ALTA
CAPITAL MANAGEMENT
A member of Guardian Capital Group Limited

MARKET LETTER

April 2021

The Pendulum Swing

As of March 31st, 2021, over 147 million COVID-19 vaccine doses had been administered in the United States, an impressive acceleration relative to the 2.8 million doses administered as of the end of 2020. Having experienced over 200,000 new COVID-19 cases per day in early January, the country is now experiencing only 70,000 per day. Even more important, daily deaths have decreased by four-fold over that time. There remains ample work and risk mitigation ahead, as well as notable uncertainties. Still, the vaccines' seeming efficacy to-date and their efficient rollout have enabled an incremental opening of lives and economies. Any declaration of victory is premature, but spring seems to be bringing a potential thaw from the COVID-induced freeze.

The hope of a spring thaw is starting to show up in economic numbers as well. In March, payrolls surged by over 900,000, beating consensus estimates by nearly 40%. Likewise, the ISM Manufacturing Index, a gauge of sentiment among US goods producers, jumped to its highest level since 1983. Furthermore, ISM's gauge of new orders jumped to its highest level since 2004 and the backlog index hit all-time highs. Demand is rising while COVID-related shutdowns pressure supply. Economic activity is accelerating to meet that demand.

Washington is simultaneously planning an 8-year, $2.3 trillion infrastructure bill designed to help modernize transportation infrastructure, manufacturing, and other parts of the economy. Meanwhile, the Federal Reserve reiterated its commitment to keeping monetary policy highly accommodative for the foreseeable future and permitting inflation to temporarily overshoot its 2% target as part of its recently adopted average inflation targeting framework.

Data points are lining up for a strong pendulum swing in economic activity. It is interesting to note that all of these positive trends are coming at a time when US household net worth is at all-time highs. The COVID-related shock to the economy in 2020 echoes in severity the dot com bust in 2000 and the financial crisis that began in 2007. It took four quarters for household net worth to recover to previous highs in 2000 and it took a full five years (20 quarters) to recover from the financial crisis of 2007. In 2020, swift fiscal and monetary actions helped cushion the economic impact of the pandemic and household net worth recovered in a single quarter. In fact, at the end of 2020, US household net worth stood 10% above pre-pandemic peaks. It took three years and six years for household net worth to recover to such levels after 2000 and 2007. US household balance sheets are in relatively good shape as the economy is set to accelerate. In this environment, it is not too surprising that some economists are calling for real GDP growth of 9% by the end of 2021.

The economic prosperity die is yet to be cast. Pandemic, geopolitical, and inflation risks still exist, as well as an expanding federal government balance sheet. The pandemic's effects on unemployment will likely be felt beyond 2021. Apart from tracking progress against COVID-19, we remain concerned about inflation expectations in the near term. However, we currently believe the increase in inflation will be transitory, and long-term interest rates will likely settle in a still low range from a historical perspective. We believe equities remain attractive relative to bonds in such an environment, though we acknowledge that current valuations suggest stocks have already priced in some recovery.

We remain excited about the prospects of the companies in our portfolios. Competent management teams have positioned market-leading products for continued success over the next decade. Our investment priorities of strong returns on invested capital, robust free cash flow generation, and visible secular growth remain in place. While many things have changed since 2019, and some changes may be permanent, we are confident that these time-tested investment priorities will continue to be relevant in a post-COVID world.

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