Market MUSINGS EDWARDS ASSET MANAGEMENT

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THE US ECONOMY'S HEALTH

Early in 2020, the US economy suffered a swift-spreading, deadly COVID-19 pandemic, causing the fastest economic recession in a lifetime. In response, the Federal Reserve and Treasury wasted no time injecting cash into the US system, increasing the M1 money supply by 40% in just weeks, and assuring the free flow of credit through the banking system. Applying massive fiscal and monetary stimulus, they stemmed the economic decline and initiated the recovery process. Responsively, the US employment report boomed with 711,000, 610,000, and 245,000 new jobs in September, October, and November, while the unemployment rate fell to 6.7%.

While many continue to confront the personal and financial tragedies of COVID-19, the economy has stabilized, and we predict significant improvement and opportunity. The Federal Open Market Committee (FOMC) continues to support the recovery by maintaining a zero-interest-rate policy, and they expect to remain near zero well into 2023. The recently passed $900 billion fiscal stimulus package offers further steroidal support. And as an increasing number of Americans receive a COVID vaccination and lockdowns are unlocked, prospects for a full recovery in 2021 are looking good.

[Authors note: If economic data isn't your thing, jump down six paragraphs to "THE ROARING 2020's"]

Jumping GDPs And Energetic Earnings

The US GDP had a record-setting leap in Q3, hurdling over the record mark with a 33.4% jump in growth for a single quarter, so says those that matter at the Bureau of Economic Advisors (BEA). Of course, this followed a record tumble in GDP of 31% in Q2 (BEA). Oh, the drama of athletics and economics. Retail sales jumped as stay-at-home students and workers became couch potato shoppers, setting online sales records for just about everything, including gaming and streaming entertainment. Simultaneously, businesses were actively restocking inventories and spending on technology, advertising, collaborative software subscriptions, cyber-security, AI, and the such. As a byproduct, in the category of awesomesauce (it's in the Oxford Dictionary), "Zoom" became a verb (let's Zoom) and our pick for 'Winner of the Pandemic.' Of course, terrific businesses and entire industries were severely damaged by the pandemic and health-targeted lockdowns. Restaurants, hotels, airlines, cruise lines, and live entertainment all sadly suffered. When the numbers were in and counted, winners and losers, the sum of corporate earnings surged 27% in Q3 (BEA). Again, there is reason to believe the economy can continue to prosper as vaccinations are administered and lockdowns lifted.

Housing Is Hot

Homebuyers were cooking with heat as the housing market reached 15-year highs, according to the National Association of Realtors (NAR). They noted that existing-home sales for November rose to an annualized rate of 6.7 million units, up 25% from year-ago levels. With tight housing inventories and historically low mortgage rates, existing-home prices rose in November by 15% from year-ago prices (NAR). In the new-home segment, the NAHB Housing Market Index, a homebuilding activity measure, reached its second-highest reading ever (86) and well above year-ago levels. Several large, publicly traded homebuilders recently noted record backlogs of home orders on their books, adding hotness to the market. According to one prominent CEO, Doug Yearley, "Since late May, the market has been as strong as I've seen in my 30-year career at Toll." (Barron's, January 15, 2021) So it's bigger kitchens, home offices, and home yoga studios for everyone.

Friendly Fed

The FOMC continued its zero-interest-rate policy and shared in their recent communication that the accommodative policies are likely to continue as the economy moves toward "maximum employment." Joining in, Fed Chair Jay Powell has promised they'll target low-interest rates into 2023. Additionally, the FOMC is making no changes to the $120 billion of Treasuries and mortgage-backed securities purchased each month. Some analysts expect this amount to increase as Congress cogitates additional fiscal stimulus plans.

Mighty Mini Interest Rates

Historically, low-interest rates prevail as central banks maintain an accommodative policy stance designed to mitigate the economy's ongoing adverse pandemic effects. The trajectory of yields has generally been downward, and as stated above, Fed and FOMC plan to keep it that way for several years. A slight steepening of the yield curve in Q4 seems a response to the recent rise in inflation and the improved outlook for the economy. The yield on the benchmark 10-year US Treasury, as of this writing, is 1.1%, while 5-year US Treasury yield is 0.46%, and the US 5-Year Expected Inflation rate is at 2.05% (St. Louis Fed).

The Outlook from Our Offices Overlooking Naples

Let's take a look at the setup starting with the general economy as the backdrop, with the vaccine here and therapeutics on the way and with most economists and strategists forecasting 4-5% growth in GDP for 2021. On the sidelines is an extraordinary amount of cash, earning near-zero return. Large US companies have stockpiled record levels of cash. They have ample borrowing power at rates as low as 1% due to generous monetary policies, putting strong tailwinds at the backs of the business values of many of the extraordinary businesses in our core portfolios. Add in massive sums of cash to support corporate expansions, R&D for future revenue, dividend increases, mergers, and lots and lots of stock buybacks - it doesn't get any better. Maybe it does...if all that cash isn't enough, we cannot imagine a Joe Biden White House, a Janet Yellen-led US Treasury, and a Jay Powell-led Fed not adding even more stimulating cash injections. So, there we have it! Our case for equities, particularly the mega-cap growth group whose balance sheets have strength, cash profits are booming, and stock prices have consolidated in recent months like a coiled spring. Of course, stock price volatility must be expected. Thus, as investors in some of the world's best businesses, we must learn that price volatility can be our friend for portfolio building and position weighting. The setup today, in the opinion and outlook of your management team, remains pure awesomesauce!

The Roaring 2020's

Americans are well known for their resiliency. As vaccine shots find arms and lockdowns become history, we can imagine a rush of business reopenings and new openings. We can imagine seeing significant, life-changing, positive social and economic leaps and strides. With COVID kryptonite in our bloodstream, we visualize families and communities participating in the tremendous social un-distancing. Join us imagining the tsunami wave of pent-up demand that will be released in the form of dining experiences, travel adventures, and cheering live performances throughout the global economy. We dream of again embracing family and friends, celebrating birthdays, anniversaries, graduations, weddings, and the holidays. We see a magnificent bull market in hearty handshakes and loving hugs, and we plan to dance and party Gatsby style into the Roaring 2020s!

"Can't repeat the past? Why of course you can!"

- Jay Gatsby in The Great Gatsby by F. Scott Fitzgerald, 1925

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Postscripting Personally

Our new office construction is complete. The expansive views over Naples are a daily joy and, coupled with the art, create an inspiring and creative environment for your team of nine – several of whom look forward to meeting you. Regrettably, it's unlikely we can gather for cocktail parties or client lunches this season, but we expect several healthy opportunities for wonderful gatherings next season. Finally, I'm missing all of you, and I look forward to again sharing handshakes, high fives, and hugs as we gather in the near future. Until then, thank you for your confidence. I value your support and welcome your questions.