, the relationship with China is getting quite a bit of attention. A few years ago, the trade situation with China was a major economic issue impacting the U.S. economy. Nothing has really improved since the change from the Trump to Biden administration. The tariffs still have stayed in force and there have been no talks proposed on either side to



address trade. Now the strained relationship is in the spotlight with the latest changes in Chinese policy. The massive stimulus package and direct payments to individuals have been a boon to China as well as the United States. The imports from China have increased as people have purchased more goods with the extra funds. This propelled China's latest quarterly GDP to 7.9% and helped a slowing economy. Chinese debt and the demographic situation have caused the government to make changes to policies. The first was the elimination of the one child edict as there is a relative generational donut hole population that is now making their way to household formation age. In addition, Xi Jinping and the government may feel that the lean towards capitalism has threatened their control. This may have been reflected in a December vow to rein in the "disorderly expansion of capital". In June there were significant policy changes to address the goals of common prosperity and national security. They were focused in the areas of private education, health care and property. One child policy or not, many Chinese citizens have lacked desire to have more children due to cost of living and stress – especially in education and property. Many Chinese parents pay for extra tutoring and education from private companies and feel the cost of raising a family to be too high. In order to combat education, that he felt was hijacked by capital, he decreed that all private education turn to not-for-profit entities. Also, he decreed that gig economy workers be paid a living wage and instituted curbs on unaffordable housing. Finally, any tech firms with more than a million users would need to go through a governmental security review before selling stock overseas in an IPO. He targeted Alibaba, Tencent and DiDi with this change. This was happening while the U.S. SEC has been trying to get Chinese companies listed on U.S. exchanges to follow U.S. reporting requirements creating further tension. This caused a Chinese stock selloff that erased approximately $1.5 trillion of value.

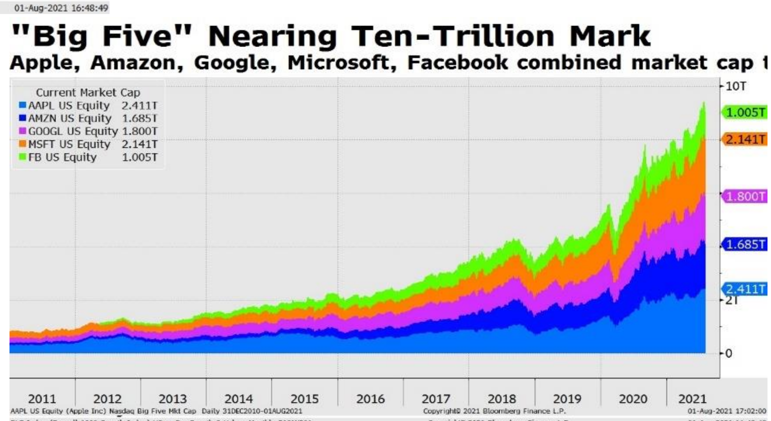


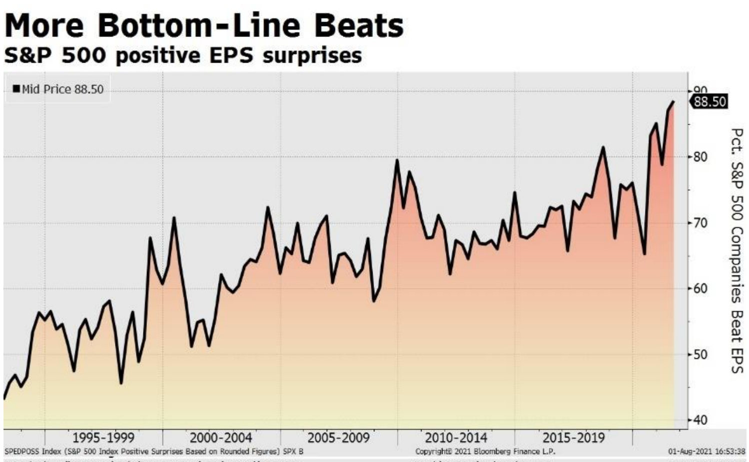
Financial Markets



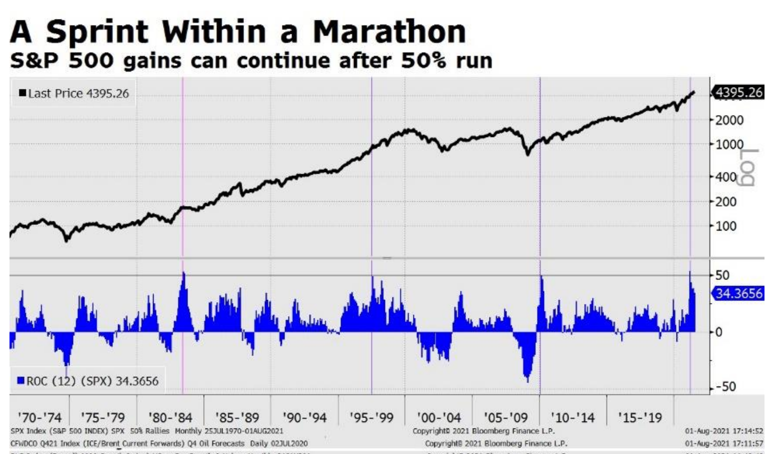
The U.S. equity markets have continued to increase in 2021 despite higher inflation (at least for now) and a resurgent virus. We have seen volatility increase this year as investors digest the news coming on the virus front and from the Federal Reserve on interest rates. We have also seen the rotation towards value from growth subside as it has in the past. In spring and again in early summer of this year the market favored stocks that will benefit from reopening but, both times the value stocks could not maintain their outperformance.

The S&P 500 is still dominated by the five growth stocks to the right. Collectively they represent almost $10 trillion in market capitalization. That is still approximately 25% of the $38 trillion market capitalization of the S&P 500. It would take significantly outsized performance from the other 495 stocks to overcome the influence of these five securities.



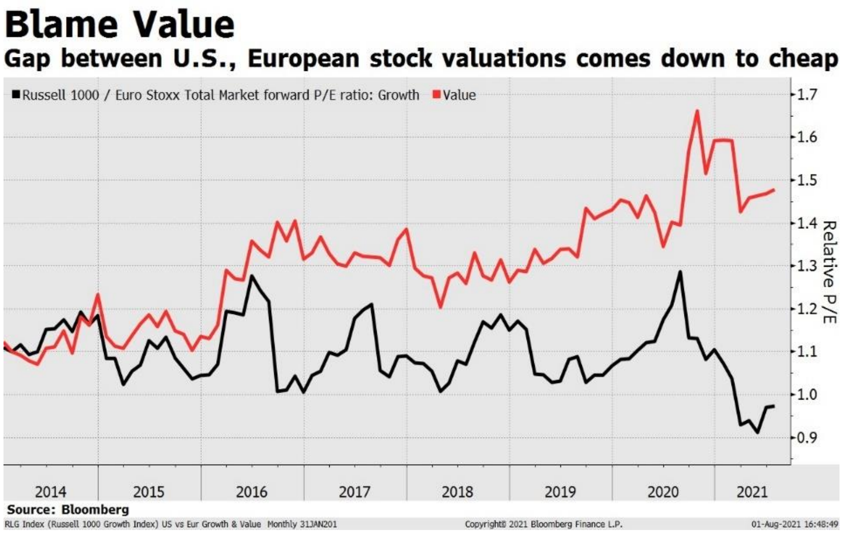


The increase in the S&P 500 has been justified by the performance of companies in the index so far this year. About half the S&P 500 have reported their results for the first six months of 2021. Of those reporting 92% have managed to meet or beat consensus earnings expectations and 86% have beaten revenue estimates. This is the best beat ratios since



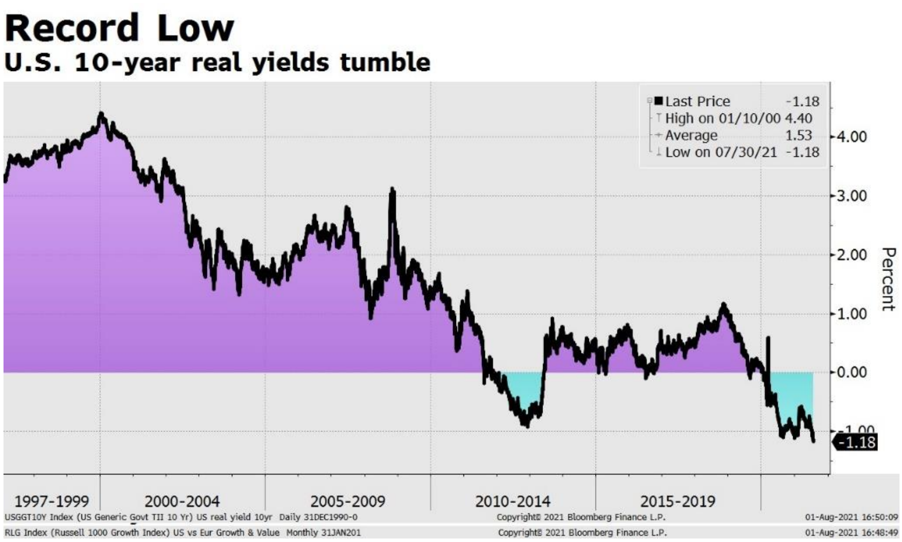
2008. As an added highlight the bulk of them also raised annual guidance though they have also mentioned higher input costs and labor shortages as headwinds.

As a final thought on the U.S. it is not unprecedented that gains in the S&P 500 can continue after the 50% plus result we saw over the last year. Three times before this year the market has continued to gain for a bit of time after such gains.



If S&P 500 valuations seem too rich and emerging markets are influenced by what is happening in China, there is another place to look for reasonable equity return probabilities. That place is developed international markets.

While the U.S. equities have continued moving up in 2021 international developed equities have become even more relatively inexpensive. While Europe and Japan are still wrestling with the virus and the beginnings of reopening the equity markets there have seemed to have not priced in the post pandemic growth in economic activity like it has in the United States.



Interest rates still pose a conundrum. Chairman Powell has reiterated again that there may be tapering in asset purchases soon but no official increase in interest rates until late 2022 at a minimum. Despite higher inflation (even if temporary), significant GDP growth and proposed massive new federal spending (all which put upward pressure on rates) the 10 Year Treasury yield has continued to fall. This year the 10 Year rate went from 1.00% to 1.75% and now back down to less than 1.20%. When factoring in inflation the real yield is about -1.18%.

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