Investor Insights & Outlook

April 2021 1st Quarter Concorde Investment Management

Domestic Economic Overview

A Message from Concorde Investment Management

We have an app for your smartphone or tablet that allows you to view your entire portfolio and includes a vault where you can access your quarterly reports, billing summaries, and share documents with Concorde from a secure portal. If you are not yet set up with the app and would like to utilize this feature, please contact Barbie Spicer for assistance.

After a year of combining sections, we are going to restart separating out the discussions from the domestic and international economies. Given the difference in the vaccine rollout between the US and everyone else (excluding Israel and the United Kingdom) along with the massive amount of stimulus enacted by the US government, expected performance of economies will greatly differ going forward.

Given the success and efficacy of the various approved vaccines, the US economy could best be described as a coiled spring. GDP grew in Q3 at 33.4% and 4.3% during Q4. The 3rd quarter was robust due to the rebound from the total government forced economic collapse last year during Q2. At this point in time, the amount of pent-up demand for goods and services is almost unmeasurable. Think about anyone you know or yourself personally. Trips, restaurants, movies, dinner out, etc. are all things that people are gearing up to do post getting vaccinated (or not). Case levels, infection rates, and hospitalizations due to Covid-19 have fallen off a cliff in Q1. Part due to vaccines, and part due to the amount of people that have been infected. The virus is running out of people to infect (reinfection is still very rare). Cases and fatalities all peaked in early Q1. We had approximately 250k people at a 7-day moving average in early January catching Covid-19 and at the end of March it was closer to 50k. Fatalities reported by the CDC went from almost 3,500 in early January to under 1,000 at the end of March. The estimated zone for herd immunity would by somewhere between 60% and 80% of the population either having caught Covid or being fully vaccinated. At the end of March, the CDC estimated around 55% of the country had protection from the virus by recovery and/or vaccine. As the country continues to open, fewer and fewer individuals will come down with the disease and more and more people will be ready to get back to living and spending money they saved during the last year or were given by the government.

continued on next page

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Domestic Economic Overview (continued)

If we look at the high frequency economic activity from JP Morgan, comparing March 2021 numbers to March of 2019 *(pre pandemic activity),* mortgage applications are up 6%, debit/credit card transactions are up 13%, hotel occupancy is down 15%, seated dinners are down 16%, and airline traffic is down 39%. The good news is that certain activities are higher than they were 2 years ago while some are close to back to normal. Airline activity may be down however that seems to be due to business travel. Airline executives have said their recreational travel is back above pre pandemic numbers.

The CBO baseline forecast for the year ending 9/30/21 is forecasting total spending by the Federal government of an eye popping $6.9 trillion. Just a shade under $2 trillion is related to stimulus spending. The concerning aspect of that number is that the government is going to have to borrow $3.4 trillion, or 50% of the 2021 spending, to bridge the gap. This is unsustainable however neither party seems to have any moral footing on reducing deficit spending. This deficit spending combined with personal savings and pent-up demand should make for a robust Q1 and Q2 GDP for the US.

International Economic Overview

Outside of the US, UK, and Israel, the vaccine rollout amongst other countries leaves much to be desired. Those 3 countries are by far and away ahead of any other country on their vaccine rollout. The UK has over 52% of the country receiving at least one dose, the US is at 44%, Israel is over 60%, and the next closest are France and Germany at around 10%. No doubt our readers have seen the headlines out of India and Brazil and the result of these government failures will be strained healthcare systems and slower economic recovery. The only countries with a positive purchasing manager's index as of 3/31/21 are China, India (that will soon change), Germany, and Russia. Every other country is below 50 which indicates a slowing economy. Without the benefit of massive stimulus spending, these economies are stuck until they can improve the vaccine rollout.

Anecdotally, Greg had an individual from Ireland in his house recently and that person got their first dose of the Pfizer vaccine. Rather than head home to Ireland and 'hotel jail', his guest elected to stay in the US for an extra 3 weeks to get the 2nd dose because the guest was told if they come home, they won't be able to get the 2nd dose of Pfizer until November or December. Unfortunately, the rest of the globe is going to be about a year behind the US in their vaccine rollout. We expect economic numbers to reflect this imbalance.

Fixed Income

The first quarter of 2021 saw the continued rise in medium and long-term U.S. Treasury yields as the economic recovery gained strength. Demand for these high-quality securities waned as a defensive investment and some concerns over potentially rising inflation began to increase. Spreads to Treasury yields for riskier fixed income did narrow some, producing better total returns for corporates, mortgage and asset backed securities. The lowest rated corporates as a group produced the best returns as perceived risk dropped.

Ten-year Treasury yields, at 1.74% on March 31, are close to levels in late 2019 although well off the highs reached in the last cycle of around 3.00% in the second half of 2018. Assuming that the broad economic recovery continues at any reasonable rate, inflation expectations should be the primary driver of base Treasury yields going forward now that rates have returned to pre-pandemic levels. The implied forward inflation rate based on ten-year TIPS and nominal yields is around 2.25% at quarter end.

With regard to investing in fixed income at this stage of the cycle, we remain in favor of investments in agency and non-agency mortgage back securities, select short-term investment and higher rated non-investment grade corporates, short-term taxable and tax-free revenue and project municipal bonds and very short-term government notes for liquidity. This mix should generate reasonable cash income with fairly low credit and duration risk.

U.S. Treasury Note Yields	03/31/2021	12/31/2020	06/30/2020
2 year	0.16%	0.13%	0.16%
5 year	0.92%	0.36%	0.29%
10 year	1.74%	0.93%	0.66%

Source: U.S. Treasury, Bloomberg; J.P. Morgan Asset Mgmt.

Equity Markets

Domestic equity markets continued the strong rebound which began a year ago, reflecting most recently an emphasis on sectors which typically rebound from traditional cyclical recessions. These sectors, including industrials, real estate, finance, materials and energy are typically emphasized in value-oriented portfolios and represent areas that have lagged in equity market performance over most of the last ten years. This recent trend and the likelihood of its continuance are logical based on the nature of the pandemic induced activity collapse compared to financially focused downturns over the past 20 years.

International equities outside of the U.S., the U.K. and China have recovered slower than these three countries, which have shown quicker rebounds in activity. It appears that because of slower vaccine distribution and acceptance, the majority of the rest of the globe may lag significantly and thus we believe a prudent investment strategy will be to remain underinvested in those areas at least for the short term. We continue to maintain some international exposure through superior large businesses with global revenue exposure that are primarily based in the U.S. or western Europe.

Looking forward, selectivity continues to be key in individual domestic stocks as the year long rally has driven valuations higher. Many equities, particularly in the long underperforming sectors discussed above, trade at valuation levels that are still attractive for multi-year time horizons, even assuming slower growth after a strong 2021 recovery. These value oriented stocks, along with a few technology and consumer market dominant businesses with superior cash flows, balance sheets and lower regulatory risk form the backbone of what we believe to be portfolios with good risk reward characteristics moving forward.

Stimulus, Inflation, and You

Federal stimulus may fuel inflation. Learn how to protect your investments.

The $1.9 trillion federal stimulus package will help many families, businesses, and state and local governments hard hit by the pandemic. But it is also fueling concerns about the ballooning federal debt, inflation, and how investors can protect themselves.

Over the last 20 years, the federal government's debt has grown faster than at any time since the end of World War II, running well ahead of economic growth. In addition to COVID-related spending, rising federal debt has been driven by longer-term trends including increasing Social Security and Medicare spending for an aging population. Today, according to the Congressional Budget Office, the federal debt is $22.5 trillion, more than 100% of gross domestic product (GDP).

Why debt matters

New Fidelity research suggests that higher debt can slow economic growth, and ultimately lead to higher inflation and more volatile financial markets. Warns Dirk Hofschire, senior vice president of asset allocation research: "Debt in the world's largest economies is fast becoming the most substantial risk in investing today."

In the short term, Fidelity's director of global macro Jurrien Timmer says a market consensus has emerged that inflation will rise in the second half of 2021: "An inflationary boom could result from the combination of COVID infections falling, vaccinations rising, ongoing massive fiscal stimulus, pent-up consumer demand, and low interest rates."

Longer term, Hofschire says, "The rise in debt is unsustainable. Historically, no country has perpetually increased its debt/GDP ratio. The highest levels of debt all topped out around 250% of GDP. Since 1900, 18 countries have hit a debt/GDP level of 100%, generally due to the need to pay for fighting world wars or extreme economic downturns such as the Great Depression. After hitting the 100% threshold, 10 countries reduced their debt, seven increased it, and one kept its level of debt roughly the same."

Only time will tell which way the U.S. goes and when. But Hofschire thinks "government policies are likely to drift toward more inflationary options." Among them:

- Federal spending aimed at lower- and middle-income consumers
- Increased public works spending not offset by higher taxes
- Protectionist measures with a "made in America" rationale
- Infrastructure upgrades targeting sectors such as renewable energy, 5G telecom, and health care
- Higher inflation targeting by the Federal Reserve
- Mandatory pay increases for workers benefiting from government assistance

In the longer term, if further free-spending fiscal policies are adopted while interest rates stay low and credit remains abundant, the likelihood of inflation could increase. But history suggests the magnitude and timing is uncertain. Many predicted an inflation surge the last time the federal government embarked on major fiscal and monetary stimulus after the global financial crisis, but inflation mostly failed to appear.