

*The American consumer, whose spending accounts for nearly 70% of the US economy, should be increasingly healthy as 2021 unfolds. A healthy consumer generally means a healthy US economy, and this should translate into a healthy stock market in 2021.*

## DONE

Well, that is one year we're glad to see in the rearview mirror. And yet the pandemic's toll of human suffering continues to be staggering. With highly effective vaccines now being distributed globally, there's light at the end of the tunnel. While the worst stretch of the pandemic likely lies ahead, the end is still in sight.

A New Year's Day article in the *New York Times* attempted to answer a question that many investors have asked themselves: "Why Markets Boomed in a Year of Human Misery." Why, indeed? Because markets did boom as the S&P 500 returned 18% for the year, and the MSCI Global Index gained 16%. In this treacherous environment, our domestic 350 equity strategy returned 21% in 2020, and our Arjuna Global equity strategy was up 26%. So, why did stocks do so well last year?

## K-SHAPED RECOVERY

The NYT article reports that while the total number of jobs US employers reported for this past November was down 6% from a year earlier, total employee compensation for the period was down only 0.5%. While this seems odd, it reflects the fact that most of the jobs lost were low-paying, service-industry positions—waiters, retail clerks, hotel staff, and the like.

This is part of the bifurcated, K-shaped economic recovery we mentioned in last quarter's *Outlook*. A much larger share of the US workforce and total compensation comes from better-paid workers in segments of the economy that weren't hit so hard and recovered quicker: technology, healthcare, manufacturing, housing. The more visible employment toll was in restaurants, hotels, airlines, but their role in the overall economy is dwarfed by that played by sectors that did better.

We spoke to this last quarter by way of explaining why so many sectors of the US economy were experiencing V-shaped recoveries: US retail sales, new home sales,

durable goods sales, automobile purchases all rocketed off the bottom of the recession and reached pre-COVID levels in the third quarter of last year.

So, that's part of the story: The stock market did well despite so much human misery, because the economy as a whole didn't suffer as dire a hit as a street-level view of the pandemic might have suggested.

## FISCAL TSUNAMI

Another part of the stock market's story is the tsunami of fiscal stimulus—i.e., cash—the federal government loosed upon the US economy in response to the pandemic. The result of this tidal wave of cash is that "Americans' cumulative after-tax personal income was \$1.03 trillion *higher* from March to November of 2020 than in 2019, an increase of more than 8%."

That startling fact also helps explain the stock market's performance. First, US consumers' buoyant personal income supported consumer spending. While spending on services like restaurant meals and hotel reservations plummeted, spending on stuff like cars, appliances, and home-office equipment boomed. Hence the V-shaped recoveries in many parts of the economy.

That said, overall consumer spending did decline during the pandemic, with the drop in spending on services exceeding the increase in goods purchases. So where did that 8% increase in Americans' overall income go?

## SAVINGS

Once again, the economic impact of the pandemic seems to defy the scale of concurrent human suffering. But the fact is Americans' overall savings exploded from March to November, with their overall savings rate (the percentage of savings to overall discretionary income) rocketing up to nearly 34% last April, the highest level on

record. So, Americans, particularly the well-paid, were stuffing their mattresses with cash during the pandemic.

Well, not their mattresses. But it had to go somewhere. With the Federal Reserve holding short interest rates near 0% to help stimulate the economy, bank deposits and bonds of most stripes didn't offer very appealing homes for that cash. Indeed, the yield on the 10-year US Treasury Note, once expected inflation is factored in, offers roughly a *negative* 1% expected annual return.

This sort of interest-rate environment forces investors further out on the risk spectrum in their search for return. And that, of course, benefits the stock market.

So, the combination of a) an overall economy that fared better than the naked eye would suggest, b) a tidal wave of cash from the federal government bolstering consumer income and spending, and c) an explosion of savings looking for a positive return, explains much of why the stock market did so well in 2020.

### GAME CHANGERS

We underlined all last year that the stock market isn't pricing the current environment; it's pricing the *anticipated* economic environment six or so months down the road. As such, the stock market's steep, V-shaped recovery anticipated a sharp bounce in much of the economy. The stock market made a new high a few months back, and we think we'll see that corporate profits did the same in the fourth quarter of 2020. That's how the stock market works and why it's considered a leading, if fallible, indicator of future economic activity.

Most notably, we remarked back in October that the market was anticipating a breakthrough vaccine in its pricing of the economy come Spring. In November, pharmaceutical companies Pfizer and Moderna both announced shockingly effective vaccines. And that was the real game-changer for the economic outlook.

### GOING FORWARD

The American consumer, whose spending accounts for nearly 70% of the US economy, should be increasingly healthy as 2021 unfolds. The \$900 billion fiscal stimulus plan recently passed by Congress will boost consumer incomes, spending, and savings. The vaccines will

accelerate the reopening of the economy, boosting job growth and consumer incomes. And the hardest hit sectors of the economy and workforce—restaurants, hotels, airlines, etc.—will get a sharp boost from a healthier consumer feeling more comfortable in a less dangerous public environment. Indeed, the market is already anticipating this as the stocks of airlines, hotels, and restaurants have begun to recover. A healthy consumer generally means a healthy US economy, and we see no reason why that shouldn't hold in 2021.

### THE GOOD NEWS

It was a very pleasant surprise when the Democrats flipped both Georgia US Senate seats earlier this month, giving the Dems a majority in the Senate once the tie-breaking vote of Vice President Kamala Harris is counted.

Interestingly, the stock market seems unperturbed by this news. With Democrats in control of Congress and the White House, corporate tax hikes are all but assured. Higher corporate taxes mean lower corporate profits, all things equal, and that should mean lower stock prices. Our guess is that the market is taking heart from the increased odds of further fiscal stimulus from the federal government now that the Dems are in control. And that should boost economic growth and corporate profits.

However, as the outlook brightens, investor sentiment is growing ebullient. Recall the old saw that bull markets climb walls of worry. We're seeing a shortage of worry currently with investor surveys showing an unhealthy level of bullishness. Other more technical indicators (e.g., put/call ratios) also show that investors' appetite for gain is overwhelming their fear of loss. This often precedes a spell of market action that puts fear and greed more in balance. So, we wouldn't be surprised by a minor pullback in stocks to cool investors' ardor.

PS: As for the disgraceful invasion of the Capitol during the electoral college certification, the markets correctly read this as economically inconsequential. The rest of us can perhaps take solace in the fact that, along with the Republicans losing two Senate seats in Georgia, Trump's incitement of mob violence in the nation's capital may have put the last nail in the coffin of his political future.

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