PERSPECTIVES

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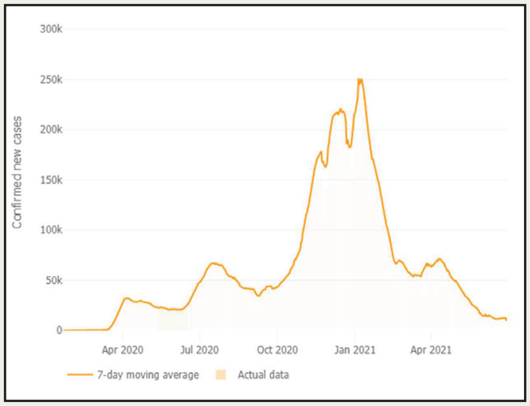
"IF EVERYONE IS THINKING ALIKE, THEN SOMEONE ISN'T THINKING."

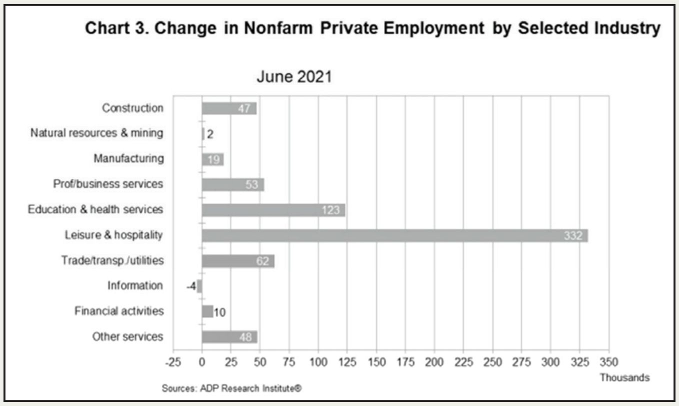
-GEORGE S. PATTON

Temperatures are soaring…in the northern hemisphere, heralding the arrival of summer. As the Pacific Northwest endures a historic heatwave and the fifth named storm of the hurricane season ("Elsa") churns the Atlantic, this summer promises to be anything but normal.

As the mercury rises…so too does the rate of vaccinations, barometers of economic activity, and of course the stock market. Optimism abounds as the economic reopening continues apace.

Going the other direction…and indeed the *right* direction, are both the number of confirmed COVID cases and the unemployment rate. While inoculation efforts continue, 46.8% of the U.S. has been fully vaccinated thus far.[1] The consequent lifting of social distancing restrictions has caused businesses, particularly those hit hardest by the pandemic, to embark on a hiring spree, adding 692,000 jobs in the month of June alone[2].





[1] Mayoclinic.org as of 6-29-21 Chart: Coronavirus.jhu.edu; [2] ADP National Employment Report June 2021

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Silly season is still with us…as the throngs of retail traders continue to speculate in "meme stocks" such as AMC Entertainment. Encouragement found in online forums has driven the beleaguered movie theater chain's stock price up 2,573% so far this year, rendering AMC worth more than companies such as Clorox and Whirlpool despite being unprofitable.[3]

For their loyalty…AMC shareholders have been rewarded with significant dilution as share issuance has reduced their ownership stake – and claim on future profits – by 66% since the beginning of this year. But hey, at least they get free popcorn and exclusive access to screenings.

At the nexus of "get rich quick and irrational exuberance"…lies Lordstown Motors. An electric vehicle startup that raised $1.6 billion in a Special Purpose Acquisition Vehicle (SPAC) offering last year, it has recently warned in a regulatory filing that it may not be a going concern within a year. They will not likely be the last to do so, for in the clamor to find the next Tesla investors poured over $6 billion into SPAC offerings by EV startups, many of which did not even generate revenues.[4]

The perils of SPACs are many…which we've attempted to highlight in prior publications. But don't take our word for it; instead, please consider the following excerpts from recent research published by Stanford University:

"We find that their structure…creates substantial costs, misaligned incentives, and on the whole, losses for investors who own shares at the time of SPAC mergers."

"SPAC shares tend to drop by one third of their value or more within a year following a merger."

"The median cost of dilution is 50.4% of money raised…"

Regulators are beginning to pay attention…which may ultimately dampen enthusiasm for the more speculative investments, a healthy development in our opinion.

Bitcoin…the highly-touted investment panacea for everything from profligate government spending to wealth inequality, has seen its price nearly halved since peaking in April. The preferred payment method of Cartels and Ransomware Hackers has invited increased regulatory scrutiny. As some foreign governments (China, India) have functionally banned cryptocurrencies, domestically the SEC, DOJ, and IRS have each opened investigations into crypto exchanges while the Biden Administration has mandated reporting of all transactions greater than $10,000.

Continuing to soar…are the prices of, well, everything! The surge in demand for goods has exceeded the ability of supply chains to keep up as the economy reopens. The increase in lumber prices alone has added over $24,000 to the price of a new house[5], and shipping delays (see also: Suez Canal/Ever Given) have increased supplier delivery times, exacerbating upward price pressures.

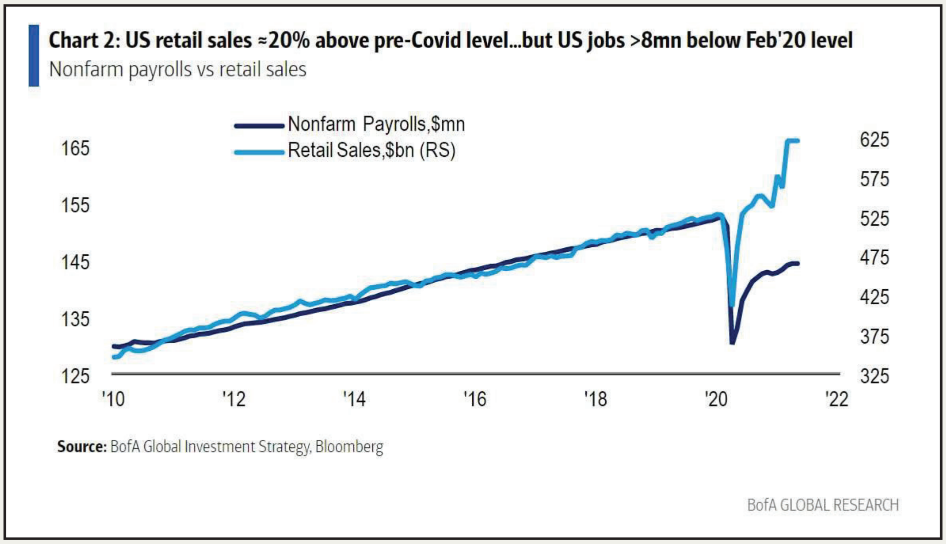
The constant quest for improved efficiency…has led to widespread adoption of the "just-in-time" method for managing inventories, constraining the ability to respond to large changes in demand. For example, consider Fedway, a liquor distributor in New Jersey. Capable of delivering 47,500 cases per day, many of which were ordered the day before, their warehouse has over five miles of conveyor belts that sort and package bottles, after which they are assembled on a truck in accordance with a computer-generated route optimized for delivery times.

[3] Factset as of 6/30/21; [4] Financial Times – Lordstown City Limits 6/10/21; [5] Bloomberg; National Association of Homebuilders 4/13/21

Is inflation here to stay? As our inboxes suggest, this is the most hotly debated topic, exposing a wide chasm among leading economic forecasters. Proponents will point to the enormous amount of stimulus that went directly into the hands of consumers and the severe labor shortages faced by employers, which could raise wages. Naysayers argue that supply constraints are temporary, commodity prices are already rolling over, and that unemployment remains high, creating slack in the economy.

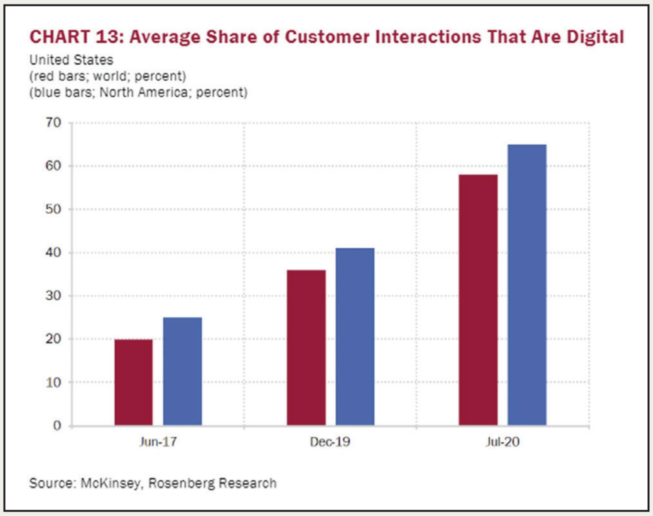
As we were taught in school…the cure for high prices is high prices. Most goods face elastic demand, meaning consumers will buy less, or none at all, when prices exceed what they are willing to pay.

Oddly enough…both sides point to the labor market to reinforce their argument, and rightly so. The historical relationship between retail sales and payrolls is clear and the recent divergence, likely influenced by stimulus checks, does not look sustainable. Furthermore, commodities contribute just over 10% to the final price of goods while wages account for 70%.[6]



Wages will be watched closely…particularly by the Federal Reserve, which has firmly taken the stance that inflationary forces are transitory and as such monetary policy can remain accommodative. Bolstering their case is the marked increase in productivity seen during the pandemic, providing a headwind to wages as companies find ways to do more with fewer workers.

Technology…and the adoption thereof, is a potent deflationary force sure to challenge policymakers for years to come. It would be difficult to overstate the impact that Amazon has had on driving down the price of goods, improving the purchasing power of American consumers, and providing hundreds of thousands of jobs along the way. This meteoric ascent has come at the expense of myriad small businesses, brick-and-mortar retailers, and soon the delivery drivers themselves, as Amazon is making substantial investments in the autonomous trucking business.[7] The economic reward for Mr. Bezos' efforts is a personal fortune estimated at $280 billion, larger than all but eight of the world's sovereign wealth funds.[8]



[6] Rosenberg Research; [7] Bloomberg – 6/21/21; [8] https://en.wikipedia.org/wiki/List_of_countries_by_sovereign_wealth_funds

We won't deign to predict the future…preferring instead to take our cues from market signals.

The recent decline in Treasury rates…across the yield curve suggests that the economic recovery may be less robust than initially expected. Slowing vaccination rates, coronavirus variants, and the prospect of tax increases all pose potential risks to growth to which the equity markets appear to be indifferent.

Complacency…is not the natural state of markets. When optimistic outlooks become consensus and disregard for risk prevails, patience and adherence to fundamentals are imperative.

For those we have the privilege of serving…we will remain vigilant and disciplined, though confident that our brightest days still lie ahead.

The future is indeed bright as we are pleased to announce the election of Justin Topping as a Partner. Justin has made significant contributions to the Firm in the eight years since he joined us, and his talents will continue to serve both our Clients and Palladium well for years to come.

Summer 2021

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