



Q
U
A
R
T
E
R
L
Y

N
E
W
S
L
E
T
T
E
R

There are two key drivers in the 2021 renaissance of the America economy. The first has been the increasingly successful fight against the coronavirus. When cases were surging, the last few months of 2020 and early this year, the economy clearly stalled. However, as new cases declined, economic statistics improved. Second was the \$900 billion relief package passed late last year, which provided \$600 middle-class checks and extended unemployment benefits. The desultory retail sales performance of 2020's fourth quarter was replaced by a near-record jump in January. While fourth-quarter GDP posted respectable growth driven by both corporate and residential investment, current projections are much stronger. Employment, which actually fell at the end of 2020, has regained momentum with the biggest job increase

since October posted in February. Even so, the United States has nearly 10 million fewer jobs than a year ago and a properly-computed unemployment rate in double digits.

The passage of President Biden's \$1.9 trillion relief program promises another fillip to the economy. In the midst of these positive indications, chances of an overheating expansion driving accelerating inflation has become a top worry.

The most important story for America's economy in 2021 is not actually a typical economic metric. It's that COVID is in retreat in the United States. From a holiday-inspired peak of over 250,000 daily cases, current levels are consistently below 75,000. Hospitalizations have fallen by half, and a noticeable decline in deaths has occurred. Estimates now suggest that all those who want to be vaccinated can be accommodated by the end of May. This development should ensure a reopening of high-

density activities and a gradual but accelerating return to normalcy.

In the meantime, the Federal government has provided relief funds in a series of programs to help those most affected get to the promised normalcy. Retail sales dropped in all three months of 2020's fourth quarter, but when stimulus checks arrived early this year, they flowed into a super-strong 5.3% monthly gain in January. The lethargic consumer spending in late 2020 partially offset strong housing and business investment, holding fourth-quarter GDP growth to 4.1%. Without those headwinds this quarter, projections from both the New York and Atlanta Federal Reserve Banks peg first quarter growth at double this rate.

**The most important story for America's economy in 2021 is ...
that Covid is in retreat in the United States.**

While overall growth is expected to best pre-pandemic levels by mid-year and even exceed the previous growth path before 2022 arrives, employment has not

bounced back as rapidly. Jobs fell by 306,000 in December and gained only 160,000 in January. February erased the shortfall, producing a strong 379,000 gain. However, this still leaves us with about 9.5 million fewer jobs than a year ago and an official unemployment rate of 6.2%. That statistic is flawed because the technical definition of unemployment doesn't count those who have left the labor force or who aren't actively looking for a job because of shuttered businesses. The more expansive unemployment rate is 11.1%, and even this total doesn't capture all of the nearly 20 million Americans who are collecting unemployment benefits.

It is the disconnect between headline economic statistics and the underlying reality for many that

JAMES SON ASSOCIATES

Recent Economic Events (continued)

the recently passed Biden relief plan tries to remedy. The most important parts of the program are one-time stipends of \$1,400 to middle-class and less affluent individuals and enhanced unemployment benefits of \$300 per week to the unemployed. Based on the January experience, these dollars should arrive as reduced-capacity service businesses emerge from lockdown. Key payments are also being included for families with children who may have had to stay home while the worst of the pandemic raged. Finally, payments directed to state and local governments (\$350 billion) will help public entities avoid layoffs.

Criticism of the program has centered on the possibility that it will cause the economy to overheat. The concern is not that we will experience strong growth, but that

Commentary • • • • • • • • • • • • •

The Republican party has become incoherent on policy. Its voting base is now much more blue-collar and populist while suburban voters (think soccer moms and middle-management commuters) have shifted towards the Democrats. And yet, instead of reaching across the aisle to work with Democrats on a relief proposal that would help their constituency, they have unanimously opposed the most recent package — a package that has more bipartisan voter support than virtually anything proposed in Congress this century. (Ironically, the only proposal with more public support was a minimum wage bill in 2007). ... revise the GOP from Geriatric Obstructionism

Carping about the deficit is, of course, nothing but rank hypocrisy, but opposing an additional \$1,400 payment to middle-class and poorer Americans seems like an own-goal since the de facto leader of the party (ex-President Trump) was a leading proponent in December. Additionally, a presumably pro-family party is against the increased child credit included in the

this growth will bring inflation. The 2020 government programs did not do so with annual core prices up only 1.5% as of January. Most economists believe that there will be a jump in annual price reports in the spring because the comparisons will be to the very weak performance when the pandemic first hit in 2020.

Whether the inflation spike persists is the question. To answer that, we need to weigh the competing factors. Arguing for acceleration is the pressure from pent-up demand confronting still-damaged supply chains and diminished globalization. (Increased demand + reduced supply = prices up.) The case for only a temporary spurt in prices depends on the huge slack in the labor market, on the digitalization which has been accelerated by the pandemic, and on aging demographics. (Excess labor + increased efficiency + reduced demand = prices down.)

package. Even Mitt Romney, who proposed a similar program, toed the line in the Senate vote.

The only way to reconcile the positions that elected Republicans have taken is to revise the meaning of GOP from Grand Old Party to Geriatric Obstructionist Politicians. Censuring anyone who has even a modicum of independence from Trump on the one hand while rejecting

programs on the other doesn't seem like a recipe for success to me. If the Republicans strive to be a true working-class party, they are going about it in a curious way.

In fact, the Republican playbook over the last 50 years has emphasized cultural grievances during the electoral season, only to hew to a tax-cutting obsequiousness to the donor class while in office. Mr. Trump pulled the veil from this strategy in winning the 2016 Republican primary. However, in office his policies reverted to the tax-cut playbook and were supported by less than half

Commentary (continued) • • • • •

of Americans. Without popular support, Republicans rely on undemocratic structures to retain power. These include campaigns against increased voter access using the canard of voter fraud, gerrymandered Congressional districts to dilute the power of urban voters in favor of rural constituencies, and the use of the Senate filibuster to stymie legislation that is supported by large majorities of the public (assault weapon ban, taxing corporations, raising the minimum wage, etc.).

I would point out to the Republican absolutists that if they should ever lose control and the undemocratic structures be washed away, they will go nationally the same way that they have in California, New York, and most recently Virginia. I would note that first time I voted in 1972, New York had a governor, two US Senators and an Attorney General from Team Red. The last statewide Republican elected in New York lost reelection in 2006.

The thing that puzzles me is the desire to play tribal politics rather than leverage the wedge that ex-President

Trump created in the Democratic party. While most traditional Democratic groups voted for President Biden, there were clear declines in majorities with Blacks and Latinos, especially male voters in these groups. I have long argued that, if Republicans appealed to minorities who would be likely to agree with conservative social views, they could upend politics in the country for the good. Currently, both sides have groups that are almost automatic supporters because the other side has some unacceptable views. Americans are far more complicated on an individual basis than the ideological purity demanded by current political orthodoxy. How refreshing it would be if true competition, rather than tribal loyalties, could prevail.

Disruption is coming to the politics of the United States. While it appears that the civil war in the Republican party will occur first, it will spread across the political spectrum. While I believe that ex-President Trump was neither a good person nor a good President, he began a political upheaval that will pay dividends for the country once the dust settles. ▀

Market View • • • • •

The forecasts in my December newsletter solidified my reputation as the Dave Kingman of market prognostication. I either struck out (fixed income) or hit a home run (crypto-currencies). I will strive for a better batting average now that spring training is in full swing.

The key characteristics of the financial markets at present are plenty of liquidity, rising long-term interest rates, strong earnings, and lofty valuations. Stock market leadership has shifted from technology and names that profit from “work from home” trends to traditional cyclical companies that can ride the wave of an improving economy.

We saw a complete disconnect between the economy and the stock market in 2020. The former fell by more than it had in the entire post-war period, while the latter

achieved all-time highs driven by record earnings. The biggest stock market stars were the large technology companies that were perfectly positioned for the accelerated use of digital options when the pandemic hit. The shares of these companies were also boosted by the collapse in interest rates which valued their future earnings at a higher multiple. Both trends have reversed in 2021.

Higher interest rates favor companies that will enjoy accelerated short-term earnings gains even if their longer-term prospects are not great. They do so for two reasons. First, the higher rates go, the less valuable earnings five or ten years down the road are to current valuations. Second, an increase in interest rates, driven by real growth rather than inflation, means stronger sales for traditional products and more operating leverage for companies with capacity to produce.

Market View (continued) •

Long-term interest rates have been primarily juiced by expectations of stronger growth and less so by expectations of higher inflation. We can see this by comparing the increase in real rates at the ten-year point (up 42 bp YTD) as measured by TIPS to the change in inflation expectations determined by comparing TIPS to regular Treasuries (up 25 bp YTD). And if we look at five-year inflation expectations (2.43%) versus ten-year expectations (2.26%), we find further confirmation that the markets are more inclined to expect a spike in inflation rather than a steady march higher.

This appears to be the view of the Federal Reserve. Recent comments by Federal Reserve officials, especially Chair Jay Powell, have reinforced the commitment to keep short-term rates right where they are for an extended period of time. Furthermore, ongoing purchases of government bonds by the Fed are still slated for all of 2021. It doesn't look like the high tide of liquidity will be ebbing anytime soon.



At the risk of doubling down on a losing bet, I continue to believe that longer-term interest rates represent value, although I admit it could be a volatile journey over the next few quarters. And if long-term rates are not likely to rise much further, that means the correction in technology stocks is close to the endpoint.

That said, it's hard to discount the clear change in investment psychology. Cyclical stocks are having their day in the sun. Balancing out your portfolio with some traditional names is a wise diversification strategy. In addition, the success that the Biden administration has had in its first major legislative initiative bodes well for an infrastructure bill addressing many of the country's needs later this year. That should keep momentum behind companies positioned to help build out

the nation's electrical grid (I'm looking at you, Texas), bridges and roads, airports, and water supply. There will also be dollars in the program for a continuing transition away from fossil fuels. ■

Editor's Note •

Groundhog Day was not auspicious for us. A few hours after Phil failed to see his shadow, Susan called to tell me she had pulled the door off of our convection/microwave oven. She had not awoken to find Wonder Woman's magic bracelets enhancing her muscle power, but rather had opened the oven to cook some oatmeal when metal fatigue took over. Fortunately, there were no injuries although wet rolled oats were widely scattered. The unit had a specific profile which reduced our options for replacement. Our choice was made in America and shipped and installed within a week. All the buttons worked except one: Start. Seems as though the oven wasn't registering that the door was shut. A trusted repairman who had fixed our dishwasher a few years ago was summoned. Yuri got the unit to recognize that the door was closed. We tried to heat water — ice cold. He deconstructed the oven again, and upon restoration, water heated. Testing a third time revealed a malfunctioning fan when using convection heat. Another tear-down was in order, but this time it was a parts issue (they are on back-order). The moral of the story is that it's fine to order American appliances, but it's even better to have a talented Russian technician on call. There may be a lesson here for election security.

