Money Talks by David Helscher

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Beyond watching billionaires doing their impersonation of Buzz Lightyear, there have been a number of items market analysts have been watching. With the re-opening of the U.S. economy, gross domestic product figures, corporate revenues and earnings, and employment figures have begun to launch upward. Many of these indicators are coming off a very low base from a year ago, when the economy was in the depths of pandemic recession. The National Bureau of Economic Research officially dated the end of the Covid-19 Recession as April 2020, making it the shortest recession on record with a duration of just two months.

The recovery from the pandemic appears ready to broaden across regions and countries in the second half of this year, aided by vaccine progression, fiscal and monetary stimulus, and consumer demand. However, will this growth be enough to meet optimistic earnings expectations without igniting sustained inflationary pressure, causing central banks to tighten monetary policy? The Fed and European Central Bank, based on recent comments, appear to be standing pat for now, but are beginning to think about discussing reducing the bond purchasing programs.

Rising yields pose some obvious risks to bond investors, but could also present opportunities. Higher yields may make some sectors attractive relative to stocks, causing some shift in investor's asset allocation. Stock investors could lock in some of their gains and rotate to higher yielding fixed income investments. Stocks can do well with some inflation. Historically, equities have done relatively well during periods of moderate inflation. Once inflation gets beyond 3-4% on a sustained basis, returns can be inhibited.

Corporate earnings surged during the first quarter of 2021 and, at this point, second quarter earnings have generally exceeded estimates. Yet earnings comparisons on a year over year basis will become more challenging as the depths of the pandemic recession recede. The rate of business growth is being compared to a very low level from a year ago, similar to the discussion of the impact of base effects on annual inflation measures. The comparative rate of growth will continue to slow, but with strong consumer demand and stimulus programs still in place, strong growth should continue for the balance of this year and could extend well into 2022. Much of the optimism reflected in U.S. stock prices is a result of vaccination programs, the U.S. being well ahead of other countries and regions. We may see a more sequential improvement in markets of other developed and emerging markets.

There are concerns to keep in mind. The consensus opinion is that inflationary pressures are transitory and will abate as post-pandemic demand lessens and supply bottlenecks are overcome. There are some trends that could produce structural shifts in inflations rates. Large U.S. deficits have greatly increased due to pandemic stimulus efforts. Baby boomers continue to retire, spending their savings, reducing risk exposures in their portfolios, and creating labor shortages and wage pressures for replacements in some areas. There is some movement to reverse the decades old trend of globalization with higher tariffs, immigrations barriers, and supply onshoring.

It would be the rare economist that would yell "to infinity and beyond". Markets and economies rarely move in one direction. Hiccups and bumps can be expected and there will be periods of increased volatility. We find ourselves in unprecedented times, again, which require careful considerations of the risks and rewards of our investment decisions.