StraightTalk
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Peak Everything

We are officially at peak everything. The least important peak is the media's unrelenting, breathless coverage of the Delta variant – which for the vaccinated among us is not a real concern. Obviously, any death or suffering from this insidious virus is awful, but the narrative around the risks is seriously lacking in context. Last month, the CDC reported that out of 161 million vaccinated citizens, just 4,072 have been hospitalized with a "symptomatic breakthrough." This equates to less than 0.003%. Even more contrary to the nightly news panic over Delta, is the fact that of those hospitalized, only 849 have died. This means the death rate among vaccinated Americans is 0.0005%, *which is 20 times lower than from the flu.* Your chance of death from a lightning strike is actually higher than that, at 0.0007%, and yet I do not recall daily news updates warning me about lightning strikes. As columnist Marc Thiessen wrote in a recent opinion piece, "if you're vaccinated, you have a higher chance of dying from a hornet, wasp, or bee sting, a dog attack, a car crash, a sunstroke, or choking on food than you do of dying from COVID-19." Yes, the hysteria of the virus variant persists in the news media, but that peak is not what is moving this market.

In fact, the market is responding to peak everything else. By everything else, I mean economic growth, inflation, earnings growth, government stimulus, stock prices, cash on the sidelines, and real estate prices. On that front, the OECD just reported that the annual house price across wealthy nations rose 9.4% in the first quarter, the fastest growth in 30 years. That is not just vacation homes in a few desirable areas – that is the average national price across a huge number of developed countries. Peak real estate, indeed.

Both the economy's rate of growth and consumer spending also appear to be peaking. Second quarter growth came in at 6.5%, and consumer spending grew 11.8% - both peak economic numbers. Even more impressive is that the overall size of the economy is also at a peak – now larger than it was pre-pandemic. This is due to a massive rebound in almost everything, as people and businesses desperately want to get back to "normal." This also means that earnings, the key data point that drives stock prices, are also at a peak, with this quarter's consensus expectation for earnings growth up 65% compared to the same quarter last year. This is an unprecedented earnings growth peak.

The expectation is that the second half of this year will enjoy continued growth, but not at the same pace – in other words, the rate of increase will be falling, even as the size of the economy and actual dollars earned by companies continues to grow. The nattering naysayers of negativity in the press will use this as a rallying cry for stock prices to follow that slowing growth downward, but I don't see it from where I sit.

This last 18 months has been one unprecedented occurrence after another, and the market – which is made up of tens of millions of participants – chose to look past those short-term unprecedenteds. Chief among them was the shortest recession in the history of recessions – which the National Bureau of Economic Research deemed over in two months. (A peak of another sort.) The recession last March and April ended the longest economic expansion ever, which had run for 10.5 years. There were no signs of a natural recession looming, and that to me, means we can expect a resumption to the upside.

In fact, last year's recession was caused by a "black swan event" – one that comes out of nowhere to change the trajectory of markets and the economy. In other words, we did not experience an economy that got overheated and had a bubble burst, nor did we have an economy that was growing almost that fast, and was then tipped into recession by an overzealous Federal Reserve Board raising interest rates too quickly. No, the two normal reasons for the business cycle moving from expansion to contraction did not occur – things were actually really, really good. Unemployment was low, labor participation rates were relatively high, earnings numbers were strong and steady, and consumer confidence was high. Then along came a coronavirus, and the resultant economic shutdown. The majority of market participants chose to assume, as I did, that this problem would somehow be solved, and we would soon find ourselves on the other side of the health crisis, largely in the same place we were beforehand. It is for precisely this reason that I believe that revenues, earnings, and share prices will continue to grow over the next couple of years.

This does not mean that we will not experience temporary price corrections, which we are overdue for, as of this writing. So far this year, we have seen small stock market price corrections of 4.5%, 5.7%, 3.3%, 4.3% and the most recent 3.6% drop in late July. Each time, I thought those to be the beginning of a routine decline of 10-15%, but thus far, the selling skids have burned themselves out quickly, and more buyers have entered the market, which has allowed prices to not only recover, but also move higher.

Speaking of higher, the annual back-to-school season begins later this month, and looks to be one of the strongest on record. Since many traditional items like school clothing and supplies were not purchased for last year's zoom school year, and general pent up demand will add to shopping totals – a rebound year is widely expected. Add in new child tax-credits that began in July, plus a mounting national stash of cash deposits, and this fall could be quite good for retailers.

Away from retail, the next few months also look like record highs for corporate revenues and earnings, and although the rate of increases in both will not be as fast as they are currently, the totals will be all time highs. Don't be swayed by news accounts of short-term supply chain disruptions, or difficulty in hiring workers – we are the owners of the great companies of America and the world. And, how did they become great? By working around, and ultimately overcoming the problems that continually arise. There can be no greater example of this than the last 18 months, when the truly great companies shined, and exhibited their ability to survive and adapt in a most difficult environment.

In addition to companies innovating their way to improved profitability, a possible catalyst for this continued economic expansion is the record level of cash in this country (another peak.) While difficult to nail down precisely on any given day, there is roughly $2.5 trillion more in cash, savings and money market than at the onset of the pandemic. Some of that may remain in savings, but a good portion of that will likely be spent consumptively, or invested in the markets, or both. The combination of the whole world reacquiring their spending habits, while simultaneously adding to their portfolios is a powerful one-two combination, one that is not likely to fizzle out just as it is getting started.

To add icing to this economic cake, household debt as a percentage of household worth has been declining for years, but it has actually accelerated post Covid. This is obviously good news, as paying down debt and improving one's own balance sheet is always a prudent financial move. However, what the Federal Reserve Board reports is happening to the interest on that debt is even more powerful – as interest rates dropped to the floor last year, everyone refinanced any debt they could. The result is that the amount of America's disposable income going to mortgage and consumer debt has dropped to a 40 year low (maybe the most important peak!) In percentage terms, only 8.2% of people's monthly disposable income is going to debt service, which is well below where we were at the end of 2019 when things were economically quite strong.

In a consumer-driven economy, having the American household in the best shape it has been in for four decades can only be viewed as good news going forward. This fact won't likely be covered in the nightly news Covid Case Count, but is ultimately far more important. A few peaks appear transitory (such as lumber and rental car price inflation,) while many others are aligned with a recovering and evolving economy - made up of strong companies with growing earnings, and populated with citizens having record levels of cash and low debt service burdens. Based on that, I would look for a higher market peak in the near future…

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