Capital Markets Group

Points to Ponder

March 19, 2021

The First Tee...

Saving for a Rainy Day…the government and markets (financial and retail) are hoping the weather will be inclement as consumers have been actively saving during the pandemic:

- Last year, consumers accumulated about $1.5 trillion is savings…this is more than double the average annual increase of GDP during the last expansion (and equal to the size of South Korea's GDP):
  - While the COVID stimulus packages helped the pace of wage growth expansion last year (helping boost savings accumulation), the pace of nominal GDP has increased about $700 billion annually since 2009:
    - The personal savings rate spiked by 33.7% last April following the first pandemic relief package, and increased by 20.5% in January…the savings rate averaged 7.2% during the last expansion and was running at 3% prior to the financial crisis.
  - The pandemic has been harder on working class families compared to wealthy ones, but data shows a large portion of both groups have managed to stockpile money during the past twelve months:
    - Aiding the pace of savings has been improved household balance-sheets and the easing of consumer debt burdens:
      - This was not the same circumstance seen when we exited the last recession…which took a long time for the consumer to recover.
    - Record low mortgage rates have been the catalyst for homeowners for reducing monthly payments and tapping into their property's equity…boosting the real-estate market as well as providing additional cash for disposable income and savings:
      - About a third of these refinancing were cash-outs, the remainder were payment reductions due to a lower interest rate.
    - The level of household debt is relatively low versus income (on a historical basis)…it will be interesting to see if this can be maintained.
  - The savings rate should see another spike in the 2nd quarter due to the latest $1.9 trillion stimulus.
- **Buy, Buy, Buy**…a key to this year's economic growth will be how fast consumer spend their savings:
  - The Federal Reserve revised its GDP forecast for 2021 higher to 5.8% to 6.6% (consumers expected to play large role):
    - The impact of the COVID vaccine and further reopening of the economy (especially in the travel, leisure, and hospitality sectors) are anticipated to entice consumer spending…with trickle-downs in categories such as energy, clothing, sporting events, concerts, movies, and plays:
      - It is projected about a third of current household savings will be allocated to disposable income spending this year:
        - If consumers become ultra-ambitious, GDP growth could expand to a 7% to 9% pace (which might test the Fed's resolve to let the economy run hot).
  - There are concerns consumers could postpone accelerated spending activity if health-risks do not abate as fast as anticipated or the recovery in the labor market stalls (pandemic trepidation relapse):
    - If consumers sit on their savings, GDP growth could ease to the average post-recession trend-line of 2.2% by year-end.
    - With the government stimulus programs concluded, wage income is expected to fall below trend-line later this year.
    - The record-run in stock values has been largely predicated on accelerated consumer spending as the year progresses:
      - If the ramp-up in consumption does not occur, it looks like the second half of the year could be correction time for equities.

The London Interbank Fat Lady is Singing…LIBOR's deadline has been set *(sort of)*:

- Year-end is now the official stated demise of LIBOR, but certain dollar denominated contracts will receive an extension to mid-2023 (extension to address difficult legacy agreements):
  - LIBOR has been so deeply entrenched in the global financial markets the volume of contracts is mind boggling…dollar denominated derivative contracts tied to LIBOR total about $200 trillion:
    - Replacement benchmarks are in place, but still being tweaked…including the U.S. Federal Reserve's "Secured Overnight Financing Rate (SOFR)", England's "The Reformed Sterling Overnight Night Index Average (SONIA)" and Japan's "Tokyo Overnight Average Rate (TONAR":
      - Some of the most troublesome contracts (that can't be switched to a replacement rate) will be switched to a synthetic LIBOR rate.
- **Big Brother is Watching**…bank regulators are ramping-up examinations for the LIBOR conversion:
  - The Fed is compiling detailed evidence on the progress banks are making to switch from LIBOR:
    - Banks are having to document details on their LIBOR exposure, their plans for amending contracts tied to the benchmark, and fallback provisions being utilized to facilitate the shift to alternatives rates (such as the prime rate):
      - It is estimated, most major global banks will spend over $100 million to prepare and execute the switch from LIBOR.

At the turn...

The Back Nine...

Suburban Renewal...**the pandemic work-from-home trend will persist, changing the business landscape and environment for workers and companies** ***(green acres versus asphalt jungle?)*****:**

- If the exodus to second cities and the suburbs has permanence, there is the potential for improved corporate balance sheets and retooling the labor market (diversity opportunities):
  - In February of last year, 8% of the workforce worked from home...after the initial March/April pandemic lock-down eased there was over 35% of workers still doing their jobs from home in May:
    - Workers are trickling back to the office as the COVID vaccine becomes more widely distributed, but a large number of work from home employees will make doing their jobs off-site a permanent change *(the pajama game?)*.
- **Sleeping on the Job**...there is push-back by some sectors regarding the work from home evolution:
  - Issues surrounding remote workers include less productivity, an erosion of corporate culture, dilution of team concept, reduction in worker interaction and worker mental health are being examined:
    - At home distractions, including children, pets, and spouses (or significant others), can also be a barrier to worker focus.
- **Pay Parity**...compensation has become a key issue in the work from home environment:
  - Companies with a concentration of employees living in high cost of living cities (such as New York, Boston, San Francisco and Seattle) could reap some labor cost savings by dispersing workforce (especially in tech sector):
    - "Localized" compensation is becoming the new buzzword as workers relocate away from high cost coastal locations:
      - It has typically been the case where employees doing the same jobs were paid different wages depending on where they lived
        - Workers relocating away from high cost urban locations are seeing 10% to 20% reductions in cash compensation (wages and bonuses).
          - In most cases, workers who took a pay-cut to relocate to a less expensive local should be able to break-even as income and cost-of-living net out.
- **Movin' on Up**...upwardly mobile urban dwellers may find they can move out without sacrificing career ambitions (it is anticipated that many younger workers will come to urban areas to start their careers):
  - The lure of being where all the action is will continue to be a lure for professionals for gravitating to the big city:
    - After the buzz of a fast-pace lifestyle (business and personal) starts wearing thin, a slower/quieter existence will be appealing to some...especially for those who wish to start a family or want to escape the day-to-day job pressure and time for commuting.
- **If that's Movin' Up, then I'm Movin' Out**...the pandemic has had major impact on real-estate:
  - Residential and commercial property values are experiencing value changes due to COVID reactions:
    - After being quarantined for almost a year, many urban dwellers are looking for more space (and fresh air!):
      - Apartment rental rates are falling in many large cities, while single-family home prices are rapidly appreciating.
    - Companies are reassessing their office space needs as many employees will remain off-site or will work a flex schedule of being in the office some days and at home the remainder *(I kind of like the idea of working from the golf course!)*

19th Hole...

If you're too busy to enjoy life, you're too busy.

Jeff Davidson

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