AMERICA REOPENS

SUMMER NEWSLETTER

JULY 2021

It's hard to believe that this year 2021 is already halfway complete.

The reopening of America has been the theme since January. It's happening. After a year of lockdowns, America is back open again. The process of reopening the nation took a big step forward in June. Economic activity will explode this Summer. It already has. The US Economy is expected to grow at the fastest clip in decades. Pent-up demand is driving it. The Market certainly likes it.

The Stock Market closed at all-time highs, as the month, the Quarter and the first half of 2021 came to an end. The S&P, up 14% in H1, completed its 5th straight monthly gain with a 5-day win streak, the longest since March. **What a difference from the first half of 2020.** Tech led the month of June, boosted by lower rates. The Tech-heavy NASDAQ banked its seventh positive month in the last eight; The Dow finished in the red for June. It broke a four-month win streak. **The first half can be summed up by strong growth, strong earnings, low interest rates,** and a Bond Market that's been lulled to sleep.

The vaccine has been the key to recovery. **Science and innovation made it happen.** Vaccination rates vary across the country and around the world. This factor keeps our focus on the US Market rather than overseas. America is growing faster than the rest of the world. There will be a catch-up play for international markets, perhaps later in the year or into 2022. That is, unless the accelerating Delta variant causes more trouble. That's a big risk. Our investment strategy for the second half resides primarily in American ingenuity on American soil.

The reopening of America is bringing serious demand for activities and services after the extended lockdown. **Americans seem to have an insatiable appetite for stuff this Summer.** It has put pressure on supply chains. Many manufacturers were forced to shut down facilities in 2020 and were not prepared for reopening so fast. Supplies of food and paper products, even used cars, were limited as demand spiked. Once supply chain disruptions can be resolved, the effects of massive amounts of stimulus fade, and workers return to the workplace, things should normalize. The hybrid model for Corporate America will be rolled out in size in the Fall and become the new normal for the workplace.

Americans are hitting the friendly skies again. The volume is back to pre-Covid levels. TSA recorded 2 Million passengers per day for the first time since the pandemic. Airline traffic swelled in June, ahead of the popular 4th of July holiday weekend. It's still not where it was at those record levels in the Summer of 2019, but it sure is moving in that direction. Road trips are increasingly popular for getaways. Flights are expensive. Jet fuel demand is roughly 75% of what it was 2 Summers ago. But gasoline demand is almost back to where it was, at 94% of June 2019.

STILL ALL ABOUT THE FED

There is no change in monetary policy for the central bank. The Fed kept the overnight rate near zero at its June meeting and still plans its existing $120 Billion in monthly asset purchases. But it did say they're ready to start talking about thinking about tapering its Quantitative Easing. What has changed is seemingly Fed confidence in the sustainability of the recovery. Expectations of a more hawkish approach toward monetary policy seem to be the key concern. The Federal Reserve recognizes it might have to raise rates earlier than expected to deal with a possible inflationary threat. Asset prices have contracted in response, after some serious inflating earlier in 2021.

Keep in mind, these inflationary numbers are compared to the washed-out levels from a year ago. When you compare to 2 years ago, Consumer Prices increased 2.5%. That's just above the Fed's targeted level, one that they are prepared to run hot. Gas prices are only up 7 cents when you compare to 2019. It's all a matter of context.

Price discovery has been distorted. The Fed and other central banks firmly have their feet on the front end of the curve, keeping it near zero. **The price of money is cheap, really cheap, which has bid up asset prices big time.** It's happened in the Stock Market. It's happened in housing. With a yield of less than 1.5% for 10-Year Treasuries, it's clear why money keeps flowing into Equities. Foreign investors have rushed into Treasuries on the back of a weaker Dollar. As low as interest rates are in America, they're even lower overseas. Cheap money has been chasing assets and inflating prices all year.

But here's the deal: The Fed has made it clear, time and time again, they are focused on outcomes, not outlooks. The Fed accomplished so much without doing a thing. The Spring stock sell-off and commodity price collapse from way overheated levels was incredibly healthy. The price of food went on sale. Housing prices seem to be cooling. **The Fed effectively talked things down. It must be very pleased to see the froth taken out.** The Bond Market seems to be in agreement with the Fed, that these inflationary pressures are not sustainable or long-lasting.

RISING PRICES

The process of recovery is inherently inflationary. **Asset prices moved first. Companies are now facing higher costs.** They see it in commodities, labor and distribution. **We consumers are picking up the tab.** Companies are passing it on to customers. Retailers have already raised prices. Hotel rooms have gotten more expensive. Rental cars have too. Restaurants are charging more for the menu. Is it transitory or sustainable? We think transitory. The reopening only happens once.

Inflationary pressures are being absorbed quite well now as the Market appears to be looking past the present and doesn't seem to fear what it sees later in the year. There was also a big rally in the Bond Market. Interest rates fell. That was new. **Inflation worries may have peaked.** It just may prove to be transitory, just as the Fed said. We won't know for a few months at the earliest, but the Market seems to agree with the Fed. It's taking it all very much in stride. The thing is, the Market rarely sells-off on the same news, especially when the news is well anticipated.

Stocks aren't cheap. But they're not nearly as expensive as they were at the end of 2020 either. **Earnings have grown swiftly while price action has been volatile. That trend is expected to continue.** There has been quite a bit of corrective price action below the surface over the last couple of months. There was a Tech wreck in the Spring. The Market has been recalibrating the expected surge in growth from recovery while factoring in the pricing pressures of inflation. Leadership continues to rotate at a fast pace.

BROAD-BASED RALLY, ROTATION AND TANGO

What's been healthy is the Stock Market has broadened its rally in 2021. That has allowed the **economically cyclical stocks to play catch-up and lead while Tech and Growth took a breather** and corrected. Industrials, Materials and Heavy Equipment companies saw their stocks rally. It's been a while since that happened. Leadership has rotated throughout the first half of the year. It happened again. June brought back a revitalized Tech and the Growth trade took off. This rotation has allowed the Stock Market to propel to new highs while speculative excesses below the surface were addressed.

Tech and the 10-Year Treasury yield have been doing a dance since Spring. It's like the **tango. They've been going in opposite directions.** One moves higher, the other moves lower. Higher yields choked off Growth and triggered that Tech wreck. But yields have fallen of late, sending Tech stocks higher into Summer.

INFRASTRUCTURE & TAXES

Americans want better infrastructure. It's old and it's crumbling. It's a politically popular topic. But cutting a deal in Congress is never easy. **A bipartisan infrastructure agreement is still getting hammered out in Washington.** There is a very narrow legislative path. Politicians keep politicking, but a deal appears to stand some chance of becoming a reality, at least as I type. **A large infrastructure program could serve the country near and longer-term. It would create jobs and boost economic growth.** It would also trigger corporate revenue and earnings growth. A modern infrastructure plan would also enhance US ability to compete with other nations in the still relatively new but hypercompetitive 21st Century.

Industrial and Material stocks rallied early on with the prospects of an infrastructure deal. They sold-off in June. **It's not just the Republicans and Democrats divided. The Democrats are facing a serious internal divide.** Progressive House Democrats have warned that they won't push for the bipartisan bill without a commitment to additional spending for a separate, larger bill that includes other priorities to be passed through reconciliation. A bipartisan bill would have no new taxes. The tax threat over a reconciliation bill seems to have shrunk given the uncertainty of path ahead. **The President needs to get both factions on board, otherwise the whole thing could come undone.** The Market seems more than ok with this now. Infrastructure is going to be an issue all Summer.

Higher taxes are a big sticking point around the country. They always have been. **Plans to raise taxes on income, capital gains and carried interest, as well as eliminating the stepped-up basis upon death and limits on 1031 exchanges, are circling the 50 states.** Taxes are always a major political issue. People have been fleeing high tax states like California, New York and New Jersey at a very fast clip. They've been landing in Florida, Utah, Texas and Tennessee. There is talk in Washington circles that the important SALT (State and Local Tax) deduction cap will not go away but might be raised from $10K to $50K. The high tax states are Blue. Democrats are having trouble with this issue within their own party. The highest taxes are in the bluest states.

SUPPLY CHAINS

One of the many victims of Covid was US supply chains. **America found itself completely dependent on foreign sources for goods.** Food supplies were strained with lockdowns from coast-to-coast. Semiconductors became a rare and prized commodity. It continued with other unexpected forces. Plagued by the Covid pandemic, as well as the Suez Canal blockade in the Spring, **the shipping industry has been strained.** The peak shipping season is just around the corner, with retailers stocking up for back to school followed by the biggest shopping season of the year; The Holidays. Ships from Asia have been taking 2 weeks to unload. Trains and Trucks have even accelerated peak season surcharges by months.

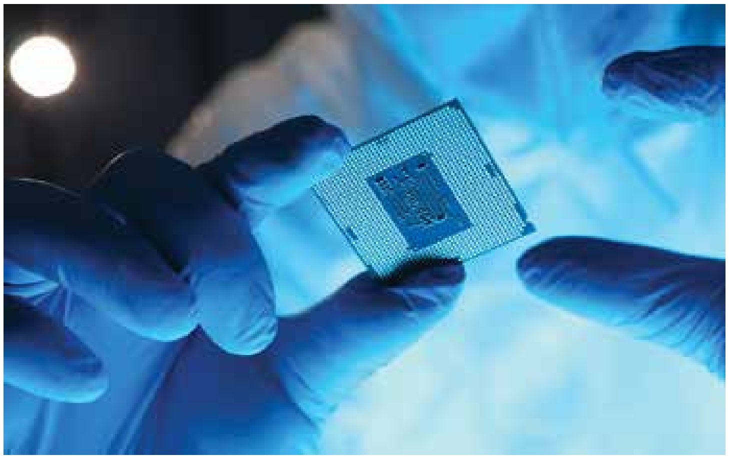
The White House is actively reviewing supply chains for critical sectors, including transportation, addressing the current state of our nation's ports and freight movement needs to be a critical component of the strategy. As trade continues to grow, **we need to make sure we have truly 21st-century ports and freight movement.** It's the most basic of supply/demand relationships. Shrinking supplies with increasing demand shocked the system. The supply chain strain means higher prices. We need a modern supply chain.

INVESTMENT THEMES

Innovation is a key investment theme for us. It always has and always will. **We took advantage of the Tech sell-off by accumulating investments in disruptive, fast-growing industries which had their stocks on sale.** We find compelling opportunities in digital payments and the digitization of the real estate industry. There are gross inefficiencies here, buried in paper and unnecessary human interactions, which can lead to increased errors. **We invested in electronic documents, believing that the pandemic accelerated a trend that was already in place.** Increased efficiencies in real estate and payments continue to be rolled out. Paper forms, documents and contracts are going away fast, being replaced with digital solutions which are more efficient, more accurate and more accessible.

A gene editor was used in a clinical trial, successfully and safely, to treat a rare disease. It was based on cutting-edge **CRISPR** technology. CRISPR stands for Clustered Regularly Interspaced Short Palindromic Repeats. The allure and the promise of CRISPR is this notion that you can change any gene, anyhow, anywhere in the genome, so long as you can get it there. **Gene sequencing has opened up new therapies. CRISPR, monoclonal antibodies, mRNA;** It's revolutionary. We're invested there.

We also added chips, the silicon kind. Whatever device you're reading this on, it's powered by semiconductors. Chances are, semiconductors drive your TV and refrigerator too. They're everywhere and inside nearly every electronic device. **Semiconductors are embedded in a vast number of products these days. They're often described as the brains of electronic devices.**



Semiconductors enable technologies critical to economic growth, national security, and global competitiveness. Semiconductors have been far-reaching in developing innovative products and industries as the Digital Age evolves. **They have driven advances in Communications, Health Care, the Military, Transportation, Energy, and countless other industries and applications.** You name it, chances are they're in it. Semiconductors are foundational for the expansion of the Internet of Things, machine learning and AI; And there is a major shortage right now. We're definitely invested there.

Besides the innovators, we also like the old reliables. Mature companies that have a predictable revenue stream and maintain profitability to pay out safe dividends. We call them **Boring Blue Chips.** They manufacture. They deliver. They play a role in our portfolios, particularly when the Bond Market provides so little in the form of yield.

MARKET OUTLOOK FOR H2

With the Stock Market consistently hitting new, all-time highs, **it's easy for investors to get greedy.** The data bears that out. The number of Bulls approached 60% as the first half of the year came to a close. That's a level that suggests some inherent complacency. It's a contrarian indicator we pay attention to. It's not very helpful in timing, because **overbought situations last far longer than oversold. Making money often masks underlying issues.** Conversely, the number of Bears shrunk to just 15%, the lowest since the beginning of 2018, an important Market top. The path of least resistance is undeniably higher for stocks. It's just one of those things that we pay attention to, and firmly understand that the Stock Market does not go up forever.

2021 brought one of the best first 6 months ever for the Stock Market. The S&P begins July at fresh all-time highs. It was the second-best half-year start since the Dot-com days. Now that's saying something. So much has been paid forward. It might get better.

Historically, a strong first half has led to a strong second half. Going back 5 decades, the S&P has had a double-digit gain 14 other times for the first half of the year. It has gone on to average a 6.3% gain over the second half of the year. The S&P finished the second half higher in 11 of those instances, or nearly 80% of the time.

Even when losses occurred, they were fairly contained. The S&P fell 1.9% in the second half of 1983 and 3.5% during the last six months of 1986. The big outlier was 1987. The S&P fell 19% in the second half of 1987, which included Black Monday, when the index sank over 20% in a single day. That was a record loss. The S&P still ended up 2% for the year in '87. Black Monday was an anomaly for the Stock Market, but it happened. We're also still very mindful of the Covid crash last year. We'll never forget. Expect a bumpy ride ahead, but history suggests upward.

We like the prospects ahead for H2 2021. It's going to be eventful. And we are confident that it will come with plenty of volatility. Navigating the Market is never easy. Summer Seasonality often brings a choppy ride for investors into Fall. For that, we are always ready.

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