Cornerstone
ASSET MANAGEMENT GROUP, LLC

5411 Commonwealth Ave | Western Springs, IL 60558 | 312-485-6847 | Kim.Suchy@csamg.com

Economic Indicators February 2021

By Kim W. Suchy

No! I will not buy you GameStop! Many people do not understand the mechanics of what is going on with GameStop, AMC, Blackberry, Macy's and others. Why are their market valuations surging when their balance sheets and outlooks are distressed? I will attempt to simplify why these stocks have reached meteoric heights in a short period of time.

GameStop, a brick and mortar company with 5000 stores, sells video gaming consoles. This was going under thanks to C19 and the fact that foot traffic grinded to a halt. Many suggest that the GameStop saga is analogous to the DVD rental company Blockbuster which collapsed after Netflix launched. With such a poor prognosis, big-name hedge funds bet on GameStop falling even more in the future, thanks to a surge in online video games during C19. What was missing from the Blockbuster scenario was an online army of small, or day time, investors determined to defeat big bad Wall Street.

The GameStop investment story has been making frantic rounds on social media. A social media site, Reddit, has been serving as a financial chat board that encourages small retail investors to push back against hedge funds that have been shorting GameStop. What motivated the Reddit chat participants was that the hedge funds were short 135% of the outstanding shares. So, the chat site encouraged each other to keep buying GameStop and push it ever higher. It worked. However, when a stock is very heavily shorted, a rise in its price can force short sellers to get out of their bets. To do this, they have to buy the stock, which pushes the stock even higher which creates a very dangerous loop because when the music stops, someone will not have a chair and lose a considerable amount of money especially if leverage was used to initiate a buy or short position.

With GameStop trading around $18 early in January, it doubled in four days. It kept moving higher, before nearly doubling on Tuesday (1/26) and then more than doubling again on Wednesday to $347.51. On Thursday, it gave back a good deal of those gains and finished the

day at $193.60, down 44 percent. Then, on Friday (1/29) it closed at $325. This is nonsense for a stock that reported earnings of -$4.22 per share; yes, minus!

Remember, over the long term, a stock's price has a tendency to track with the company's profits, and GameStop's prospects do not appear healthy. This will not end well and will certainly generate more regulatory reviews. Certainly, the exploitation of excessive shorts would surface at some point but I doubt investors and regulators saw the magnitude of what is transpiring now.

Brokerage houses have been making it ever easier for novices to get into the market and trade. We saw an explosion of retail day trades during the "work from anywhere" boredom associated with C19. Commissions have dropped to zero, and now people can trade using apps on their phones. As these barriers to trading have been relaxed, consumer advocates revel in the broadening playing field. However, they also state that it is possible to have too much of a good thing.

While I have never been a fan of excessive regulation, this is a case where the SEC must review. The SEC's role is to protect investors, and the expectation across Wall Street is that investors holding GameStop on Main Street at these bloated prices are likely to be badly burned when its price falls. Congress already has this in their sites. In fact, the House Committee on Financial Services has been very vocal and will undoubtedly have a hearing on the process that has taken place with the likes of GameStop.

Stay tuned, the findings could be a GameChanger.

Here is your look at developments in the global marketplace.

Positive Developments:

- Industrial production finished 2020 strong, rising for a 3rd straight mo. and posting the largest monthly gain since July. Moreover, gains were broad-based in December, with nearly every major series posting an increase. Industrial production has now made up 80% of the decline in activity during the height of C19 lockdowns back in March and April according to the Federal Reserve.
    - The Fed also reported that overall capacity utilization increased to 74.5% in December from 73.4% in November. Capacity Utilization is the relationship between output that is produced with the installed equipment, and the potential output which could be produced with it, if capacity was fully used. So, a gradual increase in this factor suggests the economy is beginning to accelerate.

- Durable goods orders ended 2020 at a near full recovery from the C19-related drop of more than 30% in March and April. With an increase of 46.4% since the April bottom, new orders are now just 0.3% below the February pre-pandemic high, suggesting a V-shaped recovery.

- Experian (credit score company) reported that the average FICO Score in the U.S. reached an all-time high of 710 in 2020. FICO Scores are used in over 90% of U.S. lending decisions. All 50 states and Washington D.C. registered credit score increases ranging from 3 to 10 points. Scores can range from 300 (poor) to 850 (excellent). Minnesota residents had an average credit score of 739, topping all states for the 9th straight year. Mississippi ranked last with an average score of 675.

    - *How can FICO's head higher during C19? The government's economic stimulus actions last spring helped boost the average consumer, providing one-time checks, delaying home foreclosures and increasing unemployment benefits. FICO scores also typically lag movement in the economy. In other words, scores may yet decline, reflecting the impact of the C19 slowdown.*

- Housing starts increased 5.8% in December to a 1.7M a/r. Starts are up 5.2% versus a year ago. Despite C19, labor shortages, social distancing regulations, and a host of other obstacles, builders started homes at the fastest pace since 2006, up 7.9% vs. 2019.

- The S&P CoreLogic Case-Shiller National Home Price Index, which measures avg. home prices in major metropolitan areas across the nation, rose 9.5% yoy ending Nov. 2020, up from an 8.4% a/r the prior month. November marked the highest a/r of price growth since Feb. 2014. In addition, sales of previously owned homes, which make up the bulk of the housing market, rose in 2020 to their highest annual level since 2006, according to the National Association of Realtors. Low mortgage rates increase demand, while the supply of homes for sale has remained low leading to the surge. In addition, the work from anywhere philosophy adopted by many companies has given buyers the freedom to seek larger homes in desirable areas.

- The index of consumer confidence rose to 89.3 this month from a revised 87.1 in December, the Conference Board said Tuesday. Last month's reading was the lowest in five months. The consumer confidence index tracks how consumers feel about the economy right now. Their expectations for the economy and jobs, however, advanced further, suggesting that consumers also foresee conditions improving in the near future.

- The U.S. economy downshifted in the final 3 mos. of 2020 after record Q3 growth, as the pandemic continues to batter the labor market and limit consumers' ability and willingness to spend. The Commerce Dept. noted the increase reflects both the continued recovery from last spring's lockdowns and the ongoing drag from the pandemic, including new

restrictions and closures that took effect in some areas of the U.S. in October and November. While output of goods and services was far slower than the record 33.4% rate in the previous 3 mos., the growth pace still exceeded the average of the decade-long expansion that ended early last year. *Note, we may very well see an extended rebound as many cities have relaxed their lockdowns and limits in January*.

Neutral Developments:

- Of concern is the idea that the dollar's weakness may be, in part, a referendum on U.S. mounting federal debt and increasing budget deficit. Therefore, I will keep an on the change in money supply (i.e. how many dollars are in circulation). This measure is significantly higher than it was during the financial crisis some years ago, again highlighting the massive fiscal and monetary policy currently in play. This may soon be inflationary and a plus for gold prices.
    - *First Trust reports that consumer prices (CPI) continued the trend higher that started back in June, and ended 2020 with prices up 1.4% from where the year began. While the declines of March through May held down the full-year price change, movement since May has been pronounced, up at a <u>4.1% a/r</u> which represents the fastest pace of price gains in nearly a decade. In other words, inflation since the early C19 shutdown has been running well above the Federal Reserve's inflation target of around 2%.*
    - *Producer prices (PPI) rose in November for a 7th consecutive month, and are up near the fastest 6-mo. annualized pace in nearly a decade at 3.8%, a sharp rebound from the -3.5% annualized pace for the 6 mos. ending in April. Prices for goods pushed the index higher, while prices for services were unchanged on the mo.. The key contributor to the November rise came from final demand energy, up 1.2%, led by a surge in the cost for diesel fuels for natural gas and electricity*
- We may see two modes of economic "fiscal" stimulus this year. The first, and currently in the works, is focused on additional income replacement, including direct checks, to help consumers who have not fared well throughout the pandemic. The second will be a larger package focused on infrastructure, climate spending, and other programs. This could take some time but likely that something comes through this year.
    - Note, the size and speed depends on the path that each program takes in Congress. Democrats could try to compromise with GOP and pass the measures with 60 Senate votes, but that will probably lower the scope of the program. Alternatively, they could use budget reconciliation which can be passed with a majority of 51 votes yet this may result in a much smaller program scope.
- Markets have been rallying of late on hopes that C19 vaccines will lead to a robust economic recovery later this year as business and social activities gets closer to "normal". However, increasing global C19 infections, mutations of the virus, tightening social distancing restrictions and delays in vaccine delivery and inoculation, can be viewed as near term risks to recovery.

- In 2020, Congress relaxed the withdrawal rules on (IRAs) and retirement plans due to C19. This allowed people to withdraw as much as $100K from IRAs or 401(k)/403(b)-type plans throughout 2020 without incurring the 10% early-withdrawal penalty if under age of 59. The Wall street Journal reported that Fidelity reported that 6.3% of eligible participants in its 401(k) plans took some money out while 5.7% of Vanguard participants took distributions. Note, those who took monies out due to C19 can repay the money within 3 yrs.

- The Employment Cost Index rose 0.7% in Q4. Concerns are that this is indicative of wage inflation? However, this may not be the case as there are still millions out of work and labor is not in a strong negotiating position. What is likely happening is that the increase in avg. employment costs reflects the 500K job losses in leisure and hospitality stemming from new lockdowns in Q4. *As lower paid workers leave the ranks of employed, avg. pay rose as a result. As they renter the job market, the Index will likely fall.*

Negative Developments:

- C19-related shutdowns continue to impact the economy, with consumers getting more cautious in December. Retail sales declined 0.7% for the month, lagging consensus expectations of no change. The Census Bureau further noted that the decline in sales was led by non-store retailers (internet & mail-order) and restaurants & bars. The largest gains were for gas stations and autos. Expect this to turn around as many cities commence

- Biden has suggested a number of tax changes at both the individual and corporate level. Here is a partial list:

  - Raising the highest individual tax rate from 37% to 39.6%.
  - Lowering the value of income tax deductions to 28% for high-income taxpayers (w/ some exemptions).
  - Reinstating the state and local tax (or SALT) deduction with higher limits.
  - Increasing the capital gains and dividend tax is also possible, likely in the range of 25% to 28%.
  - Raising the corporate tax rate
  - Increasing taxes on foreign source revenue of US multinationals.

- Four times as many jobs were lost last year due to the coronavirus pandemic as during the worst part of the global financial crisis in 2009. The International Labor Organization estimated that the restrictions on businesses and public life destroyed 8.8% of all work hours around the world last year. That is equivalent to 255M full-time jobs — quadruple the impact of the financial crisis of 2009.

- The budget deficit for fiscal year 2020, which ended 9/30/2020, was $3.1T, the highest ever in dollar terms, and the highest relative to GDP since WWII. This year the deficit grow further. According to studies of monetary policy, no Central Bank believes that

you can print and spend like a parched sailor…it has never worked and bad outcomes surface namely, devaluation and inflation. We can expect that bond yields will start to climb higher as inflation accelerates. It is spending, not borrowing and deficits that will provide the economy with a boost.

- More large U.S. companies (public and private companies with >$50M in liabilities) filed for bankruptcy protection in 2020, the most since 2009, according to Bloomberg. There were 244 filings in 2020, the most since the 293 in 2009. No surprise but sectors hit the hardest were energy, retail and consumer services. The energy sector was hardest hit with 47 filings.

- As a labor economist, Janet Yellen is going to be conflicted as the Biden team desires a $15 per hour minimum wage which could very well slow new job creation, especially for many struggling restaurants, service industries and small companies.

Over the past month, a new presidential administration has been busy making changes that the market is attempting to digest. The degree of penetration of C19 vaccinations continues to weigh on the market as the sooner we attain herd immunity, the quicker the consumer driven economy can move forward. Last month, health care, energy, real estate and consumer discretionary were the strongest performing sectors in the SP500 while consumer staples, industrials and materials were laggards.

U.S. Index	Last Month (% return)	1 Year (%)
S&P500	-1.1	15.2
Dow	-2.0	6.1
NASDAQ Comp	1.4	42.8
Russell 2000	5.4	22.2

On the international front, both European and Asian markets were mixed with Hong Kong, Japan and China logging positive returns. Europe was generally lower in January. Gold bullion was lower last month and posted a -2.4% return yet remains one of the best performing asset classes over the last year.

International Index	Last Month (% return)	1 Year (%)
Euro Stoxx 50	-2.0	-4.4
Hang Seng	3.9	7.5
Germany	-2.1	3.5
Nikkei	0.8	19.2
FTSE-U.K.	-0.8	-12.1
China Shanghai Comp.	0.3	17.0
Gold	-2.4	22.2

While bond yields remain near record lows the 10-year yield is now trading at 1.064 % which is 14 bps higher than at the close of December. The 2-year Treasury closed yielding .11%, which is 1 bp lower than where the 2-years closed last month. The curve has widened a bit given that the 10/2 spread is at 95bps or 15bps higher than last month.

As always, if I can be of additional guidance, please feel free to call me at 312.485.6847.

Best regards,

Kim W. Suchy
CEO Cornerstone Asset Management Group

Email: Kim.Suchy@csamg.com
Website: www.csamg.com
LinkedIn: https://bit.ly/30Gr3XF