August 2021

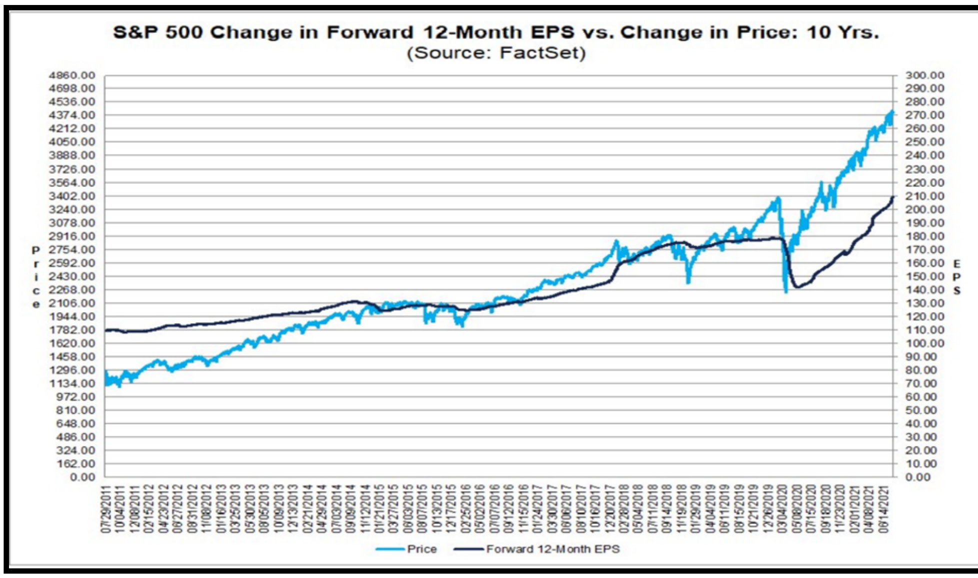
Gore Capital Management

Our only client is you.

Another hot and humid summer is underway here in the 'burg. The stock market has been hot too, rising roughly 4.5% from Memorial Day through the end of July (from Yahoo! Finance). But it's not the rise in the market that's notable; it's the sheer lack of any sort of volatility. During this first half of summer, the S&P 500 experienced just two declines of more than 2%: one in mid-June, and one in mid-July. Both were resolved in about a week, with the market almost immediately returning to new highs. As we'll discuss throughout this newsletter, we believe there are many reasons for this market support, and we approach the final 4 months of the year sharing Wall Street's signature emotion of cautious optimism… COVID aside…

Earnings first. As of this writing, we're about three weeks into second quarter earnings season. More than half of S&P 500 companies have reported, and the headlines thus far have been staggering. According to FactSet, earnings growth is averaging 85% over this same quarter last year. However, relative growth versus the 2nd quarter of 2020 (one of the worst in recent history) isn't a terribly useful data point on its own. To use an Olympic analogy, comparing this quarter's earnings to last year's is a bit like comparing swimmer Katie Ledecky to a 10-year-old.

For this reason, it's important to examine earnings from a dollar perspective. The chart below from Factset shows forward-looking earnings per share (EPS) in dollar terms over the past 10 years, represented by the black line. We apologize for the small font, but the graph shows that EPS for the S&P 500 are currently forecast around $210 for the next 12 months, versus about $180 at the end of 2019. This represents an increase of about 16% compared to 2019, which was, by all accounts, a very strong year. This, we believe, is a more reasonable comparison and one which more accurately conveys just how good this year has been (and hopefully continues to be).



Data and graph from [Factset Earnings Insight](), 7/30/21

As we've noted in prior newsletters, the price-to-earnings (or P/E) ratio of the market has been elevated well above historical averages since last year. Despite the strength in earnings, the P/E ratio for the S&P 500 is still around 21 versus the 5-year average of around 18. In simple terms, this means investors are willing to pay higher prices for a company's future earnings than they have been historically. While we believe a reduction in P/E ratios towards longer-term averages can help set the stage for future sustainable growth in stocks, it's not exactly surprising that ratios are

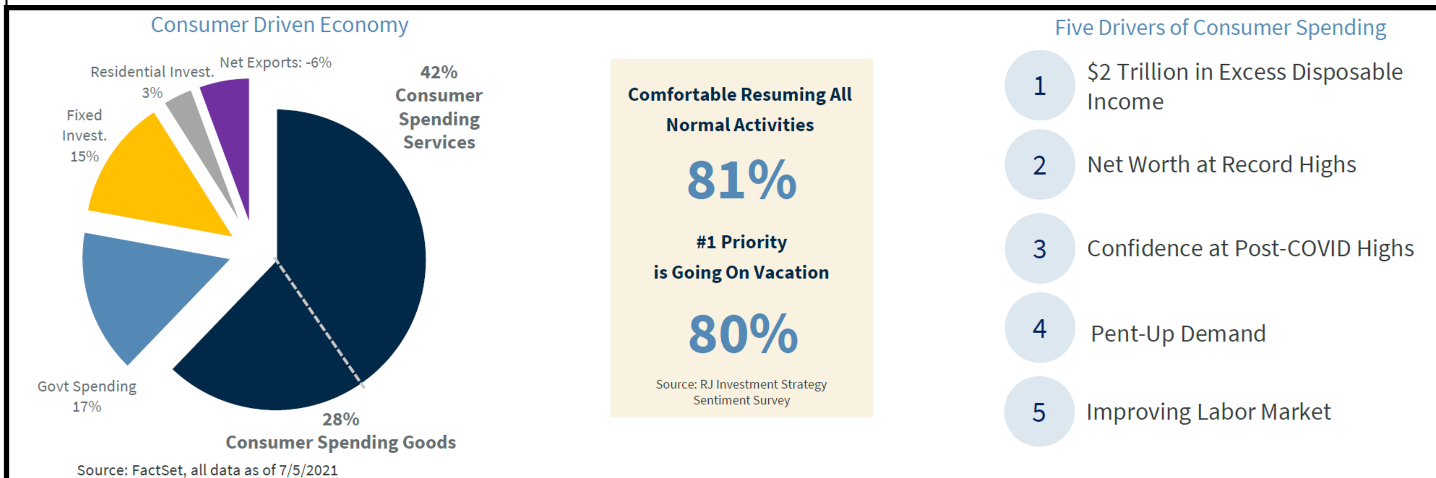
Market Statistics	July '21	YTD	2020	3-Year Annl.	5-Year Annl.
S&P 500	2.35%	17.70%	17.75%	17.50%	16.67%
Dow Jones Ind. Avg.	1.34%	15.31%	9.72%	13.72%	16.30%
Russell 2000 (Small Cap)	-3.62%	13.13%	19.50%	11.07%	13.84%
MSCI EAFE (Foreign)	0.75%	9.65%	7.82%	7.66%	9.35%
MSCI ACWI (Global)	0.69%	13.08%	16.25%	13.70%	13.81%
MSCI Emerg. Mkts. Equity	-6.73%	0.22%	18.31%	7.93%	10.37%
Barclay's Aggregate Bond	1.12%	-0.50%	7.51%	5.73%	3.13%
S&P GSCI Gold (Spot)	2.57%	-4.11%	24.42%	13.78%	6.01%

Source: Morningstar, as of 7/31/21

elevated today due to optimism surrounding our economic recovery as well as the relative attractiveness of stocks versus bonds.

The strength in corporate earnings is confirmed by the strength in the broader economic expansion. According to the [Bureau of Economic Analysis](), annualized US GDP growth for the first two quarters of the year were 6.3% and 6.5% respectively. This is compared with typical annual GDP growth over the past decade or so of around 2%. Raymond James is forecasting calendar year 2021 GDP growth of 6.2%, which would represent the best year for economic growth since the 1950s.

In the US, consumer activity represents about 70% of GDP. A healthy consumer is absolutely critical for a healthy economy. According to Raymond James, US consumers as a whole are enjoying record disposable income and record-high net worth. In a survey, RJ's analysts found that 80% of respondents were itchy to go on vacation and return to their normal activities. Adding the strong labor market, RJ's analysts believe the consumer will support GDP growth for at least the next 12 months.



These visuals were borrowed from Raymond James's July webinar titled "Investing is Not a Trivial Pursuit," a replay of which we emailed to everyone in mid-July. If you haven't had a chance to watch this replay, we highly encourage it!

Looking forward, there are two headlines which are likely to impact the market's trajectory for the remainder of the year: politics and COVID.

Congress is now on their August recess (must be nice…). Lawmakers in both houses – and on both sides of the aisle – seem to have agreed on the main provisions of a $550 billion physical infrastructure bill. This is potentially a good thing for the market, as physical infrastructure spending means lots of materials and labor will be put to work in the near future. However, the reconciliation/tax reform initiative is still unsettled. Raymond James's DC policy correspondent Ed Mills believes this is likely to be a big push in the fall as the debt ceiling debate must also be resolved. Look for more headline news on this one in September.

Unfortunately, COVID case numbers are rising again as the delta variant spreads. Many employers are embracing remote work and/or delaying their planned return to the office, which can hopefully help to keep a lid on transmission rates. However, many schools will be returning to in-person learning over the next month or so, and people tend to spend more time indoors with one another as the weather gets cooler. The CDC and other health experts have warned of a COVID resurgence coincident with the flu season. The good(?) news is that Raymond James Healthcare policy analyst Chris Meekins believes the delta variant burns "hot and fast," expecting cases to peak and subside over the next few weeks. The bad news is that he also expects new variants will continue to emerge until a sufficient number of people are either infected or vaccinated.

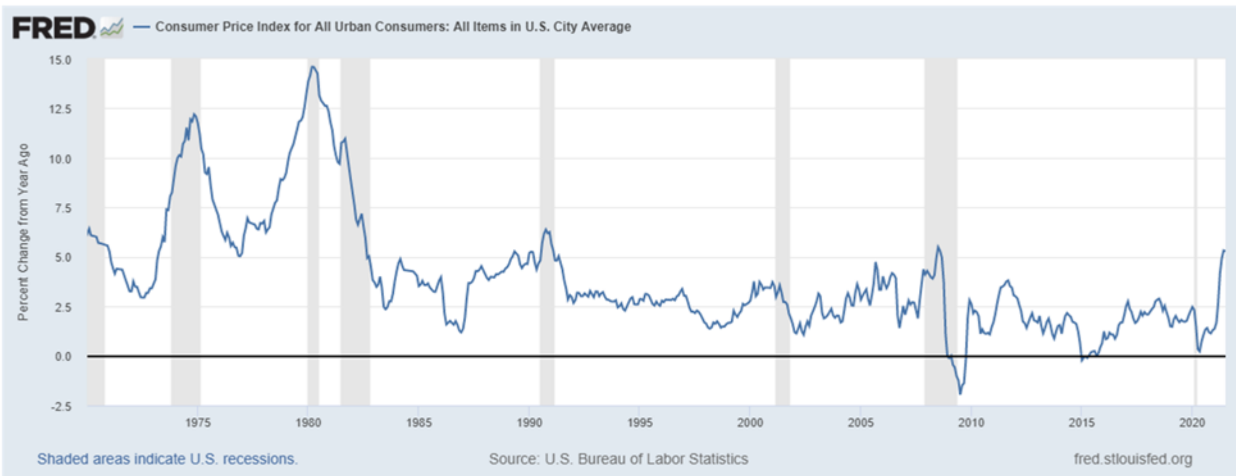
President Biden has already announced that federal employees must get vaccinated or take regular COVID tests. Mask mandates in stores are returning. Ed Mills believes these types of vax-or-mask initiatives are likely to spread across the public and private sectors going forward. We're disappointed to see case counts rising again but we're hopeful that the delta variant can be contained and we can successfully combat this ongoing threat. Our health, and the health of our economy, depends on it.

We wish you a safe and healthy back-to-school season!

Peter's Corner

The next big thing….Inflation?

No matter how it is acknowledged, whether it's "transitory" or "persistent", it is here. By "it", I mean the insidious "I" word. Many of us have not really experienced anything other than benign inflation, with prices only increasing by 2 – 3% a year. Compare that with "Hyper-inflation", a term thankfully not heard since the early 70s, which refers to the very highs level of inflation (14.6%, see chart below) experienced back then. The reason this is now a front-page issue is that inflation data (Consumer Price Index (CPI)) has once again begun to increase, now averaging about 5% (see chart below). As noted by The Financial Times, "The rapid pace of US consumer price increases steadied at a 13-year high (5.4%) in July while month-to-month gains moderated slightly…" So why does it matter if it's "Transitory" or not?



To answer this, we have to first briefly address the factors that cause prices to rise. There are many so a short but relevant list follows. Most have been brought on by the response to the recessionary pressures brought on by the pandemic:

- Enormous Monetary Policy response – The FED flooded the economy with liquidity and lowered interest rates to extremely low levels, thus making cheap cash available throughout the economy
- Enormous fiscal response – pushing money into the hands of the consumer, and businesses, through grants, loans and subsidies, etc.
- Strangled Supply Chains – closing of borders which blocked or severely impacted availability of resources needed to keep manufacturing and production of goods at previous pace as well as on time delivery (even just to keep it going: period)
- Increasing wages to entice workers back to their old jobs, even though many earned more in 2020 than they had in 2019.

These four factors boil down to the simple economic theory of "too much money chasing too few goods" which neatly explains the elevated levels of inflation we are now experiencing. A great many would argue the increase is by design. Though the impact is widespread, one notable is housing. A friend recently looked at a property near the Blue Ridge Mountains (the price started at $320K). He noted to me that day that "16 contracts price bid over $400K for a house essentially abandoned for 10 years, needs roof, gutters, hvac, new generator, 2 well pumps, all new kitchen appliances, etc. Also, mouse hole in floor raccoon size. Who knows what will happen when the power is turned back on, hope fire trucks are handy." He later found out the winning bid was $515K, cash: Yikes. We are sure you've heard similar stories but it doesn't stop at just housing. For example, lumber prices increased 540% before pulling back by 60%, used cars and trucks have increased by 42%, etc.

The Federal Reserve Board of Governors (most of them) have argued that the increases we are witnessing are "transitory" and should be expected given the amount of liquidity that has been supplied to reopen the economy following its near complete shutdown during the pandemic. Evidence is somewhat bearing this out, but at the same time one needs to remain alert as to whether it truly is "transitory" and short-lived or is it the first leg of "persistent" inflation that will be with us for longer.

Now, back to whether "Transitory or not" matters (and it does!): Two reasons why stand out. First, inflation itself erodes purchasing

Peter's Corner (cont'd)

power over time. A dollar today buys less tomorrow, and persistent inflation can have a significant impact on planning for your future. The second is effectively the Federal Reserve's (FED) response to the first. One of their dual statutory mandates directing policy initiatives is to maintain price stability and inflation at 2%. To accomplish this the Fed's primary tool for managing inflation is controlling the level of interest rates (reserve rate), increasing them (thus removing stimulus) when they feel the economy is becoming overheated and stoking inflation, resulting in slowing economic growth. Financial assets are valued based on a discount of future cashflows. When interest rates are low as they are today, stock and bond prices move higher much like we have seen over the last 18 months. If the Federal Reserve decided to raise interest rates to combat inflation, the discount rates – on which stocks are valued – would rise, meaning stock prices could be at risk of falling. Howard Marks of Oaktree Capital Management in his excellent July 31st newsletter, (Howard Marks: Thinking of Macro) argues that given today's level of interest rates, the market is reasonably priced. The bet is interest rates remain at today's level or less. He cautions that if rates rise, it will be a very different story.

"Bottom line: Since inflation will lead to higher rates (Fed changing game plan to fight inflation by raising interest rates and investors demanding higher yields on their money), getting the inflation call right is the order of the day." Steve Blumenthal Newsletter, August 6, 2021. We are remaining watchful.

One More Thing….

No Cause For Alarm With A Plan In Place | As much as we advise against attempting to time the market, we also discourage investors from allowing emotions to dictate portfolio decisions. Often times, the two go hand-in-hand, and historical returns reveal just how detrimental emotionally-driven, panicked selling can be. In fact, an investor who missed the 20 best trading days (of the total 5,030 trading days) over the past 20 years would have posted an annualized price return of -0.1%. In comparison, an investor who remained invested and participated in all the trading days would have had an annualized price return of 6.6%. Even more insightful, these '20 best trading days' occurred within two weeks of a 5%+ pullback 90% of the time, reflecting that 'panic selling' in the midst of bouts of volatility is likely to underperform the broader market over time.

This comment was drawn from RJ CIO Larry Adam's recent "Weekly Headings" report, dated 8/6/21. The statistics were surprising, even to us. It's a stark reminder that staying invested and making portfolio decisions based on changes in life rather than changes in the market is the long-term path to successful investment strategy.

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