Insights and Observations: First Quarter 2021

The $1.9 trillion stimulus bill is more of the same, emergency measures and safety-net expansions. These trends have been with us for the past forty years … under presidents of both parties … as federal income support rose by more than half to 4.3% of GDP from 1979 to 2019.

At some point, we are going have to pay for all this. But deficit reduction doesn't appear to be anywhere on the horizon.

Over the years, any efforts to reform entitlement programs have basically failed. Tax rates may fluctuate, but no president in the last 40 years has raised taxes on lower-income Americans. Most have actually lowered the burden. In fact, 43% of households currently pay no federal income tax, according to the Tax Policy Center.

> So, Mr. Biden hasn't so much changed the paradigm as turned the dial on the existing paradigm up to 11. By making the child tax credit entirely refundable, he has severed any linkage to paid work. By promising only the richest 2% will have to pay higher taxes, he is further cutting back on the overlap between those who benefit from the federal safety net and those who pay for it … he is also turning up the dial on deficits.
>
> Greg Ip – WSJ 3/17/21

During 2017, federal, state, and local governments distributed $2.8 trillion … or 22% of U.S. earned household income. Over the past 50 years, the value of these transfer payments has increased 300% (adjusted for inflation). The majority of those payments were received by the bottom two *earned income quintiles*.

The Census Bureau, however, includes only about one-third of these transfer payments as household income. Payments for such things as Medicare, Medicaid, food stamps, and the earned-income credit are *not included* as household income.

Americans pay $4.4 trillion a year in federal, state and local taxes … 82% of which are paid by the top two *earned income quintiles*. The Census Bureau *does not* reduce household income by taxes paid.

According to the Census Bureau, income inequality expanded by over 21% during the fifty years ended 2017. When the above data deficiencies are corrected, *income inequality* calculations remain relatively consistent over the past 50 years.

> The data upon which claims about income inequality are based are profoundly flawed … not only is income inequality in America not growing, it is lower today than it was 50 years ago.
>
> Gramm/Early – WSJ 3/23/21

The net U.S. federal debt is expected to reach over 102% of GDP by the end of the current fiscal year. At the end of fiscal 2019, according to the Congressional Budget Office (CBO), net federal debt was just over 79% of GDP. The CBO projects that federal debt will grow to reach 107% of GDP by 2031.

> I'm not worried about the deficit. It's big enough to take care of itself.
>
> Ronald Reagan

Low interest rates have helped manage ballooning federal debt. Treasury Secretary Janet Yellen recently observed that the governments' interest burden is actually lower than it was back in 2007, even though the ratio of debt to GDP has nearly tripled.

> Given the low level of interest rates, there's no issue about the United States being able to service its debt at this time or in the foreseeable future. There will come a time – and that time will be when the economy is back to full employment, and taxes are rolling in … when it will be appropriate to return to the issue of getting back to a *sustainable* fiscal path.
>
> Jerome Powell, Fed Chairman – WSJ 3/25/21

The key word being, in case you missed it … sustainable. Even though many of our leaders do not seem overly concerned about our debt burden, at least they admit that what we are doing is not sustainable.

The CBO expects the U.S. federal debt to double to over 200% of GDP by 2051 (not including the recent $1.9 trillion stimulus). Their projections single out rising costs for healthcare and debt service.

> The risk of a fiscal crisis appears to be low in the short run despite the higher deficits and debt stemming from the pandemic. Nonetheless, the much higher debt over time would raise the risk of a fiscal crisis in the years ahead.
>
> Congressional Budget Office – March 2021

According to recent data, there are 366 tech stocks that now trade at multiples of more than 15 times sales … up from just 25 stocks in 2017. It's the highest total since 2000 – just before tech stocks crashed – when 1,540 companies saw their stocks trade at such high multiples.

Over the past 50 years, companies trading at 15-plus multiples saw their stock prices fall by 18% and 28% over the ensuing three- and five-year periods, respectively.

Also, at the peak of the 2000 tech bubble, 36% of tech stocks were unprofitable … currently, 38% of tech stocks are actually losing money.

> Let me be blunt: Tech stocks are still alarmingly expensive … many valuations remain stratospheric.
>
> Eric J Savitz – Barron's 3/26/21

The average tech stock beat broad market measures by 28 percent last year. But investor behavior is changing, and tech stocks are now trailing the market averages.

> Look, momentum is a really powerful thing, and during growth markets you can make hay. That's the environment we've had … In short, what went up is indeed starting to come down.
>
> Toni Sacconaghi, Bernstein Research – Barron's 3/26/21

High stock valuations and below average corporate profits are a bad combination. Investors in the tech sector should proceed with caution.

Bankruptcy filings by consumers declined in 2020, while commercial bankruptcy filings rose. Consumer bankruptcies were limited by federal suspensions of evictions, home foreclosures, and student-loan payments. As Americans remained socially distanced, spending declined, while direct stimulus payments helped to pay off debts and increase household reserves.

(The national eviction moratorium was just extended an additional three months. It was scheduled to end in March, but will now be effective through June of this year.)

Economists expect the decline of consumer bankruptcy filings to be only temporary. They expect filings to pick up as government relief programs expire.

> There's a serious case to be made that this is hiding a deeper problem, and in the future, people have to pay a multiple of the debt they weren't able to maintain before the pandemic.
>
> Jaromir Nosal, Boston College economist – WSJ 3/29/21

The Urban Institute estimates the total amount of unpaid rent to be in excess of $52 billion … or about $5,586 per household.

> We need to start turning our attention to what is going to happen when America reopens and moratoria end.
>
> Rohan Pavuluri, Upsolve CEO – WSJ 3/29/21

According to Freddie Mac, lenders originated more mortgages than ever in 2020. Of those, about $2.8 trillion were refinanced mortgages, with U.S. homeowners cashing out $152.7 billion of home equity in the process … a 42% increase from 2019, and the most since 2007.

> The support coming from home equity is unparalleled in helping smooth out the degradations from Covid. For those who are in the position to refinance, it's a major source of support.
>
> Susan Wachter, University of Pennsylvania – WSJ 3/11/21

There are more real-estate agents than homes for sale in the U.S.

According to the National Association of Realtors (NAR), there were just over 1 million homes for sale in the U.S. at the end of January, down 26% from a year earlier and the lowest on record. The NAR had 1.45 million members in January, up 4.8% over the past year.

> There are very low barriers to entry, in terms of ease of getting a real-estate license. But the barriers to success are very high.
>
> Nick Bailey, Re/Max Holdings – WSJ 3/21/21

During the current five-year plan, China has pledged to increase the retirement age, which is currently 60 for most men and 50 to 55 for most women. China is taking on pension reform because they have no choice … *they are destined to grow old before they grow rich*.

China's elderly dependency ratio, the number of people over 65 per 100 people between the ages of 15 to 64, is approaching *developed-country* levels of 17 and rising. India and Vietnam are at 9.8 and 11.4, respectively. (Note that the U.S. level is just over 25.) The problem is China's per capita income is about one-fifth the level of a developed nation. That raises the potential for widespread poverty which is the most significant threat to China's Communist Party.

> When it comes to China's economy, the sexy issue is the annual growth target for gross domestic product … But only one topic is really important for the longer-term survival of the Communist Party regime: pensions. And the party knows it.
>
> Joseph C. Sternberg – WSJ 3/11/21

Here are some insights from "Rethinking Happiness", WSJ 3/21/21:

- The risk of death was higher among those who were not happy compared with those who are very happy.
- Happy people earn more and are more productive.
- Genuinely happy people are emodiverse … meaning they can manage all different emotions.

- Happy people are satisfied with the way their own life is going … which may actually be a better way to define happiness.
- Happiness is thought to be a choice and a skill.
- Positive emotions are recorded when people are in parks or by bodies of water.
- Hiking or walking with a friend raised positive feelings more than when walking or hiking alone.

> Scientists are learning how to better measure and improve happiness, as the pandemic forces many to question what brings them joy.
>
> Clare Ansberry – WSJ 3/21/21

The above insights reflect many of the financial and economic issues that have been amplified by the pandemic. The three biggest concerns at the governmental level usually focus on the “3 D’s”: Deficits, Debt, and Demographics.

Individuals will generally find themselves grappling with rising tax rates, lower investment returns, and high asset valuations … and maybe starting to focus more on the simple things that make them happy.

Let us know if we can be of any help.

Daniel G. Corrigan, CPA/PFS, CFP®