VAN LIEW TRUST COMPANY

as we see it

Fall 2021

THOUGHTS FROM OUR CHAIRMAN

"*Summertime, and the Livin' is Easy*". Even more so this year as beaches and other recreational spots are hopping. Job openings are also plentiful but with seemingly few takers as it appears many are delaying their job search in earnest until September, when unemployment benefits expire. Government's management of Covid-19 has progressed to a point where more people are comfortable about being active. Come September folks may look to go back to work and a portion of the current excess demand for goods and services is met with supply. Opinions differ as some hope for more government stimulus while others fear it. Inflation is of great concern as it paralyzes savers. On the other hand, if interest rates stay low, it will be less expensive for our government to retire its bonds. Our government, however, must fund needed infrastructure projects across the land. That investment will help us to be more productive, provide jobs and benefits businesses. The latter, with improving corporate earnings, is a stock market plus. In this Summer issue of As We See It, Wade Walbrun provides some insight on the progress of current corporate earnings and what might be anticipated.

Alfred B. Van Liew

It's All About Earnings?

Wade M. Walbrun

Earnings, it is said, are the lifeblood of stocks and, in the long run, the driver of rising stock prices. We agree and are pleased to see such progress on the bottom line of corporations so far this year. Year-over-year earnings per-share growth in the first quarter of 2021 exceeded 50%, far above early January analysts estimates, and it appears that second quarter numbers will be over 70% higher than a year ago and surpass peak levels seen in 2019. Despite these robust results, the S&P 500 Index is "only" up around 18% year-to-date. If, in the long run, earnings are the driver of stock prices why aren't stock markets up even more? What is it that is tempering investor sentiment?

Inflation – Many manufacturers and merchants were caught flat-footed in the face of robust consumer demand that stemmed, in large part, from the normalization of life post-introduction of Covid vaccine and pent-up demand. Prices for raw materials, commodities and even consumer services all soared as demand outstripped supply. Many finished products became scarce and more expensive as producers passed on higher prices to consumers to compensate for increased raw material and component costs. Investors and analysts alike expressed concerns that higher prices for finished goods and services might force consumers to buy less or seek lower cost alternatives, possibly tapping the brakes on the US economic recovery. The Federal Reserve says the current dose of inflation is transitory. They believe it will subside as material supplies catch up with demand and supply chain issues (namely labor and transportation issues) are resolved. Alternatively, some investors suggest inflation is a longer lasting issue citing increased labor costs due to worker shortages being the stickiest issue. Such shortages are broadly noted in service-oriented industries such as restaurants, hotels, entertainment and even areas of manufacturing. We think many of the labor gaps are likely filled in the following months as Covid-related unemployment benefits expire in September. We see wage increases as moderate and having nominal effect on corporate profit margins.

10 year US Treasury Bond yield – Investors often look to the US bond markets to glean some sense of what is happening or may happen in the US economy. This year was no different. From the beginning of the year to April, the 10 year US Treasury bond yield rose from just under 1% to 1.75% reflecting the expected normalization of interest rates from the reopening of the US economy and a rise in inflation that accompanies it. The message seemed clear. However, since then, the 10-year bond yield dropped to a low of 1.18% before settling to around 1.25% currently. Early in the pullback, some investors saw the move down as indicating an easing of inflationary pressures in the economy later in the year. Yet, as the interest rate dipped below expected levels, many on Wall Street struggled to understand the message the bond market was sending. No longer did it appear to be just about inflation, but some interpreted the low interest rate as a harbinger of an economic slowdown, an interruption of the US recovery. We think the volatility in rates was more a trader-driven event and may be short-term in-nature and would not be surprised to see a modest recovery in yields as the US economy maintains its growth posture.

Peak growth concerns – Reports of both economic data and corporate earnings have been quite robust this year as compared to the Covid-related shutdown months of 2020. Many investors see the large numbers reported and wonder if the data can get much better, concerned the more difficult year-over-year comparisons of the second half of 2021 and 2022 will be characterized as a relative slowdown. Some also suggest the oversized results are symptomatic of demand from 2022 pulled into 2021 and claim this year was influenced predominantly by unsustainable factors such as Covid-related government stimulus and ultra-low interest rates. We believe the US economic recovery is well on track, with or without future stimulus, and remain optimistic about consumer-led demand. Spending is poised to remain robust as the state of many consumers' household finances is strong, benefitting from low debt service levels, a high relative savings rate, growing housing prices values, and a rising stock market. Additionally, we increasingly see examples where economic and earnings data is being held up to pre-Covid 2019 results as a more relevant comparison of growth, disregarding 2020 data as somewhat of a misleading statistical outlier.

Delta variant – With around 40% of the US population still unvaccinated the Delta variant, a more contagious version of Covid 19, has the potential to disrupt US economic growth if it becomes more widespread. The number of Covid cases in the US has risen from 11,000 per day in June to over 75,000 currently, much attributed to the spread of the Delta variant. While the caseload is far from pandemic heights of +200,000 cases a day the rapid rise has many concerned. In response, new mask mandates in select areas of outbreak have been announced and investors worry further nationwide expansion of such regulation coupled with renewed business restrictions could upend or dampen consumer spending in the near term. At this time there appears to be little impact on the overall US economy but remains an important issue to keep an eye on.

Despite short-term uncertainty, we remain confident about continued recovery of the US economy. With current third and fourth quarter 2021 estimates of corporate earnings at 27% and 21%, respectively, we think this bodes well for further gains in stocks this year. Looking forward, 2022 will present more challenges and difficult year-over-year earnings comparisons for companies but current estimates for the full year reflect solid earnings growth of 10% and, in the long-run, we think that's pretty important.

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