PCM
PEAK CAPITAL MANAGEMENT

Help "Desperately" Needed

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The old Help Wanted pages are being replaced by Help Needed for many businesses today trying to escape the impact of COVID-19 on the economy. The latest labor data has many economists scratching their heads, trying to make sense of current labor conditions. The current unemployment rate is 5.8%, but is expected to drop to 4.5% by the end of 2021. The National Federation of Independent Business' (NFIB) latest report showed 42% of small businesses had job openings they could not fill. The debate over why so few people seem to be hired back has grown quite political.

In a move that some have described as a "cruel move," 25 States have opted out of the additional $300 per week Federal government unemployment stipend passed as part of the American Rescue Plan. These States have argued that the additional benefits coming from the government are providing a disincentive for people to return to work. The math likely supports that claim.

State unemployment provides a replacement for 55% of a worker's pay up to $649 per week. For example, an employee who makes $15/hour would receive $8.25/hour or $330/week from the State they live in. When you add the additional $300 benefit (equals $7.50 per hour), the employee can make $15.75/hour or $630 per week. Why would an employee return to work for 40 hours a week to make less money than they receive by staying home (or working a side job for cash)?

The scarcity of labor is making it very difficult for small businesses, crushed by shut downs due to the pandemic, to return to profitability. The economy is clearly growing based on the latest JOLTs report. The Job Openings and Labor Turnover report tells us each month how many job openings, how many new hires, how many people quit their job, and how many were laid off. The June report shows a staggering 9.3 million job openings in the U.S. This surprised many because we are only 7.5 million fewer workers with jobs today than before the pandemic. The quits rate in June was 2.7% while the percentage of employees laid off was only 1%.

Pew Research has provided some insight into the lackluster hiring of new employees and the large number of unfilled positions, particularly in the service sector such as accommodation, food service, entertainment, and transportation. Pew shows that personal income in the U.S. grew at a rate of 9.7% in 2020. In a year where 40 million people lost a job at least temporarily and the economy was shuttered for much of the year, personal income grew almost double-digits? Worker earnings actually fell by $860 billion but that was replaced with an increase of $2.55 trillion in government transfer payments. Massachusetts topped the growth list in 2020 with personal incomes rising 16.6%, largely due to an increase of 150.9% in government transfer payments, according to Pew.

> **Why would an employee return to work for 40 hours a week to make less money than they receive by staying home . . . ?**

Government policies are not the only reason people are remaining out of the work force at this time. Many school districts have not reopened to students in the classroom, creating problems for workers who need childcare. The JOLTs report also identified that 27% of small businesses state they cannot find employees with the necessary skill set to fill openings. The economic disruption caused by COVID-19 has forced many to relocate and has left many employers without qualified labor. Lastly, legal immigration is part of the problem companies are having with hiring. We see the headlines about illegal immigration regularly, but many are unaware that in the 2nd half of fiscal 2020, legal immigration fell by 87% compared the prior 6-month period and the most on record. Legal immigration is also lower in the first half of 2021 than during the same period one year ago. The workforce relies upon legal immigration to fill jobs, and resulting reduction has negatively impacted many companies, especially small businesses.

Consumption has remained very high as a result of the transfer payments and is likely the reason the stock market is at all-time highs. The supplemental unemployment benefits are scheduled to end on September 6 of this year, potentially creating a drop in disposable income for many. The Fed is also having to justify why interest rates remain at 0% and bond buying by the billions (see section on Fixed Income) continues to occur when inflation is obviously above the stated 2% target. Unless some cures for these ills can be identified quickly, the conditions that have allowed stocks to rise and valuations to soar could evaporate and the markets could fall precipitously.

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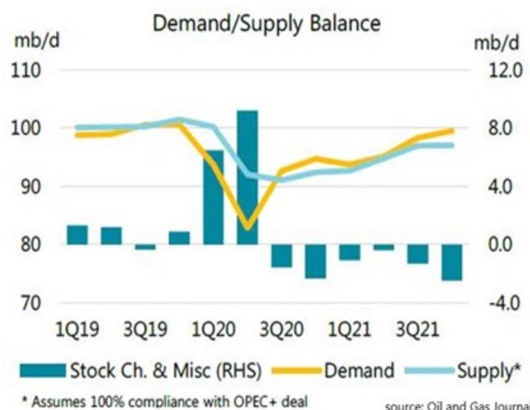
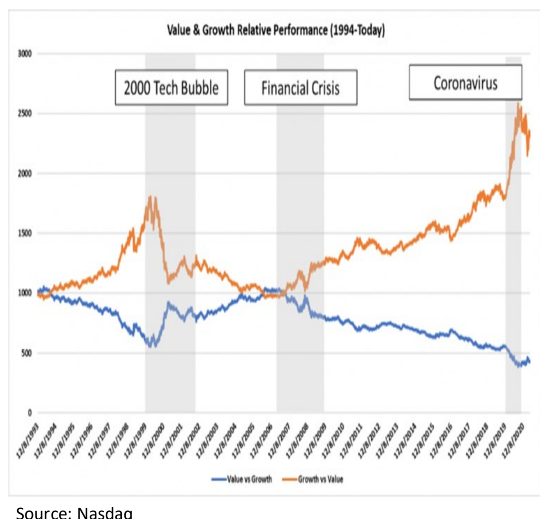
Oil is Gushing



Oil has been on a tear of late, and while many are claiming the rising price is the result of inflation or a weak dollar, I believe there are more fundamental reasons for the spike. A Bank of America analyst recently stated they believe oil will exceed $100/barrel over the next year. There are many factors impacting the price of oil today. Global demand during 2019 was right at 100 mb/d (million barrels per day) right in line with supply. The pandemic caused demand to fall by 9 mb/d and created a glut of oil and plummeting prices. Demand is just now beginning to rise above supply, and the glut should be worked off quickly as supply increases are likely to be minimal, resulting in prices continuing higher.

- After being in lockdown, some for 18 months, there is strong pent-up demand for travel that will drive demand for oil higher. Airlines are close to 2019 passenger counts and many cruises are sold out.
- Driving patterns will likely change as a result of the pandemic. Fewer people are likely to take public transportation and will drive personal cars to work and play, lifting demand.
- Supply growth will be limited by governmental policy, such as trying to achieve emission goals from the Paris accord and pressure from ESG investors. For example, the foregoing factors may have contributed to Royal Dutch selling all Permian Basin assets.

Value vs. Growth



Source: Nasdaq

There has been a years' long discussion as to when value stocks will overtake growth stocks. 2021 is proving out to hold the answer. As of 6/27/2021, the Russell 2000 value index fund is up 28.12%, while the Russell 2000 growth index fund was up 9.12% for the same time period. The Russell 1000 value index fund was up 17.11%, while the Russell 1000 growth index fund was up 11.83% for the same time period (CNBC). The question is how long value will outperform growth. The chart depicts growth vs value in orange and value vs growth in blue from 12/8/1993 to 12/8/2020. Historically, value has performed well during recovery and expansion periods (Invesco). This possibly explains value outperformance in 2021 assuming the Covid recovery.

- Value stocks are characterized by low price to book value, high dividend yield, and lower price to earnings ratios.
- Value stocks are traditionally financials, healthcare, industrials, and energy stocks.
- GDP growth and rising interest rates may point to continued outperformance for value stocks (Goldman Sachs).
- A hybrid approach to growth and value is growth at a reasonable price (GARP). This may be an effective approach until growth or value leadership becomes clear.
- Bank stocks, making up a meaningful portion of value indexes, often benefit from a rising rate environment

Gold and Inflation

We have written extensively over the past few months about the prospect of higher inflation. Numerous readings – primarily the Consumer and Producer Price Indexes – have experienced recent upticks as the economy reopens from COVID-19. Likewise, the 10-year breakeven inflation rate has risen from roughly 2% at the beginning of the year to approximately 2.4% currently. So, the market is pricing in higher inflation, although the rate of increase has subsided a bit recently. With inflation a headline topic, we might expect gold to be trading higher for the year as demand for the precious metal would increase. However, so far for the year, the price of gold has actually subsided, despite the uptick in inflation expectations.

- The chart to the left plots the price of the SPDR Gold Trust ETF, which, somewhat surprisingly, is down roughly -7% year-to-date. Taking lessons from fifty years ago, there is an assumption that gold will shine when inflation expectations are on the rise. Gold, after all, is a store of value when prices rise.
- Perhaps gold is struggling because the market sees inflation as transitory. Likewise, investors might be favoring other assets like Bitcoin or commodities in high demand (metals, oil) to hedge inflation. Either way, the demand for gold has yet to materialize and the precious metal has largely missed out on this year's run up in commodity prices.

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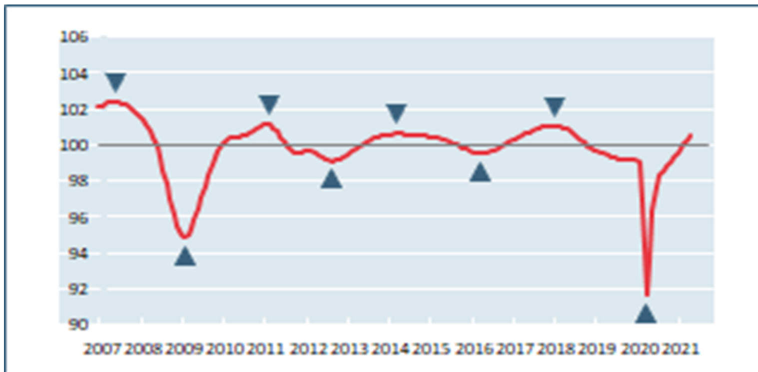
Macro View – Leading Indicators

There is significant discussion in terms of changes in recovery out of Covid and a transition into expansion of the economy. The chart from the OECD shows the Composite Leading Indicators (CLI). The chart depicts a sharp Covid contraction and recovery. As the red line passes 100, expansion is noted. The US, Japan, Canada, Germany, and Italy are all above trend. The UK and France remain below trend (OECD). Among emerging economies, Russia and China demonstrate steady growth in the CLI, while India demonstrates moderate CLI growth, and Brazil shows slowing growth. Vaccines and containment of the virus are largely attributed to the recovery and expansion. The CLIs are designed to show trends leading by 6 to 9 months, such as orders and inventory changes and business confidence surveys. The OECD is calculated monthly on OECD countries and non-OECD countries.

OECD Chart of Composite Leading Indicators



Source: OECD

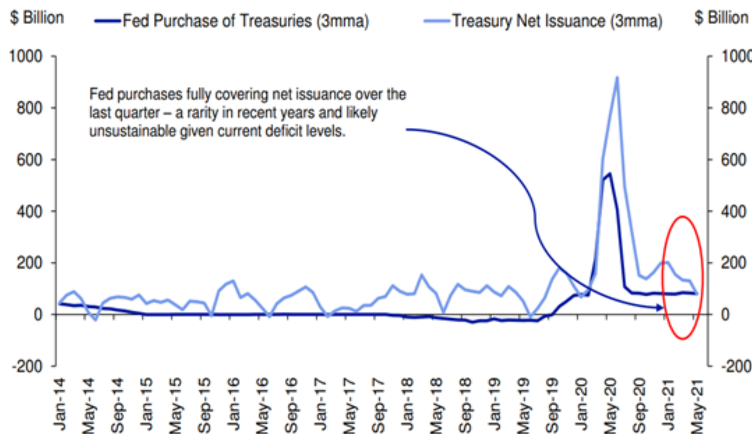
Taking Stock – Meme Stocks

Meme stocks are stocks driven by social media coverage and retail investor momentum, marked by unusual trading volume. Meme stocks came into the consciousness of the broad public through the notable volatility in Gamestop. Recently, AMC Entertainment and Blackberry have filled in where Gamestop left off. Meme stocks are often fueled by a short squeeze. Investors use social media to coordinate concentrated buying efforts, forcing short sellers to close their positions, resulting in further upward price pressure. The chart depicts both Gamestop in blue and AMC in Green YTD as of June 27, 2021. Game stop is up 1402% YTD while AMC is up 1845% YTD. Blackberry has become another Meme stock darling, up 82% YTD for the same time period. Gamestop continued to see upward price pressure as it was added to the Russell 1000 index as a result of its meteoric rise in market capitalization.

Source: CNBC

Fixed Income - Last Buyer Standing

You would not be alone today in questioning who is willing to buy U.S Government debt at the current yields, given where inflation is now and is expected to go in the future. How do you make financial sense out of buying a bond that does not mature for 30 years that yields 2.1%, when many are forecasting that inflation may average 4% over that same period? For example, $100,000 invested today in a 30-year Treasury would only retain $30,821 in purchasing power at maturity if inflation averaged 4%. If your assumption for inflation is 3%, you still are left with only $41,200 in real terms at maturity. A 10-year Treasury today will lose more than 25% in real terms at maturity with just 3% inflation. As the chart demonstrates, among the only parties willing to lock in these losses is the Fed.



Technical - Running out of Margin?

One of the data points market technicians keep close tabs on is margin debt on the S&P 500. History suggests that when margin debt peaks then retreats, it creates pain for investors long in the stock market. We are at the highest margin levels in history, just exceeding $1 trillion in June, doubling in just 18 months. Margin works wonderfully when stock prices are rising, but forces selling when stocks begin to decline. Just as margin creates artificial demand when markets are rising, they create artificial selling in a downturn. Margin levels peaked in 2000, 2007, and 2018 in advance of large stock market declines. Those hoping peak levels of margin will no longer be a leading indicator for the stock market may find themselves disappointed. Historically, the stock market does not sell off until margin starts its decline, so the bull market may have a bit more room to run.

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Advice for Young Investors

Clint Pekrul, CFA

Investing advice for young investors – those just starting their careers – is much the same today as it was decades ago. Financial independence and security come about by following some basic rules that anyone can follow.

Ultimately, as you work your way through your career, you will either own or owe. You can be an owner of assets – stocks, bonds, real estate, etc. – and be financially independent, or you will owe someone something.

It is difficult later in life to be in debt and have financial obligations that seem to never go away. Starting early in life down a path to ultimately be an owner of assets can help ensure a comfortable retirement. Below are three best practices that can help get you started:

Do Not Spend Beyond Your Means

Starting out on your own can be difficult, especially if you do not have a safety net to fall back on, such as an inheritance or a trust fund. For most, your income in your early twenties will be just enough to get by. After paying for living expenses, such as rent and utilities, the amount left over might not take you very far.

However, it is better to sacrifice now than when you are older. One of the worst financial decisions you can make is to rely on unsecured debt (i.e., credit cards) to fund a lifestyle that you cannot afford. Financial institutions are more than willing to give you access to a line of credit. In fact, you will likely receive multiple credit card offers with the allure of instant access to funds you otherwise would not have.

As you are likely aware, unsecured lines of credit are expensive. The interest rate that banks charge you on credit card balances is exorbitant simply because there is no asset to collateralize the debt. Unlike a mortgage, if you do not pay the balance on a credit card, the bank cannot repossess your house.

These exorbitant interest rates are quite costly over time. After the utility you receive from a credit card purchase is long gone, you will likely continue to pay for it for some time. If you do not pay off your monthly balance in full, your credit card balance will continue to rise simply due to the interest accrual.

Understandably, there will be emergency expenses that can arise. But by and large, using credit cards for frivolous purchases should be avoided.

Invest Early and Often

The number of books and publications written about the long-term benefits of investing is almost too large to count. But the concept is proven true time and again due to one simple process – compounding.

Even if the amount you can invest early in your career is a relatively small amount, over time the cumulative value of your investments will tend to grow exponentially.

Perhaps the most convenient way to set aside a portion of your paycheck for savings is by participating in a 401k plan through your employer. If this option is not available, you can always establish a personal account and automatically set aside a portion of your paycheck every month.

Perhaps the most straightforward way to invest is through an index fund that tracks the broad equity markets like the S&P 500. Simply buying a few shares of an index fund every pay period (a process known as dollar cost averaging) can accumulate into a considerable balance over several decades.

If you reinvest dividends and make steady periodic investments, your return will compound over time. You will eventually earn future dividends on the dividends you reinvest today. Furthermore, the dividends are not something you paid for but something you earned by owning stocks.

Your $100 investment today could eventually grow to $1000. Imagine a series of $100 investments per paycheck all eventually growing to $1000. This is the power of compounding and how you accumulate wealth over the course of a career. Would you rather invest $100 for your future or pay $100 to a credit card company and have nothing to show for it?

Strive to be a Homeowner

Being a homeowner is not always pleasant. Unexpected costs arise periodically and selling your house can be costly if you must move. But in general, a rule of thumb is to strive to eventually own your own property.

More often than not, rent or a mortgage payment will be your biggest monthly expense. The difference is that a mortgage will eventually be paid off and the monthly expense will go away. The result is that you will own a real asset that will likely represent one your most valuable investments.

Rent, on the other hand, will not go away. In fact, rental payments will tend to increase over time. There is some convenience to renting, but over the long run you are simply paying your landlord’s mortgage and will have nothing to show for it.

Planning for a secure financial future is not overly difficult if you follow some best practices today. Avoid using expensive debt to pay for a lifestyle you cannot afford, invest early and often, and strive to own your own property.

As decades go by you might be surprised at how much wealth you can accumulate while avoiding the pitfalls of having no financial plan for the future.

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Q: What should we make of recent Bitcoin volatility?

As Bitcoin struggles to become more mainstream and an acceptable tender for payment, people are taking note of very large volatility swings in the price of the cryptocurrency. The most reported cause of the correction in Bitcoin prices is a crackdown by the Chinese government on mining in the country. According to blockchain.com, more than 65% of global Bitcoin mining occurs in China. The latest crackdown is said to have reduced mining in China by over 90%, according to the CCP-backed newspaper Global Times. China has also pressured finance companies like Alipay to restrict trading and payments in Bitcoin. Crackdowns by the Chinese Communist Party are not that surprising -- it has happened three times in the last eight years.

The sharp retreat in prices, after doubling since the beginning of the year, caused what is technically known as a "death cross" for Bitcoin. A death cross occurs when the 50-day moving average crosses below the 200-day moving average. This technical indicator has preceded many major stock market corrections, but history suggests another likely outcome when looking at Bitcoin. A death cross has occurred seven times with Bitcoin, and the price has climbed 11% on average over the following 30 days. Trading Bitcoin is more speculating than investing, so volatility that might spook stock investors will likely feel more like a buying opportunity for owners of Bitcoin. Do not be shocked to see prices higher in the near future.

I would not make too much of a concern about recent volatility in the cryptocurrency. If there is one certainty about Bitcoin, it's that its price movements can be quite volatile. When you think about Bitcoin, it is basically a commodity at this point. It produces no cash flow, earnings, or dividends, so it is no surprise that we experience wild price swings in the short term. Gains of 200% or 300% can easily be followed by declines of -50% or -60%. Historically, for example, Bitcoin traded around 19,000/USD around the end of 2017, and then fell to around 4,000/USD at the end of 2019. It then subsequently surged to over 60,000/USD earlier this year, but now trades at roughly 30,000/USD. If you were fortunate enough to buy Bitcoin early on you are likely still trading well above your initial cost basis and sitting on some substantial gains.

However, if you are just beginning to trade Bitcoin, I think it is important that you appreciate the volatility and understand how rapidly the value of your position can change in a very short period. Active traders actually welcome the volatility in order to make short-term profits. However, if you are simply holding a strategic position in Bitcoin, be sure you have a long-term time horizon to recoup any short-term losses.

Q: What is the latest data on insider buying and selling?

Institutional investors have been increasingly reducing stock market exposure as the markets surge to new highs, and tracking the activity of company insiders is likely one of the reasons. It is presumed that people considered insiders, board members, and key management and executives, have non-public knowledge about the outlook for company earnings or other reports that would impact how their stock is likely to trade in the future. While there are obvious reasons why insiders sell, diversification and personal liquidity needs when the numbers become very skewed towards buying or selling can signal a change in market direction.

The most recent data out of tracking company Sentiment Trader shows the ratio of insider sells to buys at a staggering 143-1. That means there are 143 insiders registering a sale of stock for every insider registering to buy their company's stock. This is the highest level since data was tracked starting in 2006, and more than double the previous peak according to the firm. It is not surprising, given the historically elevated valuations, that smart investors, regardless of insider status, would be selling into strength. It is the magnitude of selling that suggests that a turning point may be imminent. When you consider that margin in brokerage accounts recently exceeded $1 trillion, an increase of 72% from this time last year, there are multiple indicators suggesting stocks could be near an inflection point.

Tracking the net insider buying and selling of the overall equity market can help gauge investor sentiment and predict if the market is likely to continue moving higher, or perhaps move lower in the near term. After the onset of the COVID-19 pandemic in March 2020, the ratio of the number of insiders selling to the number of insiders buying briefly dipped below one. Not surprisingly, at the time, there were more insiders selling than buying. However, as we moved through 2020 the ratio quickly changed and accelerated upward. By the end of the year there were roughly four-and-a-half times more insiders buying than selling. Markets surged to new highs, which pushed valuation multiples into the stratosphere.

What we have seen recently, however, is a bit of a pullback in the insider ratio from a high of four-and-a-half down to roughly three-and-a-half. This pullback is not too surprising when you consider the magnitude of the run up in stock valuations off the pandemic lows a year ago. Perhaps it is an indication that insiders are simply taking some profits off the table. However, it could reflect increased concerns about inflation and uncertainty about the Fed's future path on interest rate policy. For now, markets are calm, but insider activity is worth monitoring.

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