JAMESSON ASSOCIATES
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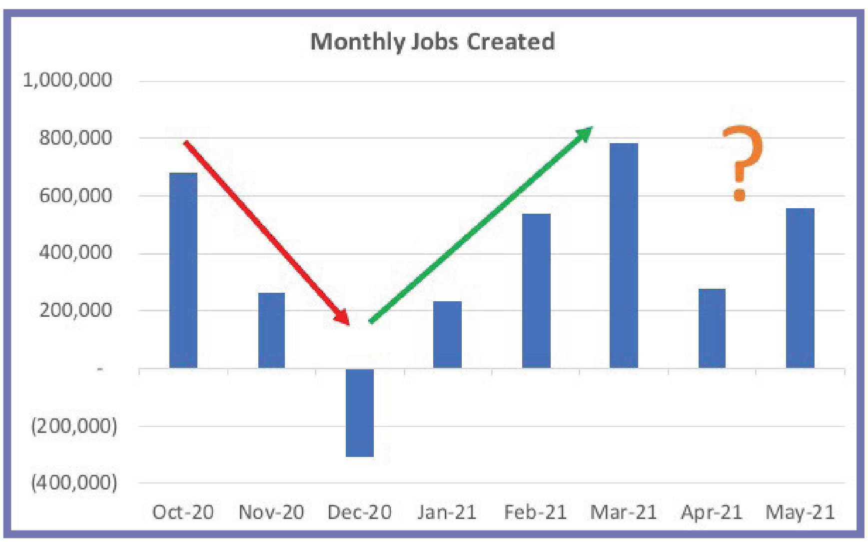
QUARTERLY NEWSLETTER

Recent Economic Events

Recent economic reports have been unwelcome news for those who believe in straight lines. The American economy delivered an exceptionally strong GDP performance in the first quarter, powered by consumer spending and both residential and business investment. Retail sales bounded ahead, aided by two sets of government relief checks. In fact, demand was so strong that it caused inventories to plunge and imports to jump. Supply constraints were a key theme in the up-and-down performance of the different categories. Were more homes for sale, computer chips on hand, or potential workers available, the economy might have been even stronger. Employment statistics have been weaker than expected even as output has boomed. Remembering Economics 101, imbalances between supply and demand are resolved by price changes. In these cases, by the opposite of what we saw when COVID sent us into isolation.



First quarter real GDP grew at an annualized rate of 6.4%. The star of the show was the consumer, who contributed 7.4%, or more than 100% of the growth. Business investment added 1.4%, led by gains in both equipment and intellectual property. Housing kicked in another 0.6% as builders tried to keep up with demand, and direct government purchases added 1.0%. Subtracting from the total, inventories and net trade shaved 4.0% off the gain. It's pretty clear that demand surprised businesses, requiring them to draw on inventories and tap foreign producers for product.

The hope is that inventories will be restocked and that domestic producers can catch up as the economy reopens. In the meantime, supply shortages will dominate the headlines.

The housing market has remained red hot even in the face of increased home prices (up 13% from a year ago) and somewhat higher mortgage rates. The supply of homes for sale compared to the sales pace is at multi-decade, if not all-time, lows. Stories of multiple over-asking-price bids are not uncommon. Contributing factors include a shortage of labor, lumber, and land in non-metropolitan locations as work-from-home possibilities proliferate.

The auto market has also seen its share of disruption. When the pandemic first hit in the early spring of 2020, travel activity collapsed. As a result, rental car companies dumped their fleets on the market to conserve cash. Automakers found demand initially evaporated, so they cut production and slashed orders for parts. However, after a plunge of a month or two, car demand bounced back with a vengeance as some mass-transit commuters switched to personal vehicles. In the meantime, chip makers had reoriented production to the booming work-from-home market and were not keen on producing low-value chips for the automakers. Voila: a shortage of chips for new cars. Currently, there appear to be 25,000 vehicles that are just shy of completion, needing only a few inexpensive chips.

Recent Economic Events (cont.)

Nowhere has the volatility in economic statistics been more obvious than in the labor market. March job gains of 785,000 drove the unemployment rate down to 6.0%, while April disappointed with 271,000 jobs and an unemployment rate of 6.1%. But just as many were bemoaning the reluctance of the unemployed to fill record job openings, the May report from the Bureau of Labor Statistics delivered job gains of 559,000 and a post-pandemic low in the unemployment rate of 5.8%. Perhaps we will learn that depending on one data point to determine the state of the economy is a fool's errand.

Price increases on those items in short supply have heightened concerns about inflation. All of the recent releases of price indices produced uncomfortable annual inflation statistics. Headline CPI up 4.2% with the core up 3.0%. The PCE index, which the Federal Reserve targets, showed a headline increase of 3.6% while the core gained 3.1%. It's clear that if these increases persist, the Federal Reserve will have to act. The question is whether price pressures are a temporary result of strong demand colliding with still-damaged supply chains or whether the inflation genie has been released.

Straight-line forecasting will continue to disappoint. The next few months will determine whether economic activity settles into a more normal path or whether the volatility of an unprecedented economic collapse followed by record government relief continues to bedevil.

Commentary

The wind is shifting. After decades of advantaging capital over labor, we are seeing a clear change. The relief programs passed to counter the impact of the pandemic had an emphasis on putting dollars in the hands of individuals rather than companies. Some of these dollars leaked into the stock market by way of commission-free trading at Robinhood, propelling certain stocks driven by social media to front-page status.

Other initiatives from the Federal Government have validated the shift as well. Both the American Jobs Plan and the American Family Plan direct money to building an economic foundation to help ordinary Americans rather than boosting the theoretical "job creators" of previous attempts. The public is solidly onboard, with the greatest support for upgrades of veteran's hospitals, bridge and road repairs, and elder/disabled care improvements. Traditional infrastructure has been expanded.

The accompanying proposal to raise taxes on both corporations and affluent individuals represents a significant break from the economic themes of Ronald Reagan and the supply-siders. Not only have higher taxes been proposed, but so has a sharp increase in the IRS budget to crack down on tax cheats. No trickle-down economics here.

The assault on multinational corporations continued over this past weekend. Janet Yellen was able to secure an agreement amongst the Group of Seven government finance heads to institute a worldwide minimum corporate tax of 15%. The aim is to arrest the race to the bottom that has led to corporate taxes representing less than 1% of GDP (pre-tax profits exceed 11%) in the United States. We will see how this fares in Congress, but it is quite popular with voters.

The shift in perspective is evident in monetary policy as well. Note that the Federal Reserve is no longer obsessively focused on inflation. Their current operating philosophy explicitly states a goal of full employment in addition to price stability. And price stability has been redefined in a way that will contribute to more growth in the economy before the Fed taps on the brakes.

Commentary (cont.)

And how do we explain the rather remarkable rebuke to oil companies by both their shareholders (Exxon) and the courts (Shell)? A turn away from deferral to company leaders and towards an energy transition has gained critical mass. This is also apparent in the rush by companies to comment on social issues instead of being entirely focused on direct business topics. Employees are voicing their views on more than just wages. Job quality and work environment have become more and more important.

Attitudes towards work have changed as well. Job-seekers are looking for more than the same-old that existed before the pandemic hit. Two changes are key. First, work-from-home is no longer an oddball arrangement. Apple recently announced that all of their employees would be required to spend at least three days a week in the office come September. It took all of one day for employee backlash. The other key employment development is how much potential workers are looking for in wages from a new job. A study by Goldman Sachs indicated that lower-wage workers are looking for wages 25% higher than they would have been satisfied with pre-pandemic.

> ATTITUDES TOWARDS WORK HAVE CHANGED. JOB-SEEKERS ARE LOOKING FOR MORE....

Why are we seeing these changes? I believe that the failure of neo-liberal capitalism to deliver for all but the most affluent set the stage, but COVID and its aftermath accelerated the process. Americans came to understand that their lives could be easily upended by a foreign pathogen. The realization brought home the idea that "you only live once" (YOLO), prompting many to hasten their retirements. This sped up the replacement of Baby Boomers by Millennials in the labor force. The latter's life goals are different. They are digitally native and use social media to amplify their voices. Other workers have concluded that their previous "rat race" approach needed to be throttled back. And still others have decided that they want something more than a dead-end job. All these factors lead to a lower supply of labor, and a lower supply changes the relationship with employers, especially those who have benefited from an excess of low-skilled workers with few other opportunities.

Time will tell whether the shift towards workers is durable, but given the trends both pre- and post-pandemic, I would bet on it.

Market View

Like most human endeavors, markets have a dominant narrative that guides their direction. Riding the narrative is the best path to success, remembering that markets tend to overreact and can become quite irrational. It's when a new narrative confronts the old that you have to choose sides. We may be facing such a decision now.

Markets have been supported by a combination of ample liquidity and low inflation. With prices of goods and services under control, the extra money in the system has gravitated to the financial markets. Stock prices go up and bond yields go down. This process has been turbocharged over the last year by three sets of relief payments by the Federal government to offset the impact of the pandemic.

However, recently the game has changed. Pent-up demand has collided with shortages of a variety of inputs. As a result, we have seen some truly impressive price jumps of items in short supply. Commodity prices have been the most obvious beneficiaries, but we have also seen increases in used car prices, fast-food worker wages, and shipping containers.

Market View (cont.)

The current situation will test the old adage that "high prices are the cure for high prices". If you believe that capitalism works and that the profit motive will resolve supply chain shortages, then this bout of price spikes will end with oversupply and stable, if not falling, prices. I note that there is a glut of hand sanitizer and N-95 masks at present.

Furthermore, the secular trends that have kept prices in check for decades are likely to reassert themselves. Increased digitalization and automation have been accelerated by the pandemic. Even small businesses now have digital receptionists, and online shopping is clearly cheaper than brick-and-mortar retail. The aging of populations continues unabated which leads to more savings and less spending over time.

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However, there are factors that could let inflation build momentum. The money supply has increased by an unprecedented amount, while the productive capacity of the economy, even after supply chain woes retreat, has not. Globalization, which brought cheap products to our shores, is in retreat, and recognizing the true costs of fossil fuel usage will boost energy prices. Finally, increased wages without increased productivity forces businesses to raise prices, setting the stage for a wage-price spiral.

If I had to choose one word to describe the last year and a half, it would be "disruption". That means that trying to project the future on what is happening short-term is destined for failure. Neither was the collapse in 2020 lasting, nor is the present the new normal. I believe the narrative is unchanged. We will overcome the supply issues, and the long-term trends will reassert themselves.

That means stocks still have value and so do bonds. Commodities associated with the digital and green transition (lithium, carbon credits, etc.) make sense, but current stars (lumber, oil, grains) will be limited by restored production. Crypto-currencies and precious metals are the toughest to gauge, but given the corrections in price, I would still lean towards the former in moderation.

Editor's Note

What a difference a year makes! June 2020 saw us self-isolating, wiping down our groceries with disinfecting solutions, and wearing a mask every time we ventured out of the house. I certainly won't have nostalgia for those times. However, we may fondly remember the demise of drunken karaoke bar singers. Fortunately, with both doses of vaccine administered, we traveled to New Orleans for the month of April and were able to enjoy nice weather and good food. The last vestiges of cabin fever dissipated as we journeyed to NYC for a long weekend, where we ate in full restaurants and were jostled by pedestrians on crowded sidewalks. It may be that those clever New Yorkers have figured out how to have three meals a night to catch up. We haven't done that, but we are doing our part day by day, week by week.

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