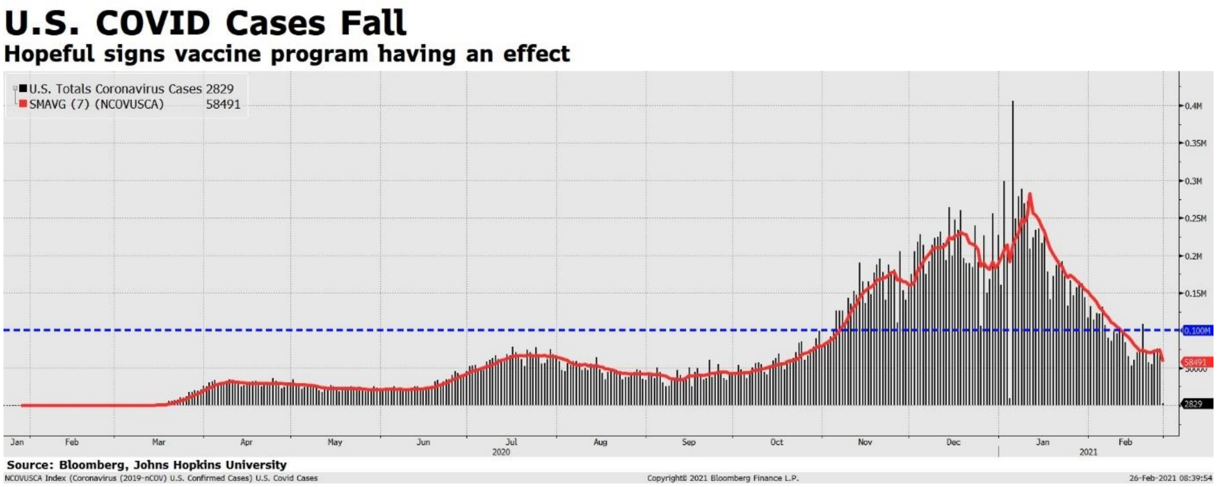
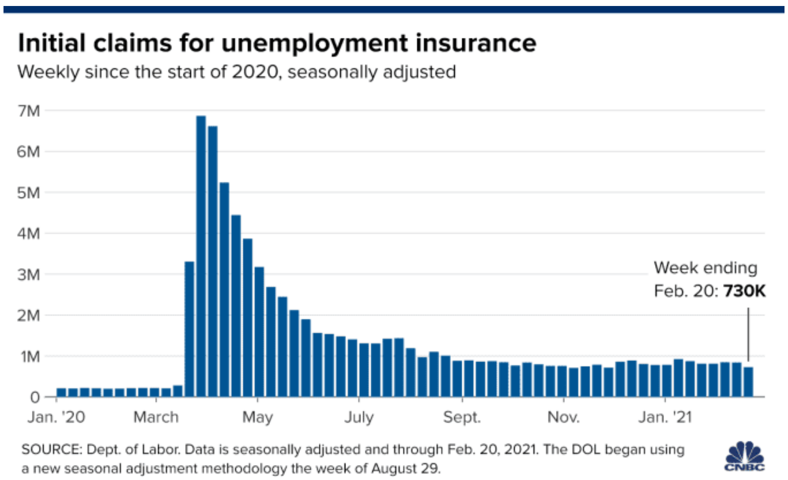
Courier Capital, LLC
Registered Investment Adviser
An affiliate of Five Star Bank

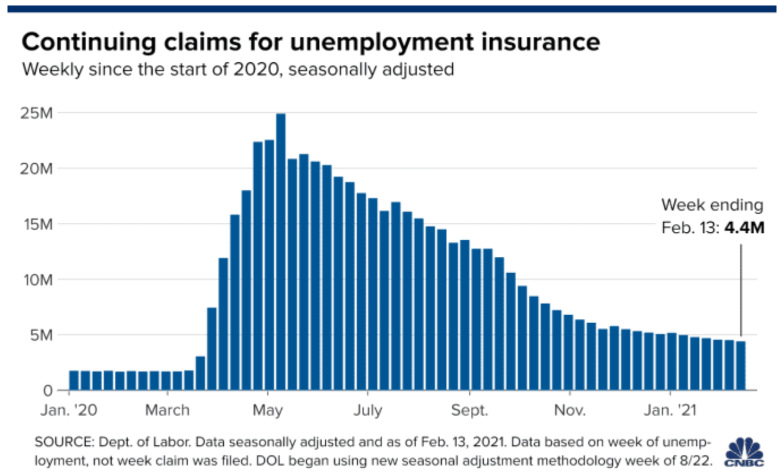
Economic and Market Update – TOO MUCH OR TOO LITTLE (02/28/2021)

Latest Developments and Economics



As the vaccines continue to rollout and ramp up, aided by a third approved vaccine by Johnson and Johnson, optimism for lifting lockdowns and a reopening of the economy continues to build. While vigilance is still required, the vaccine administration, prior immunity and individual behavior have contributed to a significant decline in virus cases. The daily average and the seven-day moving average (red line) have continuously fallen since early January.

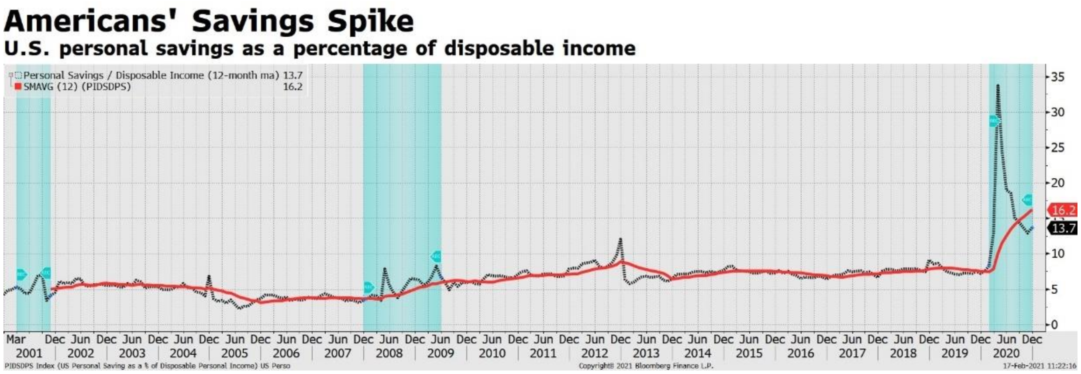


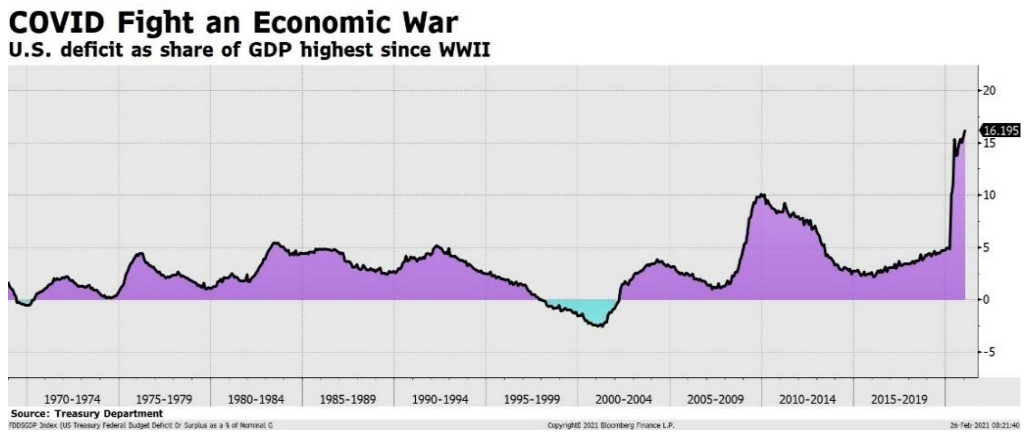


Unemployment news continued to improve on a steady, albeit slow, pace. Latest initial claims came in at 730,000 (vs. an expected 845,000) and continuing claims fell by over 100,000 to 4.4 million. Both are still high relative to prepandemic levels and the recent winter storm may impact these numbers in March. It will most likely take a full reopening to dramatically improve these numbers further and is likely to be a while before the unemployment rate is below 4% again.

Against this backdrop is the heated debate over the Biden Administration's $1.9 trillion stimulus (see last month's letter for details). The deliberation is not whether additional assistance is needed for persons/businesses impacted by the virus but more about the content of the package, whether it is targeted well enough and if the magnitude is too great. Part of the delay was procedural as the Democrats have decided to push the bill through without chance of filibuster or requiring votes from Republicans. In order to do this, they are employing the Budget Reconciliation process which allows them to move quickly and pass a proposed bill with a simple majority. The problem is that Reconciliation is limited in scope to certain spending and tax items and frequency of use. The Parliamentarian of the Senate has ruled that the $15-hour minimum wage that was part of the bill is out of scope of Reconciliation. Speaker Pelosi and the House passed the bill on 2/27, with the minimum wage requirement. She is letting the Senate deal with the issue, but still with the goal of delivering it to President Biden's desk by March 14. The Congressional Budget Office estimates that the new minimum wage would lift 900,000 people out of poverty but cut 1.4 million jobs and cost the federal government $54 billion.

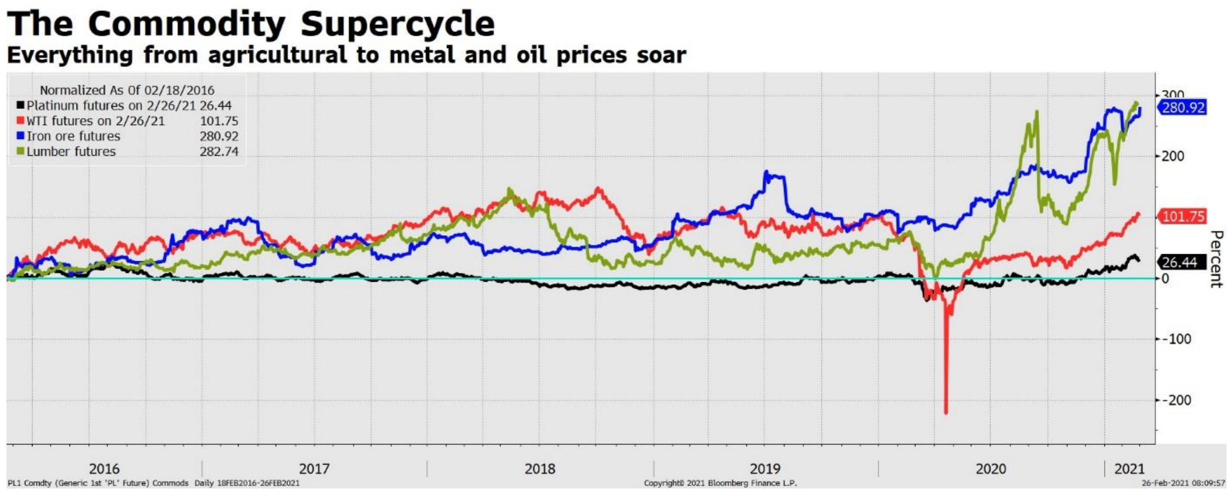
Those in favor of a big bill argue that the U.S. economy is still in a precarious spot with close to 10 million people out of work and many small businesses struggling to survive. In addition, the rollout of the vaccine requires funding to move quicker and states need support given revenue declines and additional expenses related to dealing with the virus. While there is general agreement on more assistance those arguing against this bill see too much ancillary content and feel that $1.9 trillion (about 9% of GDP) is too much given the $2.8 trillion last spring and additional $0.9 trillion in December. The extra $1,400 per eligible person may not be necessary for such a large portion of the population given that the last direct payments resulted in a huge increase in the savings rate, which was 33% of income in April - the highest since the end of WWII when it was 26%. Furthermore, the $600 in December resulted in a personal income increase of 10%. The $1,400 may also result in increased savings by many since there are still few ways to spend it. Another concern is continued large deficits and the impact on national debt. Even without the additional $1.9 stimulus the deficit is reaching historic levels at over 16% of GDP (highest since WWII). This would bring the overall national debt past $30 trillion by the end of the year. Furthermore, the decline in the economy as measured by the output gap (the difference between the economy's current growth and its potential growth) has been estimated by economists to be about $900 billion on an economy that is over $21 trillion annually. This $1.9 trillion would bring the total support to $5.6 trillion dollars over the last year to cover that gap.





Probably, the chief worry mounting against the bill involves igniting inflation beyond what the Federal Reserve is targeting. The risk, shared by former Treasury Secretary Larry Summers, concerns the combination of a high level of liquidity with a fast reopening economy. The large consumer savings from the direct payments plus significant pent-up demand over the last year could all be released in a very short amount of time. We have already started to see some impact of consumer spending increases with the unexpected jump in retail sales in January. This increase was 5.30% month over month and 6.15% excluding autos and gasoline. So far stimulus supporters have pointed to the fact that even in the face of the increase in consumer income, the large savings figure and additional consumer spending the latest inflation figures were still benign. The Fed's preferred indicator of inflation (PCE) rose only 1.5% year-over-year in the latest reading – well below its target of 2.0% and its tolerance above that figure for a short time.

Despite the low official reading of inflation there is evidence of remarkable price increases in certain pockets of the economy. Commodity price increases in categories such as industrial metals, precious metals, agriculture, energy and lumber have recently been substantial. The $64,000 question is whether the commodities and the potential for consumer spending results in a temporary price spike

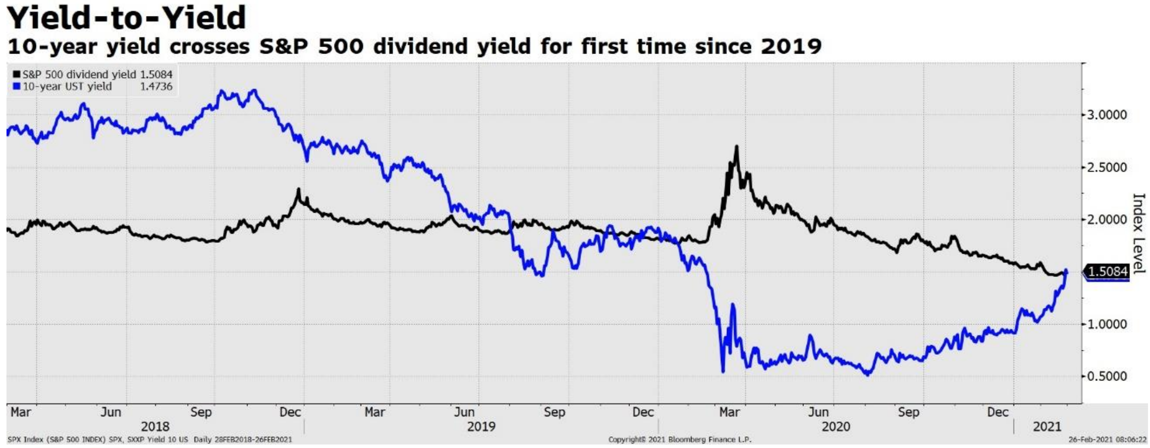


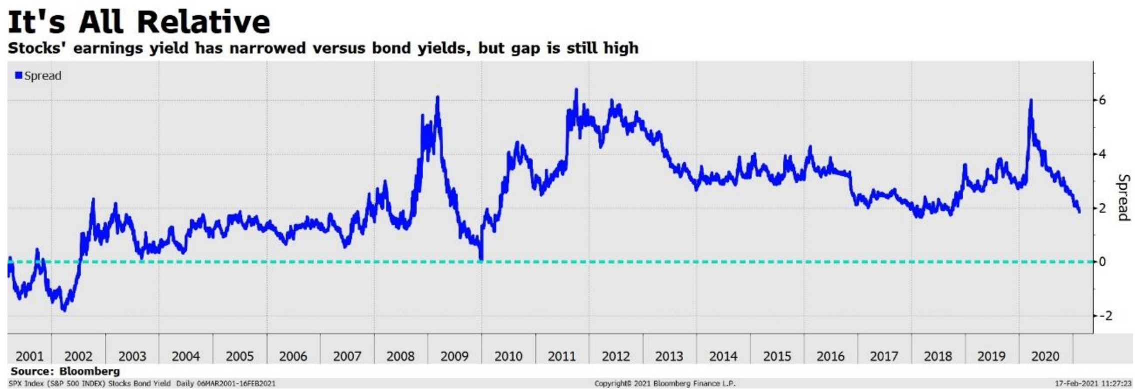
or true underlying inflation. On one hand many of the commodity increases have explanations rooted in supply constraints and supply chain disruptions. A good first example is the headlines of microchip shortages causing a slowdown in vehicle production. Oil has surpassed $60/bbl., driven by temporary overseas production cuts, lower domestic production and recent US government policies. According to the USDA Food-At-Home prices were up 3.5% in 2020 versus a 20-year historical average of 2.0% caused by a COVID-related increase in eating at home and transportation costs. Lumber prices were up 112% year-over-year caused not only by the substantial increase in demand from new homes and remodeling, but production limited from wildfires, weather events and virus-related mill shutdowns. The increase in the cost of new builds plus the limited of supply of homes for sale has caused the national Case Shiller Index of home prices to increase by 10.4% over the last year. The national median home price in the U.S. was $340,000 in December as measured by realtor.com. On the other hand, there is still significant slack in the general economy as we are below GDP potential. Moreover the 10 million unemployed are helping to keep a lid on wage increases, traditionally a significant component of lasting inflation.

You can also add general deflationary factors of demographics (i.e.: more retirees who spend less), technology (think Amazon) and globalization all working to keep prices low and it is hard to see any true inflation so far. Longer term inflation is one of the items we are watching carefully as the market has had a recent strong reaction to expected coming inflation with breakeven inflation rates over 2.19% for future time periods.

Financial Markets

The strong quarterly results by the big tech companies early this month were not enough to prevent declines in those stocks by the end of the month due to interest rate movements and higher expectations for the tech earnings. Also, energy companies confirmed that the slow recovery had a significant impact on recent earnings. After nearing or setting record highs in the middle of the month the last week's equity market decline, the largest since October, saw the S&P 500 end the month slightly ahead of its February start with a 2.76% return. The story of the last week of February was the quick rise in U.S. interest rates. In January's letter we noted how yields rose 50 bps from 0.50% to 1.00% in 6 months, the same yield rose another 50 bps in 1 month. We started February at 1.00% and ended at 1.50% (briefly touching 1.61% before settling back down). The sell-off was not as much on fundamentals but due to technical factors and liquidity related to low demand for new 7-year treasury notes and a large unwind in 5-year treasury notes. This leaves the 10-year treasury rate at about the same level as the S&P 500 dividend rate for the first time since 2019. In addition, the yield of earnings of the S&P 500 to its price level (which is often compared to the 10-year treasury rate) has narrowed significantly but remains still about 2% greater. We are closely watching the pace of interest rate increases rather than their absolute level. Rates may have a near-term upper limit as Fed Chairman Jerome Powell reiterated in his comments to Congress last week that they remain committed to maintaining an accommodative low interest rate environment “until substantial further progress has been made” on employment goals.



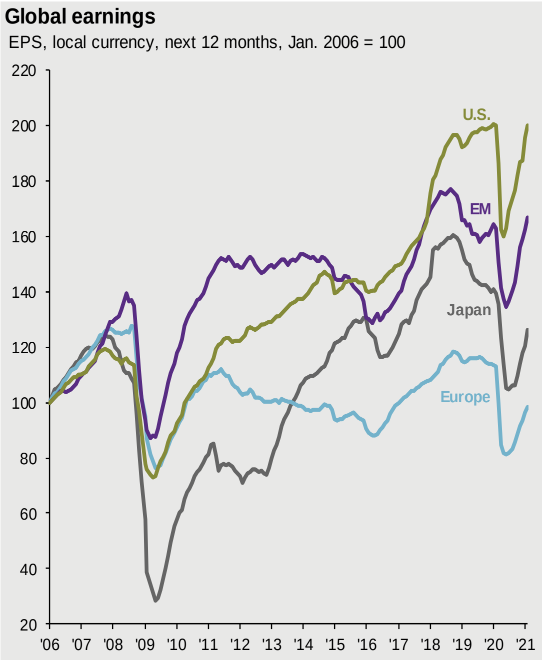


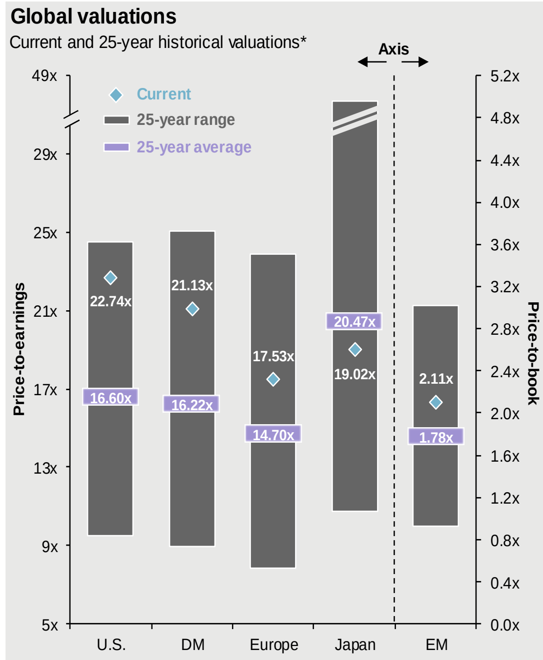
The reflation story with the economy closing in on a slow return to normal activity remains intact but there are certain other parts of the market that look to have significant potential as well. Within large cap U.S. equities health care still retains its growth characteristics through innovation (such as the rapidly developed virus vaccines) plus is reasonably priced relative to other parts of the S&P 500 on a P/E basis.

1Source: JP Morgan

	Energy	Materials	Financials	Industrials	Cons. Discr.	Technology	Comm. Services*	Real Estate	Health Care	Cons. Staples	Utilities	S&P 500 Index	
S&P weight	**2.9%**	**2.7%**	**11.4%**	**8.5%**	**12.3%**	**27.1%**	**11.0%**	**2.5%**	**13.2%**	**6.0%**	**2.5%**	**100.0%**	Weight
Russell Growth weight	0.1%	0.8%	1.9%	4.5%	16.3%	45.1%	11.7%	1.7%	13.7%	4.3%	0.0%	100.0%	
Russell Value weight	5.3%	4.7%	20.8%	13.4%	7.6%	9.6%	9.6%	4.4%	12.8%	7.0%	4.9%	100.0%	
QTD	30.3	2.7	11.8	3.3	-1.1	-0.3	4.8	4.0	0.1	-5.0	-5.2	2.2	Return (%)
YTD	30.3	2.7	11.8	3.3	-1.1	-0.3	4.8	4.0	0.1	-5.0	-5.2	2.2	
Since market peak (February 2020)	-5.1	25.9	8.7	11.1	23.9	28.0	21.6	-4.6	11.2	2.6	-12.3	15.1	
Since market low (March 2020)	115.2	97.0	90.4	90.6	81.4	85.9	70.3	53.2	54.3	35.1	36.3	73.9	
Beta to S&P 500	1.53	1.18	1.22	1.15	1.12	1.07	0.95*	0.74	0.78	0.60	0.29	1.00	β
Correl. to Treas. yields	0.49	0.52	0.62	0.54	0.39	0.43	0.47*	0.17	0.32	0.25	0.18	0.49	ρ
Foreign % of sales	51.3	56.8	30.1	43.8	34.0	58.2	44.7	-	38.5	32.7	-	42.9	%
NTM earnings growth	10670.5%	27.9%	21.2%	78.3%	43.4%	16.3%	13.9%	3.8%	12.0%	6.9%	4.4%	22.5%	EPS
20-yr avg.	**10.5%**	**18.5%**	**21.8%**	**11.5%**	**15.5%**	**13.5%**	**9.3%***	**7.4%****	**9.2%**	**8.2%**	**4.4%**	**11.1%**	
Forward P/E ratio	28.8x	20.0x	14.9x	24.5x	34.4x	25.7x	22.6x	20.9x	15.9x	19.5x	17.6x	21.5x	P/E
20-yr avg.	**13.8x**	**14.6x**	**12.4x**	**16.1x**	**18.5x**	**18.8x**	**18.8x***	**15.9x**	**15.6x**	**16.9x**	**14.6x**	**15.4x**	
Buyback yield	0.9%	0.9%	2.9%	0.8%	0.3%	2.0%	1.9%	-1.1%	0.9%	0.7%	-1.1%	1.4%	Bbk
20-yr avg.	**1.6%**	**0.7%**	**0.1%**	**2.1%**	**2.4%**	**2.8%**	**1.2%**	**-1.1%**	**1.9%**	**1.8%**	**-1.0%**	**1.6%**	
Dividend yield	4.5%	2.0%	1.9%	1.6%	0.7%	1.0%	1.0%	3.0%	1.7%	2.9%	3.5%	1.6%	Div
20-yr avg.	**2.6%**	**2.5%**	**2.3%**	**2.2%**	**1.4%**	**1.1%**	**1.4%***	**4.2%**	**1.9%**	**2.8%**	**3.9%**	**2.1%**	

2Source: *JP Morgan*





Another area of relative value and potential is international equity markets. They are trading at less of a premium than U.S. markets when compared to their respective 25-year history. Some economies are experiencing a quicker rebound from the virus. In addition, the emerging markets over the longer term have the benefit of demographics, a growing middle class and better government fiscal positions than many developed market counterparts. This makes for a compelling argument in favor of including an appropriate level of allocation to equity portfolios.

Should you have any questions please contact us.

Image sources: Bloomberg and CNBC unless otherwise noted

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