



Client Note

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2020, despite a massive pandemic and a severe global recession, central banks, with some fiscal assistance from governments, have managed to keep financial asset prices elevated. Significant declines in revenues, profits and employment arguably the worst since the 1930's alongside surging stock index price levels, have conspired to give us the most overvalued market since 1929 or 2000 (some argue "ever"). How long can this endure? Depends on when central banks begin to whisper about 'normalization'.

For 2020, the **SP500 gained 18.4%**, the aggregate **bond index gained 7.5%**, and **gold gained 26%**. European shares eked out a positive year while the Asian indexes fared very well. My conservative portfolios gained mid to upper single digits while the average moderate portfolio gained a bit more than **13%** on the year. The pullback in Moderna and precious metals provided a weak end and lackluster start to the year. The **energy sector** was the worst sector in the SP500, **losing 28%** and the **tech sector** fared the best **gaining 48%**. **Healthcare and energy are likely to be strong outperformers in 2021**. The addition of TSLA to the SP500 has increased the risk of market volatility. Past observances of new additions to the index show they generally perform worse than prior to their addition. TSLAs outrageous market value (valued more than the 9 largest global auto makers combined; selling at 28x **sales**) and the 7th largest company in the index, put the index and any sector it is in at risk of increased volatility.

Gold and gold miners are **at risk of starting another correction**. Recent lows at Thanksgiving are being approached. The rally from late November to January 6 was the largest run up since gold's consolidation began in August. However, IF we can hold the longer-term uptrend, **upside potential is significant**. Bonds too, are seeing **prices under pressure** as metals/lumber/agriculture/oil prices' surge is generating calls of "Inflation!". **It's quite early to claim prices are going up due to renewed growth**.

Asia came out of the COVID-19 lockdowns much quicker and effectively than western nations. This re-opening (as a result of very stringent testing/tracing/ and effective lockdowns) allowed those economies to re-stock and re-open driving up demand and prices for raw commodities. From 2015 to late 2017 base metal prices and oil were moving up quickly. Cries of inflation were heard then as well. **Inflation never showed up** (unless you count 2.1% as INFLATION). This is due directly to US consumer spending growth, or lack thereof.

Aggregate **consumer spending is significantly below trend**. Dig a little deeper and you can see many economic indicators picked up in 2015 through 2017, then rolled over during summer 2018, after the brief impact of tax reform (most of the benefits went to the top where additional money isn't spent). Current total annual spending was \$14.8trillion and growing at 4.2% for the past few years (income at almost the exact same rate). **MOST recently spending has declined the past few months while aggregate income also is declining**. Today we can see the next few months will likely show a **spending gap of \$1trillion**. A \$1trillion gap is almost 7% of total spending and reflects the concurrent GDP output gap and an outright decline in GDP of around 4% year over year. Looking ahead, the real problem may

lie in the US inability to deal with the virus effectively. Yesterday, an article stated that **in Ohio, 50% of nursing home workers are refusing the vaccine.** Layer in low compliance with mask mandates (>70% compliance in order to be effective), and I truly wonder if an end to the virus is, in fact, in the offing.

As a consumer driven economy, the point is, while one can find prices of products higher (or packaging smaller at the same price), we spent a lot less in 2020 and will continue into 2021. And unless personal spending increases, we **should not see a difference in the economy or inflation going forward.** This may bode well for bonds. TLT the 20-yr treasury bond elf, gained more than 15% in 2020, but has fallen a similar amount off its highs this summer. Expectations for higher rates may have gotten ahead of itself and we could be near a low in prices. Layer in the fact that bets against prices are near extremes may **indicate the decline in bond prices is nearing an end.**

In addition, or perhaps running parallel to the decline in spending is the **truly massive amount of people on unemployment insurance.** In 2006, **Continuing Claims for unemployment insurance** hit a low of 2.35 million. This began to increase in early 2007 and hit **a high of 6.62million in June 2009,** after the Great Financial Crisis. **By June 2010, this fell** to below 4.5million, and continued to decline **into October 2018 to 1.65million.** Claims remained flat until February 2020. May 9, 2020 claims **hit 24.91million.** And over the **past 8 months has receded to only 5.1million.** It was only in November that our current Continuing Claims for Unemployment Insurance fell below the GFR Peak in 2010. The number and duration of **unemployment today has not been seen in the post WWII era.** Fortunately, today, we have unemployment insurance and a Federal Reserve acting to support financial markets (almost perpetually since 2009).

We should not expect any kind of normalization in the economy or improving numbers at least until employment, and thusly spending, improve rapidly. This is completely dependent upon containing the spread of covid-19.

Due to the length and depth of the declines in spending and employment, the longer-term **collateral damage** will not be seen until things begin to normalize. Once all the rent and loan deferments, PPP loans, random stimulus checks, and enhanced unemployment benefits disappear we will be able to see the extent of the long -term damage. **Ironically, that knowledge will come at the same time we declare victory over this virus-recession and may be concurrent with a market decline.**

In the meantime, let us hope the Fed does not mention ANYthing about tapering the current \$120billion per month they are pumping into the financial markets, hoping that the **Wealth Effect** is more than theory. So, while prices continue to climb, we will participate and listen intently for any signs the Fed is “confident” enough to reduce the variety of market interventions currently underway.

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