THE AMERICAN INVESTOR

A SOPHISTICATED APPROACH TO BUILDING WEALTH

Reynolds and Associates
12345 Anywhere Street
San Diego, CA 92127
858-592-6262
www.markreynoldsandassociates.com

Mark Reynolds
CPA, Director

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All Eyes on High-Frequency Indicators

Economists and investors are focusing on high-frequency indicators to monitor the impact of the pandemic and the progress of the economic recovery.

The United Kingdom Suffered a Historic Slump

The U.K. economy contracted 9.9% in 2020, making it the most severe downturn in 300 years. This was also the largest annual decline among the Group of Seven advanced economies.

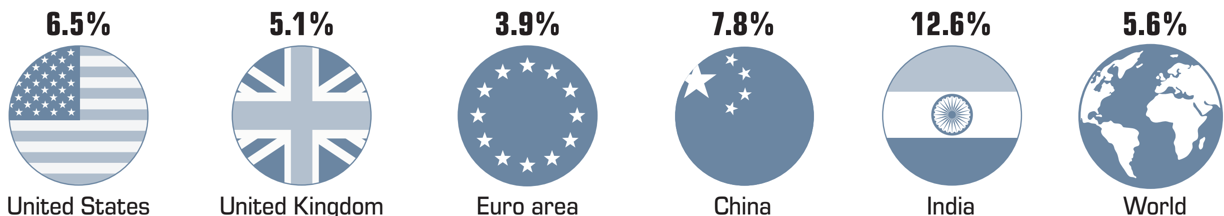
Source: *The Wall Street Journal*, February 12, 2021

Preview

A Brighter Economic Outlook for the United States, and the World

After gaining ground on COVID-19 vaccines and enacting a third injection of fiscal stimulus, the United States is poised to help drive stronger global economic growth.

Forecast for 2021 gross domestic product growth*



*Forecasts are based on current conditions, are subject to change, and may not come to pass.

Source: Organisation for Economic Co-operation and Development, 2021

Practical Insights For Your Financial Goals

All Eyes on High-Frequency Economic Indicators

Since the pandemic began, disruptions in business activity have varied greatly from region to region, and often from one week to the next, according to the severity of local COVID-19 outbreaks. Unfortunately, many of the official government statistics used to gauge the health of the U.S. economy are backward looking and somewhat delayed.

Changes in the nation's gross domestic product (GDP) indicate the rate at which the economy is growing or shrinking, but the first GDP estimate is not published by the U.S. Bureau of Economic Analysis until about one month after each quarter ends. In fact, rapid changes in virus conditions — for better or worse — can make many of the monthly reports that gauge employment, consumer spending, and production seem outdated and irrelevant by the time they are released.

Consequently, economists and investors have been focusing on more timely data sources to monitor the economic impact of the pandemic throughout the nation. This information is reported every week, and in some cases every day, by government agencies or private companies with access to key business insights.

Here are some of the high-frequency indicators that may be helpful in evaluating the progress of the economic recovery.

Employment Picture

A weekly report from the U.S. Department of Labor includes the number of new claims for unemployment insurance benefits under state programs filed by workers who recently lost their jobs, as well as the number of continuing claims filed by those who remain unemployed. This provides an early look at whether the labor market is improving or worsening on a state-by-state and national basis.

The American Staffing Association Staffing Index, which tracks weekly changes in temporary and contract employment, has long been considered a leading indicator. Many employers rely on temporary help before hiring additional permanent employees, so staffing agency trends tend to lead nonfarm employment by three to six months.

Consumer Behavior

The proprietary Johnson Redbook Index captures consumer spending trends based on weekly data from a representative sample of thousands of large general merchandise and apparel retailers.

The reservation app OpenTable has been monitoring the impact of COVID-19 on the hard-hit restaurant industry, providing data that doubles as an indicator of the "openness" of local economies around the world. Daily data shows changes in the number of people dining at restaurants compared with the same day of the same week in the previous year (*opentable.com/state-of-industry*).

Mobility and Travel

Other technology companies rolled out tools designed to help public health officials around the world monitor day-to-day mobility trends with data collected from navigation apps. Apple's Mobility Trends Reports (*covid19.apple.com/mobility*) show changes in routing requests (since January 2019) for walking, driving, and public transportation trips, the latter of which have been slower to recover. Google's Community Mobility Reports (*google.com/covid19/mobility*) show changes in visits to places like grocery stores, retail shops, and parks.

The number of people who pass through U.S. airport checkpoints is posted daily by the Transportation Security Administration (*tsa.gov/coronavirus/passenger-throughput*). The hotel occupancy rate (released weekly by STR) is another good indicator of the willingness of consumers and businesses to spend money on travel (*str.com/data-insights/news/press-releases*).

Real-Time Tracker

In May 2020, Harvard-based nonprofit Opportunity Insights, in partnership with several private-sector providers of high-frequency data, launched a real-time Economic Tracker (*tracktherecovery.org*) as a free public service. Interactive charts show day-to-day changes in U.S. debit- and credit-card spending, small-business revenue, employment, online job postings, and time spent outside the home. In addition to nationwide statistics, disparities in progress can be broken down by income and industry, as well as by state or metro area.

Weekly Economic Index

The Weekly Economic Index (WEI) signals the state of the U.S. economy based on 10 different indicators of consumer behavior, the labor market, and production that are available daily or weekly. The WEI is scaled to the four-quarter GDP growth rate, which means the weekly result is the economic growth that could be expected if current activity continued for a year. Because changes are measured over a 52-week period, the strong increase at the end of Q1 2021 reflects the sharp deterioration in economic conditions during the same time last year.

Source: Federal Reserve, 2021 (data through March 27, 2021)

Preview

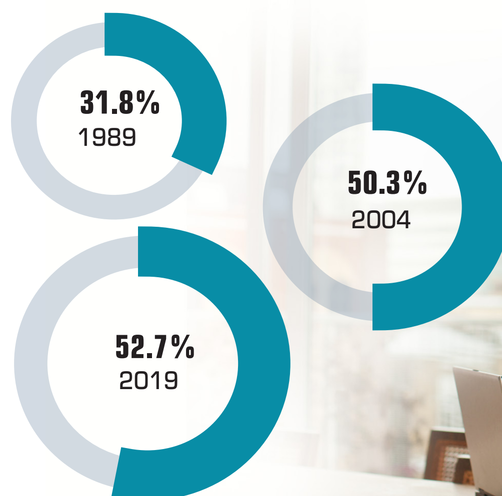
Stock Market Risks in the Spotlight

During March 2021, the widening availability of COVID-19 vaccinations, signs of improving economic conditions, and a third, $1.9 trillion stimulus package brought about more optimistic growth projections. Even though a healthy economy could be good news for many businesses and the financial markets, rising inflation expectations caused a multi-week sell-off in U.S. government bonds that pushed up longer-term yields and sent the Nasdaq Composite Index into correction territory on March 8, 2021.[1]

Promising a patient approach, the Federal Reserve stated that it would not raise interest rates until the labor market fully recovers and inflation moderately exceeds the 2% target for some time.[2] But some investors worry that sharply higher inflation could force policymakers to boost rates sooner than originally expected.

Here's a closer look at some specific types of investment risk that could influence individual stock prices and/or cause broader market swings during the second half of 2021.

Percentage of U.S. Households Who Own Stocks*



*Directly or indirectly through investment vehicles

Source: Investment Company Institute, 2021 (data from Federal Reserve Board Survey of Consumer Finances)

Preview

Inflation and Interest-Rate Fears

Inflation and interest rates are two different but closely related investment risks. The Federal Reserve is tasked with fostering full employment and controlling inflation. One way it balances these two goals is by lowering interest rates to stimulate business activity or raising rates to help slow inflation when the economy is heating up too fast.

High inflation erodes the value of investment returns, but when interest rates rise, bond values fall (and vice versa). These risks are obvious considerations for bond owners, but they also impact stocks. When goods, services, and credit cost more, consumers have less purchasing power, which can hurt company earnings and stock prices as well.

Rising bond yields might continue to have a negative effect on stock values, because as they move up, borrowing costs for most businesses also rise, cutting into profits. Higher yields could also entice risk-averse investors to sell their stocks and buy more stable bonds instead.

Legislative or Regulatory Impacts

Some government actions (such as antitrust lawsuits, higher taxes, and more stringent regulations or standards) make it more difficult and expensive for companies to do business, which can adversely affect their earnings and stock prices. On the other hand, government subsidies and tariffs on foreign products can provide competitive advantages.

The Justice Department, Federal Trade Commission, and numerous states are in the midst of antitrust lawsuits or major investigations into the business practices of several market-dominating tech companies.[3] In another example, the Securities and Exchange Commission is considering new standards for corporate disclosures related to environmental, social, and governance risks.[4]

Event or Headline-Driven Volatility

Headline risk refers to the possibility that events reported in the media could hurt a company's reputation and/or earnings prospects. Troubling news can cause market backlash against a specific company or an entire industry. Companies try to manage this risk through public relations campaigns and other efforts to generate positive news that leaves a good impression on consumers. Events that threaten to disrupt business activity nationwide, regionally, or around the world can cause sudden stock market declines.

The market responds to news, good or bad, almost every day. For this reason, your portfolio should be designed to weather a range of market conditions and have a risk profile that reflects your ability to endure periods of market volatility, both financially and emotionally.

The principal value of bonds may fluctuate with changes in interest rates and market conditions. Bonds redeemed prior to maturity may be worth more or less than their original cost. The return and principal value of stocks fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Investments seeking to achieve higher yields also involve a higher degree of risk.

1) *The Wall Street Journal*, March 8, 2021
2) Federal Reserve, March 17, 2021
3) Reuters, December 16, 2020
4) *The Wall Street Journal*, February 24, 2021

Bankruptcy Changes Throw a Lifeline to Sinking Small Businesses

The Small Business Reorganization Act of 2019 (SBRA) added a new Subchapter V to Chapter 11 of the Bankruptcy Code, which was intended to “streamline the process by which small business debtors reorganize and rehabilitate their financial affairs.” Prior to the SBRA, using a Chapter 11 bankruptcy to restructure took a long time and was often cost-prohibitive for small businesses, forcing many to liquidate instead.

Just weeks after the SBRA took effect in February 2020, Subchapter V eligibility was temporarily expanded by the Coronavirus Aid, Relief, and Economic Security (CARES) Act in a bid to help more businesses survive the pandemic. The debt limit to qualify as a small-business debtor was increased from $2,725,625 to $7,500,000 through March 27, 2021. At the last minute, Congress extended the higher debt limit once again through March 27, 2022.

Subchapter V loosens many of the requirements that make the traditional bankruptcy process difficult and expensive for small businesses to navigate.

Fewer Hurdles and Lower Costs

As always, filing for bankruptcy protection under Chapter 11 halts creditor collections and buys time for owners to renegotiate the terms of their debt, leases, and other contractual obligations. Subchapter V loosens many of the requirements that make the traditional process difficult and expensive for small businesses to navigate.

Preview

Debtors who elect to proceed under Subchapter V must file a Chapter 11 plan (consensual or nonconsensual) within 90 days of filing, reducing the amount of time spent in bankruptcy. Debtors don’t have to pay U.S. Trustee fees or file disclosure statements, creditors are not allowed to file competing plans, and certain committees have been eliminated — all of which helps to reduce the overall cost.

Forging a New Path

The Chapter 11 plan must include a brief history of the debtor’s business operations, a liquidation analysis, and projections that demonstrate the debtor’s ability to make plan payments. The debtor is required to contribute all net operating income (after expenses such as rent, payroll, and goods) to pay creditors for the next three to five years.

A specialized trustee is appointed to monitor the case and facilitate the confirmation of a viable reorganization plan — not to control the debtor’s assets or operations. While the emphasis is on the development of a consensual plan, the court can confirm a nonconsensual plan that it views as “fair and equitable” even if creditors don’t like it, and the owners can keep their equity and continue running the business. Still, creditors must be paid at least as much as they would in a Chapter 7 liquidation.

Bankruptcy may offer a fresh start, but there are many potential financial and legal consequences to consider. Be sure to consult a qualified legal professional.

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Getting carried away in the heat of the moment could be detrimental to your portfolio’s long-term performance. We can provide tools to help you manage market risks and strengthen your mindset.