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Update on the Economy and Investment Markets

Welcome to the Stearns Financial *Fireside Chat.*

This week, the U.S. stock market looked largely past a highly publicized impeachment trial, the record numbers of daily deaths from COVID-19 and an ongoing battle between small retail investors and the big hedge funds, demonstrating optimism in a post pandemic recovery.

Treasury Secretary Janet Yellen expressed confidence in the resiliency of American markets following a review of the retail vs. shorts frenzy. As outlined in recent *Chats*, smaller companies are far more susceptible to the kind of price manipulation experienced by some companies in recent weeks. While a David and Goliath movie is no doubt coming our way, the likelihood of stock manipulation within our portfolios at SFG is far less likely given the underlying companies making up our holdings have natural barriers to manipulation.

The primary barrier is that larger companies are not nearly as susceptible to price manipulation by small investors. Most of our larger companies have an average daily trading volume of over $10 billion as compared to the smaller companies that barely average $100 million in daily trading volume, though this number climbed to $4 billion during the height of the frenzy. In short, it takes far greater volume to move the stock price of a larger company.

Dr. Yellen also predicted elevated unemployment rates through 2025 but went on to say that further economic stimulus would likely result in a recovery to pre-pandemic employment rates by 2022. This is good news coming from someone who is highly respected and keenly knowledgeable in economic matters. We expect some version of Biden's proposed stimulus package to pass given the proposal now requires only a simple majority (see U.S. Fiscal Stimulus Update below). While the nation's debt burden continues to grow, the stimulus package should provide the economic band-aid required to get us through to the other side of the pandemic with fewer long-term wounds.

As Americans look forward to getting back to work, they may find that some of their jobs no longer exist. Fortunately, Dr. Yellen has been a vocal supporter of re-training programs as well as a major overhaul of the country's aging infrastructure, including the U.S. electrical grid. The hope that these projects will provide jobs for those displaced by the pandemic looms large.

Turning to stocks, so far, **the news is positive.** More U.S. companies are reporting earnings *growth* by wider margins than historic trends. Of the 59% of S&P 500 companies reporting, 81% have reported positive earnings surprises by an average margin of 15%. Note that earnings *growth* is a very important metric, as it allows stretched valuations prevalent in parts of the U.S. stock market to become less stretched due to expected outsized earnings post pandemic. This is why we've cautioned our clients not to focus as much attention on P/E ratios which are often higher coming out of recessions. Earnings growth is critically important and needs to continue. **If there are any negative surprises along the way, volatility in stocks will increase and we could see a meaningful correction.**

The U.S. consumer is poised to play a significant role in 2021 assuming pent-up demand results in increased spending. Low interest rates, suppressed commodity prices, historic fiscal stimulus and curbed spending due to lockdowns have led to approximately $2 trillion in "excess" savings. This means the personal savings rate has risen to its highest level since World War II. We expect consumer spending to normalize rapidly as the impact of widespread vaccinations become more prominent, even though the messy COVID-19 endgame (discussed in this *Chat's* FAQ section) will still reflect some measure of caution for consumers contemplating a trip to the mall.

Unfortunately, many small businesses are closing permanently in the pandemic, unable to compete with well-capitalized larger companies that have adapted quickly to the pandemic environment and enhanced cost controls. In the full-service restaurant industry, for example, larger players could take up to 15% of the market share previously controlled by smaller chains.

We don't, however, count out the small companies, many of whom provide exceptional, local service with personality. Around the U.S. and overseas, there are grassroots efforts underway to keep small retail establishments, many of whom make up the fabric of local communities from going out of business. Fortunately, the new stimulus plan includes help for small businesses and closes some of the loopholes for larger companies (who didn't really need the help) that the Paycheck Protection Program provided.

SFG's Take: Parts of the U.S. stock market are closer to bubble territory, while others remain fairly valued or even undervalued. We expect overall U.S. equity returns to be relatively moderate in 2021, trailing an economic recovery that is already reflected in much of the U.S. stock market.

Meanwhile, we expect the rotation away from growth, large cap and domestic U.S. stocks toward value, small cap and international stocks to continue.

Key Points to Consider

- **Job updates:** The latest job gains of 49,000 were lower than expected, coming in at roughly half of consensus expectations. December's report was revised down, as the lower unemployment rate of 6.3% was due to **reduced labor participation**, rather than employment growth.

  There are numerous reports we're seeing on the impact of fewer women participating in the COVID-19 workforce, usually as a result of childcare issues. Older workers are also being displaced disproportionately.

  To learn more about the demographic forces changing labor participation, and why the participation rate may not rebound to late 1990s/early 2000 levels in the near future, click here: https://www.thebalance.com/labor-force-participation-rate-formula-and-examples-3305805

- **U.S. Fiscal Stimulus Update**: Congress voted to authorize a $1.9 trillion stimulus package that is protected from the filibuster in the U.S. Senate.

Here is the projected path of the legislation from one of our favorite research entities, Strategas:

Over the course of the next couple of weeks, Congress will need to fill in the components to this budget window with specific policies. Still, some spending provisions that are being proposed may not qualify for budget reconciliation.

Additionally, there is a growing belief that $1.9 trillion is too large relative to the current size of the output gap and that **more income replacement today will result in less infrastructure (dubbed "Build Back Better") spending later this year.** As such, the package may not reach the full $1.9 trillion, but we are raising our estimate to $1.5 trillion.

States are a big winner in the proposal's current form as they will get major relief for their lost revenues (income tax and sales tax in particular), making state tax rate hikes less likely in 2021.

Democrats would like to pass the stimulus bill by March 14, when the expanded unemployment benefits put in place as part of the December stimulus package expire.

Now that both chambers have passed the budget resolution, the committees in the House and Senate will work to put together the actual legislative language. The House will return the week of February 22 at which point a vote is expected. The Senate is expected to pursue a similar timeline, though Trump's impeachment trial this week could slow down the process.

The measure is now easier to pass in the House with a simple majority. The Senate measure will be more difficult because even one Senator – particularly a moderate like Joe Manchin, the Democrat senator from West Virginia – could change the outcome.

SFG in the News

- **Charitable Giving: Future Trends and Best Practices** – For those of you who enjoyed the SFG **Giving Done Right Live Chat** with Phil Buchanan, CEO of the Center for Effective Philanthropy and the author of the book by the same name, here is the link to Dennis Stearns' longer "deep dive" webinar for the Street.com/*Retirement Daily* that digs deeper into philanthropy trends for the next decade and how donors can be more intentional with their giving, now or at death: https://www.thestreet.com/retirement-daily/learning-center/ten-keys-to-more-effective-philanthropy
- **Good news for children affected by the pandemic** – Thanks to the participation of several SFG clients and team members, another $5,000 (for a total of $10,000 including SFG's contribution) was raised for the East Durham Children's Fund via an on-line auction of a fabulous post-pandemic celebration dinner hosted by famed restaurateur George Bakatsias.

  Thanks also to other SFG clients and friends of the firm around the country who are donating to similar programs in their own community.

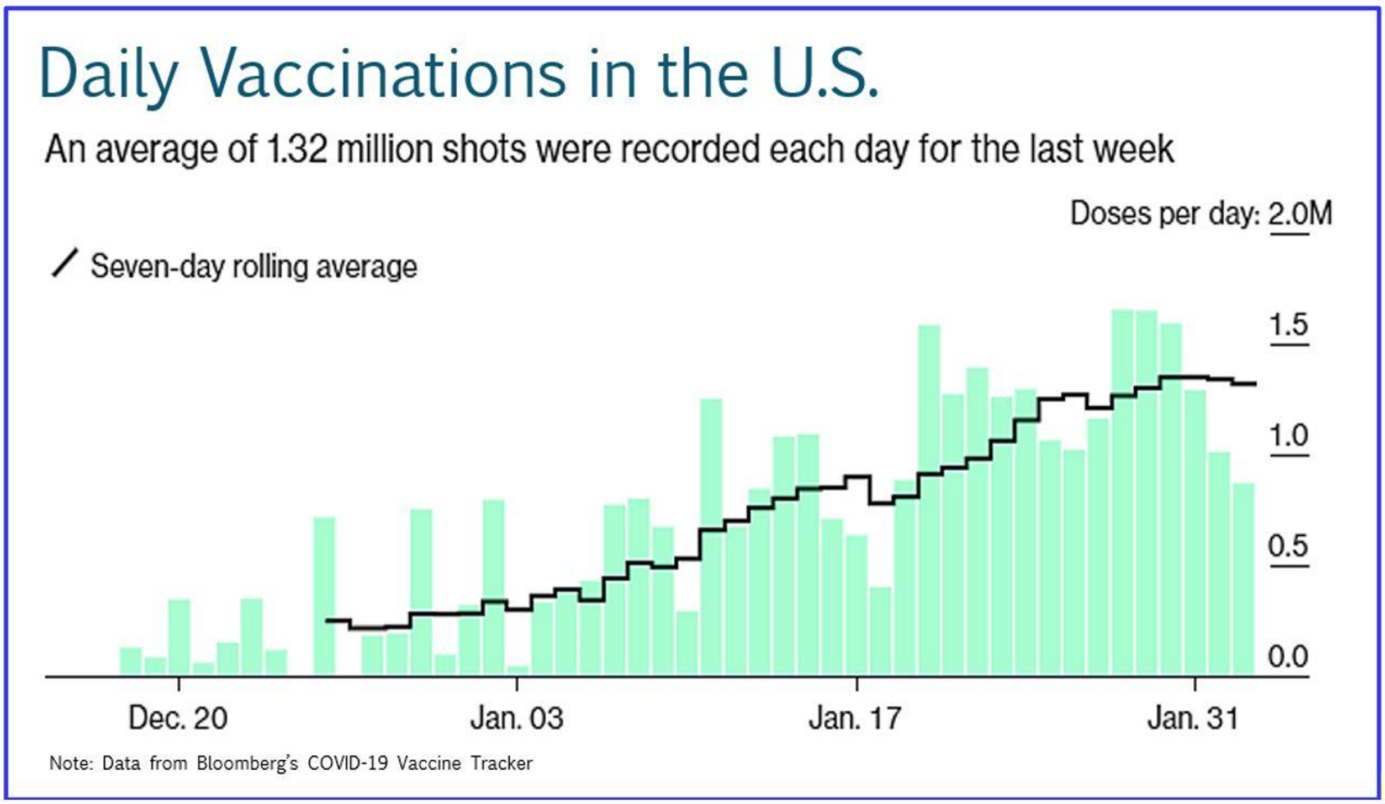
Frequently Asked Questions

Q: What are your research sources saying about the numerous mutation strains that are less affected by at least one of the vaccines being administered?

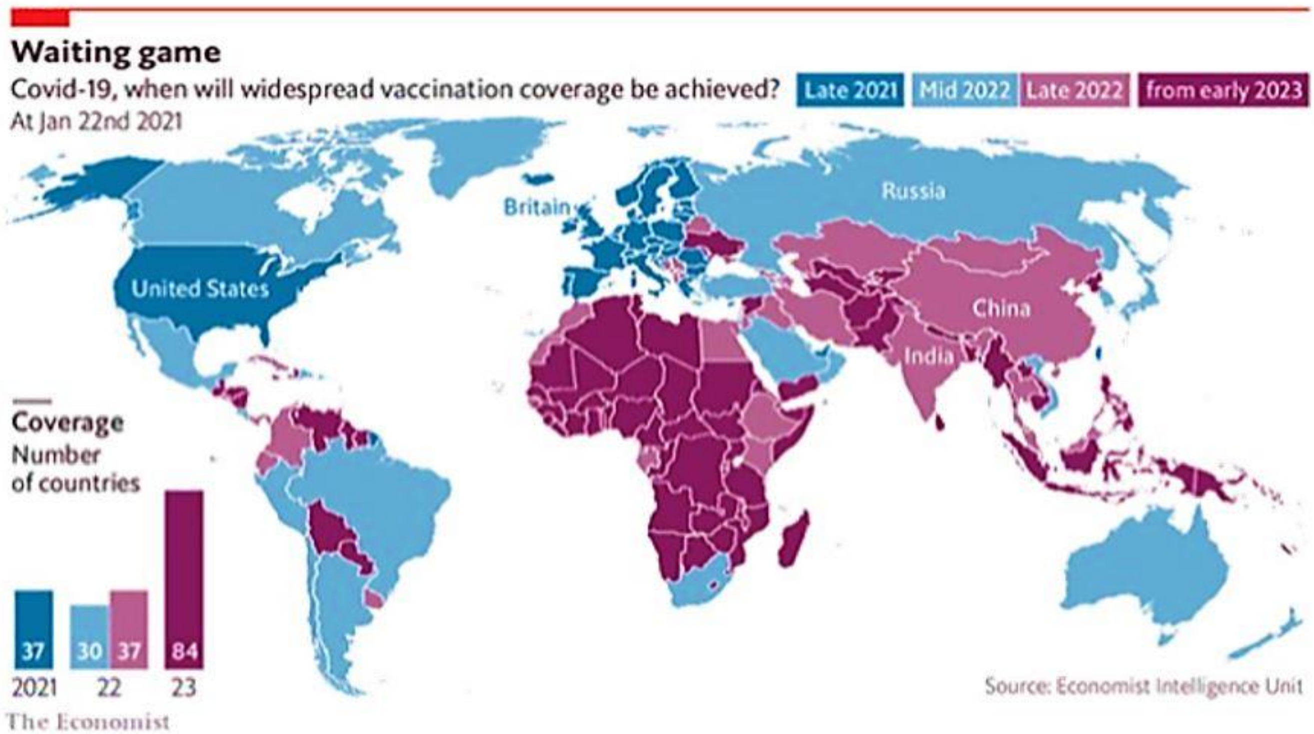
A: The U.S. reached a grim milestone in daily death counts, surpassing 5,000 deaths a day on February 4th despite improved therapies. U.S. Congressman Ron Wright was the first sitting member of Congress to die from COVID-19 – it should be noted he was also battling lung cancer.

However, there is good news. The seven-day rolling averages of new COVID-19 cases have fallen by 50% since January 12, while hospitalizations are below 90,000 for the first time since November.

These remarkable improvements may be the result of lower post-holiday get-togethers (this may be the primary driver in falling hospitalizations) and a more comprehensive federal plan to administer vaccines. News of a third vaccine by Johnson & Johnson, approved for distribution by mid-March should help improve these numbers further.

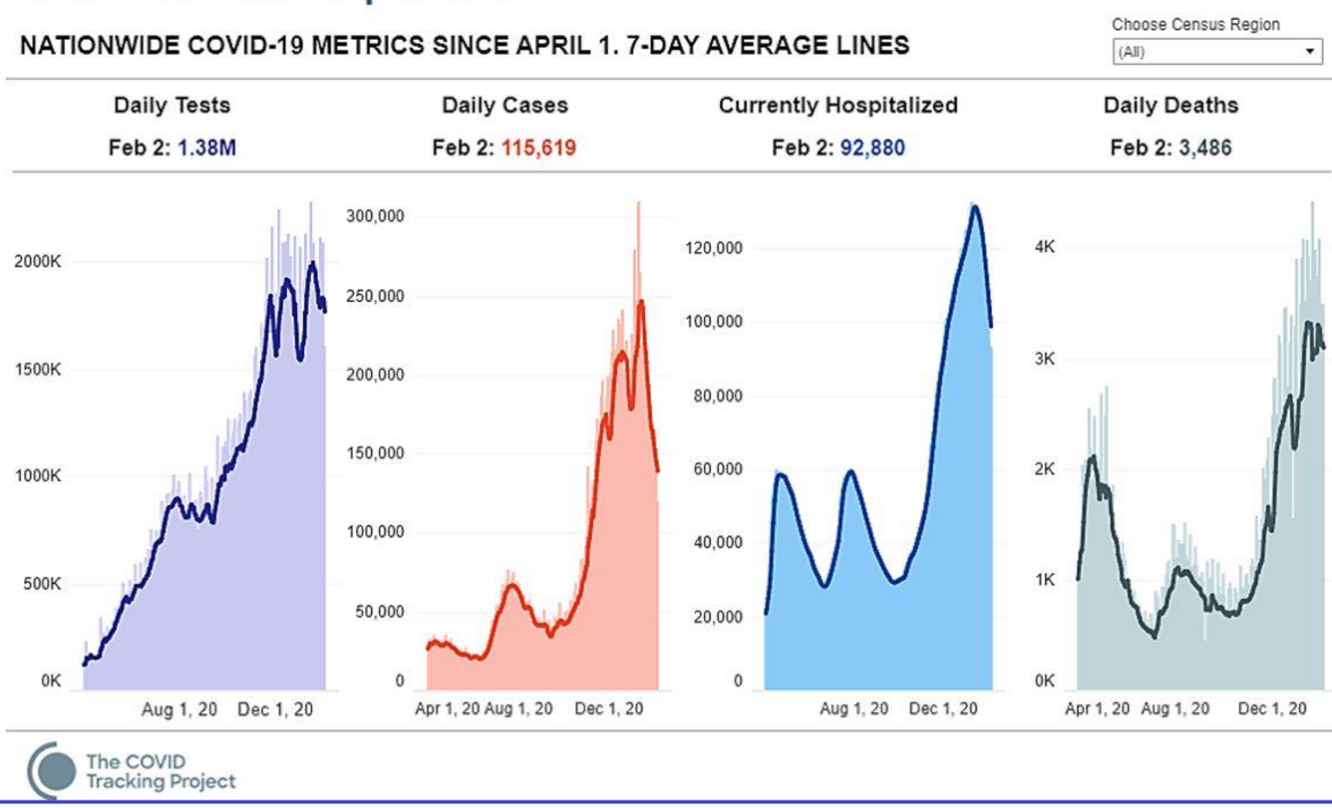


Global Vaccination Forecast



Daily chart

COVID-19 Update



Even non-vaccine developers are exploring ways to help with manufacturing. Merck & Co. is in talks with governments and health authorities about possibly producing already authorized COVID-19 shots, the *Wall Street Journal* reported. https://www.fiercepharma.com/pharma/merck-after-canning-covid-19-vaccine-programs-talks-to-help-shot-production

A wider distribution network which includes up to 40,000 pharmacies will be utilized for vaccine administration beginning in the coming week. The pharmacy footprint in the U.S. is within a five-mile radius of over 95% of the U.S. population. Around 15% of these pharmacies will begin receiving vaccines in the coming week, with full rollout occurring in March and April. https://www.npr.org/sections/coronavirus-live-updates/2021/02/02/963234468/biden-administration-will-ship-covid-19-vaccines-directly-to-pharmacies

These improvements bolster our confidence in a return to "normal" sooner rather than later. However, it's still a messy landscape.

Numerous virus mutations and the pre- and post-Super Bowl party in Tampa, where the South African virus mutation has gotten a toehold, could create more upward infection waves in Florida and other states when travelers return home. Most of the party goers were younger, which is part of the vaccination challenge – recent CDC and NIH studies confirm the ones who are spreading the virus the most are younger Americans – the ones who are at the back of the line to get vaccinations or who believe they are less likely to be severely affected by COVID-19.

It's good to note that drug and biotech entities you don't hear about as much in the news continue to advance their therapies. **The FDA approved Eli Lilly's combination antibody drug for emergency use, paving the way for a treatment option that may help combat COVID-19 mutations.**
https://www.wsj.com/articles/covid-19-antibody-drug-cocktail-from-eli-lilly-cleared-for-use-11612964599

In Europe, Pfizer's vaccine reduced symptomatic infection risk in U.K. patients by almost two-thirds.
https://clicktime.cloud.postoffice.net/clicktime.php?U=https%3A%2F%2Flink.mail.bloombergbusiness.com%2Fclick%2F22901107.121455%2FaHR0cHM6Ly93d3cuYmxvb21iZXJnLmNvbS9uZXdzL2FydGljbGVzLzIwMjEtMDItMTAvdS1rLXZhY2NpbmUtZHJpdmUtc2hvd3MtcGZpemVyLXNob3QtZ2l2ZXMtdHdvLXRoaXJkcy1wcm90ZWN0aW9uP2NtcGlkPUJCRDAyMTAyMV9PVVMmdXRtX21lZGl1bT1lbWFpbCZ1dG1fc291cmNlPW5ld3NsZXR0ZXImdXRtX3Rlcm09MjEwMjEwJnV0bV9jYW1wYWlnbj1vcGVuYW1lcmljYXM%2F5fed04aa2746f115cf390e74Bee34c029&E=dstearns%40stearnsfinancial.com&X=XID727ZBJmkk4708Xd2&T=HTAD&HV=U,E,X,T&H=67fcb278d60c3f2cf22bcdda20d86783d51730af

It's also interesting to note the work going on overseas in vaccines and therapies which could change the trajectory of the map. Virus updates:
https://clicktime.cloud.postoffice.net/clicktime.php?U=https%3A%2F%2Flink.mail.bloombergbusiness.com%2Fclick%2F22901107.121455%2FaHR0cHM6Ly93d3cuYmxvb21iZXJnLmNvbS9uZXdzL2FydGljbGVzLzIwMjEtMDItMDkvY2hpbmEtbGFiLW9yaWdpbi1kZW5pZWQtS1zLWhhcy12YWNjaW5lLXNrZXB0aWNzLXZpcnVzLXVwZGF0ZT9jbXBpZD1CQkQwMjEwMjFfT1VTJnV0bV9tZWRpdW09ZW1haWwmdXRtX3NvdXJjZT1uZXdzbGV0dGVyJnV0bV90ZXJtPTIxMDIxMCZ1dG1fY2FtcGFpZ249b3BlbmFtZXJpY2Fz%2F5fed04aa2746f115cf390e74B291662c9&E=dstearns

%40stearnsfinancial.com&X=XID727ZBJmkk4708Xd2&T=HTAD&HV=U,E,X,T&H=71fb3a0f3259a6ef36226addefa2984fce1ecfd4

The Gates Foundation contributed another $250 million in grants starting in December 2020 to help less developed countries. An excerpt from the Gates foundation newsletter:

"The world now has much of the science it needs to end this pandemic, and as regulators put their stamp of approval on it, the field of action is widening beyond the lab. It's expanding to the factories that will make the drugs, tests, and vaccines; to the warehouses, planes, and refrigerator trucks that will deliver them; to the clinics and health workers that will sit at the end of the supply chain and administer them to patients.

"The planet is about to be crisscrossed by a massive anti-covid manufacturing and delivery network. In some places, it's already up-and-running. The world's richest nations have pre-purchased enough vaccine supply to cover their populations; some will be able to cover everybody two or three times over.

"But the situation is very different for the majority of human beings that live in low- and middle-income nations, which include everywhere from South Sudan to Peru. In these countries, the supply chain hasn't started to hum. Few deals have been cut with pharmaceutical companies, and the forecasts for vaccine supply are low. As things stand now, these countries will only be able to cover 20% of their people at most, according to our foundation's projections."
https://ww2.gatesfoundation.org/ideas/articles/coronavirus-funding-additional-250-million-suzman

While this is concerning, leaving open the possibility of more and more variant strains, it really all boils down to whether the current vaccines can keep the virus under control, even as it mutates. On that front, Deutsche Bank strategist Robin Winkler thinks there's reason for optimism.

"There is no indication that protection against severe illness is compromised by any new strain, and this is what matters," he told clients this week, predicting that "hospitalizations and fatalities will thus drop sharply from late spring," allowing reopening to take hold in earnest.

Summary

SFG is balancing numerous opportunities and threats in our portfolios, customized to our clients' unique circumstances. We are being more cautious as parts of the U.S. stock market have exhibited irrational exuberance in response to positive developments in ongoing stimulus, corporate earnings and COVID-19 vaccines.

In **growth** portfolios, we are leaning into a variety of short- and intermediate-term asset classes and trends that we believe have favorable forward-looking risk/reward relationships.

In more conservative **growth and income** portfolios, we are taking more steps to be defensive, while still striving for positive real returns over inflation.

Our COVID-19 endgame investing approach can be summed up by six themes:

- Diversification with a balance of offensive and defensive measures, depending on the desired risk tolerance of our clients,

- Underweighting, or avoiding areas of higher future concern,
- A focus on higher-quality investment themes,
- Identifying and implementing buying opportunities that may be appropriate for more growth-oriented portfolios, and,
- A more defensive stance using different portfolio tools for more conservative growth and income portfolios,
- Utilizing select alternatives to traditional bonds and stocks.

~ Dax, Dennis, Glenn, Jason, John and PJ
(the SFG Investment Committee)

REMINDER THAT COVID-19 OFFICE HOURS ARE STILL IN EFFECT

Please keep in mind that we continue to maintain limited in-person service hours at our offices in Chapel Hill and Greensboro, NC until we can all return to the office full-time.
If you have a need to meet with us in person or to pick up or drop off documents, we are glad to accommodate you. We also have a number of traditional and technology-enabled tools to facilitate paper transfers. Please contact us in advance to confirm availability.

FT FINANCIAL TIMES | Top Financial Advisers 2020 | ria FUTURE 50 2019