Eagle Strategies LLC

The Eagle Edge

Quarterly

MARKET & ECONOMIC OUTLOOK

MARCH | 2021

On the Radar Screen

1. **The pace at which it is deemed safe for businesses to fully reopen this spring,** and the speed with which customers return, will profoundly impact economic activity and corporate profitability in the months ahead.
2. **Vast sums have been distributed to citizens in recent weeks via both stimulus payments and tax refunds.** How that money is used (consumption, bank savings, securities investments) will be an important driver of market activity in the months ahead.
3. **Businesses report that input costs have been rising sharply.** This has the potential to erode profit margins if the businesses absorb those costs or drive inflation higher should they pass them on. Neither scenario bodes especially well for securities markets.
4. **Also factoring into inflation are wages.** How quickly the economy can reabsorb idled labor and the degree to which firms must compete with enhanced unemployment benefits will influence price stability and bond yields.
5. **With the Biden administration toeing a firm line in negotiations with China, Russia, and Iran,** geopolitical tension may return as a driver of market volatility

Insights from Multi-Asset Solutions' Portfolio Managers

"The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics." – Thomas Sowell

Everything for everyone. With the vaccination campaign well underway, and a significant portion of the population having acquired natural immunity, the prospect of the end of the pandemic and a return to economic normalcy looms. Already mobility data suggests that consumers are resuming a more standard level of activity. Businesses are euphoric at the prospect of customers returning in force, building inventory, and adding capacity in anticipation of a spring surge.

A powerful triumvirate of factors forms the foundation for this coming economic boom. The first has been the extraordinary policy measures enacted by the Federal Reserve Bank. Overnight lending rates pegged near zero and enormous purchases of Treasury and mortgage-backed debt combine to create an explosion in the supply of money, ensuring that credit is inexpensive and widely available.

Equally consequential is the accumulated firepower of U.S. consumers. Aggregate personal income rose over the past year as a result of government stimulus and enhanced unemployment payments that more than offset a loss of wages. At the same time, the ability to shop and spend those dollars was somewhat constrained as many businesses were closed. The net result was an enormous uptick in personal savings. With their wallets now so well padded, consumers are primed to drive a burst in retail sales as the businesses they would like to patronize gradually reopen to full capacity.

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Insights from Multi-Asset Solutions' Portfolio Managers

Lastly, passage of the American Recovery Plan Act in recent weeks adds still more fuel to the incipient fire. Fiscal support over the past year has dwarfed all prior peacetime efforts to boost the economy and comes just as conditions appear set for takeoff even absent that helpful lift.

There are two types of economists in this world: those who cannot forecast interest rates and those who do not know that they cannot forecast interest rates. The yield on the ten-year Treasury bond has climbed from a low near 0.5% last summer to approximately 1.7% today. That's a significant change, and one that few forecasters saw coming. As bond yields climb, the equity risk premium (i.e. the gap between earnings yield and bond yields) diminishes, rendering stocks less attractive from a relative valuation standpoint. The same strong economic performance that promises to drive corporate profits higher also exerts upward pressure on bond yields, paradoxically threatening the equity bull market. Should that be how it plays out, it would be an instance of good news for the economy being bad news for investors.

"Finance is the art of passing currency from hand to hand until it finally disappears." – Robert Sarnoff. Market segments that may be especially vulnerable to rising yields are those in which valuations have become most extended, possibly reflecting speculative excess. The list of security types that have seen a dramatic rise in valuations is relatively lengthy. Earlier in the year, some of the narrower thematic strategies including electric vehicles, cloud computing, and genomics seemed to fit that description, although they have retreated some since. The "meme" stocks (e.g. GameStop, AMC Entertainment, Express Inc, and others) popularized amongst retail investors on platforms such as Reddit have climbed to prices that seem improbable relative to their recent history. Special Purpose Acquisition Companies, SPACs, also known as blank check companies, have seen a similarly worrisome boom in activity. And this list would be woefully incomplete if it did not include digital collectibles traded as non-fungible tokens, or NFTs, which have soared to heady levels in recent weeks. These pockets of excess do not pose a systemic risk to markets but bear watching, nevertheless. A significant shift in sentiment regarding these darlings of the bull market might have broader implications. Should investors become weak in the knees, high valuations across markets might prove difficult to sustain.

There is no assurance that the investment objectives will be met.

Past performance is no guarantee of future results, which will vary. All investments are subject to market risk and will fluctuate in value.

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Stocks and bonds can decline due to adverse issuer, market, regulatory, or economic developments. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner, or that negative perception of the issuer's ability to make such payments may cause the price of that bond to decline. A bond's prices are inversely affected by interest rates. The price will go up when interest rates fall and go down as interest rates rise.