Doug, Ralph, Chris, Michelle, Andrea

Portfolio Talk — Market Update 3/19/2021

It's been another week of volatility as we watched the 10 & 30-year US Treasury rate climb to 1.75% & 2.45% respectively, doubling their rates in less than five months. The 2-10 yield spread (10-year treasury minus the 2-year) is greater than 1.5%, back to where it was pre-pandemic. While this is still at historic lows, the pain is felt most by the higher growth companies. The question is, should the pain be as great as it is or have the markets over-reacted to the move in rates? I wish I knew, but I can offer you this, according to Chairman Powell (Chairman of the Federal Reserve) in his testimony on Wednesday, rates are to stay low for the foreseeable future. He went on to say that until the Fed sees actual economic growth and inflation above their target, the Fed will not move to hike rates and/or stop their monthly $120 billion bond buying program. He emphasized the word actual verses forecasted growth and inflation. This is what has me scratching my head. If we are clawing our way back to normal and growth is accelerating, but not expected to be back to pre-pandemic levels until the latter half of 2021 or first half of 2022, why should interest rates move up so quickly? I believe it's the same reason GameStop moves between $5 a share to $480, or Bitcoin, or digital art (NFT's), or Tulip Mania in the 16th century, it's speculation. The gamble is to be the first one to call the move and hopefully gain an advantage…. notoriety, fame and fortune at the risk of losing for those who have entrusted their financial future too.

The "them" manage risk in different ways. Some are the Vegas type (GameStop) while the majority, I believe, are those willing to risk a portion of the portfolio entrusted to them to try and gain a little more alpha, or excess return against their relative benchmark (i.e., S&P 500). While I do believe we have the potential for accelerating inflation, the evidence is not so clear cut. The most common examples used in siting the causes for increased inflation are rising national debt, decreasing value of our currency, rising costs of healthcare and higher education, cost of energy, and supply chain dependency from foreign sources given our just-in-time-inventory management systems businesses have adopted to gain efficiencies (more difficult to control costs and supply, something we've seen currently with chips). These are valid causes, but we need to look under the hood to determine their true potential. The best example of these concerns not baring out have been seen in Japan starting in the early 1980's to current day. As you can see in Chart 1 – Japan's Debt/GDP, Japan has increased their national debt to GDP from approximately 50% to 236% over the past 36 years. Yet they have actually been fighting deflation for nearly 30 years (Chart 2 – Japan's Inflation/Deflation)! How is it that their national debt rose, costs of social programs increased, their reliance of foreign resources remain high, and yet their government is finding it hard to fight deflation even while pumping in yen to support their banking

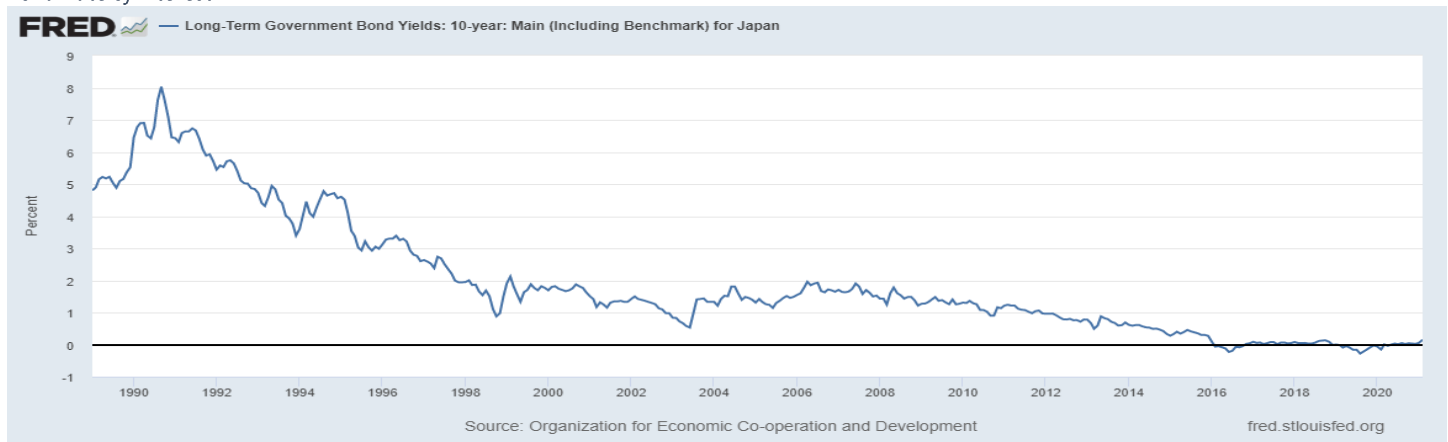
system and have bond and equity purchase programs in place to support the markets and the economy. Sounds a little familiar, right? Almost, but there are differences between “them and us”.

Chart 1- Japan’s Debt/GDP

Chart 2- Japan’s Inflation/Deflation

Chart 3- Japan's 10-Year Bond Rate of Interest

Bond Rate of Interest



To start with, Japan has an aging population. 29.18% of individuals in their country are age of 65 and older verses 21.96% are those 25 and younger. That will strain all social programs such as healthcare and retirement benefits going forward, more receiving benefits than those paying in! Japan is also a homogeneous society, meaning the only way to become a citizen is if you come from a Japanese bloodline. Since the younger generation has better birth control options, many are choosing to start their families later or not at all. For these reasons, Japan’s population growth has slipped, decreasing .2% in 2019, a downward trend that continues. And finally, their reliance on foreign resources is plentiful. They have very few natural resources such as oil, minerals, and land to expand on for manufacturing facilities. While they’ve bought excess capacity in countries where they sell product, their ability to control their own destiny has diminished. Now comes the real head scratcher, why over the past 4 decades would the yen go from 300 yen to a dollar to 80 yen and is now trading at 109? Also, if all of

these inflation causing issues were of concern, why is their 10-year Bond trading at .109%, well below our 1.716% today (see Chart 3- Japan's 10-Year Bond Rate of Interest)? Could it be that the rest of the world caught up with Japan's once seen as "more efficient" advantage? Or could it be the fear that an aging population will have less product demand and thereby more reliance on foreign support? I'm not sure, but I believe it's part and parcel to all of these thoughts and I'm sure few more.

Now, how do we differ from Japan? Here are a few differences. First, we are not a homogeneous society and by virtue of this we are one of the few developed nations that actually has a positive population growth rate, .5% in 2019. We are also a nation that is energy independent, we have natural resources that allow us to import less and have less reliance on foreigners. And finally, we still are the world reserve currency meaning our dollar is considered the most stable.

So, for those that see interest rates climbing because of issues we're facing, I wouldn't be so quick to place a bet on that horse. While we may have fits and starts going forward with rising and falling rates, using strategic income vehicles, and staying relatively short term in duration on fixed income is probably the best option. That means, in our estimation, the larger high growth companies are still attractive, especially if they pullback on multiple contraction. However, using the barbell approach, having both large cap growth alongside large cap value may help stabilize the volatility going forward.

Economic News

- Monday:
  - Empire State Index for Mar., 17.4 vs. 15.0 expected and 12.1 previously…good.
- Tuesday:
  - Retail Sales for Feb., -3.0% vs. -0.4% expected and 7.6% previously…weather related.
  - Retail Sales ex-autos for Feb., -2.7% vs. -0.1% expected and 8.3% previously…weather related.
  - Import Price Index for Feb., 1.3% vs. 1.0% expected and 1.4% previously…lower inflation.
  - Industrial Production for Feb., -2.2% vs 0.3% expected and 1.1% previously…maybe weather?
  - Capacity Utilization for Feb., 73.8% vs. 75.6% expected and 75.5% previously…slowing.
  - National Assoc. of Homebuilders Index for Mar., 82 vs. 83 expected and 84 previously…holding.
  - Business Inventories for Jan., 0.3% vs. 0.3% expected and 0.8% previously…good.
- Wednesday:
  - Building Permits (SAAR) for Feb., 1.68 million vs. 1.75 million expected and 1.89 million previously…slowing, weather or mortgage rates going higher…. we'll be watching.
  - Housing Starts (SAAR) for Feb., 1.42 million vs. 1.58 million expected and 1.58 million previously…slowed, same as above.
- Thursday:
  - Initial Jobless Claims 9state, SA) for Mar. 13th, 770,000 vs 700,000 expected and 725,000 previously…increasing!
  - Continuing Jobless Claims (state, SA) for Mar. 6th, 4.12 million vs. 4.14 million previously…holding.
  - Philadelphia Fed Manufacturing Survey for Mar., 51.8 vs. 22.0 expected and 23.1 previously…outstanding!
  - Index of Leading Economic Indicators for Feb., 0.2% vs. 0.3% expected and 0.5% previously…continued growth and no signs of a recession!
- Friday:
  - None Scheduled

The weather throughout most of the US had an effect on retail and housing in February and early March. Manufacturing continues to have quite impressive results leading us to believe that the world economy could have hit bottom and is improving. Asia appears to have been the first to show signs of growth, followed by the US and the lagger Europe. Over 100 million Americans have received at least one dose of a vaccine and with more than 2 million per day (and growing) getting vaccinated, we're headed toward getting to herd immunity by

the end of May! Amazing!! Now let's hope we avoid the potential knew variants that could cause a wrinkle in our progress.

FedEx and Commercial Medals reported this week, and both did extremely well beating on both top and bottom lines. FedEx benefited from continued online shopping while Commercial Medals reaped the benefits of worldwide infrastructure spending and accelerating commercial building (multi-family and commercial buildings). Earnings season is pretty much done now, and the beginning of the next reporting season will begin in about three weeks. We'll be watching!

Stay Safe!!!!!

Douglas E. Wells
Managing Director
Chief Investment Officer
(330) 752-4843

Ralph E. Trecaso
Managing Director
Family Wealth Advisor
(330) 752-6093

Christopher C. Walters
Managing Director
Portfolio Manager
(330) 242-0580

Michelle L. Weaver
Client Service Director
(330) 752-8825

Andrea B. Otte
Client Service Director
(330) 752-190

IMPORTANT DISCLOSURES

The information set forth was obtained from sources believed to be reliable, but we do not guarantee its accuracy or completeness. The views expressed herein are those of the author. All opinions are subject to change without notice. This information has been prepared solely for informational purposes only and is not an offer or a solicitation of any offer to buy or sell any security or other financial instrument, or to participate in any trading strategy. Past performance of any security is not a guarantee of future performance Securities offered through Cabot Lodge Securities, LLC [CLS] Member FINRA / SIPC. 200 Vesey Street, 24th Floor, New York, NY 10281, 888.992.2268. Advisory services through Wells Trecaso Financial Group, LLC. Wells Trecaso Financial Group, LLC is not controlled by or a subsidiary of CLS. An investment in any security may involve risk and the potential loss of your initial investment. Investors should review all "Risk Factors" before investing. Investors should perform their own due diligence before considering any investment. Wells Trecaso Financial group, LLC and Cabot Lodge Securities, LLC does not provide tax advice. Any discussion of taxes herein is for informational purposes. Past performance is not indicative of future results. Investment products, Insurance and Annuity products are not FDIC Insured/Not Bank Guaranteed/Not Insured by a Federal Government Agency/May Lose Value.