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Economic & Market Summary
July 2021

The pandemic seems to be retreating in the US. Aided by vaccinations, new daily cases and deaths continue to decline. However, the situation remains fluid and it's premature to declare an end to the pandemic. Other countries, especially in lesser-developed parts of the world, are still struggling with the virus. New COVID-19 variants pose a risk and slowing US vaccination rates are a concern. Yet, if the positive healthcare trends continue, as we expect, economic activity will accelerate throughout the year.

Inflation has clearly picked up. The key question is whether this uptick is a temporary aberration or a structural change in the economy. The Federal Reserve believes it's transitory; we're unsure. On the one hand, pressure is most acute in areas heavily impacted by the pandemic such as car and truck prices, commodities, airfare, and freight costs. As the pandemic subsides, this pressure should abate as supply chains normalize. Wage inflation, is also perking up, driven by pandemic-related barriers to filling job vacancies, namely generous unemployment benefits, childcare struggles, and virus concerns. All of these barriers should come down over the coming months. On the other hand, there's an important caveat to the "transitory" narrative that gives us pause. The money supply grew rapidly as aggressive fiscal and monetary policies were implemented to prevent an economic collapse last spring. In our view, prices did not increase commensurately because money velocity, the rate at which money is spent in the economy, fell dramatically and has yet to recover. As the economy reopens, there's a chance velocity increases faster than expected which could create additional inflationary pressure.

Even if inflation is transitory, we still view it as a key near-term risk to stock and bond prices. The Fed is willing to let inflation run above its target in the short-term in order to move the economy back to full employment. There's a risk inflation will run too hot because the distorting effects of the pandemic take longer to recede than expected or because velocity rebounds. This could force the Fed to accelerate their timeline of tightening monetary policy. This already seems to be happening. As recently as March, the Fed indicated that rate hikes would not occur until 2023 or later. By contrast, projections from the June meeting suggest that rate increases are very likely in 2023 and possibly 2022.

Another risk to asset prices are the Biden Administration's proposals for tax hikes and a huge increase in government spending. These policies reflect an incredible tolerance for trillion dollar deficits under a dangerous assumption that the US Government will enjoy low borrowing costs for years. They also represent a retreat from free market principles and a view that the government should play a larger role in the economy. Both are generally bad for long-term growth. Elevated stock valuations and ultra-low bond yields reflect a belief that Fed tightening will not happen anytime soon and that the aggressive policies will not get through Congress. Also, a hot IPO market and the "gamification" of investing by retail investors tell us that market exuberance is still prevalent. Consequently, we are somewhat cautious on stock and bond prices at current levels. However, we are increasingly optimistic about the economy, which is clearly recovering from the shock of last year, fueling strong corporate earnings growth.

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To request our SEC Form ADV Part II, please contact Mark J. Sprtel, Chief Compliance Officer, at the address above.