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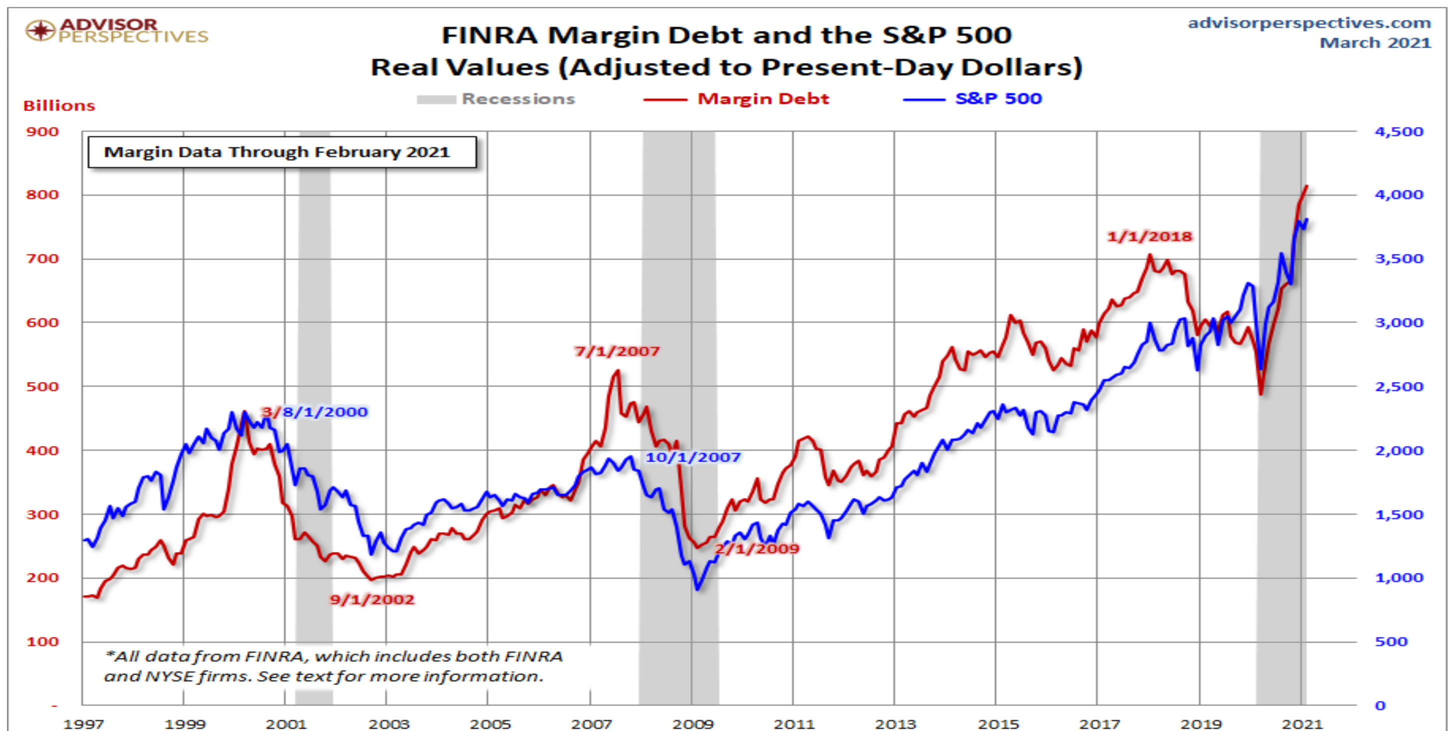
Portfolio Talk **Market Update 4/09/2021**

The large cap names we've come to love made an impressive come back this week. Companies such as Apple, Google and Microsoft were some of the best performers in the S&P 500. Why? I believe the reopening trade has lost a little of its mojo and fundamentals are back in vogue. Take for example, names and sectors like Snowflake, Zoom, airlines, cruise lines and hotels have either given back some of their gains or have gone sideways. There's some truth in the fact that many of the reopen trade companies are trading near pre-pandemic highs, but their capital structure is totally different. Airlines, for example, have issued new shares in the market (dilutive) and piled on debt to survive as they burned through their cash. TSA announced last week that the average number of passengers boarding flights came in at approximately 1.3 million (spring break), that's down from approximately 2.5 million pre-pandemic (not spring break). Their stock price may be higher, but their capital structure means the comparisons are much different. Dividing earnings by an increased number of shares means that the earnings has to be that much greater just to equal the same. Multiples (fundamentals) have to be the focal point, not the stock price. Added to this is the rationale that interest rates may be headed higher. The 10-year treasury settled in today at 1.64%, below the 1.75% where it peaked the beginning of last week. While these rates may seem insignificant, the potential directional change is what drives the market. The "Quant" managers, those relying on algorithms and automated computerized trading, could be the reason rates have been so volatile. Story lines mentioning hyperinflation can start a firestorm of trading only to create a lot of trades with very little return (you can tell I'm not a fan). The longer lasting returns should come from the companies benefiting from the shift in technology going forward; Artificial Intelligence (AI), Virtual Reality (VR), 5G, and Electronic Vehicles (EV). These would be the growth areas of our portfolio. However, the real potential are the large cap value companies that have not participated as much over the past 13 years. Companies in the manufacturing and industrial sectors whose earnings are growing nicely given cost cutting while improving productivity through the use of robotics and other advances in technology. Added to that is the proposed massive $2-2.2 trillion infrastructure plan. Given that the proposal is just that, a proposal, many believe we'll have some , if not most, enacted. The plan is laid out over an eight-year time frame and could be a stimulus for the next few years. I guess the big question is what it does to our national debt. Let's hope there's some revenue neutral areas in the plan that offset the cost. We'll be watching to see what the net affect will be.

Another conversation that's surfaced over the past few months is the amount of margin debt secured by equity values in the market. Margin limits are held to 50% of the equity value at the time of purchase. If the equity value of the portfolio goes down below 30% the investor either has to add funds to the account to bring the equity value back to or above 30% or the custodian is required to sell enough in the account to match that level. As you can see by the chart below the level of margin debt is reaching an all-time high. However, the markets are also doing the same. The problem as I see it is that if the markets decide to have a meaningful correction, the fallout may be exacerbated by the potential increase in margin calls that may result in forced selling. I'm not that concerned given the amount of cash on the sidelines continuing to filter in with almost every pullback, but it's something to watch.



Economic News

- Monday:
  - Markit Services PMI (final) for Mar., 60.4 vs. 60.2 expected and 60.0 previously…very good!
  - ISM Services Index for Mar., 63.7% vs. 59.2% expected and 55.3% previously…very good!
  - Factory Orders for Feb., -0.8% vs. 0.3% expected and 2.7% previously…weather related.
- Tuesday:
  - Job Openings for Feb., 7.4 million vs. 7.0 million expected and 7.1 million previously…good.
- Wednesday:
  - Trade Deficit for Feb., -$71.1 billion vs. -$70.5 billion expected and -$67.8 billion previously…imports expanded.
  - Consumer Credit for Feb., $28 billion vs, $5.5 billion expected and $0 billion previously…weird, but the consumer is spending?
- Thursday:
  - Initial Jobless Claims (state, SA) for Apr. 3rd, 744,000 vs. 694,000 expected and 728,000 previously…continued improvement.
  - Continued Jobless Claims (state, SA) for Mar. 27th, 3.73 million vs. 3.75 million previously…improving.
- Friday:
  - Producer Price Index for Mar., 1.0% vs. 0.4% expected and 0.5% previously…rising inflation?
  - Wholesale Inventories for Feb., 0.6% vs. 0.5% expected and 1.4% previously…flat.

Employment is improving, inflation is starting to rise, and manufacturing is hitting all-time highs since the ISM Index was created! While inflation is somewhat troublesome, the rest of the data is very encouraging. Earnings will be forthcoming over the next few weeks so keep your seatbelts fastened, it's going to be very interesting!

We continue to vaccinate approximately 3 million individuals in the US daily. About half of those are getting their first shot while the others are finishing their second. President Biden has announced that as of April 19th anyone that wants to be vaccinated is eligible, no age requirements posted! We are getting there and a form of normal is around the corner. Hang in there and Stay Safe!!!

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