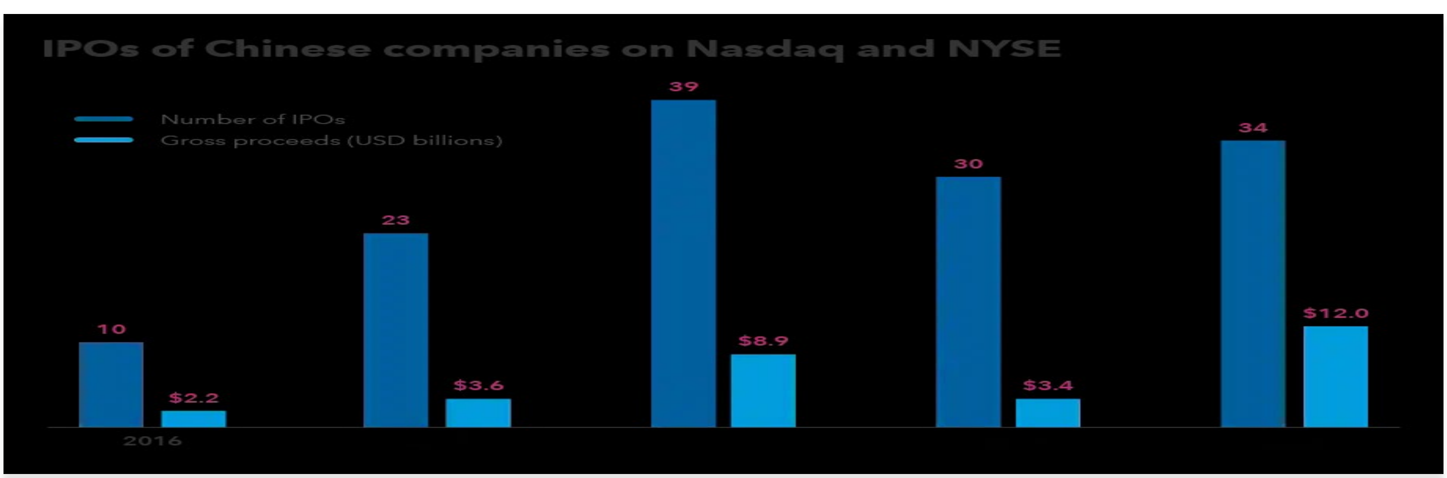
WELLS TRECASO
FINANCIAL GROUP

Doug, Ralph, Chris, Michelle, Andrea

Portfolio Talk **Market Update 4/02/2021**

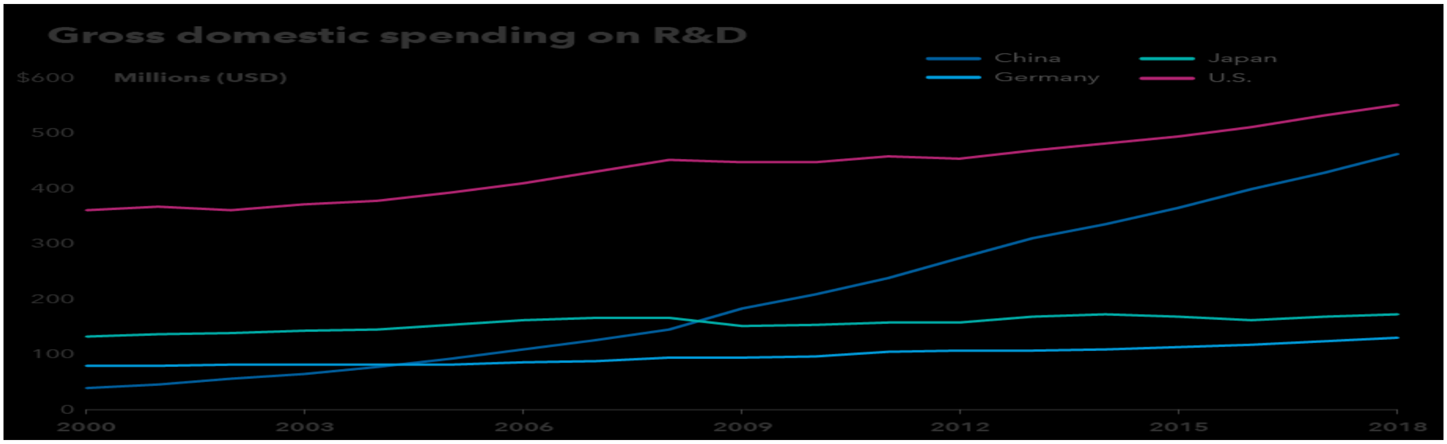
As the Biden administration begins trade policy negotiations with China, what will the relationship look like? Will it be “Déjà vu all over again” as Yogi Berra would say? Or will we take a tougher stance to try and protect our corporate intellectual property, fair and equal pricing policies, as well as allowing companies to establish facilities in China without having to have a 50/50 joint venture. The biggest problem with not dealing tough with China now is that the stronger they get economically, the harder it will be to have an economic impact on them to deter bad trade behavior! We know their plan is to be the world’s dominate economic power starting as soon as 2025. They have not been shy in delivering this message. The investments they’ve made have also indicated this path of dominance. Take for example the amount of Initial Public Offerings (IPO’s) they’ve brought to the US markets. As you can see on Table 1 below, even with the pandemic, China issued 34 deals worth $12 billion last year. Even though they peaked in 2018, momentum seems to be building. These are funds that help them strengthen their position in the industries they are focused on, building an ever-increasing base of dependency. Additionally, given their government subsidizes their country’s businesses, they have the ability to undercut our businesses pricing potentially eliminating the competition. None of these actions are good!

Table 1 - IPO's



Taking it a step further, not only are the funds created by the IPO's used for facilities, they are also used in research and development (R&D), the foundation for future growth (see Table 2). Of the developed nations they have been the leader in R&D investment since 2000 as a percent of GDP. The China we once thought of as a country that could mimic creating cheap products is now emerging as a leader in areas such as telecommunications, semi-conducters, robotics, etc.

Table 2 - R&D Spending



So, why should we be concerned about China becoming the economic powerhouse? Simply put, they are a communist nation, controlled by individuals that use a heavy hand to intimidate their citizens and create fear. What happens if they are the economic leader in the world? Would they cut off the supply chain to other countries if they didn't like the direction they were taking either politically or socially? Some think that's already happening with semiconductor chips and rare earth minerals (materials needed to make long lasting batteries)! What's to stop China from holding other countries hostage, demanding ransom to get what they want? The olive branches they've offered in the past, when disruptions occurred, have always felt insincere and much like a head fake to slow down any impediments that would slow their economy. We still have a sizable lead against the #2 economy, $20 trillion plus vs. $13 trillion plus. That lead is shrinking and if China continues to average 6% plus Gross Domestic Product (GDP) growth against our 2-3% plus, they have a shot at surpassing us sometime in the near future. The policies we, along with our allies, implement will determine exactly what that timeline looks like. I emphasize "with our allies" because standing alone we can slow China, but getting the European Union along with the USMCA (United States, Mexico and Canada), India, Australia and Southeast Asia on board could send a message that would be so punitive that China would have to fall in line. Let's hope this is the eventuality and not the other!!

Economic News

- Monday:
  - None released
- Tuesday:
  - Case-Shiller Nat'l Home Price Index (YOY) for Jan., 11.2% vs. 10.4% previously…supply shortage.
  - Consumer Confidence Index for Mar., 109.7 vs. 96.8 expected and 90.4 previously…great.
- Wednesday:
  - ADP Employment Report for Mar., 517,000 vs. 525,000 expected and 117,000 previously…flat.
  - Chicago PMI for Mar., 66.3 vs. 60.3 expected and 59.5 previously…excellent!
  - Pending Home Sales for Feb.,-10.6% vs. -3.1% expected and -2.8% previously…supply shortage.
- Thursday:
  - Initial Jobless Claims (state, SA) for Mar. 27th, 719,000 vs. 675,000 expected and 684,000 previously…still slowing
  - Continuing Jobless Claims (state, SA) for Mar. 20th, 3.79 million vs. 3.87 million previously…flat.
  - Markit Manufacturing PMI (final) for Mar., 59.1 vs. 59.2 expected and 59.0 previously…good.
  - ISM Manufacturing Index for Mar., 64.7% vs. 61.7% expected and 60.6% previously…very good!

    - Construction Spending for Feb., -0.80% vs. -1.0% expected and 1.7% previously…holding, weather related.
    - Motor Vehicle Sales (SAAR) for Mar., 16.4 million vs. 15.7 million previously…very good!
- Friday: ***Market and WTFG Closed***
    - Nonfarm Payrolls for Mar., vs. 675,000 expected and 379,000 previously…
    - Unemployment Rate for Mar., vs. 6.0% expected and 6.2% previously…
    - Average Hourly Earnings for Mar., vs. 0.1% expected and 0.2% previously…

The number of individuals re-entering the workforce is accelerating! This is very good for the economy but could cause inflation to accelerate. Approximately 60% of inflation is wage based, wages along with benefits. As the labor market tightens, we could see wages creep up, a good dynamic, but could cause the markets some indigestion. We've already seen commodity prices advance due to supply chain shortages. If wages add to this acceleration the Fed may have to start tightening credit by raising short term interest rates and exit their bond purchasing program. These are "what if" scenarios, but this could be the inflection point for interest rates to normalize. If this does happen, bond durations should be kept as short as possible and the long end of the maturity range could see a bear market that would be hard to recover from.

A major development that actually surfaced last Friday was Archegos Capital getting margin calls that created a forced liquidation of the firm. It's always a slap in the face when a firm such as Archegos operates outside the guardrails of the regulations. Archegos is/was what's known as a "Family Office". This means that they did not manage money for the public and therefore were exempt from many of the filing requirements of the regulatory agencies, i.e., Securities and Exchange Commission and the like. The founder, Bill Hwang, made a name for himself when working for Julian Robertson of Tiger Capital in the late '90's and early 2000's. He left Tiger under the dark cloud of insider trading. Archegos was built on leveraging highly volatile stocks. That leverage was as high as 20:1 on some positions meaning a 5% slippage in the position wipes out the entire equity. It was a ticking time bomb that was destined to vaporize. What's concerning is the lack of scrutiny the banks had in looking into the trades conducted by Archegos and the number of lending facilities involved. Does it feel like 2007 again when the banks did robo-mortgages with very little oversight, knowing they were going to package up the mortgages and sell them in the marketplace? On the surface it does not appear to be the case. I'm sure there are probably some more land mines out there, but I do believe the banks are in much better shape than they were then. However, a discerning eye on these types of issues need to be on the radar screen!

Fears of another surge has the CDC issuing warnings about staying vigilant on masking, washing hands and social distancing. Thirty-three states have reported an increase in COVID-19 cases this past week, up from thirty last week. Positive cases are running at 61,000/day, up 5,000 cases/day from the week before. This while we're vaccinating 3,000,000 individuals/day! It appears to be a race, COVID-19 verses Vaccinations! The finish line….Herd Immunity.

Earnings season will start gearing up beginning next week. Comparisons are going to be very good given we are now comparing earnings against those when the economy was partially shutting down. I would expect some rather huge surprises.

Happy Easter and Stay Safe, we are getting close to the end of the pandemic, God willing.

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