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Update on the Economy and Investment Markets

Welcome to the Stearns Financial *Fireside Chat.*

COVID-19 data continues to improve, as the seven-day run rate of vaccinations is now two million per day – and trending higher. The governors of Mississippi and Texas recently signed executive orders ending all COVID-19 economic restrictions and mask mandates in their respective states. While controversial, these actions are likely to have a ripple effect for the timing and pace of regional re-openings and significant implications for some select "re-opening" stock sectors. If Mississippi and Texas maintain positive/improving COVID-19 trends, we would expect more states to follow suit. Furthermore, with $2 trillion in excess savings in personal savings accounts and another round of fiscal stimulus coming, consumer spending should rapidly improve, providing a potential tailwind for the economy and some, but not all, stocks.

Wonder why the Dow is up many days in the last few weeks but the Nasdaq is down? Many large growth companies, including technology companies, have given back some of their stellar pandemic profits as a result of rising interest rates. Then interest rates settled back last week, and big tech shares rallied. Referring back to a previous *Chat*, when interest rates are super low, fast growing companies get the benefit of earnings they expect in five to ten years being discounted back to today at a low discount factor. Higher rates mean those future earnings are not considered as valuable today.

The run-up in interest rates has been more orderly than expected, and has even cooled off a little, with no signs to date that the economy is overheating. Even so, the newly approved $1.9 trillion stimulus package remains highly contested with many concerned that higher stimulus or higher debt levels will result in runaway inflation. More inflation, possible. Runaway? Doubtful. **As outlined in our recent Live Chat special edition on inflation, and the *Fireside Chat* summary, the four powerful Ds (Détente, Disruption, Demographics and Debt) that drive inflation are showing mixed signals.** We expect the Fed to remain focused on long-term inflation and employment targets, taking a more measured approach to its accommodative policies.

Meanwhile, investor sentiment measures continue to concern us. As mentioned in previous *Chats*, a bit of exuberance is to be expected when coming out of the pandemic, however, too much may be harmful to stock prices near term. As previously noted, both behavioral (what investors are doing) and attitudinal (what investors are saying) sentiment measures remain higher than we like to see at this early stage of a bull market.

SFG's Take: Parts of the U.S. stock market have declined from bubble territory, while others remain fairly valued or even undervalued. We expect overall U.S. equity returns to be relatively modest in 2021, trailing an economic recovery that is already reflected in much of the U.S. stock market.

For our "core" client portfolios, we remain focused on quality across geographies, sectors and industries in our stock and alternative assets. For "explore" portfolios, we are using a broader lens to consider assets that have promising five-year prospects.

Key Points to Consider

- **U.S. Fiscal Stimulus Update: The stimulus bill has been passed, and now the Biden administration will move to the next big agenda item: the infrastructure/climate change proposal.**

  The Congress and President have signed the $1.9 trillion COVID Relief Bill. Now Congress begins to debate what the infrastructure/climate change bill will look like.

  The next bill will be more complicated than the one just passed, particularly if the bill will be in the $2- to $4-trillion range. Why? According to Strategas, reconciliation rules will make it difficult to include infrastructure provisions. In order to get this through, taxes will either need to be raised or reconciliation rules changed. Last weekend, Senator Manchin called for bipartisanship but also said he would support up to $4 trillion in spending with tax increases. However, Republicans will not support trillions in spending or tax increases. This debate still needs to play out.

  The legislation could also be forced into a three- to five-year bill to make it easier to pass. The annual impact is important: $1 trillion of infrastructure over 10 years is the same as $300 billion over three years. That would not be as large an amount of spending as what was just passed in the stimulus bill.

- **Dividends may matter (again):** Dividends have always been an important part of the equity market. Since 1930, Strategas reports that dividends and reinvestments accounted for over 40% of the annualized return of the S&P 500. But 2020 marked the worst calendar year for dividend cuts and suspensions since 2009, as the policy response to control the pandemic resulted in earnings uncertainty.

  The stay-at-home economy and the large monetary and fiscal stimulus disproportionately benefited some areas of the equity market, notably growth, technology and non-dividend paying companies. As a result, dividend-payers lagged the broader market and appear relatively well valued, suggesting high-quality, dividend-paying companies are well positioned. Dividend-paying companies offer attractive relative valuations, with their P/E multiples trading well below the 10-year average, while non-dividend payers are trading well above their 10-year average.

  Of course, not all dividend-paying companies are alike. We favor ETFs and institutional grade mutual funds with a focus on sustainable payout ratios, healthy balance sheets and a good track record of capital allocation, including returning capital to shareholders in the form of a growing dividend. The combination of strong capital flexibility and growing dividend payments may also help mitigate future inflationary pressures.

COVID-19 Updates

Novavax results

Novavax's COVID-19 vaccine is more than 96% effective against early coronavirus strains, the Maryland company reported yesterday. This is based on a U.K. trial; until its U.S. trial is complete, Novavax can't apply for emergency authorization there, but the EU is already reviewing the drug. As for the more contagious U.K. variant (B.1.1.7), Novavax's vaccine has 86% efficacy – though it's entirely effective in suppressing severe cases caused by any strain.

AstraZeneca trouble

More countries have decided to pause their rollouts of AstraZeneca's vaccine, due to potential (but unproven) links between the jab and dangerous blood-clotting. The latest to termparily shun AstraZeneca include Italy, Norway and Thailand. However, the Philippines and Australia are siding with the European Medicines Agency, which says there is no reason to suspend the vaccine's deployment. https://www.bloomberg.com/news/articles/2021-03-12/thai-premier-delays-astrazeneca-shot-after-suspensions-in-europe?sref=Vz2OwQtb

Vaccine geopolitics

Slovakian health minister Marek Krajci has resigned over the country's purchase of Russia's Sputnik V vaccine, in a move designed to stave off a government collapse over the issue. Some parties in the governing coalition said the Russian deal threatened Slovakia's West-facing orientation.

China has scored a big vaccine-diplomacy win, after the International Olympic Committee accepted its offer to vaccinate athletes at the Supper Olympics in Tokyo this July.

https://fortune.com/2021/03/12/covid-vaccine-china-deal-olympics-athletes-tokyo-2022-games/?utm_source=email&utm_medium=newsletter&utm_campaign=ceo-daily&utm_content=2021031211am

https://www.aljazeera.com/news/2021/3/11/slovakia-health-minister-resigns-over-russian-vaccine-controversy

https://www.nbcnews.com/health/health-news/novavax-covid-vaccine-highly-effective-u-k-trial-drugmaker-says-n1260727

Frequently Asked Questions

Q: In your recent Live Chat on fumbles you're seeing in the third and fourth quarter of life, you highlighted the new research on money actually buying happiness. Love to know more!

A: We've highlighted previous studies that indicate money can, in fact, buy happiness, but only up to around $75,000/year. Our anecdotal experience corroborates this finding as some of our clients state they were happier when they were "less well off." Similarly, some of our family-owned business clients have seen offsetting good and bad effects of greater wealth. Many other clients have found a high level of satisfaction (which for some means "happiness") when they achieve true financial independence.

Interestingly, new research suggests a different, more nuanced answer.

Using over a million real-time reports from a large U.S. sample group, this study found that happiness increases linearly with reported income and continues to rise beyond the $80,000/year mark.

How is Happiness Measured?

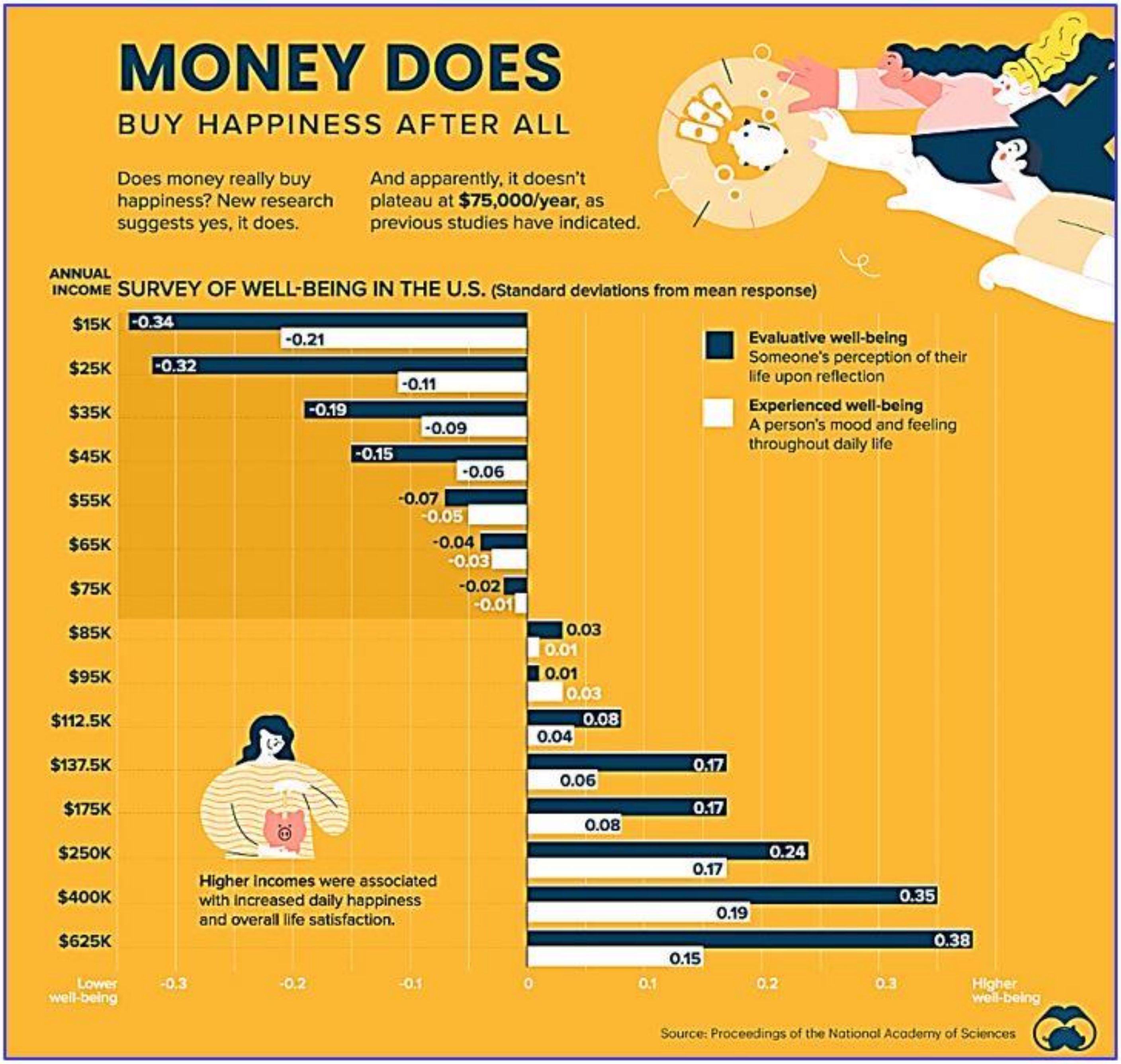
Past research on happiness relative to income has relied on retrospective data, which leaves room for human memory errors. In contrast, this new study uses real-time, logged data from a mood tracking app, allowing for a more accurate representation of respondents' experienced well-being.

Data was also collected by random prompts over a period of time, with dozens of entries logged for each single respondent. The National Academy of Sciences reported that this provides a more well-rounded representation of a person's overall well-being.

Two forms of well-being were measured in this study:

- **Experienced well-being –** A person's mood and feeling throughout daily life.
- **Evaluative well-being –** Someone's perception of their life upon reflection.

Both forms of well-being increased with higher incomes, but evaluative well-being showed a more drastic split between the lower and higher income groups.



For incomes up to $80,000/year, larger incomes were associated with significantly higher levels of four of the five positive feelings (confident, good, interested and proud) and significantly lower levels of all negative feelings (afraid, angry, bad, bored, sad, stressed and upset).

Above $80,000/year, larger incomes were associated with **significantly higher levels of all positive feelings** (confident, good, inspired, interested and proud) and **significantly lower levels of four of the seven negative feelings** (bad, bored, sad and upset).

Increased comfort

As someone earns more, they may have the ability to purchase things that reduce suffering. This is particularly true when comparing low- to moderate-income groups – larger incomes below $80,000/year still showed a strong association with reduced negative feelings.

More control

Control seems to be tied to respondents' happiness levels. In fact, having a sense of control accounted for 74% of the association between income and well-being. **SFG has observed that knowing what is truly controllable, versus what is outside our control, lends itself to less frustration and greater happiness.**

Not all respondents cared about money. But for those who did, it had a significant impact on their perceived well-being. In general, lower income earners were happier if they didn't value money while higher income earners were happier if they thought money mattered.

SFG's Take: Just as there is no one number that represents financial independence, there are different levels of wealth that create optimal happiness for each individual and couple. SFG has reported on the greater lasting satisfaction that comes from "experiences" versus "buying things" – how you spend your money matters! **Our clients who understand their own unique strengths and weaknesses from their SFG Financial Independence Roadmap™ report a better feeling of control and confidence, two keys to feeling happier.**

Many of our clients are considering what their long-term legacy should include, from traditional estate planning to charitable giving to their "why?" in the fourth quarter of life. **Those who have it mostly figured out have expressed more happiness overall than those still struggling for answers.**

Our SFG team can help as you find your own balance of money and happiness.

SFG's Happiness and Well Being Prescription: view this TEDx talk for some ways you can "train your brain," increasing your own happiness now and in the future at: https://centerhealthyminds.org/news/watch-center-founder-richard-davidsons-tedxsanfrancisco-talk-how-mindfulness-changes-the-emotional-life-of-our-brains

Want to dig into the study? Click here: https://www.pnas.org/content/118/4/e2016976118

Source: Proceedings of the National Academy of Sciences

Details: Participants were 33,391 employed adults living in the United States; median age was 33; median household income was $85,000/year (25th percentile = $45,000; 75th percentile = $137,500; mean = $106,548; SD = $95,393); 36% were male; and 37% were married.

Summary

SFG is balancing numerous opportunities and threats in our portfolios, customized to our clients' unique circumstances. We are being more cautious as parts of the U.S. stock market have exhibited irrational exuberance in response to positive developments related to our "three pillars" of recovery: 1) ongoing government stimulus, 2) higher corporate earnings and 3) positive news surrounding the COVID-19 vaccine strategy.

While we feel some exuberance is warranted (all three pillars are seeing positive trends), we remain cautious in areas that are more overvalued.

In **growth** portfolios, we are leaning into a variety of short- and intermediate-term asset classes and trends that we believe have favorable forward-looking risk/reward relationships.

In more conservative **growth and income** portfolios, we are still somewhat defensive, while striving for positive real returns over inflation.

Our COVID-19 endgame investing approach can be summed up by six themes:

- Diversification with a balance of offensive and defensive measures, depending on the desired risk tolerance of our clients,
- Underweighting, or avoiding areas of higher future concern,
- A focus on higher-quality investment themes,
- Identifying and implementing buying opportunities that may be appropriate for more growth-oriented portfolios,
- Maintaining a more defensive stance using different portfolio tools for more conservative growth and income portfolios, and,
- Utilizing select alternatives to traditional bonds and stocks.

~ Dax, Dennis, Glenn, Jason, John and PJ
(the SFG Investment Committee)

REMINDER THAT COVID-19 OFFICE HOURS ARE STILL IN EFFECT

Please keep in mind that we continue to maintain limited in-person service hours at our offices in Chapel Hill and Greensboro, NC until we can all return to the office safely.
If you have a need to meet with us in person or to pick up or drop off documents, we are glad to accommodate you. We also have a number of traditional and virtual tools to facilitate document transfers. Please contact us in advance if an in-person meeting is needed.
