
# Ready, Set, Go!

## Q2 Market Update

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"Well, the road rolls out like a welcome mat.
To a better place than the one we're at.
And I ain't got no kinda plan.
But I've had all of this town I can stand."
-*Chris Stapleton*. *Starting Over*. Mercury. Nashville, 2020

Life begins again, for most Americans, at vaccination dose two. It is entertaining to think about what we will do with newly granted freedom of movement; seeing family is often top of the list, followed close behind by travel. As we all look forward to turning the page on COVID, we should realize this restart is not necessarily pushing us back to normal but forging forward into the new normal. So, what might 2021 have in store for us? We outline 5 main themes for the rest of the year: Improving Economy, Pent up Demand, Inflation Fears, COVID Trends to Stick Around, and Market Bubble Questions.

### I. <u>Improving Economy</u>

COVID took its toll across the globe as millions lost their jobs or their businesses. The Black Swan event of a complete shut-down was not one any risk manager foresaw. The lasting scars from this event will be most prevalent in small businesses and hospitality industries. However, with any meltdown comes new opportunities built upon forced innovation. Through the end of February, per the BLS, the unemployment rate was 6.2% and the estimate of unemployed persons at 10 million, still well above the pre-pandemic average of 3.5% and 5.7 million, respectively. We anticipate that rate continuing to normalize as more states and businesses reopen. The improving employment picture as well as a large stimulus bill should continue to kickstart the economy back to more normal levels. Increased monetary supply and historically low interest rates are both bullish indicators for growth. An improving and growing economy should lead to stronger profits and earnings.

**Chart 1. Unemployment rate, seasonally adjusted, February 2019 – February 2021**

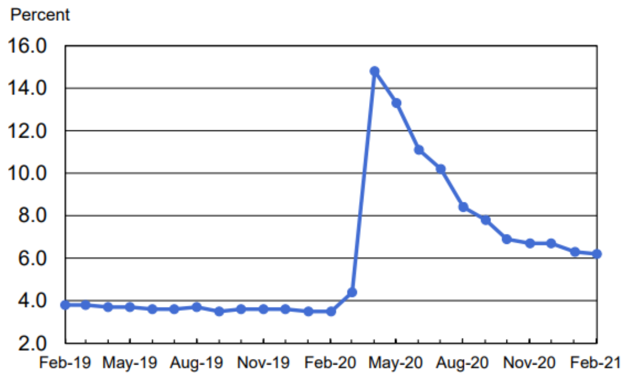
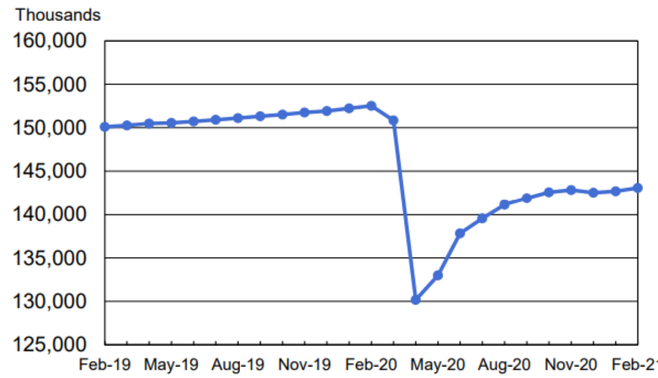



**Chart 2. Nonfarm payroll employment, seasonally adjusted, February 2019 – February 2021**




Lindsey Ice, Michael J. Rieley, and Samuel Rinde, "Employment projections in a pandemic environment," *Monthly Labor Review,* U.S. Bureau of Labor Statistics, February 2021, https://doi.org/10.21916/mlr.2021.3.

## II. Pent Up Demand

Who can't wait to travel abroad again? Go to a concert? Splurge? I feel confident most of us have a wish-list of things we want to do when we feel safe to move freely again. While the shutdown has been difficult on some, it has overall increased our savings rate and reduced consumer debt. Per the Census Bureau, 73% of households who received a $600 stimulus check in the first half of February saved it or paid down debt. This correlates to credit card and consumer borrowing falling, as well as revolving credit balances declining in January. These 2 data points align with better household balance sheets and less overall household spending.  In our opinion, this bodes well for pent up demand for consumer spending as the country normalizes. A more secure job market, less virus uncertainly, and minimal travel or mask restrictions will stimulate people into vacations and larger purchases they potentially put off due to uncertainty. For those who are high risk or elderly and saw their world shrink down due to the virus, the vaccine paves the way for more freedom and interactions going forward. The vaccine is not perfect, nothing works 100% of the time for 100% of the people. However, with the vaccine you are highly unlikely to have a symptomatic COVID infection. The CDC recently issued guidance for fully vaccinated people that, while not a full green light for all activities, enables a more normalized life. I know there is some fear about "only" 95% effective, or some of the what-ifs on vaccination, but most potential issues are low probability.

The Lancet may explain this best, per an article published February 17, 2021 by Piero Olliaro[1] discussing the Pfizer and Moderna Vaccines: "Simple mathematics helps. If we vaccinated a population of 100,000 and protected 95% of them, that would leave 5,000 individuals diseased over 3 months, which is almost the current overall COVID-19 case rate in the UK. Rather, a 95% vaccine efficacy means that instead of 1,000 COVID-19 cases in a population of 100,000 without vaccine (from the placebo arm of the abovementioned trials, approximately 1% would be ill with COVID-19 and 99% would not) we would expect 50 cases (99.95% of the population is disease-free, at least for 3 months)." I am not a doctor, and not advocating for anyone to do any activities they feel uncomfortable with, but I also wanted to share what the math means for the "95%" that we are all discussing. Everyone has their own comfort levels and will reopen at their own pace. Regardless of pace, we are certainly headed the right direction.

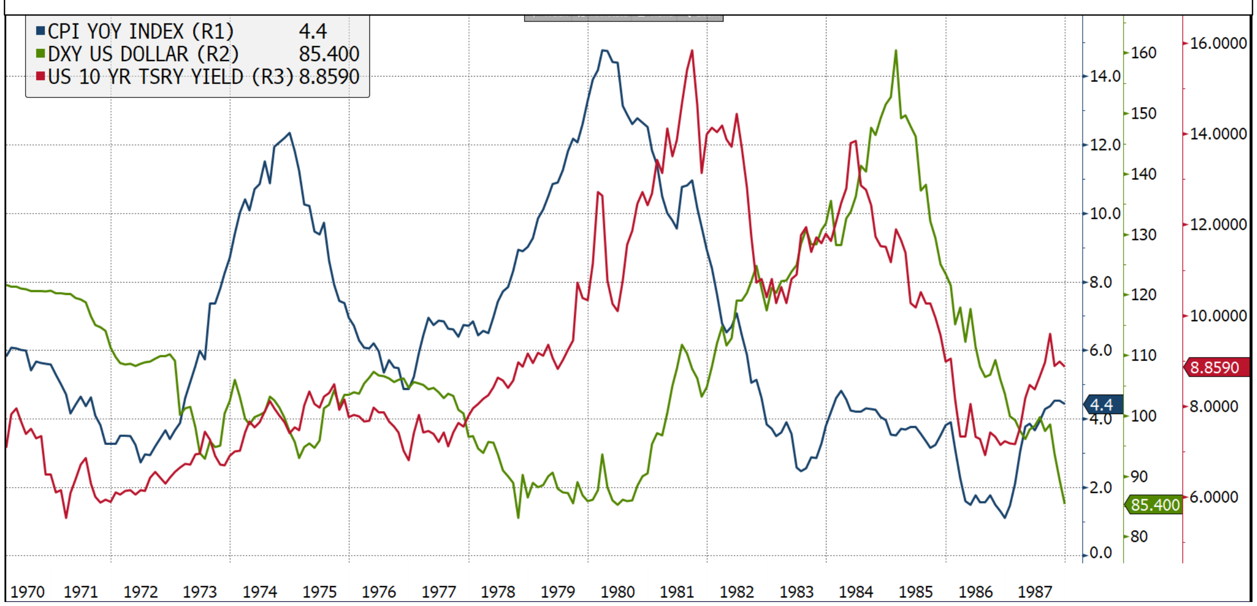
[1]"What does 95% COVID-19 vaccine efficacy really mean?" Published 2/17/201 by Piero Olliaro
https://www.thelancet.com/journals/laninf/article/PIIS1473-3099(21)00075-X/fulltext#:~:text=Rather%2C%20a%2095%25%20vaccine%20efficacy,at%20least%20for%203%20months
https://www.bls.gov/opub/mlr/2021/article/employment-projections-in-a-pandemic-environment.htm

## III. Inflation Fears

Inflation has become the market and economic boogeyman. To be feared, not really seen yet or felt yet, but this sense of impending foreboding and the unknown scariness ahead. How the world-wide printing of money to support global economies effects the future is yet to be known. Recent history, however, has shown there is no clear long-term correlation between the 10-year Treasury Yield and the US Dollar (US DXY). Currency moves and inflation are always relative to the markets and goods you are comparing them to. The most common valuation of the dollar is the DXY which is considered the general international value of the USD by averaging the exchange rates between USD and major world currencies. The dollar can be stronger vs. the Euro than it is against the Yen. This would make importing European goods, or a trip to Europe potentially cheaper than Japanese goods or a trip to Japan. Inflation is also relative, as if CPI is going up, but wages are going up in tandem it keeps any effects muted. For 2020, US inflation was 1.2%, following 1.8% in 2019- these are still low numbers and in line with the OECD total indexes going up 1.4% and 2.1% in 2020 and 2019, respectively. According to Bloomberg, the current forecasted CPI Year-Over-Year changes for 2021 are 2.4%, and 2.2% for 2022. US GDP is also expected to grow 6.5% in 2021 and 4.0% in 2022- slightly above the G20 Forecasted average pre a March OECD Economic Outlook report. These statistics are forecasting moderate inflation and strong economic growth which should help us avoid the main fear that we will hit a 1970's-1980's era of uncontrolled inflation. That era is not a direct correlation to where we are now for several reasons:

1. Oil price shock and the oil embargo of the 1970's. We are now more self-sufficient in oil and natural gas production as well as reserves.
2. Failure of Macroeconomic policy including Nixon's wage and price controls in 1971. The Federal Reserve and US Policymakers learned from the disasters in the 1970s and 1980s which is why we did not see major inflation in the 2000's with Tech and Economic crisis.
3. US debts & deficits relative to the rest of the world were climbing at a faster rate. Every developed nation has expanding deficits with COVID- more parity across nations.
4. Completely dropping the Gold standard in making the US Dollar fiat money for the first time and severely devaluing the Dollar. The likelihood of a dollar shock event of this magnitude is low.

History of the US Dollar Index v. CPI vs. US 10-Year Treasury Yields during 1970-1987




Bloomberg LP

## IV. COVID Trends

As the dust settles on the pandemic, there will be structural changes that remain long after COVID is gone. The largest shifts that G Squared feels will stick long term are Work-From-Home (WFH) and technological innovation. WFH was once a taboo never to be mentioned in large Fortune 500 companies lest you look like a hippy slacker and not a team player. WFH was for part-timers or the purely creative types who could make that workplace happen. However, the pandemic forced every company to rethink its workflow and expectations of employees. Technology opened the door for this with the ability to collaborate, share and work with others from a great distance. Many companies are rethinking full time employees having to work in physical offices. It could be a big cost savings for companies to be able to reduce their office footprint. While many companies and employees would rather not WFH full time, I believe this will usher in a new era of workplace flexibility providing employees with happier workplace environments. Technology made this possible, and technology will continue to drive innovation in the workplace and at home. This will shift employment opportunities, what people study at College, and how we interact and spend our time. Food delivery is now seamless and easy as well as many restaurants adapted for to-go making a wider range of options for those preferring to dine at home. A decade ago, the only delivery that was available was pizza and Chinese food. Now you can summon delicacies at a press of a button. Movie theaters are being overtaken by 4k TVs and better direct to consumer product. The ability to order and summon almost every good for curbside pickup from Kroger to Target changes the consumer shopping pattern. Technology played a key role in keeping people connected and feeling normal in 2020, now it will shape our interactions going forward even as the pandemic wanes.

## V. Market Bubble?

"Double double toil and trouble; Fire burn and caldron bubble" William Shakespeare, *Macbeth*, (1.4.10-11). Anxiety has increasingly grown about how high markets are trading. Nonetheless, relative to bonds and cash we still find the equity markets attractive. Earnings were strong, companies have solid balance sheets and are primed to grow for the next few years. We did have a recession, as short, sharp, and brief as it was, it was still a recession. Markets tend to do well post-recession as companies rapidly grow with economic expansion. We will see more spending and more growth in the coming quarters which will drive revenue expansion- though all sectors of the markets are not created equal. We favor Value over Growth and encourage you to watch your allocations to high flying stocks and sectors such as technology or very popular stocks. We feel we are still in the middle-innings of a secular bull market, similar to the 1950's or 1980's, and while we can have pullbacks and corrections within this market, the long-term trend is still poised to go higher. Investors are always better off sticking with stocks for the long term- even with recessions and depressions thrown in there- the stock market is the way to keep the real value of your wealth safe from inflation and growing over your lifetime. Investors do need to understand their liquidity and cash flow needs, as it is painful to have to sell during a period of volatility or down markets. So, while the markets may toil and bubble, we recommend keeping your allocation to stocks, ensuring you own the right kind of stocks for this market, understand and plan for cash needs, and stay focused on the long term.