Andrew 0:05

Hello, and welcome to JGUA financial commentary podcast. I'm your host, Andrew Barron. And in this episode, I sit down with research analyst Bill Armstrong to discuss the state of the markets and what to watch in the global economy for 2021. But first, a short disclaimer, the contents of this podcast are strictly for informational purposes only, and nothing said shall be taken as investment, tax or legal advice. Any strategies discussed may not be suitable for listeners specifically and JGUA encourages consulting with your advisor before implementing any strategies to ensure they meet your individual objectives. And with that out of the way, welcome to the podcast bill.

Bill 0:49

Thank you. Glad to be here.

Andrew 0:51

All right, as we record this podcast on January 5 2021, I see Dow Jones is above that magic number 30,000. But over the last 12 months or so we've seen a lot of volatility. Can you give us a recap about what's happened?

Bill 1:06

It's been pretty crazy to say the least. We began last year with stocks doing very well, the economy doing very well. We had 50 year low unemployment, you know, things were really chugging along. And that of course, COVID-19 hits, everything falls apart, at least for a short period of time, the markets obviously collapsed, but not for long. The Fed steps in with virtually unprecedented liquidity measures to prop up markets. So bond markets had threatened to freeze up, fed took care of that, stocks reacted very favorably a lot of liquidity injected into the market. Then on the fiscal side, we have the cares act, stimulus, we just got a new one just a week or two ago, that was smaller, but still more stimulus, PPP loans, help small businesses help people keep getting paychecks, you had extended unemployment benefits, all those things were very good in propping up the economy, propping up consumer spending, consumer saving, we had a big trend and work from home stocks or stay at home stocks, you had traditional retail, of course, taking it on the chin, especially high touch type of businesses like restaurants, hotels, sporting arenas, amusement parks, that sort of thing, where you have a lot of crowds. Those still have not really recovered, we're still in, you know, a quasi-lockdown mode, even as we speak, with a second wave of infections. One of the other issues for stocks, of course, are interest rates being super low near zero really got the Tina effect, there is no alternative to investing your money, you're not getting any return in bonds. So the default is real estate or stocks. Now sitting here, we have vaccines that are out there. And so there's light at the end of the tunnel. And the market is pricing that in. So far, the problem hasn't been with adoption of the vaccines has been with distribution, hopefully with the states and the various authorities that are charged with actually getting needles into people's arms. And we'll start to get a lot of people vaccinated. And hopefully at some point later this year will be at least close to normal again.

Andrew 3:32

Before we get into the next question, I want to expand on that work from home stocks and Tina concept. We saw really unprecedented growth in a number of tech stocks, especially in companies providing video services and deliveries as everyone kind of scrambled to adjust. But also a number of old established retailers declared bankruptcy in 2020. So there's really a sense that we've entered kind of a new era. And we probably were always headed there. But COVID really accelerate us to make that change. And then there's that acronym, Tina, there is no alternative. Where because there are limited options on where to invest in to actually get yield, or seeing the same company soar even higher. And while the stock market gets lots of attention, here at JGUA, we pride ourselves actually on our balanced portfolio philosophy. So we actually use bonds to help offset the volatility of the stock market. So that leads us into my next question, what's going on in the debt markets Bill?

Bill 4:42

Well, we've got record low interest rates, and not just in the United States, but you know, Japan, Europe, pretty much worldwide. We've had close to a 40 year old market in bonds. And now as interest rates go down, bond prices go up. It's an inverse relationship. How much further interest rates go there actually are negative interest rates for European government bonds. We haven't gotten there yet in the United States, maybe we will maybe we won't. Negative interest rates are something that a lot of people have a hard time getting their head around, why should I lend money and then pay the borrower to borrow money from me that seems crazy that for a lot of people, understandably, makes bonds a very unattractive investment, because you're guaranteed to not have any positive return. That makes it that makes it tough. It's great if you're a borrower, but not so much. If you're a lender, again, that sort of makes stocks a default investment choice for people that are looking for income.

Andrew 5:45

You said at the beginning of your answer about bond bull markets, can you talk to our listeners about why bond have come down so much over the last 30, 40 years,

Bill 5:56

It really started in the 80s, when you were coming out of the 1970s, with very high inflation. Paul Volcker, who was then chairman of the Fed use monetary policy to break the back of inflation, that for a short period of time led to very high interest rates, interest rates have been coming down ever since some of it has to do with economic productivity, you've got more money chasing, perhaps, you know, less investment opportunity over time. But it's been obviously a multi decade process. And we're now it seems at the logical conclusion of that bull market. Because, again, interest rates, to my knowledge have never been negative until very recently. And it seems like that's about as far as I can get.

Andrew 6:45

So since we are in this low interest rate environment, and anyone looking for their typical safe yield is kind of struggling. But you mentioned a little bit earlier, how is that playing out for borrowers?

Bill 6:59

For borrowers, it's great. If you're looking to buy a house, you can get very cheap mortgages, mortgages are at record lows, car loans, if you're a corporate borrower, borrowing is very cheap. If you're the government, you're paying little or next to nothing in terms of interest rates. Japanese and German governments are actually, like I said before, getting negative interest rates. Yeah, it's great for borrowers not so good for lenders.

Andrew 7:28

That actually leads us into my next question. We've seen bond yields decline for decades. And there's very low interest rates worldwide, including those negative yields in Japan and Europe. But there's also been a lot of money printing in response to the pandemic, as governments try to stimulate their economies while they are managing those outbreaks. With all of this sudden inflow of money, should we be worried about inflation?

Bill 7:59

I'm not worried about inflation right now, that was a big concern, a dozen years ago, coming out of the financial crisis, when the Fed and other central banks, pumped tons of liquidity into the system. And the fear back then was we were going to have a big bump up of inflation, and didn't happen. Inflation has been very tame. For a long time. Now, the Bank of Japan has spent 30 years trying to get inflation higher, they haven't been able to do it. The Fed has a 2% inflation target, which gets hit every so often, but not on a consistent basis. And they said, you know, the Fed said recently that we're going to keep interest rates very low, at least for another two to three years, until we get to our 2% inflation target. One of the things right now, I think that is also making inflation, a very distant threat or just likelihood is the fact that we do have high unemployment. So you don't have any upward pressure on wages. Even before pandemic, when we had an ultra-low unemployment, we still had very low single digit inflation rates. So it's not like we've got an overheated economy that is pushing prices up. We're just not seeing it. So I think one of the things that's worked to help keep inflation down is the fact that even though we had, you know, a record recovery from the financial crisis in terms of length went over a decade. When you look at the growth rates, there are actually very low, low single digit growth in GDP every year. So you did not have overheated conditions. You have pockets of inflation and certain commodities here and there, but we did not see it on a broad base or sustained basis.

Andrew 9:50

So we have a stock market that's high and we have you know, heating up home market, but at the same time, there's some concern that This isn't full recovery, that there's a disconnect. Can you talk to our listeners about why the stock market and the overall economy aren't the same thing.

Bill 10:09

Historically they move in the same direction. But there are always periods where there's divergence, and then they reconverge. Again. And I think that will happen. In this case, the biggest problem in the economy right now, stemming from COVID is high unemployment. Unfortunately, for those who are the victims of this, most of the jobs lost were in low wage positions, low wage occupations. And so because of that, while the number of individuals who are employed are high, the impact on aggregate personal income is relatively muted, because these are low wage earners. So the stock market, obviously, you're investing in companies, not in individuals. So certain industries, like airlines, movie theaters, retail restaurants, those have been hurt, and those stocks have reflected it. But most other large companies and industries after the initial shock, have recovered pretty nicely. And that's why you see what appears to be a disconnect. Now we have a new stimulus package, we have a vaccine. Hopefully, a lot of the people who lost their jobs will regain them or other jobs will be created, I think there will be, again, renewed demand for restaurants, for sporting events for entertainment cruises for travel. So I think we'll see recoveries in those sectors, but those will be the last to recover because they require large groups of people in close proximity. So those sectors happen to employ large numbers of people in relatively low wage jobs, but still jobs that can sustain people. And so I think that'll be the kind of last leg to seeing a full normalization, or renormalization of the economy.

Andrew 12:17

Re-normalization, that's a word you're hearing a lot. But we're already seeing companies changing how they do business. And we're seeing people change the way they buy stuff. And some of these behaviors will remain for years to come. So what else can we watch for in 2021?

Bill 12:35

I think the biggest thing is the vaccines, like I was saying before, they need to be distributed more efficiently and get some more people. Hopefully these initial fits and starts are just that you have people coming off the holidays, maybe there were not enough personnel for distribution. And hopefully both will get worked out it will start to get mass vaccinations sooner, of course, you also have a certain segment of the population that doesn't necessarily trust vaccines. I think a lot of people will come on board as they see more of their families, friends and coworkers getting the vaccine and not having ill effects. And like I said before, production does not seem to be a problem. Moderna and Pfizer are producing tons of this stuff. And new vaccines will get approved. AstraZeneca just got approved in the UK. They're thinking phase three testing in the United States or other companies as well. I think once the vaccination process gets more efficient, we're going to see rapid improvement in vaccination rates and rapid declines in infection rates.

Andrew 13:46

I know we went through a lot of information on all of this. So if our listeners do have any questions, please send them to info@jgua.com. And also visit our website for additional content. Thank you so much for being part of this. And thank you to all of our listeners as well. Until next time, everyone, stay smart.