WASATCH CAPITAL MANAGEMENT OF RAYMOND JAMES®

"YOU REALIZE YOU REALLY WEREN'T SUPPOSED TO TRY TO KEEP UP WITH THE KARDASHIANS?"

MARCH 2021

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Don't Fight the Fed -Article by Mark Lazar

***A nation is not made wealthy by the accumulation of shiny metals, but it is enriched by the economic prosperity of its people*. Adam Smith**

In March, president Biden signed the $1.9 trillion COVID relief bill (American Rescue Plan), U.S. COVID vaccinations exceeded the 100 million mark, weekly COVID deaths have dropped 62% since the peak in January, states and schools are reopening at an increasing pace, and the country is forecast to achieve herd immunity by mid-summer. All of which bodes well for a robust economic recovery.

Because markets are forward-looking all of this was priced in months ago, which is why equity indices finished sharply higher in 2020, and are off to a good start in 2021.

Item	YTD Change
Dow Jones Ind Avg	1.21%
S&P 500 Index	1.72%
EAFE Foreign Index	.99%
Barclays Agg Bond Index	-2.15%
10-Year Inflation Forecast	2.21%
1st Quarter GDP Forecast	8.4%
Unemployment Rate	6.2%

**Market index data as of 2/28/2021*

Let's take a moment to better understand the economy and how it's calculated. Gross domestic product (GDP) is the yardstick by which we measure the economy. The formula to calculate GDP is simply C + I + G + (X - M). Specifically, **GDP** = private sector **consumption** + gross **investment** + **government** spending + (**exports - imports**). The 2021 GDP forecast is $22.3 trillion, or a 6% increase from 2020. GDP is expressed in real numbers, meaning net of inflation.

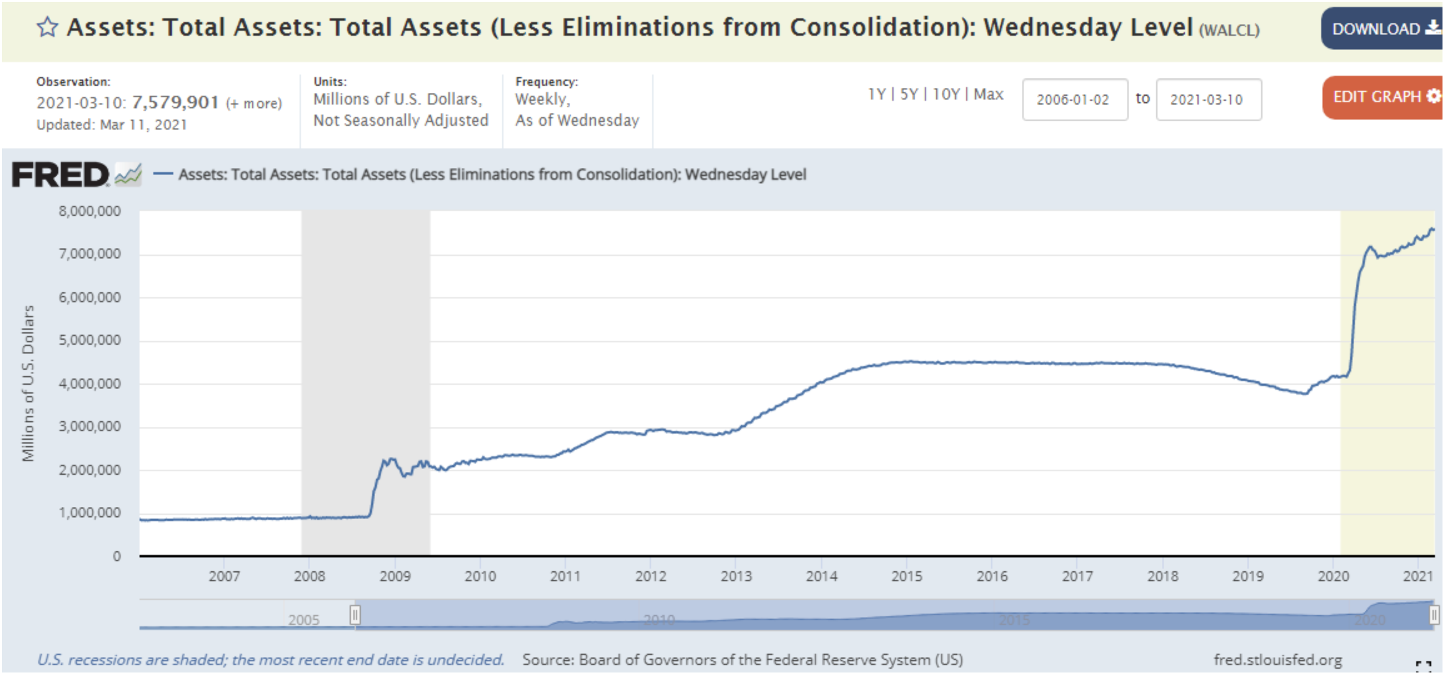
We can calculate average income per capita by dividing GDP by total population. The 2021 forecast is ~$67,000 per person ($22.3 trillion/332 million). When GDP is rising faster than population growth, real wages and, consequently, the standard of living is increasing. Conversely, when the population is growing (birth rate + net immigration), faster than the economy, the opposite is true.

For the past fifty years, federal spending relative to GDP has averaged slightly less than 20%. In other words, federal spending represents about one-fifth of the economy. However, in 2020 the federal government's share of the economy exceeded 31%; the highest since WWII. When state and local spending data are included, 2020 total government outlays exceeded $9.78T; federal $6.55T; state $1.97T; local $2.04T.

In 2020, Uncle Sam collected $3.4T but spent $6.55T. The difference, $3.15T, represents the federal deficit, or the shortfall between tax revenue collected and what was spent. The national debt, which is the total amount of money that the government owes its creditors (government bondholders), is currently $28T, or $84,000 per person.

One might ask, *where does Uncle Sam get the money?* The simple answer is *you*; the taxpayer. When a household spends more than it earns, it must borrow the money (e.g., home mortgage, bank loans, credit cards, etc.) and the federal government is no different—just a lot more complicated, and involves both the U.S. Treasury and the Federal Reserve.

In a nutshell, the Treasury both mints currency and borrows money by issuing Treasury bills, notes, bonds, savings bonds, etc., whereas the Fed creates "Federal Reserves" (digital money) with which it purchases bonds (mostly Treasury securities) held by financial institutions. This effectively injects liquidity into the financial system, and lends money, albeit indirectly, to the Treasury, with banks being the middleman, so to speak.



At the beginning of 2008, the Fed's balance sheet was [$900B](), whereas U.S. GDP was [$14.7T](), meaning the Fed's balance sheet was 6% of GDP. Today, it's $7.6T, or 34% of GDP; nearly six times the historic average. On top of massive [fiscal stimulus](), the central bank has embarked on an unprecedented combination of [monetary stimulus]() measures (e.g. [quantitative easing](), zero interest rates, modern monetary theory ([MMT]()), [yield curve manipulation](), etc.) intended to goose the economy, inflate stock prices, and punish holders of cash/cash equivalent savings.

There's an old Wall Street saying; *Don't fight the Fed*, which means if the Federal Reserve is attempting to boost the economy, stock prices typically benefit. Today, the Fed isn't just [dovish](), it's accommodative on crack. Similarly, Uncle Sam is writing checks so fast he's developing a hand cramp. On top of an economy that is improving daily due to the reopening of businesses, the consumer has a lot of pent-up demand. Add it all together, and you have a recipe that should push stocks and real estate prices higher, bonds lower, and accelerate inflation; meaning cash loses money, albeit *safely*.

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Wasatch Team Updates

Mark

Mark & Savina visiting Fairbanks last month with friends

Stan

Stan has 4 generations together this month for the very first time!

John

John hiking above Salt Lake with his dog, Stella.

Beth

Beth walking her furry friend, Danika.

Michelle

Michelle enjoying a winter afternoon shopping excursion with family in Wisconsin.

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