JAMESSON ASSOCIATES

FALL 2020

QUARTERLY NEWSLETTER

Recent Economic Events

The economically disastrous first half of 2020 is in the history books, and historical it clearly was. GDP and employment dropped by the largest percentage in the post-war period. Virtually all economic statistics reflected the sharp decline. But Washington loosened its purse strings, and the Federal Reserve joined in, shocking the economy with a record level of fiscal and monetary support. The effect was to stop the freefall and spark a recovery. Both housing and the stock market have been boosted by the resulting low interest rates, but these sectors skew towards the more affluent. The public action was supposed to be a temporary bridge for the private economy to take the baton once the pandemic was controlled. That control has been elusive to say the least, and further relief dollars have become a political football. This has had a disproportionate impact on those least able to weather the recession. The current drivers of economy are the inherently unknowable medical and political developments, not established economic trends.

After dropping by 5% in the first quarter, GDP collapsed by 31.7% in the second. These figures have been annualized, but annualized or not, the hit was worse than any in the living memory of all but nonagenarians. The American economy is running at less than 90% of its 2019 pace. From the peak, employment was down by 22 million jobs at the nadir in April. Since then, over ten million jobs have been recouped, bringing employment back to about 92.5% of the high point. That's less than half of the decline, and I fear that those gains were the low-hanging fruit. The American economy has grown 2% to 3% a year since the turn of the century. That means we have now been set back to where we were three or four years ago.

This is neither socially or politically acceptable, which explains the extraordinary measures implemented by Congress and the Federal Reserve. The combination of special pandemic relief, on top of an already-huge Federal revenue shortfall, has boosted this year's projected deficit to an almost inconceivable $4.3 trillion. That represents around 25% of expected GDP and shows just how critical these dollars have been. The Federal Reserve has done its part by cutting interest rates to near zero and gobbling up most of the new Treasury debt issued this year.

Government relief efforts have temporarily stabilized the economy. The initial $1200 per adult, $500 per child tax rebate, along with the extra $600 per week of enhanced unemployment benefits (also extended to the self-employed), created an increase in personal income. This was unprecedented for a recession where income inevitably falls. Paycheck Protection Program loans were another fillip to a battered private economy. Even so, consumption cratered in the second quarter before recovering to roughly pre-pandemic levels at summer's end. Relief funds have now halted, so it will be up to the private economy to maintain the recovery.

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Housing, which has been greatly boosted by low interest rates, is one area that looks strong. Housing starts have recovered dramatically, and home prices are reflecting strong demand. Construction employment has jumped, as has home builder confidence (tied for all-time high at 78). Industrial production has also recovered much of its pandemic swoon, but it has done so with far fewer workers. In fact, the second quarter produced a huge increase in productivity (10.1%, the biggest jump in almost 50 years) because production fell by less than working

Recent Economic Events (continued)

hours. This is not how you want improvement to occur. The result is downward pressure on both employment and inflation.

In fact, as businesses figure out how to produce revenue with fewer folks on the payroll, they will enhance their survival while job growth lags. Keep in mind, it is the recycling of wage income from worker to business that is the true sign of a strong economy. Can't have one without the other. So, businesses may be able to survive at less than 100% recovery, but they won't be able to thrive. This highlights the need for fiscal support of workers.

The infection rate in the US has been on a rollercoaster with both Memorial Day and the Fourth of July producing COVID spikes a few weeks later. We will have to see if Labor Day follows the pattern or if the recent slowing in cases holds. We also must overcome school reopenings and the onset of cooler weather, which will chase more folks inside.

The health of the economy is dependent not on economic forces but on the course of the coronavirus and possible therapies and vaccines on the one hand, and the political developments in Washington on the other. That makes economic prediction even more like astrology than normal.

Commentary

America is facing an existential crisis. Both the left and the right feel that this election represents a battle for the soul of America. The left has joined the conspiracy bandwagon, filling my in-box with fears of Post Office shenanigans. The right is up in arms (figuratively and literally) over lockdowns and protests. I think everyone needs to chill.

> Current events are more a continuation of America's clash of ideals than they are something new.

The increased emotions on both sides of the political spectrum reflect the dawning realization that the myth of America doesn't match its reality. One side points to world-beating incarceration rates, accelerating income and wealth inequality, and close to 200,000 COVID deaths, skewed to those less fortunate. The other harps on law and order, the inability of coastal elites to understand heartland issues, and a cancel culture out of control. It doesn't help that we are all suffering at least mild mental illness from being stuck at home for six months without our normal outlets.

Contrast "Black Lives Matter" with "All Lives Matter" and "Make American Great Again" with "Again?" and we can see a divide that is hard to reconcile. But the United States has always been a country of contrasts and differing opinions on what it means to be a real American. The country was born in war and has been at war for much of its history. Innocent bystanders we are not.

The Declaration of Independence promotes the ideals of the Enlightenment — inalienable rights of life, liberty, and the pursuit of happiness. The Constitution aims to "form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare, and secure the blessings of liberty." Guess what: these goals are in conflict and have always been. It's up to each generation to establish the balance between them.

The Civil War was fought to preserve the Union and end slavery, but Lincoln suspended habeas corpus while it raged. The Constitution had to be amended to provide for Black citizenship and to allow women to vote. Japanese-Americans were interned during World War II. The 1960s saw protests for Civil Rights and against the Vietnam War while forcing the country to contend with three significant political assassinations.

Commentary *(continued)*

Current events are more a continuation of America's clash of ideals than they are something new. They are generational, sectional, and ethnic/racial. Many of us hold strong views of how things should be. We will not abandon those views just because one side or the other wins the upcoming election. It is but a battle and the war of ideas will continue.

Left-wing tropes suggest the President will stage a coup and not leave office even if he is defeated at the polls. Right-wingers contend that the Democrats will usher in full-blown socialism on the heels of a narrow political win. Both discount the rule of law and the pragmatism of the American people. Were either of these outcomes to occur, it would be proof that a government of the people, by the people, and for the people had perished from the earth. I reject that, and if you believe in the United States, you have to reject it too.

Market View

Financial markets have not followed anything close to a coherent script this year. Both US Treasuries and precious metals have appreciated. The most important industrial commodity, oil, is down about a third, while both copper and lumber are hitting highs. The stock market has become a tale of two markets, with tech stocks and others benefiting from the pandemic soaring, while most equities languish. This is pretty consistent with the bifurcated economy, suggesting that the Wall Street may be more in sync with Main Street than the headlines imply.

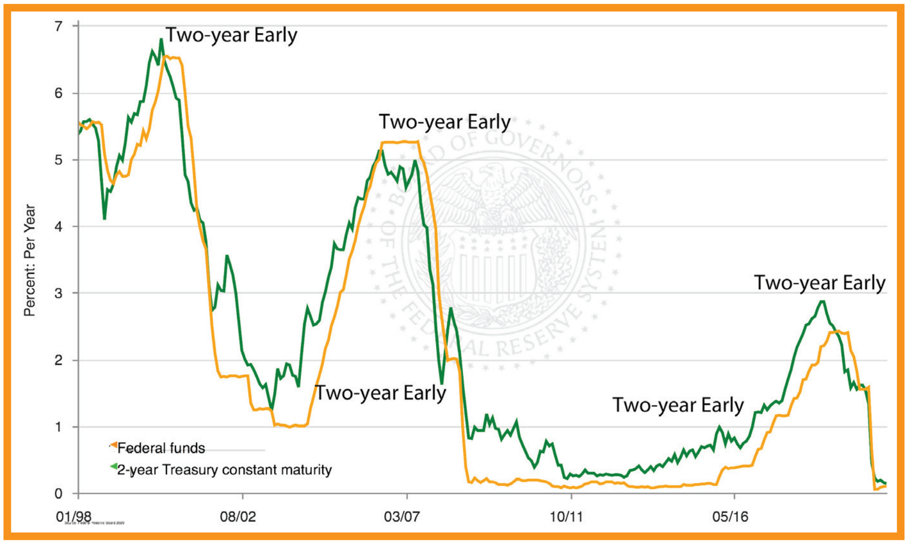
Those of us who try to divine the direction of the markets can hardly complain about incoherence. It comes with the territory. Our inability to fully understand what is occurring stems from being in the early stages of a truly secular shift. We are moving away from old business models which were dependent on mass consumerism towards a more targeted digital experience. The consequences will affect all businesses. There will be wrenching adjustments that have been accelerated by the upheavals of the pandemic. Excess capacity, especially in certain real estate types (offices, malls, hotels), and amongst workers replaced by technology (robotics, AI, etc.) will put downward pressure on prices.

Into this world, the Federal Reserve announced a "new" approach to inflation targeting. No more would they try to boost inflation to 2% and then stop, but rather, they would allow prices to increase beyond the 2% level for long enough to create an average rate of 2%. Never mind that they have been unsuccessful in raising prices to the target except for a handful of months in the last decade. The market was initially fooled by the "change," backing rates up by 10 basis points or so. On further consideration, we moved right back to where we were before the announcement. There are two key takeaways from this episode. First, the Fed is much less able to affect the markets and inflation than they would have us believe. In fact, if we were to look at the timing of Federal Reserve interest rate moves, we could make a reasonable case that they follow the market rather than leading it. Second, this is simply an excuse to keep short-term rates pegged to zero for a very long time.

What types of investments make sense in the world that I see? While my 2020 vision hardly matches its implied ophthalmological meaning, it is clear enough to make some recommendations. My priors include technological acceleration, ongoing low inflation, abundant financial market liquidity, and an uncertain coronavirus prognosis. The first three will put a lid on longer-term interest rates and a floor on tech stocks that are benefiting from the secular trends towards digital commerce and green energy. The last assumption presupposes that no safe and effective vaccine is available before the end of the year and that even when it is, a significant portion of the public will

Market View *(continued)*

be wary of being inoculated. This means that businesses that depend on high-density customer traffic remain speculations, not investments, notwithstanding their reduced prices.



Look to devote dollars to the transition to renewable energy from fossil fuels. The shift will be enhanced by lower costs for green technology and low interest rates allowing for large upfront investment with long payback periods. Political meddling will also lean in this direction.

I have been a long-time bull on Treasury securities and continue to believe that they represent good value. The Fed, by anchoring short-term rates near zero, serves to tether long-term interest rates as well. While I am comfortable in believing that long-term rates are unlikely to rise by much, we may be getting to the point where further declines are limited. We still have a way to go before zero, but if that level is achieved, it will be time to sell. TIPS have reached the exit point. As an alternative, look to income-producing real estate and dividend-paying utilities.

Precious metals have had a great run, but it's hard for me to see an ongoing rally. Keep some as a hedge but don't make it the core of your investments.

Editor's Note

Our travels have been more circumscribed than normal due to health concerns, but we have ventured outside the bunker from time to time — a few outside restaurant dining meals, socially distanced wine tastings, and a trek up and down the gorge in Watkins Glen. Our most adventuresome journey took us to NYC to pick up our son and his girlfriend for a week's stay in beautiful Scottsville. We planned the trip to arrive in New York about noontime to avoid rush-hour traffic both on the way in and on the return. We left at 6:30 AM and maintained a pretty steady ETA between 12:00 and 12:15. Traveling over the George Washington Bridge and down the FDR to the East Village was as painless as I can remember. We made the last turn onto the street where the apartment is located, having to cross about five more blocks when we ran into a line of stopped traffic. Nothing was moving. Time passed. Minutes stretched into a quarter hour. It was hot (90°). At this point, spontaneous citizen action took over. First, people got out of their vehicles and started looking up the street and complaining. Second, the time-honored NYC solution was tried: everyone started honking their horns. Surprisingly, these actions had no impact. Then, the crowd decided to back up. The driver at the corner warned oncoming traffic of what was happening and one-by-one we exited Purgatory and were on our way. To quote Hannibal Smith, leader of The A-team, "I love it when a plan comes together."

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