# 2021 STOCK MARKET OUTLOOK – PART II

## Executive Summary

Global markets extended their climb in Q1, rising 4.9% as economically sensitive value stocks—laggards in 2020—led.[1] In our view, this value burst looks like a typical brief countertrend underpinned by increasingly widespread expectations of accelerating economic growth tied to reopening and US government spending plans. But, as we will discuss, these theses are widely known and likely overstated, in our view. Hence, looking ahead, we expect growth stocks to resume leadership. While a correction (short, sharp, sentiment-driven drop of -10% to -20%) is always possible for any or no reason, we think this growth-led year should be quite rewarding for equity investors.

In our view, while 2020's downturn exceeded -20% and had a fundamental cause—making it a bear market by definition—it acted like a hugely oversized correction, with the snap back in prices nearly as swift as the fall. There was little to no excess before governments shuttered the global economy to restrain COVID's spread, triggering a contraction unlike normal recessions. Markets priced this rapidly—too fast to reset the market cycle, in our view.

Value stocks typically lead off a bear market's lows. Yet they didn't last year. Growth did—a typical late bull market feature. To us, that suggests stocks are behaving like these are the late stages of the bull market that began in 2009. Many, if not most, observers now envision a young bull market with years to run amid extended value leadership. As Ken Fisher often says, the stock market is The Great Humiliator. It loves to fool the masses. While we believe this bull market has room to run now, it is likely closer to its end than most expect.

That makes this now a time to focus on diversification and market-like returns, rather than chasing fads and hot corners of the market. This is one of an investor's most difficult tasks in a late bull market, when tales of hot stocks and quick riches hog headlines. In our view, pundits' reaction to the so-called meme stock frenzy is telling. They glorified retail investors who struck quick riches with concentrated positions, and in their wake, trading activity in penny stocks surged as a new wave of investors tried to replicate their success. Compared to these tales, a diversified portfolio focusing on growth stocks—whose reputation is a bit stodgy outside Tech and Tech-like industries—may seem boring. But what seems boring is also crucial to managing risk and reaping the long-term returns necessary to fund retirement and other endeavors.

Sentiment is classically late-cycle. Optimism abounds. Pockets of euphoria exist in areas like cryptocurrencies, digital assets called non-fungible tokens and so-called blank check companies (special-purpose acquisition companies, or SPACs). These fads wouldn't happen in a typical new bull market, when pessimism dominates.

Pockets of skepticism exist, though. Politics underpins lots of them. Many investors are concerned about spending and potential tax increases. This is understandable, and somewhat more legislation may pass early in President Joe Biden's term than we initially envisioned. But reams of data show markets pre-price widely watched bills like taxes and spending, limiting their power over stocks—positively or negatively.

To see why, think through market principles. Major tax and spending hikes dominated last year's campaign. The vast majority of Americans expected them in some form. Therefore, efficient markets dealt with all of this by the time Biden was elected. Also, his "honeymoon" period with lawmakers and voters is nearly over. To pass a tax bill (or similarly divisive measure), it must be watered down. Ramming bills through repeatedly would likely wear out fast, as many in Congress eye 2022's midterms. As 2021 passes, gridlock's realities should grip tighter.

Markets' ability to pre-price major, widely discussed developments was one of last year's biggest lessons, but many people haven't learned. It won't surprise us if the major economic data swings likely ahead whipsaw sentiment—up and down. Many data series are calculated on a year-over-year basis. Last spring's deeply depressed figures are about to be the base for that, which will yield huge growth rates even if activity is less eye-popping month to month. As summer hits and last year's sharp rebound enters the denominator, we believe it could drive big slowdowns or even drops for the same reason. The challenge for investors who need equity-like returns for some or all of their portfolio to reach their investment goals? Staying even-keeled amid data and headline volatility.

This "base effect" will also boost inflation briefly. But it looks temporary to us. Inflation and interest rates move globally, not nationally. Global forces are relatively benign. This is just one area where we vary from the crowd. Economic expectations are another. Many envision a big, stimulus-fueled boom. Growth may pop temporarily. But we don't think a huge, lasting surge is ahead. We aren't pessimistic. But staying cool now is vital. Late in bull markets, high expectations and greed can drive normal, intelligent people to haphazard, risky portfolio decisions counter to their long-term financial objectives. We don't want that happening to you.

At least for this year, we think the bull market has room to keep running. But we are vigilant for what could end it and diligently seek signs of excess infecting stocks broadly.

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Phone: (844) 237-6902
Website: www.fisher401k.com

# Appendix I: Optimism—Rational Versus Overstated

As 2021 dawned, optimism was only beginning to sprout. Now it is blooming broadly. Vaccines are fanning out across the country. Economies are increasingly, if irregularly (e.g., Europe, Japan) reopening. More and more people see a return to near-normal as close by. Sunny economic forecasts of robust growth abound, with many envisioning a lasting upshift—a new "Roaring Twenties." While partisanship persists, the 2020 election's wild political backdrop and aftermath has calmed. Forecasters, already bullish at the year's start, seem more so now.

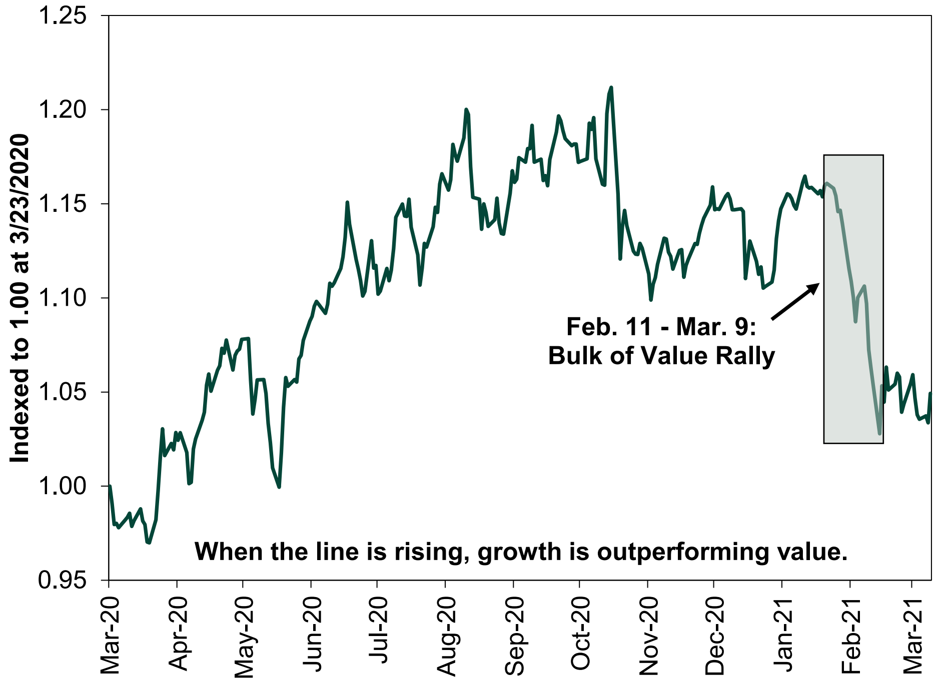
Feeding on this optimism, global stocks rose 4.9%, extending gains as the bull market turned one.[2] We think this is a down payment on strong full-year returns. For one, stirring animal spirits are usually a powerful tailwind. It takes time for optimism to become full-blown euphoria, and even that transformation isn't auto-bearish. All the while, burgeoning cheer drives powerful returns.

Fundamentals are bright. As Appendix II will detail, the stage is set for what we call the perverse inverse: stocks' overwhelming tendency to deliver robust returns in Democratic presidents' inaugural years. Abundant fear over tax hikes and contentious sociological measures feeds this, as they keep expectations low. That tees up big positive surprise as legislation proves more moderate than the radical change markets contemplated during the campaign. Meanwhile, the economic recovery from lockdowns continues as vaccines roll out and businesses reopen, powering a big rebound in corporate earnings. These factors are well-known, but economic drivers are improving, not worsening—a great backdrop for stocks. Economic growth from 2022 onward may not be as rousing as everyone expects, but this isn't bearish—at least not for now. Rather, we think it benefits growth stocks, defying the many who expect value to lead tied to a big, lasting acceleration.

### The Value Countertrend

Our expectations for growth to beat value are uncommon, especially after value's Q1 outperformance. Brent oil prices, the global benchmark, rose 24.1% in Q1 as expectations for resurgent demand rose, driving value-oriented Energy stocks up 21.8%—the best-performing sector.[3] Similarly, expectations for accelerating inflation sent long-term interest rates up from 0.93% at 2020's close to 1.74%.[4] That climb further aided value—especially Financials, which outperformed markedly in Q1 as hopes for rising loan profits grew. Meanwhile, Tech stocks rose, but only by 1.4% as less economically sensitive growth stocks trailed.[5] In our view, though, value's Q1 leadership doesn't look lasting. For one, like a brief spurt last November, most of the outperformance occurred in a short timeframe. (Exhibit 1)

**Exhibit 1: Value's Burst**




**Source: FactSet, as of 4/4/2021. MSCI World Growth Index divided by MSCI World Value Index, both with net dividends, 3/23/2020 – 3/31/2021.**

Value bulls cite the category's typical outperformance early in bull markets, as stocks anticipate a sharp economic acceleration. Today, many see this bull market as young, with vaccines and government "stimulus" set to power years of fast economic growth. But we see many problems with this thesis. Chief among them: There are many signs this bull market is late-stage, not early.

## The Bear Market That Acted Like a Correction

Last year's flash downturn was technically a bear market—it breached -20% from a peak and had a fundamental cause. Yet in many ways, it acted like a hugely oversized correction.

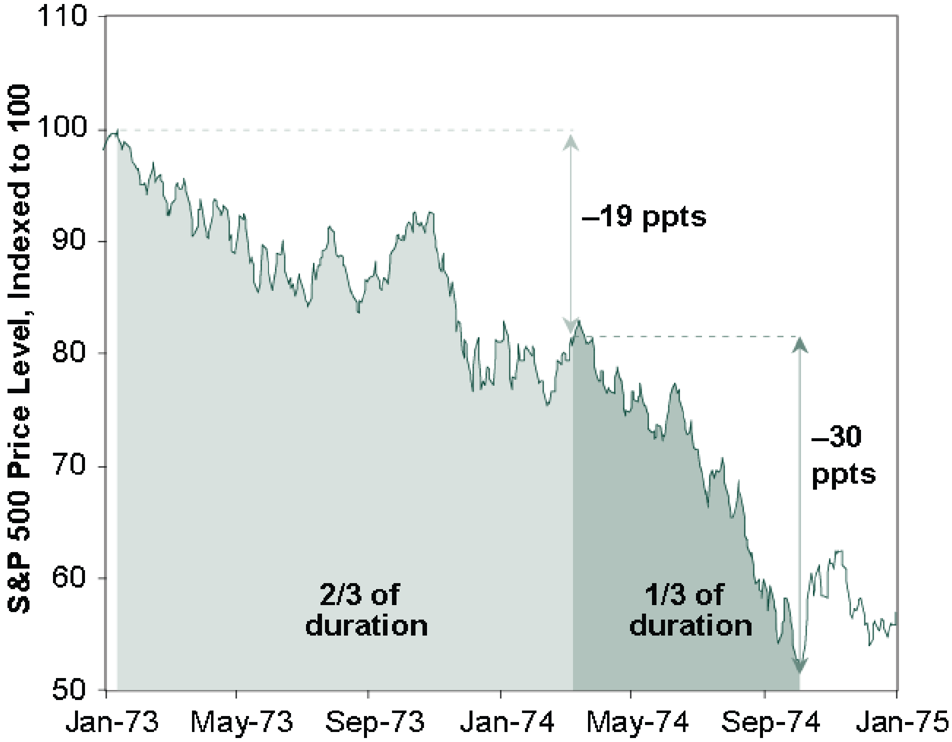
Today's optimistic sentiment would be highly unusual early in a bull market, when the downturn's sting is fresh. As Sir John Templeton put it, "Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria." The prevalence of speculation-tinged offerings like special-purpose acquisition companies (SPACs), cryptocurrencies, "meme" stocks and more shows sentiment is far from pessimistic. (Appendix V) This warming sentiment—likely due to the bear market's correction-like speed—is a key sign we are late, not early, in this bull market.

## Speed Defines This Cycle's Evolution

Speed was arguably the 2020 bear market's defining feature. World stocks tumbled from record highs in mid-February to bear market lows in mere weeks—the fastest ever. That speed typifies corrections, not bear markets.

Bear markets normally begin with a whimper, not a bang. They first grind lower, as investors dismiss declines as buying opportunities while overlooking the bear market's fundamental cause. Only late, when people realize the negatives driving weakness are fundamental, do the violent swings arise. We think this is why bear markets typically begin with a long, rolling top and gradual declines. 2020 aside, about a third of bear markets' peak-to-trough declines comes in the first two-thirds of its lifespan. The worst drops come late. We call this the two-thirds, one-third rule. Exhibit 2 shows this, using the 1973 – 1974 bear market.

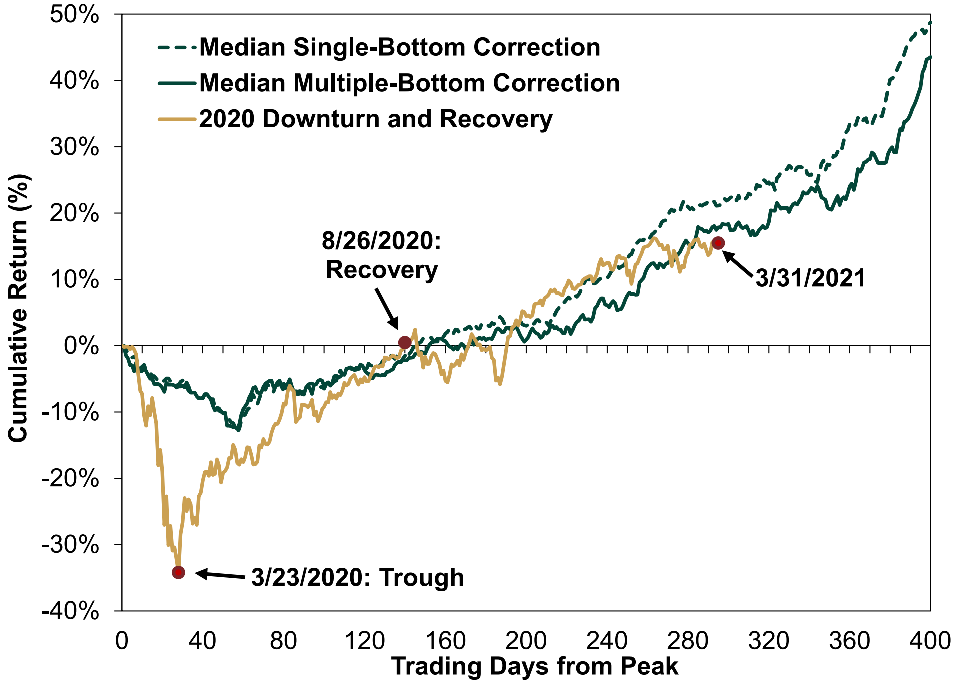
**Exhibit 2: The Two-Thirds, One-Third Rule in 1973 – 1974**




**Source: FactSet, as of 3/12/2019. S&P 500 price index, indexed to 100 at pre-bear market peak on 1/11/1973. 1/1/1973 – 1/1/1975.**

It would be senseless to recreate this graph for 2020, given the decline's speed. But that is the point: That pace resembles a correction much more than a bear market—on the way down *and* up. Exhibit 3 shows you this, plotting the MSCI World Index during 2020's market movement against the median single- and multiple-bottom correction. (We differentiated the two to highlight how similar typical correction recoveries look despite swings around the low.) The similarities are striking.

**Exhibit 3: 2020's Correction-Like Bear Market and Recovery**




**Source: FactSet and Global Financial Data, Inc., as of 3/31/2021. MSCI World Index price returns. Data are monthly from 6/6/1975 – 12/31/1975 and daily thereafter.**

## Why Speed Matters

This isn't mere trivia. A bear market's speed drives its effect on sentiment—which influences the market cycle's evolution. Typically, fear builds slowly until the panicky final third. Bear markets end with capitulation, when all but the heartiest investors have thrown in the towel.

Late in bear markets, value stocks—more economically sensitive and credit-reliant—are usually hit hardest. Tied partly to the credit cycle and value firms' lower quality, many investors fear for their survival. Banks restrict credit to them, threatening their viability. Some do fail. In a bear market's final throes, fear towards value firms is usually at fever-pitch.

But, as Ken wrote in his March 1 *LinkedIn* post:

> Inevitably, but after a long time, panic goes too far. Central banks cut short rates, long rates hold steady and yield curves steepen. Markets, foreseeing a lending boost, pre-price that effect so value stocks lead the rebound. Value's early leadership is historically and primarily a relief rally from prior credit tightening reversing.[6]

While value trailed during last year's downturn, its speed didn't let the sentiment and credit effects unfold, in our view. There was no extreme, disproportionate credit tightening. While some pundits soured on value, we never reached typical bear market extremes. Rather, most looked to the historical record, saw their typical early outperformance in new bull markets and assumed it would repeat.

But without investors giving up on value, relief—value's traditional fuel—was absent. Hence, growth led before, during and *after* the downturn. That last part is highly unusual following a bear market. But leadership persisting before and after a correction? Entirely normal.

## Value: Still Too Loved

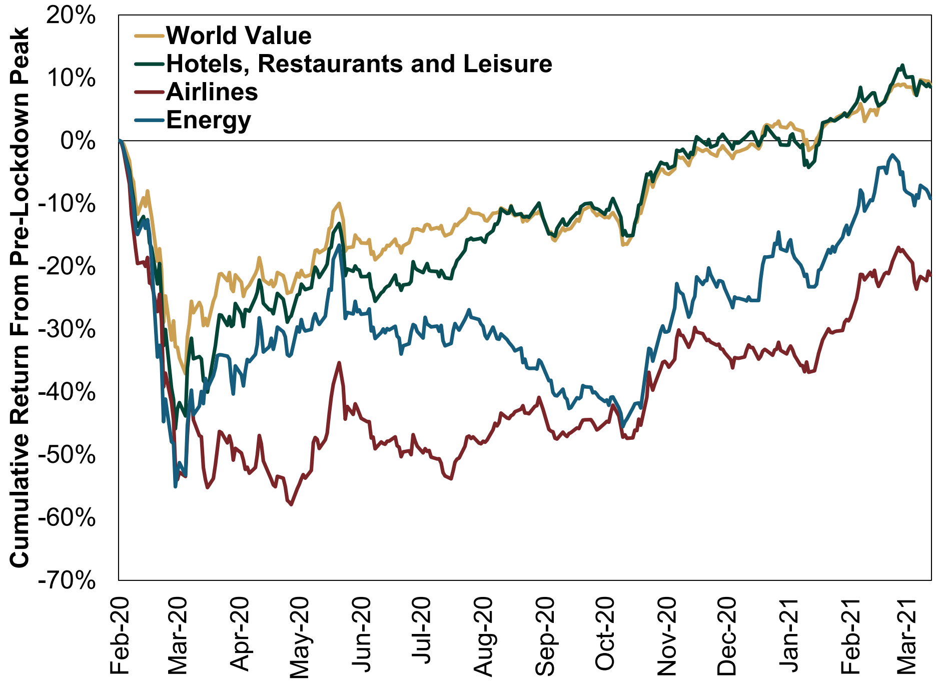
The bullish case for value is widely known—unlikely to sway markets for long. Rampant enthusiasm partly reflects vaccinations and quick reopening expectations. Partly, it is popular expectations for "stimulus" plans' effects. (Appendix III)

Throughout 2020, pundits dissected every emerging vaccine development. When successes emerged in early November, focus turned to distribution. Now headlines hype daily inoculation counts, distribution issues and successes, and more.

Nearly everyone now anticipates near-term economic reopening. So do economic forecasts. The IMF sees US GDP growing 6.4% this year, a hair behind the Fed's 6.5% forecast.[7] The median of 67 brokerage forecasts puts 2021 US GDP growth at 5.8%.[8] Any would be the fastest annual growth since 1984, a widely discussed comparison.[9] Expectations overseas are similarly robust. The IMF expects a 5.3% surge in UK GDP this year.[10] The eurozone, much maligned for its slow vaccine rollout, is still expected to grow a whopping 4.4%.

The vaccine-driven boom is, and has been, the common forecast globally. Markets are efficient, pre-pricing common opinions, views and forecasts. As Exhibit 4 shows, returns for airlines, leisure firms, Energy and value—areas most reopening-exposed—seemingly pre-priced it.

**Exhibit 4: The Reopening Trade Is Closed**




**Source: FactSet, as of 4/7/2021. MSCI World Value, Energy, Airlines and Hotels, Restaurants and Leisure returns with net dividends, 2/19/2020 – 3/31/2021.**

Saying reopening and vaccines support value means arguing markets are near-totally inefficient. Yet one of the last year's chief investing lessons is this very pre-pricing function. Stocks began climbing before data registered the extent of the lockdowns' economic damage. They were already done dealing with the widely expected contraction—and looking ahead to recovery.

You can apply the same logic to many other widely discussed factors some point to in markets. Fiscal aid and infrastructure plans? Headline news since last year's campaign. (Appendix III) As for taxes, Biden has talked them up since 2019 and pundits fret them daily—muting the likely market impact. (Appendix II)

That value's arguments are so widely known likely means their Q1 leadership was a sentiment-driven countertrend—unlikely to last. Such countertrends are normal in bull markets. They are the relative-performance version of volatility or a correction amid a bull market. For long-term investors, reacting to them, like reacting to corrections, is usually wrong.

Last year, we saw several value countertrends many pundits thought were real. They weren't. Early last June, after two weeks of value outperformance, pundits claimed big growth was losing its "mojo" as "an extreme confluence of various technical factors … are set to drive a significant upswing in traditional value stocks."[11] Last September, another two-week countertrend had many arguing reopening would drive cyclical value stocks' outperformance. Sound familiar?

Looking further back, longer countertrend rallies are easy to find. In Tech- and growth-dominated 1999, value led from February to May. Pundits were sure "overvalued" Tech was spent. "The abandonment of technology stocks, until recently the backbone of the Wall Street bull market, began last week as investors developed a new fervor for cyclical stocks—shares of companies that do well when the economy is strong."[12] Yet by yearend, growth had again led significantly in the run up to the Tech bubble's top. In the 2009 – 2020 bull market, value had extended countertrend rallies in 2012, 2016 and 2018. Yet overall, growth dominated.

## Rational Optimism, but Keep It in Check

The world is gradually returning toward normal economically—and that is a sound reason for optimism about the immediate future. But as an investment thesis, we think it flounders. Any investment rationale must look beyond reopening, vaccines and the pandemic. As we will discuss more throughout this Stock Market Outlook, we think a look at that timeframe reveals a 2021 economic acceleration that proves temporary, inflation that never meaningfully materializes and value leadership that gives way to growth before long.

Furthermore, some pandemic-era changes may never reverse fully—like the drop in business travel. The exact permanent changes defy prediction. But markets will likely see them before the crowd and pre-price it efficiently—and have probably already begun to. Many of these trends seem set to benefit Tech and growth stocks, which could be a positive surprise value bulls aren't considering.

# Appendix II: Appreciating the Gridlock Ahead

*Our political analysis is intentionally nonpartisan. We favor no politician nor any party and assess developments solely for their influence on markets and personal finance.*

President Joe Biden's first 100 days were busy. Between the $1.9 trillion COVID relief bill and big infrastructure spending and tax proposals, Congress may not feel gridlocked. But whether this stirs your hopes or fears, consider: There are far more procedural roadblocks and intraparty gridlock than most coverage suggests. As 2021 unfolds and Biden's honeymoon period ends, the feeling and reality of gridlock should grow, fueling the big returns typical of Democratic presidents' inaugural years.

Gridlock doesn't mean nothing passes. Indeed, more could pass early in Biden's term than we initially envisioned. But gridlock frequently waters down legislation, as we have already seen. Plus, everything on Biden's agenda was discussed to death on the campaign trail last year. Markets likely already priced ideas like COVID relief, tax hikes, infrastructure plans and the like, making them a poor basis for an investment decision.

## On Course for a Typically Big Democratic Inaugural Year

Stocks generally post robust returns in a Democratic president's inaugural year—16.2%, on average, since 1925.[13] To many right-leaning readers, maybe that seems counterintuitive. But the reason is simple. In our experience, most high-net worth investors lean right. Democrats, like Biden, typically campaign on issues these investors fear—like tax hikes or increased regulation. Markets pre-price fears of the new president passing everything discussed during the campaign—delivering below-average returns in years a Democrat wins the White House. This tees up big relief rallies as gridlock and congresspeople's increased focus on re-election waters down most big bills from initial proposals—hence, the well above-average returns in Democratic presidents' first years.

The COVID lockdowns, and the steep recovery from them, skewed last year's returns from this trend. But the fundamental recipe is classic and seems set to play out in a big way in 2021. Talk of tax hikes and big spending looms but, as we will show, is likely already priced in. Meanwhile, gridlock among Democrats is becoming more evident. Although more legislation may pass than we initially envisioned, most major proposals today have long been discussed and seem likely to be watered down—limiting their ability to shock stocks. As investors fathom this, returns should strengthen throughout the year.

## The Ins and Outs of Budget Reconciliation

Those anticipating a sea of legislation, for good or ill, cite budget reconciliation as the key. This process lets a party pass legislation with a simple Senate majority—avoiding the 60 votes needed to dodge a filibuster. This is critical now, tied to the Senate's 50/50 partisan split.

Here is how reconciliation works—and what its limits are. Once per fiscal year, the Senate can use reconciliation to pass bills pertaining to revenues, spending and the debt ceiling. But that doesn't mean they get three shots at reconciliation—it means a bill can address any of the three issues once. If a bill covers spending and taxation but not the debt ceiling, then that ticks the "spending bill" and "revenue bill" boxes, leaving only a pure debt ceiling bill. The "Byrd Rule," named for the late Senator Robert Byrd, prevents "extraneous" measures. Broadly, these are measures that don't alter revenues or spending, aren't under the relevant committees' discretion, amend Social Security or increase deficits beyond 10 years. The arbiter is the non-partisan Senate Parliamentarian. Since 2012, that has been Elizabeth MacDonough.

We have already seen reconciliation in action once this year. The $1.9 trillion COVID relief bill, dubbed the American Rescue Plan (ARP), passed via reconciliation with unanimous Senate Democratic approval. But the path to that approval shows reconciliation's limitations. The ARP initially included a measure raising the federal minimum wage to $15 per hour. This attracted fierce Senate opposition from states with relatively lower incomes and cost of living, where a higher statutory wage could threaten many small businesses' existence. That opposition included a number of Democrats. But it never came up for formal debate, as MacDonough ruled it ineligible for reconciliation. Attempts to bypass her ruling didn't muster anywhere near a majority amid opposition from several swing-state Democratic senators. We think this previews what to expect as the party goes back to the reconciliation well later this year.

Because Congress didn't pass a budget for fiscal 2021 before former President Donald Trump left office, Biden's term began with two shots at reconciliation in each category this calendar year: once for fiscal 2021 and once for fiscal 2022, which begins on October 1.

But in early April, senators petitioned MacDonough to let additional bills pass via reconciliation as long as they merely amended earlier budget bills. Theoretically, this gives the party additional shots at changing spending and taxes via reconciliation, under the guise of updating prior bills. This stoked fear, but we don't think it changes much. One, the general limits still apply. Two, taking multiple shots at spending and tax rates doesn't change the basic incentives for swing-state Democrats to moderate—especially those facing uphill re-election battles in 2022. West Virginia Senator Joe Manchin, who isn't even up for re-election until 2024, stated his opposition to repeatedly using reconciliation in an April 8 *Washington Post* op-ed. The further we get from the inauguration, the more Biden's honeymoon period will wane. As it does, gridlock within the Democratic Party likely escalates as senators' self-interests gain primacy.

## Beyond the Filibuster

As the abandoned federal minimum wage increase shows, there are strict limits to what can pass via reconciliation. That is bad news for those pressing big bills on non-budget topics, which we classify as "sociology"—unrelated to markets. Their mooted solution: nuking or neutering the filibuster so all bills can pass with a simple majority. This stoked big fears among many right-leaning investors, but it faces two obstacles: One, intraparty divides likely mean the filibuster isn't going anywhere. Manchin and Arizona Senator Kyrsten Sinema have publicly rejected calls to ditch it. Manchin said it succinctly in the aforementioned op-ed: "There is no circumstance in which I will vote to eliminate or weaken the filibuster."[14]

Secondly, fears of the filibuster's elimination overstate its importance as to checking power. As

*The Wall Street Journal's* Kim Strassel highlighted in her March 19 column, it is merely 1 of 44 standing rules in the Senate, most of which the opposition can use to gum up the gears.

The Senate's standing rules serve to differentiate it from the House, making it a more deliberative body. It was never meant to be a rubber-stamp parliament like Britain's House of Lords—its purpose is to be a check on the House. As Strassel explained, many of the standing rules "are designed to enhance 'the rights of individual senators' at the expense of 'the powers of the majority.'"[15] Even the most mundane can halt Senate business. One rule requires unanimous consent for simple actions like opening the chamber in the morning, moving to the day's business, and skipping recitation of every bill and amendment. One objecting Senator could obstruct any of this, and it would require a majority to overcome the objection—requiring all Democratic senators present at all times. Senators could also issue "quorum calls" to verify there were 51 members present, then vacate the premises to ensure they wouldn't pass. Together, these moves could eat up an entire day. As Strassel depicted it:

"The Senate convenes. Quorum call. The presiding officer asks for consent to forgo reading yesterday's journal. Republicans object. Roll call vote. The officer asks for consent to speed through 'morning business.' Republicans object. Democrats move to get on an issue. Point of order. Roll-call vote. Quorum call. Republicans object to the motion. Roll-call vote. A speech. Quorum call. Etc., and so on, until adjournment."[16]

Perhaps this scenario was in Manchin's mind when he wrote that, "Every time the Senate voted to weaken the filibuster in the past decade, the political dysfunction and gridlock have grown more severe."[17] The only thing preventing this now is comity, which won't last long if Democrats try to ram multiple bills through. The more they try to do after the honeymoon period, the more hostility will replace graciousness, and gridlock's grip will tighten.

### What Gridlock Does (and Doesn't Do)

Gridlock doesn't mean nothing happens. It often means legislation that squeaks through is watered down versus initial proposals, as we saw with the ARP's minimum wage provision. Even for measures that can pass with a simple majority vote, swing-state Democrats' incentives to moderate support intraparty gridlock.

But moderation may not mean "no." A bipartisan House vote approved the return of earmarks, now known as "community project funding requests," with new transparency guidelines aimed at preventing corruption and waste. Republican senators may follow in hopes of securing funding for their states from the upcoming infrastructure bill. (Appendix III) If this happens, it isn't hard to imagine Senate majority leader Chuck Schumer horse-trading to win over moderates from either party. In exchange for community funding, swing-state senators may support smaller-than-advertised tax hikes or minimum wage increases—basically, normal politics at work.

### Don't Let Tax Talk Tax You

As a result, Democrats could push through higher taxes, unnerving many investors. This is understandable to some extent, as taxes are perhaps the most direct way government impacts the public. But there is ample history and theory showing you tax increases aren't likely to drive a bear market—neither are tax cuts fuel for a bull market.

Taxes are a classic case of investors believing events have predetermined outcomes—X causes Y, always, and "everyone knows it." But we have a very long history of tax changes and market returns, making this theory easy to test. Tax hikes usually *don't* coincide with negative returns. The reason is simple: Markets move most on surprises, and there is no such thing as a surprising tax change—especially now, as the entire country has discussed potential Democratic tax hikes since the primaries. Chatter escalated after Biden became the nominee. By the time he won election, most saw higher taxes as a foregone conclusion. It would be difficult for stocks to *not* have already priced them.

The data support this. Consider corporate taxes, which Biden's infrastructure plan would raise from 21% to 28%. The US government has hiked corporate tax rates 13 times since good market data begin in 1925. In the ensuing 12 months, stocks rose 9 times, averaging 11.1%.[18] Personal income taxes? The government has hiked the top bracket rate 14 times. The S&P 500 rose in the next 12 months after 10 of them, averaging a whopping 16.8%. Similar positivity holds after capital gains tax hikes. Ironically, average returns after tax cuts are lower.

Many naysayers point to the fact that more than one tax type may rise this year. But it makes little difference. Exhibits 5 and 6 show returns before and after two of the three main taxes (income, capital gains and corporate) were hiked or cut simultaneously. In the 12 months before such sweeping hikes, returns are varied and average -0.5% as markets discount the likelihood of change. But in the 12 months after, stocks were overwhelmingly positive—much more than after tax cuts! The S&P 500 rose 9 of 11 times, averaging 16.7%.

Of course, this average—and the pre-hike average—are skewed by 1932's huge drop before the hike and enormous rise after, which weren't related to that single percentage point hike to the top marginal rate. Coincidentally, that hike fell near the Great Depression's June 1932 trough, skewing results. Regardless, the median return shows you a similar, if less extreme, effect. Stocks' median pre-hike return was a tepid 7.2%, which jumped to 11.8% after. To us, that illustrates stocks' pre-pricing mechanism near-perfectly.

**Exhibit 5: Returns After Simultaneous Tax Hikes**

| | Changed? | | | S&P 500 Price Return | |
|---|---|---|---|---|---|
| Effective Date | Personal | Corporate | Cap'l Gains | 12 Months Before | 12 Months After |
| 1/1/1930 | X | X | | -11.9% | -28.5% |
| 6/6/1932 | X | X | | -61.1% | 98.0% |
| 10/21/1942 | X | X | | -3.5% | 25.2% |
| 9/23/1950 | X | X | | 24.8% | 20.4% |
| 10/20/1951 | X | X | | 15.9% | 4.3% |
| 1/1/1952 | X | X | | 16.5% | 11.8% |
| 6/28/1968 | X | X | X | 9.1% | -2.3% |
| 1/1/1969 | X | | X | -11.8% | 0.7% |
| 1/1/1991 | X | | X | -6.6% | 26.3% |
| 8/10/1993 | X | X | X | 7.2% | 2.4% |
| 1/2/2013 | X | | X | 16.3% | 25.3% |
| | | | **Average** | -0.5% | 16.7% |
| | | | **Median** | 7.2% | 11.8% |
| | | | **% Positive** | 55% | 82% |

**Source: FactSet, US House of Representatives Archives, US Senate Archives, Tax Policy Center, as of 3/19/2021. S&P 500 price returns 1/1/1929 – 12/31/2020.**

**Exhibit 6: Returns After Simultaneous Tax Cuts**

| | Changed? | | | S&P 500 Price Return | |
|---|---|---|---|---|---|
| Effective Date | Personal | Corporate | Cap'l Gains | 12 Months Before | 12 Months After |
| 1/1/1946 | X | X | | 30.7% | -11.9% |
| 2/26/1964 | X | X | | 18.9% | 12.3% |
| 1/1/1965 | X | X | | 13.0% | 9.1% |
| 1/1/1970 | X | X | X | -11.4% | 0.1% |
| 1/1/1971 | X | X | X | 0.1% | 10.8% |
| 1/1/1979 | | X | X | 1.1% | 12.3% |
| 8/13/1981 | X | | X | 8.3% | -22.2% |
| 1/1/1987 | X | X | X | 14.6% | 2.0% |
| 1/1/1988 | X | X | | 2.0% | 12.4% |
| 5/28/2003 | X | | X | -11.3% | 17.6% |
| 1/1/2018 | X | X | X | 19.4% | -6.2% |
| | | | **Average** | 7.8% | 3.3% |
| | | | **Median** | 8.3% | 9.1% |
| | | | **% Positive** | 82% | 73% |

**Source: FactSet, US House of Representatives Archives, US Senate Archives, Tax Policy Center, as of 3/19/2021. S&P 500 price returns 1/1/1929 – 12/31/2020.**

Nothing in this history suggests a potential tax hike spells trouble for stocks. None of this means tax hikes are a whopping positive or somehow bullish. They may even be economically detrimental! But markets priced tax-hike fears during the campaign. Over the past year, little has been hashed, rehashed, discussed or speculated about more than big tax changes and public spending. If changes get through Congress, it is highly unlikely to shock stocks. So, as Appendix III will show, is the prospect of big new spending.

# Appendix III: Economic Reopening and Beyond

Full speed ahead! That sums up most economic forecasts. Pundits everywhere see vaccines, reopenings and "stimulus" firing up years of robust growth, fueling enthusiasm for value stocks.

We probably will see strong economic growth as more businesses reopen. But we don't think it will last. Growth probably slows towards the pre-pandemic trend after an initial pop. Today's popular forecasts underrate how much of the recovery already occurred and overrate fiscal stimulus's impact.

## Stocks Already Reflect the Reopening Boom

Reopening is a powerful economic force. We saw that last summer and early autumn, when businesses returned from the first COVID wave. But many indicators recovered most of that lost ground. Some even hit new highs. The winter COVID wave brought new shutdowns, but the economic impact wasn't nearly as severe as last year's. Factories remained open and many services businesses, while still hit by restrictions, found workarounds to cushion the blow. Stocks, which generally look 3 – 30 months ahead, are well aware of all of this. They moved ahead of last year's reopening boom and have likely already priced vaccines and the removal of lingering restrictions.

Exhibits 7 and 8 show how far the US economy has already come. Retail sales are at record highs. Industrial production (IP) is near pre-pandemic levels. GDP is only -2.4% below its Q4 2019 high.

**Exhibit 7: Retail Sales & IP**

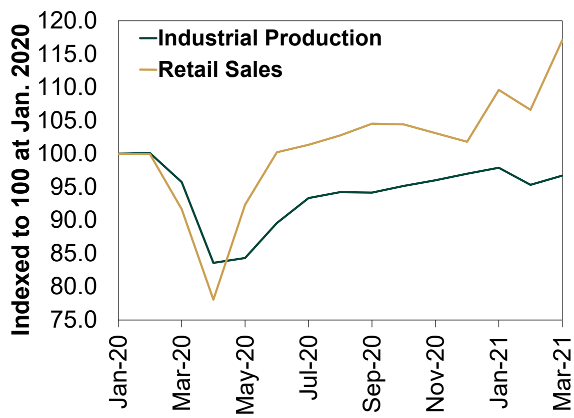
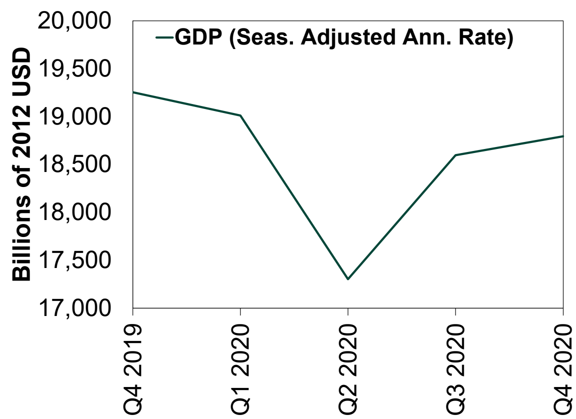



**Exhibit 8: GDP**




**Source: Federal Reserve Bank of St. Louis and US Bureau of Economic Analysis, as of 4/19/2021.**

These gauges aren't perfect—and retail sales and IP highlight the "goods" segment of the economy, which was hit less than America's huge services sector. Regardless, these charts show the economy's resilience, which stocks have pre-priced for the past year. Stocks' "V"-shaped recovery preceded the economy's by several months—efficient markets at work.

But they also show most of the initial boom is over. Yes, pockets of weakness linger in leisure and hospitality, and those will enjoy a long-delayed recovery as recreational travel and indoor dining return in earnest. For the affected businesses and workers, this will be very welcome. But last summer's rebound was sharp and short, and any visible impact on data as the remaining businesses come back to life is likely equally fleeting. Overall, the post-COVID trend should eventually look like the pre-COVID trend of slow-but-steady GDP growth. That was fine for stocks then and should still be fine, but as we have already seen in recent years, it benefits growth stocks much more than value. Value stocks do best when the economy is accelerating—a stretch we think is now mostly behind us, not ahead—and that forward-looking markets already anticipated.

## Europe Isn't Far Behind

Most European nations are behind the US due to their tougher, longer-lasting winter lockdowns and well-documented difficulties with vaccine distribution. (Appendix V) Yet they, too, are largely following the same trajectory: big "Vs" in economic data last spring and summer, followed by smaller contractions in the autumn and winter. But markets know all of this, including the course the US has charted for the rest of the developed world. To us, that suggests strongly the rebound immediately ahead is priced there, too, which is a particular headwind for the value-heavy UK and European stock markets.

**Exhibit 9: UK Rebound**

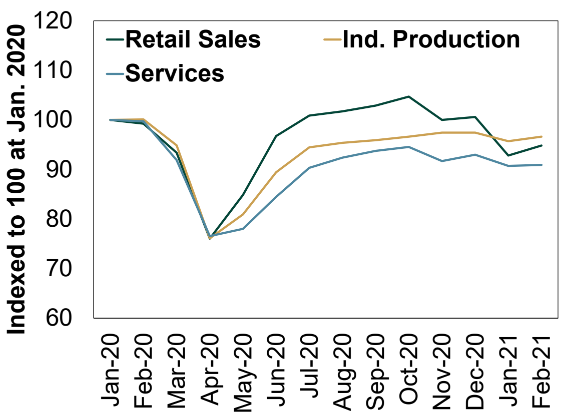
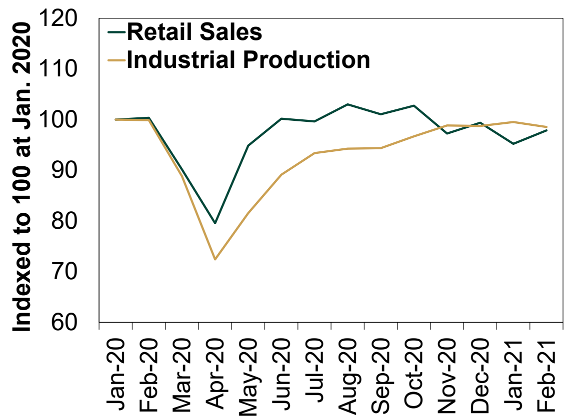



**Exhibit 10: The Eurozone's V**




**Source: FactSet and UK Office for National Statistics, as of 4/19/2021.**

## Get Ready for Weird-Looking Data

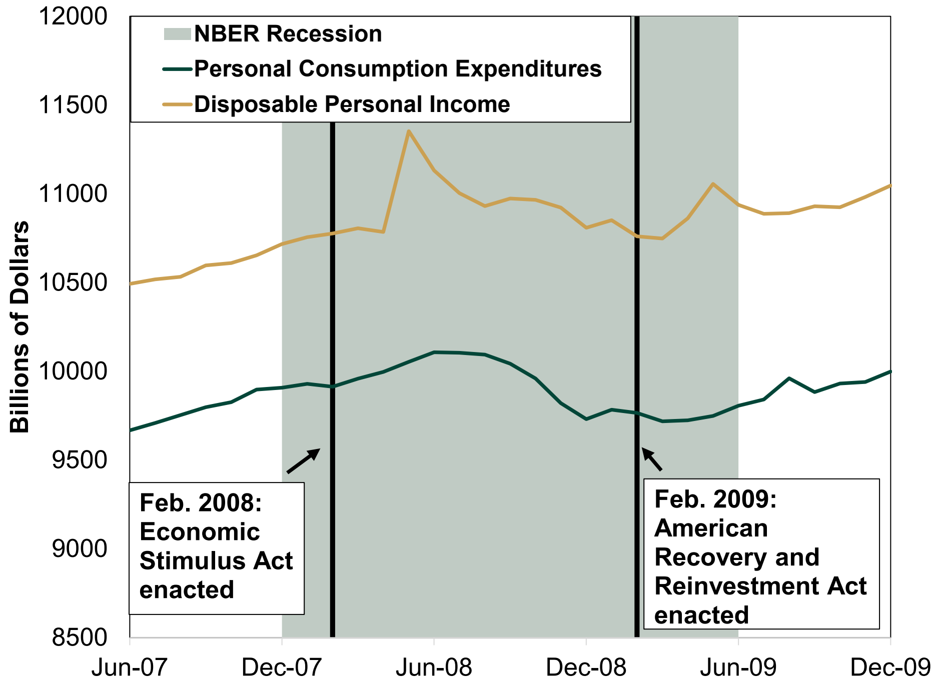
Some indicators over the next few months might seem to counter everything we showed above. This is because many data series—perhaps most notably US inflation—are calculated on a year-over-year basis. That is, the percentage difference between a given month and the same month a year prior. In normal times, this helps smooth volatility in month-over-month calculations, especially in Emerging Markets where data aren't seasonally adjusted. This year, however, the year-over-year calculations will have the opposite effect. The base—last year's results in March and April—will be deeply depressed from lockdowns. This will massively inflate results this year. The steep rebounds in late spring and summer do the opposite for May, June and beyond. As a result, year-over-year growth rates will likely show huge increases immediately ahead, followed by sharp slowdowns or even contractions, even if data are static from month to month.

In Emerging Asia, which took the economic hit from lockdowns before the US and Europe, these wild results are already materializing. In China, which combines January and February to remove skew from the Lunar New Year, that two-month stretch saw retail sales jumping 33.8% y/y, industrial production surging 35.1%, exports up 50.1% and imports a whopping 14.5%.[19] Q1 GDP soared 18.3% y/y.[20] In South Korea and Taiwan, March exports surged 20.1% y/y and 29.1%, respectively.[21] Soon we will see it in UK and European data, which also emphasize year-over-year results. Prepare yourself now to take these eye-popping figures with a grain of salt, and don't expect year-over-year figures to be telling until much later this year.

## Fiscal Stimulus? More Like Stimu-Less

The entire world thinks a huge fiscal stimulus boom is coming. This stems partly from the multiple rounds of checks sent to many US households—the latest of which hit this spring. All told, qualifying individuals have received up to $3,200 each, which pundits characterize as several hundred billion dollars' worth of pent-up demand waiting to be spent once businesses reopen. We think this is a big stretch. As Exhibit 11 shows, similar payments in 2008 – 2009 didn't really move the needle. Nor did similar payments sent in 2001.

**Exhibit 11: Stimulus Checks Didn't Do Much in 2008 – 2009**




**Source: Federal Reserve Bank of St. Louis, as of 4/12/2021. June 2007 – December 2009.**

Several surveys suggest consumers aren't itching to spend. Saving and paying down debt were among the top uses for the first round of checks, according to the National Bureau of Economic Research and Philly Fed. Ditto for the second round, according to the Census Bureau's Household Pulse Survey. These findings suggest relief payments won't turn immediately into new spending or propel consumption to a higher plateau. You might get a short bump as businesses reopen, but we wouldn't expect much more—especially since the past year showed many the extreme importance of a sizable emergency fund.

## The Infrastructure Plan

Also fueling high expectations is the Biden administration's $2.3 trillion infrastructure proposal. We think they are in for a big disappointment, and not just because the bill stretches the definition of infrastructure. Even the measures that do entail direct spending and investment in infrastructure and technology won't pack a big punch, for a simple reason: Many probably won't ever happen, and those that do will trickle out over many years.

The plan, released at March's end, directs federal money to bridges, rail, green energy and much, much more. But it all happens over the next eight and a half years—these are not former-President Barack Obama's "shovel-ready" projects, which is telling. Even those proved imaginary a decade ago, when the American Recovery and Reinvestment Act failed to juice GDP. As Obama acknowledged in an October 2010 *New York Times* interview after local governments struggled to spend money allocated to them: "There's no such thing as shovel-ready projects."[22] If there were, they would already be in progress and politicians from both parties wouldn't still be whining about infrastructure. Funding has never been the issue. The real stumbling block is permitting.

Getting even simple projects approved is a herculean, costly feat. Small projects generally need town, city or tribal approval, and usually county, too. Those spanning multiple counties need double that, plus state. A road or bridge connecting two states adds more complexity, including federal approval. At each level, there are multiple agencies weighing in—all possibly stopping or delaying potential projects.

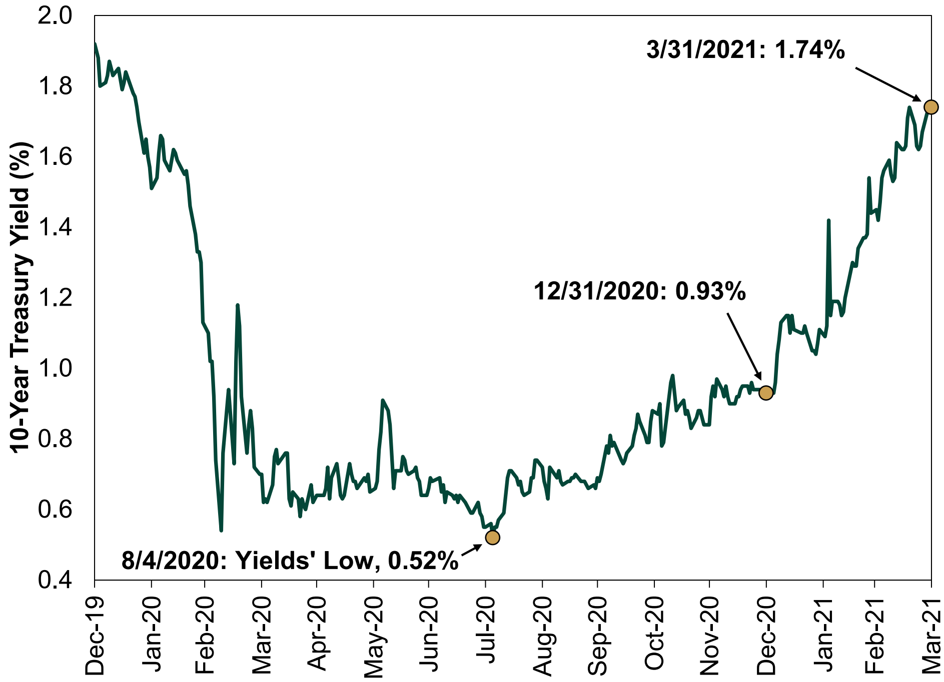
A shining example lurks near our office in Camas, WA: The I-5 Bridge connecting Portland, OR and Vancouver, WA. This WWII-era bridge is one of two Columbia River crossings in the Portland area and is a chief West Coast lifeline for goods. It is so outdated that it is actually a drawbridge, with lifts for large ships headed up or down river snarling traffic endlessly. Civic officials on both sides of the river have agreed on the need for big upgrades since the mid-1990s, to no avail. There is too much foot-dragging from multiple agencies on both sides. Our Bay Area employees tell similar tales about the long-planned BART extension to Silicon Valley, which voters first approved funding for in 2000 but remains a distant dream.

Biden's plan advertises everything he would like to accomplish. It is a wish list. It isn't ironclad. Even if it does pass in its present form, which is a big *if* (Appendix II), eight years is a long time. Midterms loom next year. We could have a Republican Congress in 2023, and it could supersede Biden's plan with its own budget—which another Congress could supersede in 2025, and so on. One big reason for this is redistricting. Several traditionally Republican states stand to gain seats, while several Democratic strongholds stand to lose. Given the Democrats' majority is historically slim, and the president's party tends to lose relative power at midterms, a shift is plausible—although it is much, much too early to forecast this now.

# Appendix IV: Interest Rates and Inflation

Long-term interest rates jumped in Q1—a global phenomenon seemingly underpinned by US Treasury yields. Rates began the year at 0.93%, then nearly doubled to 1.74%—more than triple their 2020 low. (Exhibit 12)

**Exhibit 12: The Treasury Yield Jump**




**Source: FactSet, as of 4/8/2021. 10-year US Treasury yields, 12/31/2019 – 3/31/2021.**

Some saw this as fuel for value stocks. For others, the rise spurred fears (or hopes) of faster inflation. Still others saw it as the beginning of a bond bear market, with a persistent rise fomenting debt troubles worldwide. But to us, like the value countertrend, this move seems much more about sentiment than fundamentals. Despite the upswing, we still expect the full year's rate moves to be benign in hindsight. From here, rates are likelier to fall than rise.

## Bond Market Fundamentals

Bonds, like stocks, move on supply and demand—factors set globally, not nationally. As most everyone knows, increased debt issuance tied to global governments' COVID responses has sent supply surging. Yet demand is similarly strong.

Monetary authorities' quantitative easing (QE) programs hoover up trillions' worth of bonds. Entering 2020, the Fed held just over $2 trillion in US Treasury notes and bonds (securities with greater than a 1-year maturity). Now it holds over $4.2 trillion.[23] Other major central banks are purchasing similarly vast quantities of assets under QE. While we don't think it is terribly sensible, QE adds to demand for bonds and takes vast quantities off the market.

Even beyond this, Treasury demand is healthy. America's yields are higher than almost anywhere else in the developed world, luring investors. Much of Europe, including Germany, France and Switzerland, have negative 10-year yields.[24] British, Spanish and Italian yields are under 1%. Japanese 10-year yields are pinned near 0%.

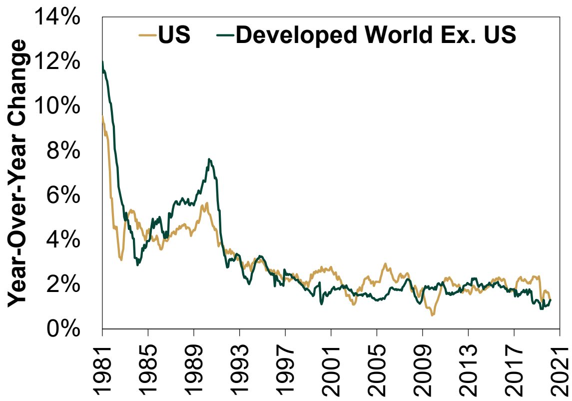
Inflation expectations are a key demand driver. With QE running globally, it would likely require runaway inflation to send yields surging—improbable any time soon. More likely: After a brief, base-effect driven bump (Appendix III), inflation slows—dampening interest rates.

## Why Inflation Isn't Likely to Soar

Interest rates' Q1 rise has many watching for hot inflation. Some cite rising commodity prices, like oil or lumber. But isolated price jumps are normal—functions of supply and demand. Inflation is different. It entails prices rising *across the economy*. It is a global monetary phenomenon. Today, despite pockets of price pressures, inflation signs are scant worldwide.

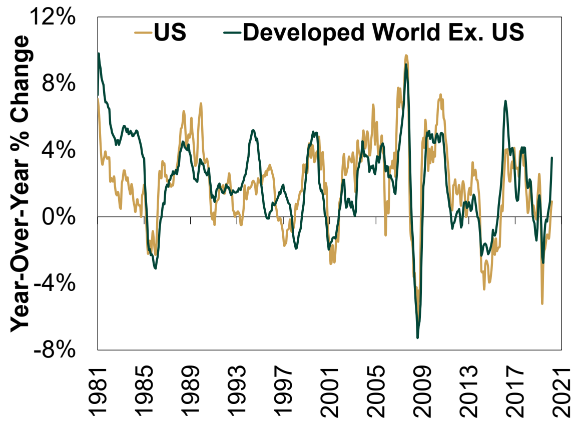
In the developed world, inflation rates—and therefore interest rates—are tightly correlated. Few things are as easily exchanged as currencies, as that is their purpose. There are few barriers to moving money across borders. Exhibit 13 shows you this, plotting the consumer price index excluding food and fuel (to avoid sharp swings from weather and other disruptions) in the US and the rest of the developed world (weighted by GDP). Exhibit 14 echoes the point, plotting the producer price index—a measure of input costs—for the same regions (also GDP-weighted).

**Exhibit 13: Core Consumer Prices**




**Source: FactSet, as of 4/9/2021.**

**Exhibit 14: Producer Prices**




**Source: FactSet, as of 4/9/2021.**

Sixty years ago, Milton Friedman said inflation is always and everywhere a monetary phenomenon: Too much money chasing too few goods. We think there was plenty of evidence supporting his theory, and logically it holds up.

But a year has passed since central banks exploded money supply while production capacity remained constrained. Based on Friedman's logic and analysis, we should see signs of inflation now. Yet we aren't. In our view, this raises important questions about the measurement of money supply and velocity (how often money changes hands—the "chasing"). The financial system has evolved dramatically since Friedman's day. It wouldn't surprise us if money supply measures are out of date, including many things that aren't really money (a medium of exchange).

Virtually all economic indicators must be updated over time, or they lose relevancy. For one small, recent example, consider COVID's effects on business travel. Given the success of virtual meetings and teleconferencing solutions, it wouldn't surprise us if a substantial portion of business travel never returned. This could detract from GDP, tied to reduced airfares, hotel stays, meals and more, with potential downstream impacts on statistics like productivity. This kind of discrepancy drives disconnects between many economic measurements and the real world.

### What Is Money?

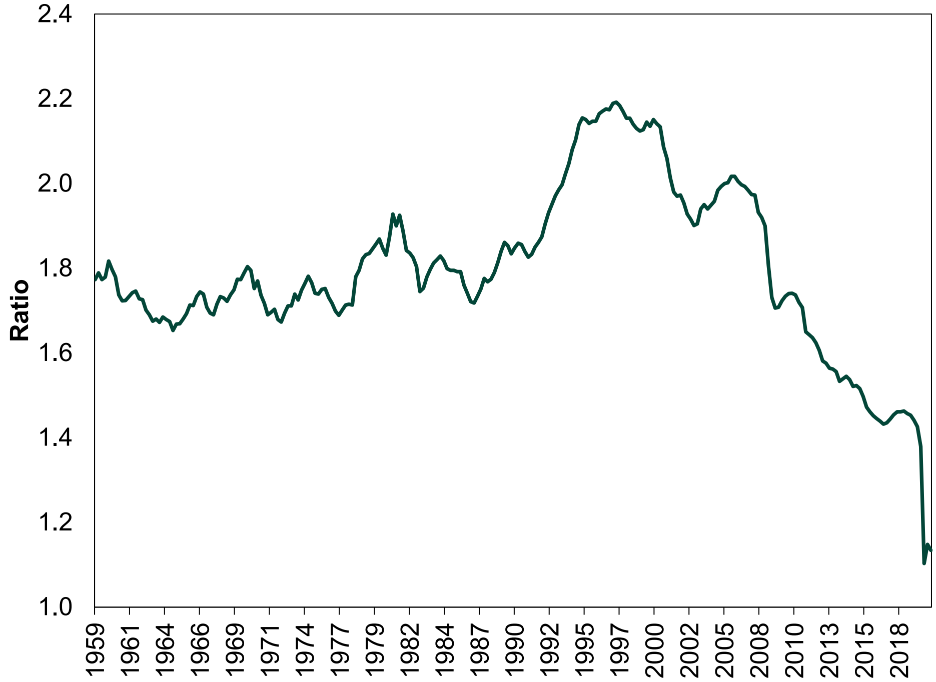
There are five main money supply measures: M0, M1, M2, M3 and M4.

- M0, or the monetary base, is hard currency in circulation plus bank reserves—money created by the Fed that doesn't circulate. (Relatedly, it is a myth that the Fed "prints money." It does no such thing, controlling money supply mostly by expanding or contracting reserves, which underpin bank lending.)
- M1 is M0 plus checking and demand deposits held at banks and credit unions.
- M2 adds savings accounts, small, short-term CDs and money market funds.
- M3, which the Fed no longer publishes but is tracked elsewhere globally, adds large CDs and institutional money funds (including repurchase agreements—effectively IOUs exchanged for short-term bonds, usually between financial firms).
- M4, the broadest measure, adds commercial paper and government debt with less than a year to maturity. In the US, the Center for Financial Stability publishes these data. Elsewhere globally, some central banks, like the Bank of England, do.

In Friedman's world, M1 and M2 predicted inflation. Today there are far more tools one *could* see as money, like those lumped into M4. But it isn't clear all the ingredients of M3 or M4 are actually used in transactions. M4 rose almost 30% last year.[25] Monetary policy's economic effect usually hits at a lag. Yet a year after the increase, few signs of inflation exist.

Money supply alone won't determine inflation. It must change hands, chasing goods and services. To gauge this, one would look to velocity measures—perhaps M4 velocity slowed markedly, offsetting the supply increase. That would surprise most economists, given longstanding theory held that velocity was relatively stable. Regardless, there is no way to know. There is no M4 velocity measurement. M2 velocity is all we have. It is near all-time lows, suggesting perhaps velocity did tank. (Exhibit 15)

**Exhibit 15: M2 Velocity Near All-Time Lows**




**Source: Federal Reserve Bank of St. Louis, as of 4/8/2021. Q1 1959 – Q4 2020.**

Or, consider: We lost a ton of velocity to lockdowns a year ago. Perhaps the added supply merely filled the void temporarily. It would be a mistake to call this "money supply growth"—a strange twist on Frederic Bastiat's legendary "Broken Windows Fallacy." Replacing something destroyed doesn't equal actual growth.

Either way, something is happening that is different from what Friedman observed 60 years ago, when money supply and velocity were easily measured and widely watched. Hence, basing big inflation expectations solely on increases to the money supply is flawed. It failed to hold true post-2008 and fails now, despite a mammoth increase to any monetary measure you choose. The good news: Inflation is generally slow-moving, so you don't need an arsenal of hints about where it is headed. In addition, there is little evidence historically that inflation is problematic for stocks. Companies can adapt to price pressures, passing on costs if needed. Actually, long-run inflation is one key reason retirees likely need to get at least some equity-like growth.

# Appendix V: Sentiment Warms Further

Today's optimism is classically late-cycle and mostly rational, but there are signs of expectations running a tad hot. Some pundits have started projecting years-long economic and market booms. Pockets of euphoria exist in niche markets. Greed is overtaking fear as the dominant emotion. Optimism can last a while and is a great backdrop for stocks—as is early euphoria. But sentiment usually overshoots eventually. We don't think we are there yet, but we are watching for signs of excess infecting markets broadly. In the meantime, checking greed—and remembering the benefits of a diversified portfolio—remains one of long-term investors' most important tasks.

### Widespread Optimism, Pockets of Euphoria

There is no single, perfect way to measure sentiment. Hence, we track several measures that we think, combined, indicate the prevailing mood. These include merger & acquisition activity, initial public offering (IPO) performance and other market-based indicators. They also include public sentiment surveys as well as our proprietary gauges. Some have flashed froth recently, including a jump in margin debt—a potential sign of greed as investors lever up to take more risk. Yet others—including consumer and business sentiment surveys—remain muted. That tells us that despite broadening cheer, stocks have some "wall of worry" to climb.

### Cryptocurrencies

But there do seem to be isolated pockets of euphoria, including cryptocurrencies. Excitement returned as bitcoin and others spiked in recent months. Proponents argue now is different than 2017/2018's boom and bust, saying cryptocurrencies' moment as the future of money has arrived. They cite banks' letting clients hold cryptocurrencies, a few public companies investing in them and some firms accepting bitcoin as payment. It all strikes us as bandwagon-jumping. For example, a few, select companies hold bitcoin on their balance sheets—with one arguing it is superior to cash as a corporate treasury asset. We disagree. Corporate treasury assets should be stable and liquid, like cash—not hugely volatile like bitcoin.

Further illustrating crypto enthusiasm's irrationality is Dogecoin, a joke cryptocurrency launched in 2013 based on an Internet meme about a Japanese dog breed. Dogecoin serves primarily as an online gratuity to reward content creators. Aside from a boom and bust alongside bitcoin in 2017 and 2018, it has mostly traded flat versus the dollar. But in late January, Dogecoin jumped over 800% in 24 hours, driven by a group of Reddit investors—who were perhaps inspired partially by Tesla founder Elon Musk's tongue-in-cheek tweet about the coin.[26] When a mock cryptocurrency climbs eightfold because of memes and tweets, sensibility seems absent.

In our view, cryptocurrencies remain speculative. Most aren't a viable medium of exchange due to their extreme volatility. If crypto actually was money, it wouldn't generate a return—and few would clamor to own it.

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### Non-Fungible Tokens (NFTs)

NFTs—basically digital collectibles—are files that the creator certifies and stamps as unique. They are used primarily for art, Internet memes and sports highlight clips. One *New York Times* writer auctioned a column as an NFT, raking in $560,000 for charity.[27] Jack Dorsey sold an NFT of the first tweet for $2.9 million.[28] While these can theoretically be reproduced infinitely, only one has the NFT stamp. That creates scarcity—and hype. NFTs are receiving a lot of attention because of their association with cryptocurrencies, and in our view, the mania recalls the 1990s' beanie baby and baseball card booms (which, incidentally, have also made a big comeback).

### Special-Purpose Acquisition Companies (SPACs)

Known as "blank-check" companies, SPACs are a way for companies to go public with less regulatory scrutiny than traditional IPOs. The SPAC is a holding company with a single mission: to acquire a private firm within a given timeframe (usually two years), making it a publicly traded company. It starts with high-profile backers, then raises money from investors in an IPO. Ideally, it then completes the merger and delivers a big payout to its investors. Big names from the investment and celebrity worlds, along with some hot initial returns, have generated buzz. Some SPACs have bought startups in widely hyped areas such as hydrogen and electric vehicles—giving the impression of being a ground-floor entry point to these hot new technologies. That is seductive, considering how many firms have stayed private for eons, IPOing only after becoming bloated and diluted.

SPACs seem to us like a market-based solution for firms looking to go public without the IPO paperwork and costs—a legacy of 2002's Sarbanes-Oxley Act. They aren't new, but they are increasingly widespread. SPACS have jumped from generating just over 20% of US IPO proceeds a year ago to 65% over the past 12 months (Exhibit 16)—perhaps signaling excess.





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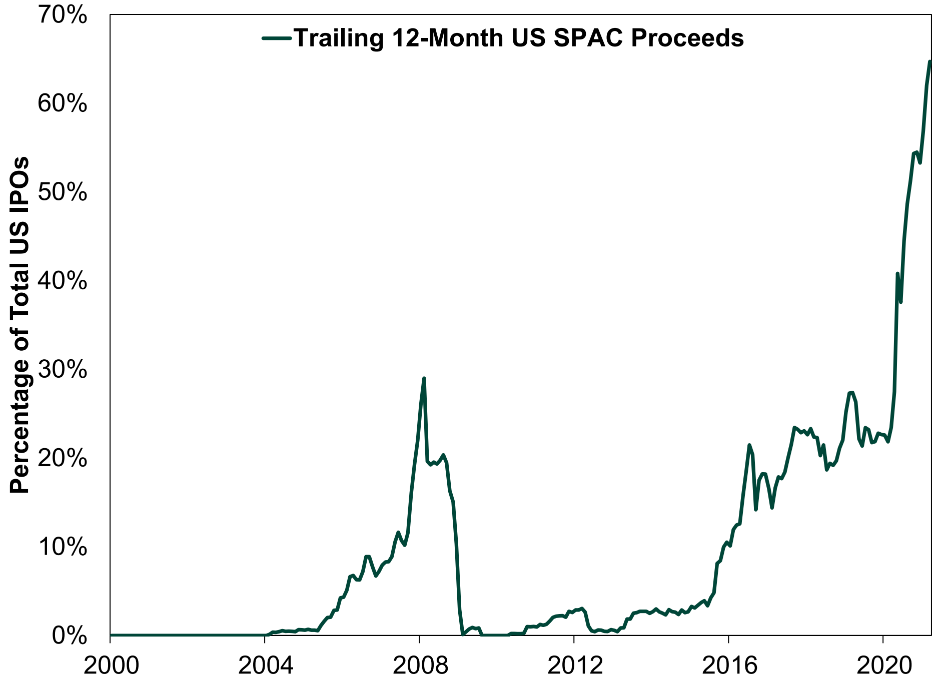
**Exhibit 16: SPACs Lead US Issuance**




**Source: Refinitiv, as of 3/30/2021. Trailing 12-month inflation-adjusted US SPAC Proceeds, January 2000 – March 2021. Calculated based on the IPOs' end-of-month value.**

Cryptocurrencies, NFTs and SPACs are faddish and speculative, like the boom in sports cards and headlines' recent obsession with GameStop and other "meme stocks." In perhaps the most telling sign of the times, Topps—a longtime sports card company that now also sells NFTs—is going public via a SPAC funded by well-timed meme stock trades.

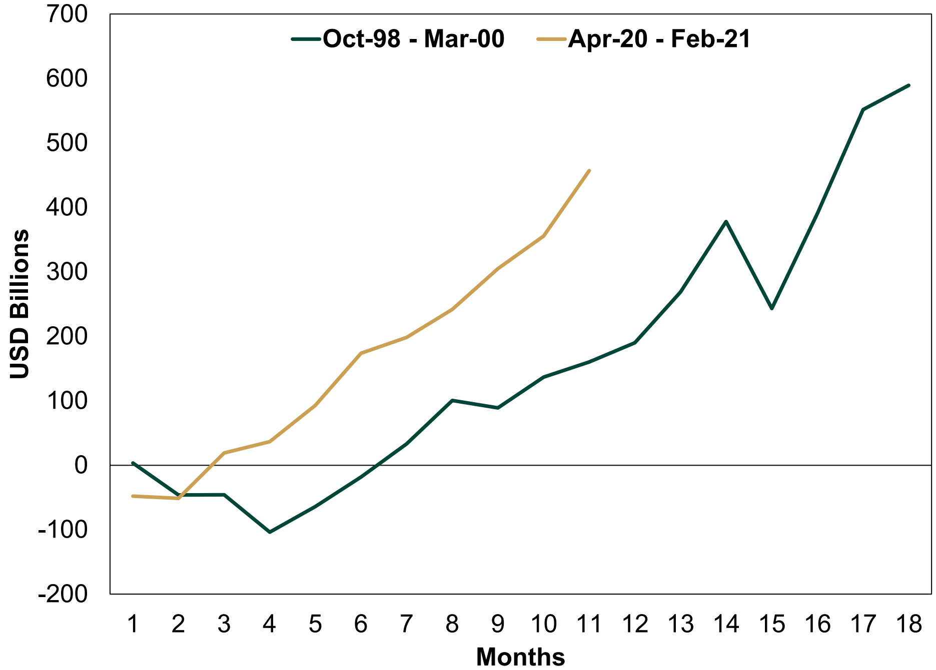
You wouldn't get that intersection of fads early in a bull market. People would be too fearful of risky ventures and huge associated volatility. Pundits would warn about these assets, too, not celebrate them. But this typifies late bull markets. To us, this plethora of fads—and common celebration of them—indicates this bull market is closer to its end than many think.

## Keeping an Eye on Supply

Unless they are walloped prematurely, bull markets generally peak when stock supply outstrips demand. That usually comes when sentiment is runaway euphoric. Since April 2020, US net stock supply (initial and secondary offerings minus buybacks, buyouts and delistings) has traced a path similar to the 18 months prior to March 2000's bull market top—reminiscent of the early stages of the Tech bubble. (Exhibit 17) Global issuance is also up.

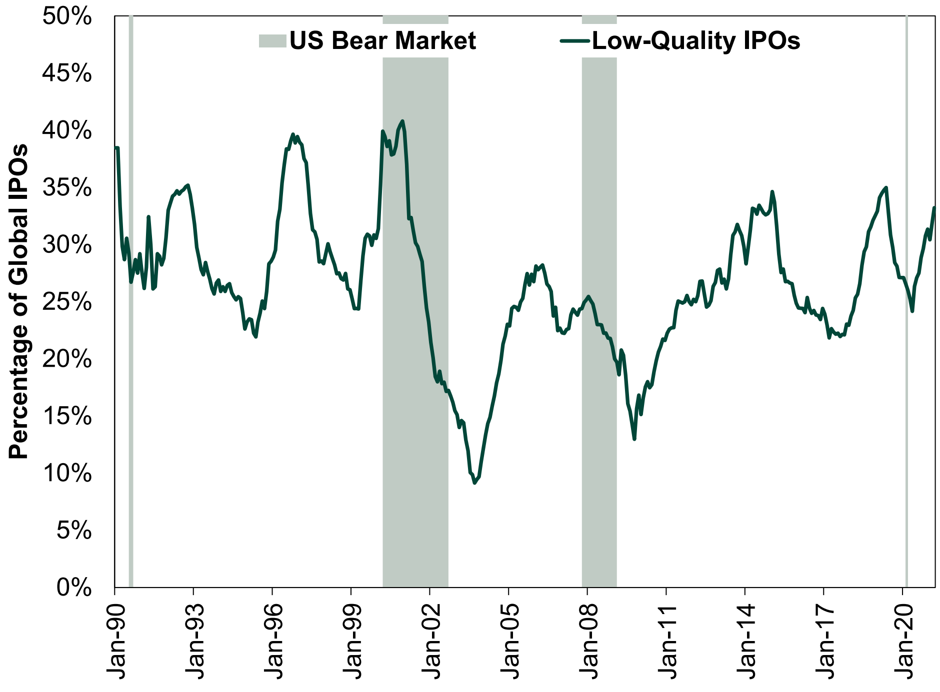
However, rising supply alone isn't necessarily bearish. IPO quality is crucial. We gauge this by tracking the percentage of "low-quality" IPOs—i.e., IPOs with negative earnings per share (EPS) or net income. (Exhibit 18) Globally, IPO quality has worsened, but it is still better than at the Tech bubble's peak.

**Exhibit 17: Comparing Late 1990s Equity Supply to Today**




**Source: Refinitiv and FactSet, as of 3/5/2021. Cumulative change in US equity supply, adjusted for inflation, October 1998 – March 2000 and April 2020 – February 2021.**

**Exhibit 18: A Look at Global IPO Quality**




**Source: Refinitiv, as of 3/30/2021. Trailing 12-month inflation-adjusted global IPO proceeds, January 1990 – March 2021. SPACs aren't included as they don't have net income or EPS figures.**

### Lingering Pockets of Skepticism

Another sign euphoria isn't here: some fears get serious attention, extending the bull market's wall of worry. When euphoria reigns, bears get chastised and ridiculed—not the case today.

### Fretting America's Huge Debt

While many economists cheered the Biden administration's big COVID relief spending plans, some voiced concern. The nonpartisan Congressional Budget Office (CBO) projected a $2.3 trillion federal deficit for fiscal year 2021—10.3% of estimated GDP.[29] That comes on the heels of the postwar-record $3.1 trillion in fiscal year 2020.[30] The deficit drove net public debt, which removes intragovernmental holdings, to $21.6 trillion at 2020's end—100.1% of GDP.[31] The CBO sees the deficit exceeding its historical average even after the pandemic's impact wanes.

That stirred fears of soaring debt jacking up borrowing costs—and creating a debt crisis. But as ever, most ignore the key question: Can the government afford interest payments?

We think so. As of fiscal year 2020, US interest payments were 10.1% of tax revenues.[32] This figure has been rising since 2011, but it remains well below the 15% – 18% range from the 1980s – 1990s—a great period for the US economy.[33] Moreover, today's low yields let the Treasury refinance maturing debt at a cheaper rate. In March 2011, the Treasury sold $21 billion in 10-year notes at a 3.48% median yield.[34] A decade later, $38 billion in 10-year notes fetched a just 1.47%.[35] US debt's weighted-average maturity is over 64 months.[36] Interest rates would have to skyrocket and remain high for years before debt affordability became problematic. We don't think the government can borrow and spend hand over fist without consequence. But debt was a long-running concern before COVID—and remains a false fear, in our view.

### The Ongoing COVID Battle

The COVID nightmare hasn't vanished, as the virus keeps flaring up in places. However, vaccines are rolling. If you combine natural immunity with recovered immunity and vaccine immunity, herd immunity is likely close. Some states and countries may be there already.

Still, many worry about vaccine delays in Europe. Yet stocks probably don't care about short-term delays, as they look much further out and have likely already pre-priced vaccine progress.

Other parts of the world will have a much harder time distributing vaccines than Israel, America or Britain—particularly, the developing world. That impacts them disproportionately, driving talk about a K-shaped economic recovery where rich countries get richer and poor get poorer. This is the tragedy of poverty and a humanitarian crisis we don't discount in the slightest. But coldhearted stocks are well aware of this—and are likely looking beyond it.

We hope you found this information helpful. Please contact Fisher Investments 401(k) Solutions at (844) 237-6902 or visit [www.fisher401k.com](http://www.fisher401k.com) for more information about our 401(k) services.

The Investment Policy Committee
Aaron Anderson, Ken Fisher, Bill Glaser, Michael Hanson and Jeff Silk

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[1] Source: FactSet, as of 4/1/2021. MSCI World Index return with net dividends, 12/31/2020 – 3/31/2021.
[2] See note 1.
[3] Source: FactSet, as of 4/6/2021. Brent crude oil price percentage change, 12/31/2020 – 3/31/2021 and MSCI World Energy sector return with net dividends, 12/31/2020 – 3/31/2021.
[4] Source: FactSet, as of 4/6/2021. US 10-year Treasury constant maturity yield, 12/31/2020 and 3/31/2021.
[5] Source: FactSet, as of 4/6/2021. MSCI World Information Technology sector return with net dividends, 12/31/2020 – 3/31/2021.
[6] "'Why' Is Always Crucial. Why It's Not Time For Value Stocks," Ken Fisher, *LinkedIn*, 3/1/2021.
[7] "IMF Lifts Outlook for Global and US Growth," Greg Robb, *MarketWatch*, 4/6/2021.
[8] Source: FactSet, as of 4/7/2021.
[9] Source: US Bureau of Economic Analysis, as of 4/7/2021.
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