JAMESSON ASSOCIATES
WINTER 2020
QUARTERLY NEWSLETTER

Recent Economic Events

Driven by consumer spending, the American economy posted the strongest growth in GDP on record during the third quarter. Unfortunately, it wasn't quite powerful enough to fully recover from the six-month swoon of early 2020. Washington's initial response to the pandemic boosted personal income even more than spending, resulting in plenty of savings available to satisfy pent-up demand. Employment also bounced back but is now slowing noticeably. Housing, aided by all-time lows in mortgage rates, has been a bright spot, while consumer prices, after spending a few months sorting out the disparate impact of lockdowns and shortages, have settled into a benign pattern. This positive economic news has been dampened by a resurgence in coronavirus cases, hospitalizations, and deaths. Multiple vaccines have been put forward, but it's unlikely that widespread vaccination will be available until early spring. These developments will place obstacles in the path of our economy which already seems to be slowing, opening the possibility of a double-dip recession. That possibility is on a knife edge given the on-again, off-again fiscal talks in Washington. In the absence of another program, Federal government relief funds are set to expire at year-end.

Real GDP grew 33.1% annualized (7.4% quarter-to-quarter) in the third quarter, clawing back a significant portion of the first and second quarter decline. However, we remain 3.5% below last year's fourth quarter and over 5% below where we likely would have been in absence of the pandemic. The good news is that the CARES act replaced more income than was lost through unemployment. Many of the relief dollars were initially saved. For those fortunate enough to have kept working, spending options were curtailed, boosting their savings as well. This huge store of funds helped power consumer spending (25 of the 33 percentage point gain in third quarter GDP) and leaves some money on the table to get through the holiday season. Even so, it's likely that it will take until at least mid-2021 to get back to 2019's level, and we may never regain the previous growth trajectory.

Employment gains have been less robust than GDP both becausebusiness, in survival mode, has used the crisis to automate and streamline processes and also because many of the unemployed are in service businesses that have yet to regain altitude. While the unemployment rate has been more than halved from April (14.7%) to November (6.7%), job gains have slowed each month since June (only 245,000 in November). There are still almost 10 million fewer jobs than there were in February. Unless the pace picks up, it will take over three more years to recover them all, and this doesn't count normal increases due to population growth.

Recent Economic Events *(continued)*

Driven by the combination of lower interest rates and an exodus from high-density metropolitan areas into suburbs and exurbs, housing has been one of the strongest sectors of the economy. New home sales have topped 1 million annualized, and existing home sales almost 6.9 million annualized, both in excess of pre-pandemic statistics. This is likely to continue on the strength of work-from-home trends, creating geographic flexibility for a good slice of the workforce. In the inflation indices, higher housing prices have been offset by lower rents. This helped produce flat CPI and PCE numbers in October, keeping year-on-year core inflation at 1.2% and 1.4%, respectively. These figures are well below the Federal Reserve's stated inflation target of 2%, suggesting that interest rates will remain low for quite a while.

While we all hope that positive news on vaccine effectiveness delivers a return to normalcy, I am afraid we have a tough few months to get through. Coronavirus cases, hospitalizations, and deaths are spiking as cold weather arrives, and we all are experiencing social-distancing fatigue. The CARES act sought to bridge the period from the springtime collapse in economic activity to a rebound in the private economy. It has worked well so far, but relief from the program expires at yearend, and the hoped-for end to the pandemic continues to recede into the future. Restarted Congressional talks offer some hope for action before January. Perhaps 2020 will end with a Christmas miracle. Failing that, the economy is at risk with only the Federal Reserve at the stand-by.

Commentary

The election is over (unless you are unfortunate enough to live in Georgia) and Joe Biden will be inaugurated in January. The results of the vote revealed two losers: Donald Trump and the left wing of the Democratic party.

> ...TWO LOSERS: DONALD TRUMP AND THE LEFT WING OF THE DEMOCRATIC PARTY

Our polarized political climate is not going away because both sides feel that they lost something on November 3rd. How so? A rather remarkable percentage of Republicans believes that Trump won the election in the face of clear facts suggesting he lost by over seven million votes nationally and by the exact same Electoral College margin that he termed a landslide in 2016. Democrats bemoan the evaporation of the expected "Blue Wave" that was to deliver progressive governance to America. They lost ground in Congress and especially in statehouses, where, to their chagrin, gerrymandering will prevail.

The question that I am wrestling with is whether the political/cultural rift in the United States can be healed. And if not healed, at least made smaller. There are some glimmers of hope.

Florida voted to raise the minimum wage to $15 over time, echoing other states and cities that have done so over the past few years. Decriminalizing drugs, especially marijuana, is becoming widespread. Citizens in more than one red state have approved expanding Medicaid and devoting increased tax revenues towards education and childcare. On the flip side, deep blue California turned down regulatory overreach for gig workers and refused to increase taxes on commercial real estate. Illinois defeated a progressive income tax.

There are other areas where significant majorities of the public agree but where elected representatives or high-profile pressure groups have taken extremist stands. There is widespread support for tightening gun control measures and creating a path to citizenship for DACA designees, but Congress is afraid of acting. Similarly, there is practically no backing for the left's "Defund the Police" or "Abolishing ICE", but Democrats have had to toe the line to retain progressive favor.

Commentary *(continued)*

Could it be that we the people have a lot more in common than we thought if only the volume from those who benefit from conflict could be muted? It will be up to President-elect Biden, Majority Leader McConnell (or Schumer), and Speaker Pelosi to tamp down the extremes and empower moderates if we are to have any chance. Perhaps I have become a starry-eyed optimist in my dotage, but it does seem that the opportunity for compromise has been heightened, not dashed, by the closeness of the election outcomes. Both sides have to watch over their shoulders lest a thorough crack-up of the political structure in the country becomes the base case.

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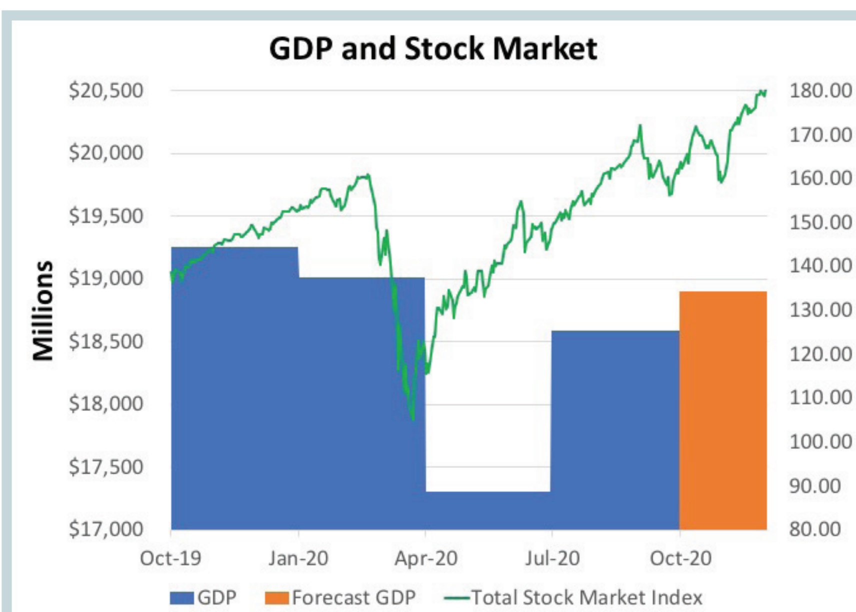
Market View

The stock market has powered ahead to hit all-time highs on a sea of liquidity, promising vaccine news, and election results strongly suggesting divided government. Even if the Democrats pull off upsets in the two Georgia Senate runoff elections, Congress will be closely balanced, putting power in the hands of those few legislators who straddle the ideological divide. Less likelihood of sweeping change promises what investors are always looking for — no surprises.



It's an understatement to say that many assumptions have been upended by COVID and the response to it. First, while never a hard and fast rule, the idea that the stock market and the economy move together has been thoroughly debunked. In fact, even directional correlation has proved elusive this year. The economy and corporate profits are likely to end the year below 2019 levels, and yet, stock prices are up anywhere from 5% (DJIA) to over 35% (NASDAQ). At least interest rates are more in sync with a weak economy. Mortgage rates are near all-time lows, and bank deposit rates are approaching zero. A question to ask is whether these trends will reverse in 2021 if the economy picks up once widespread vaccination occurs.

A key consideration as we contemplate the investment landscape for 2021 and beyond is how many of the trends established in 2020 will continue. Will remote work options have staying power, favoring internet conversations instead of in-person meetings? Note that oil prices are down over 20% from where they were a year ago, reflecting the dramatic decline in transportation demand as the result of the pandemic. There are now respectable firms suggesting that we have

Market View *(continued)*

seen peak oil, ushering in an inexorable decline of fossil fuel companies. A concrete example of this is the exit of Exxon from the Dow-Jones along with the elevation of Tesla into the Standard & Poor's 500. However, peak oil doesn't mean peak energy. Modern economies need reliable energy in order to function. I believe that fossil fuels are in a secular bear market while renewables are in a secular bull market. That suggests selling the former on strength and buying the latter on weakness. This trend has years to run and has only been turbocharged by the pandemic.

The accelerated changes we have seen this year have put a premium on innovation. Nowhere is this more obvious than in the rapidity of vaccine development. The process has been aided not only by mobilizing the global scientific community, but also by new technologies. It's safe to say that had this virus spread a decade or more ago, its effects would have been even more devastating than they have been.

As optimism has spread in the markets, longer-term interest rates have risen from their lows. However, they remain down nearly 1% from a year ago, and the Federal Reserve has committed to keeping short-term rates near zero for an extended period of time. Consider that the recently revised approach to rate management indicates a near-zero regime until inflation as measured by the PCE deflator averages 2% for some time and unemployment declines to levels suggesting full employment. The Fed has tacitly admitted that they raised rates prematurely after the financial meltdown and increased them too much when they did. This new approach to inflation and employment supports my view that any backup in rates is more a temporary move than a permanent one. My views on this would change if the 10-year Treasury breaks above 1.25%.

To me, technological acceleration and low interest rates together mean that the outperformance of growth versus value is durable. In fact, innovation is a key factor in limiting both inflation and employment gains, reinforcing the Fed's comfort with a low-rate environment.

Aside from my oft-stated recommendation to favor green technology over fossil fuels, I would lean into all manner of technology versus staid old-economy options. Choose crypto-currencies over precious metals, online and streaming media over magazines, newspapers, and even traditional TV, and warehouses supporting online retail over shopping malls. You get the idea.

Editor's Note

This Thanksgiving was not one any of us would want to repeat. Instead of the table full of traditional foods, family, and cacophony, we sheltered in place with only a Zoom call to connect with loved ones. Susan and I downsized from turkey to duck, but we stuck with one green and one orange vegetable. I did manage to head to the sofa for my regularly scheduled after-dinner nap, however.

With extra time to contemplate because of the reduction in familial conversation, I had an epiphany: Thursday holidays are way better than Monday holidays. No more waiting for the last Monday in May to start summer; we can tap the beer keg the preceding Thursday and have the long weekend to recover. Extra days off will reduce worker burnout, increasing productivity, and lower-wage workers who typically have to work on holidays will have added hours at time and a half wages. Win, win, win! By the way, if you have trouble reaching me on a Friday, you'll know why.

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