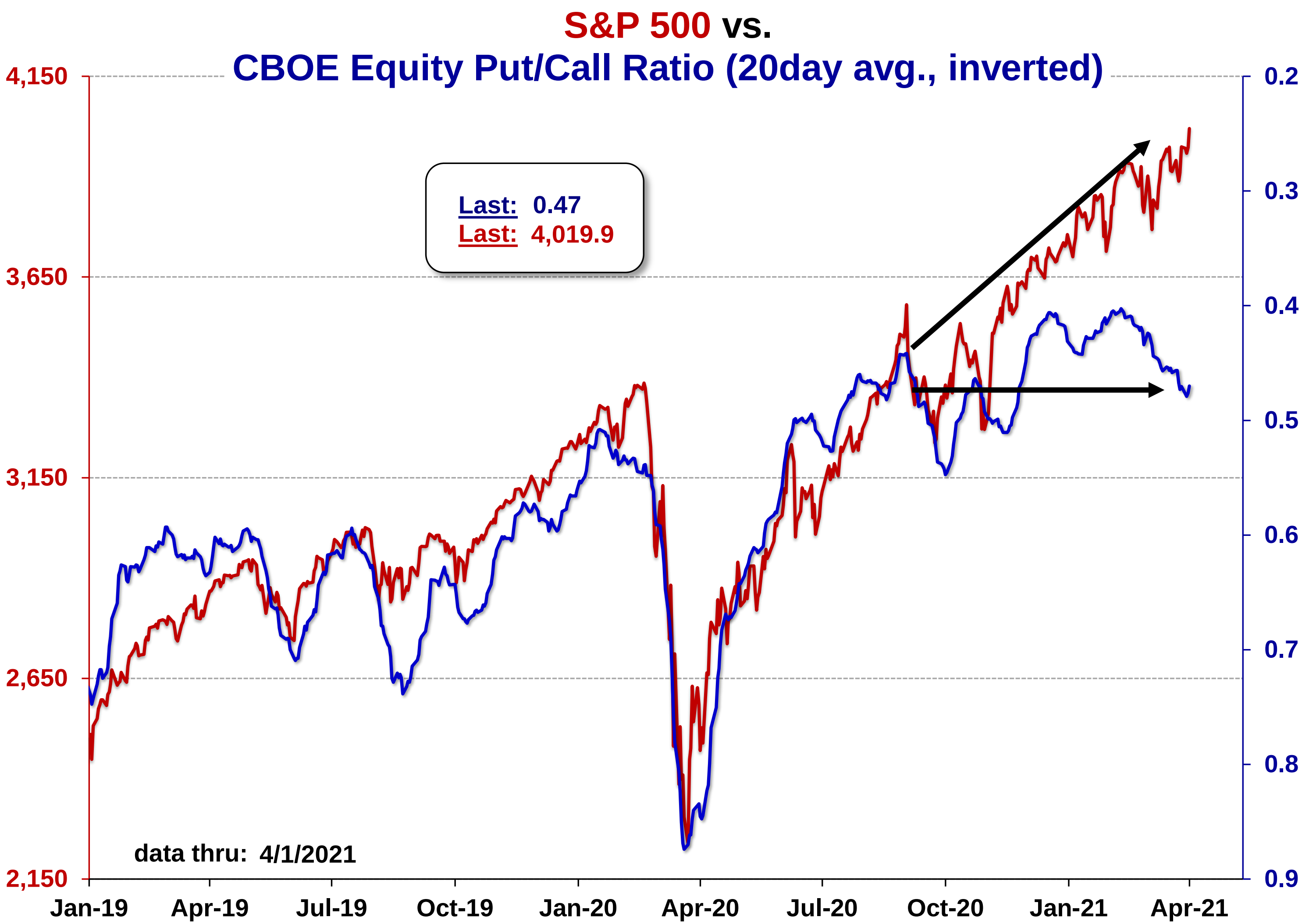
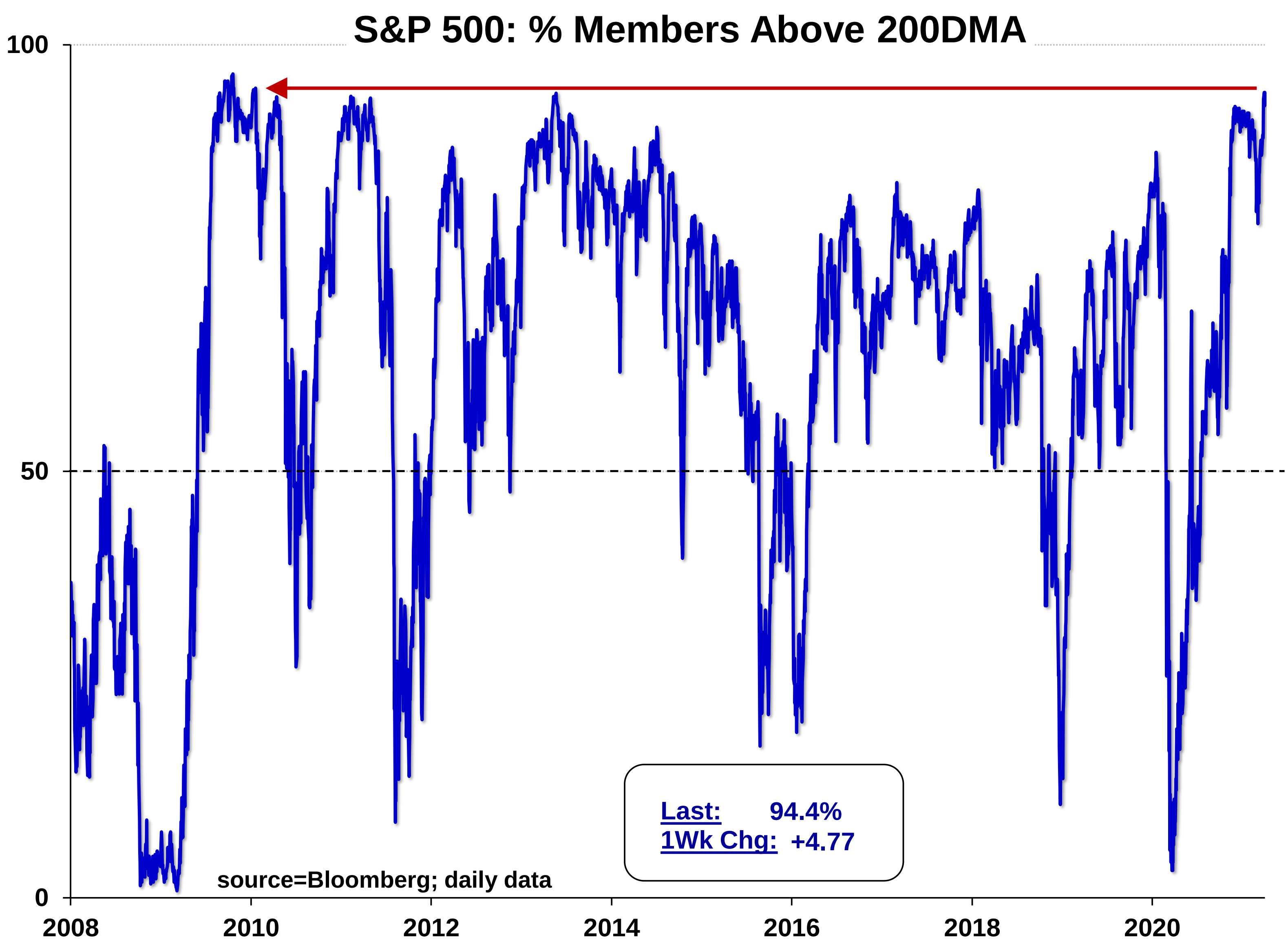
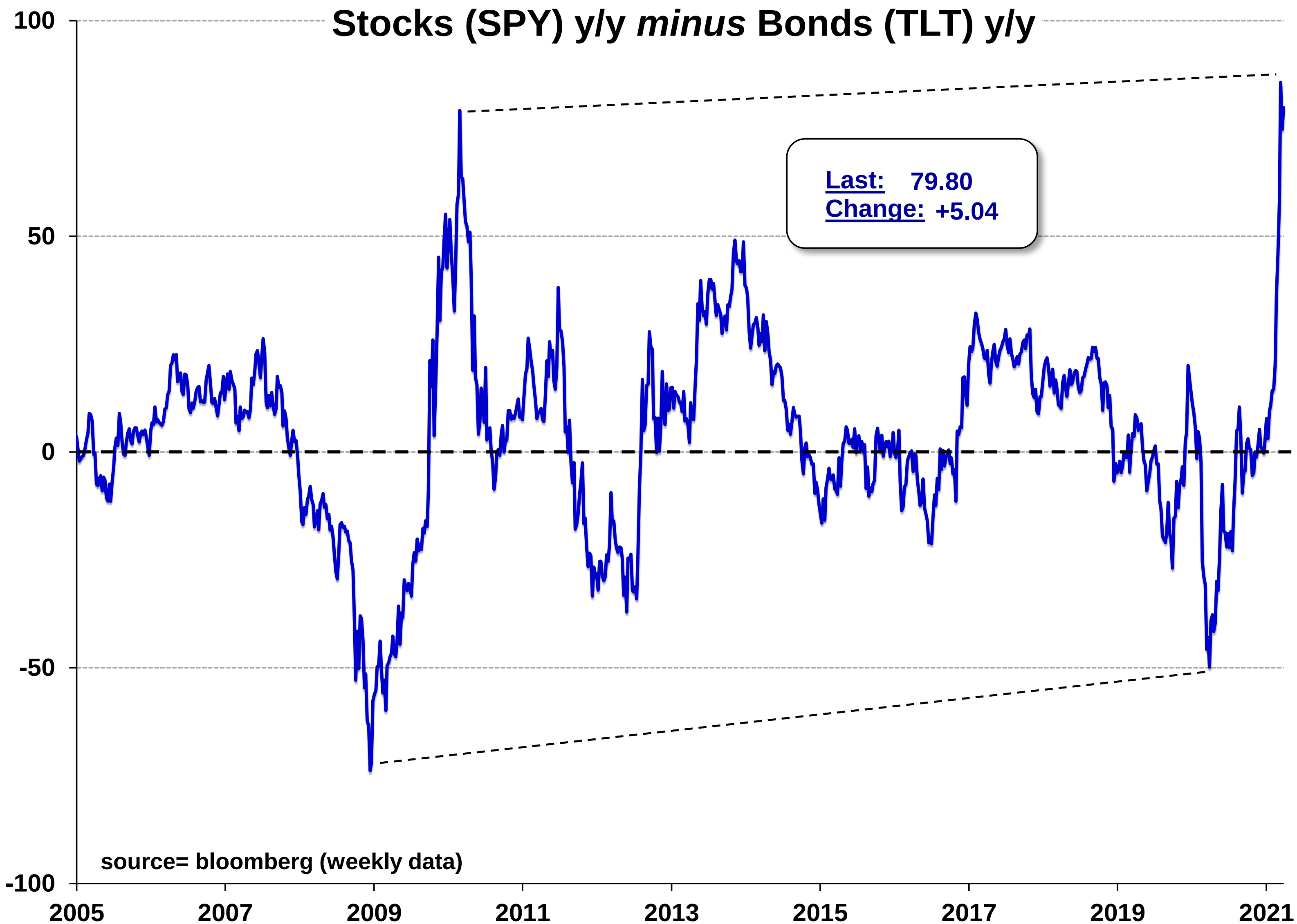
Market Froth: S&P 500 launches further into thin air, finishing the holiday-shortened week at a record high….as Equity Put/Call Ratio continues to signal caution.



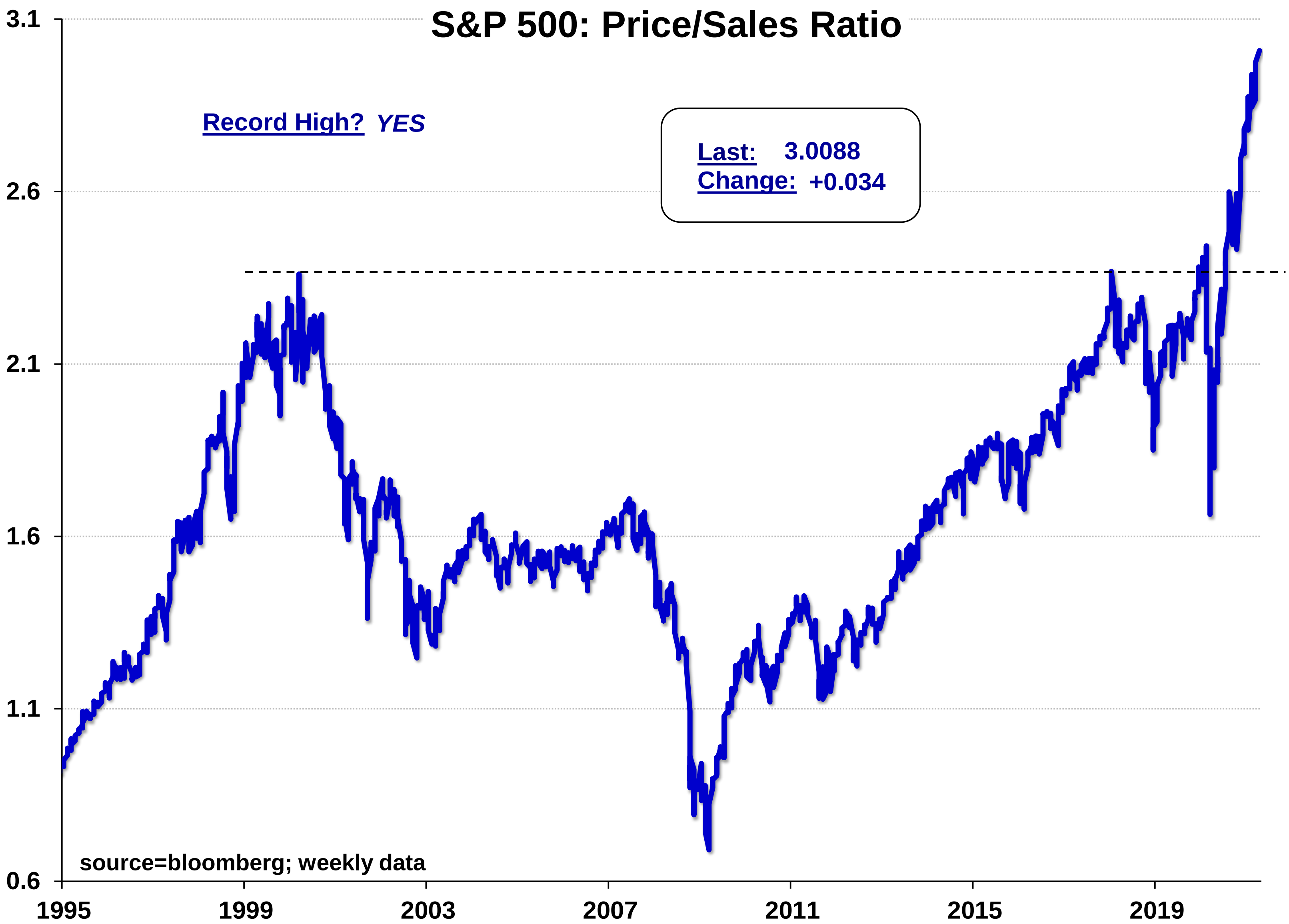
Market Froth: S&P 500 % members above 200dma hits 94.4%...**highest since January 2010**



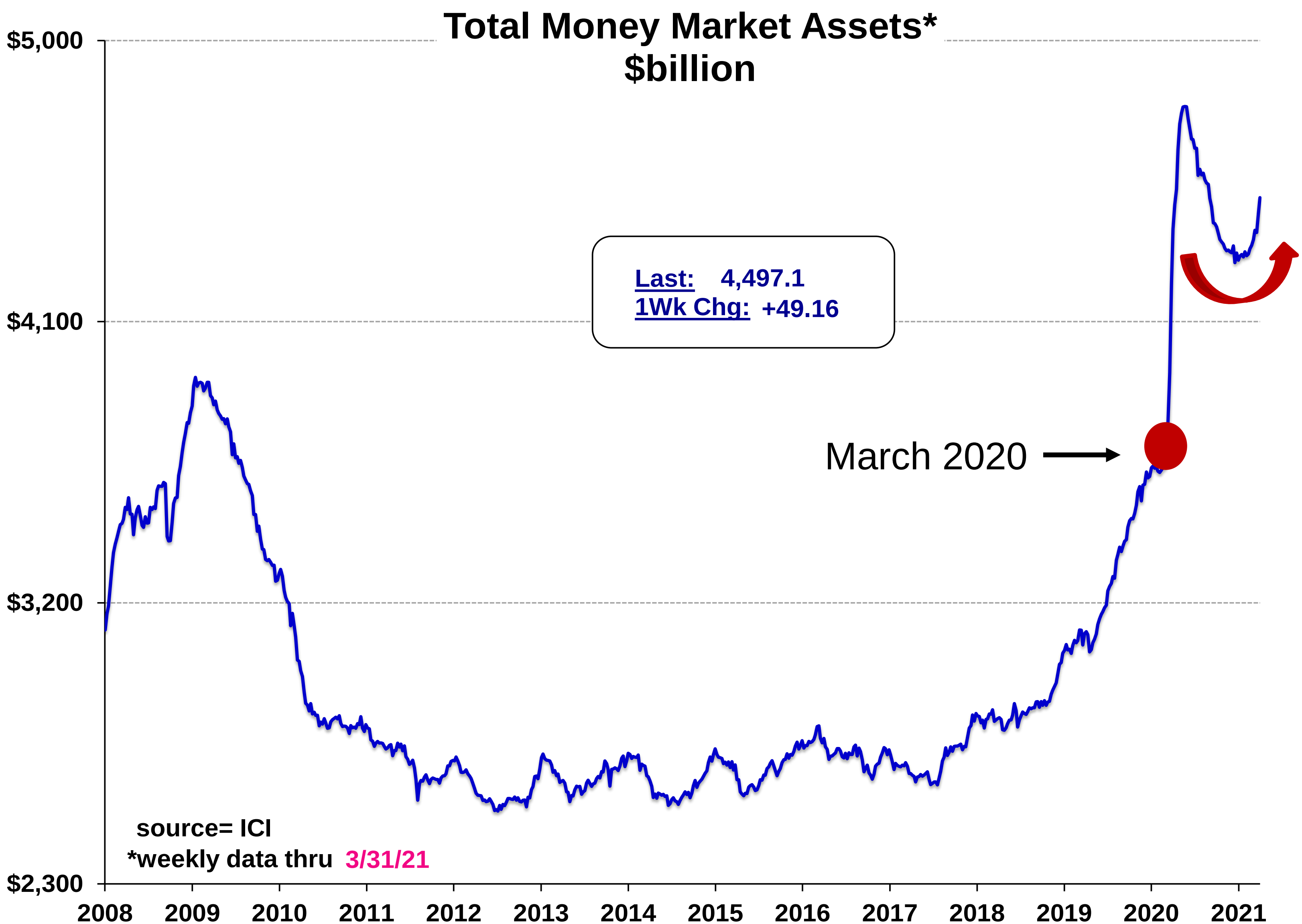
Market Froth: Stock-Bond performance gap recently exceeded that of Feb. 2010 and looks as if set to turn lower. As a reminder, just a few weeks after the Feb. 2010 high, the 10yr Yield fell 160bp over the following 6 months and the S&P 500 began a -16% correction over the following 2.5 months



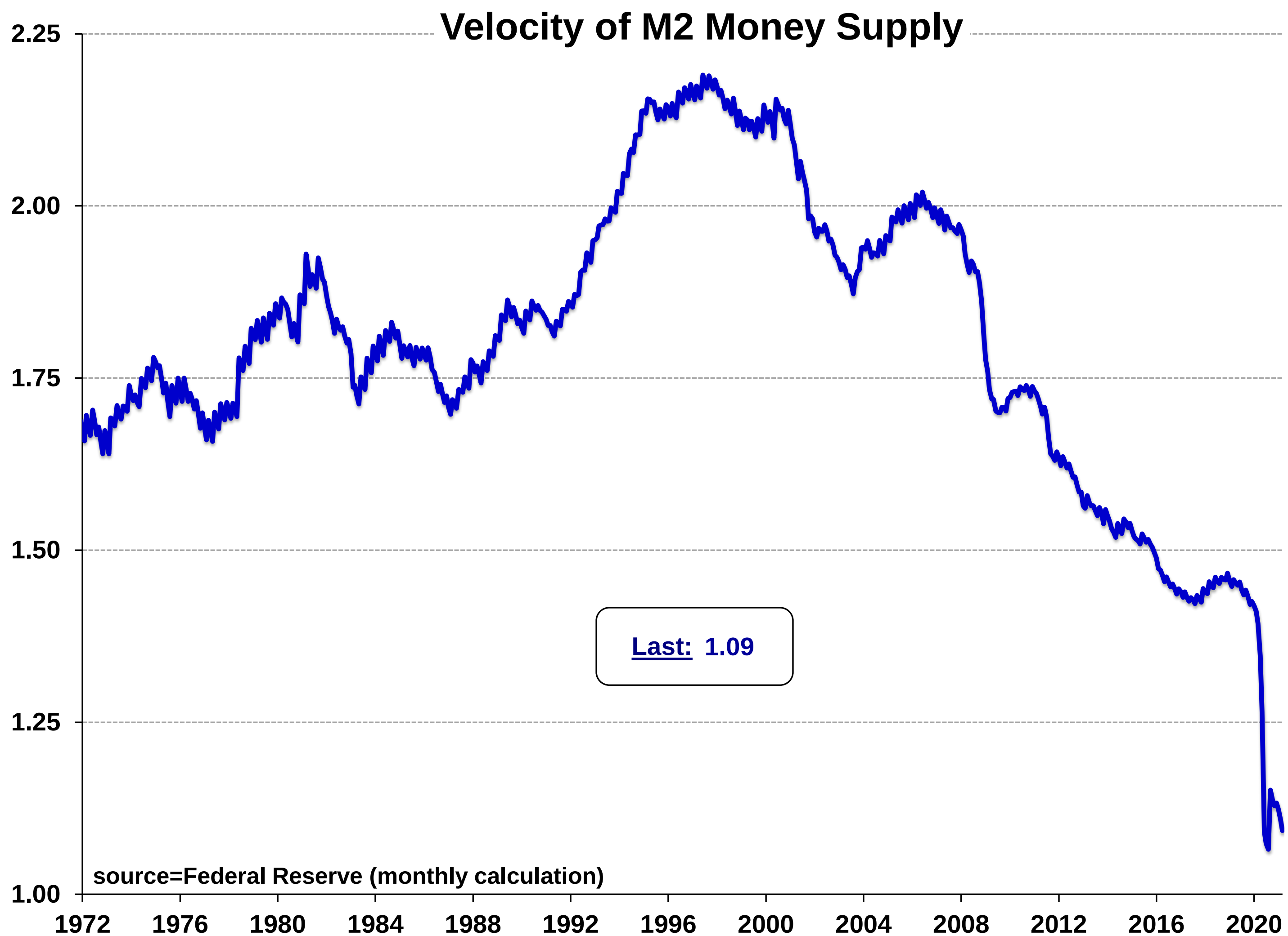
Market Froth: S&P 500 Price/Sales Ratio **breaks above 3.0 for first time on record**…and has spent 39 straight weeks above dot.com bubble high of 2.36.



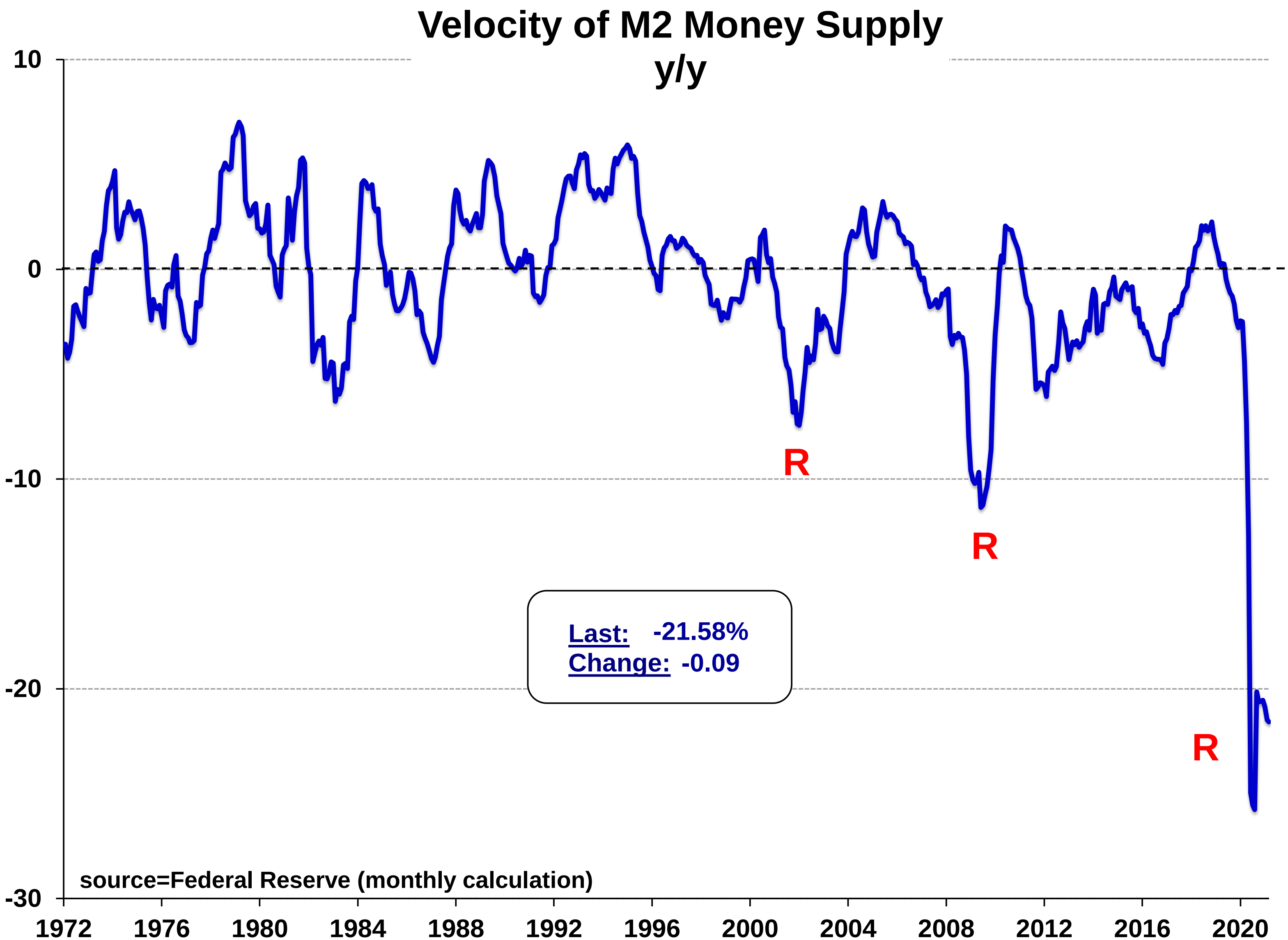
***Heading for The Sidelines**:* Money Market assets continue to rise: +$49bln w-w, <u>+$200 billion over last 3 months</u>.



We thought it a good time to revisit Velocity of Money to see just how far stocks have decoupled from reality. Velocity of Money (Nominal GDP / M2 Money Supply)…effectively a measure of rate of money flow through the economy… now stands at 1.09 (this is our monthly calculation), not far off its record low reading of 1.07 last June. With economic activity picking up we should expect to see a bounce in the year ahead, yet for now it seems to be stuck near record lows as activity / consumption remain weak (see: consumers saving and paying down debt).

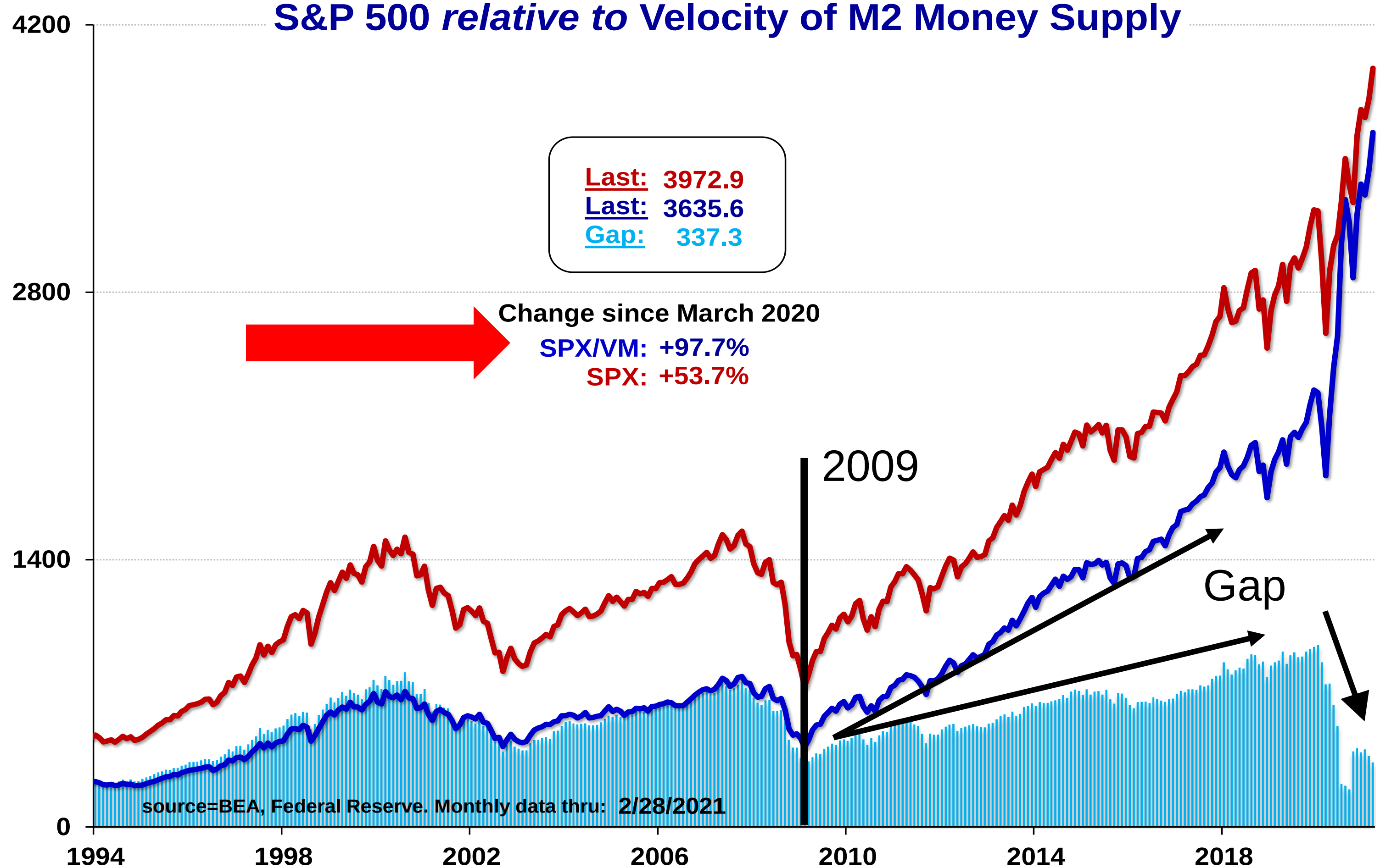


Velocity of Money crashed to record low -26% y/y in Q2 2020, and remains down -22% y/y…deep in recession territory.

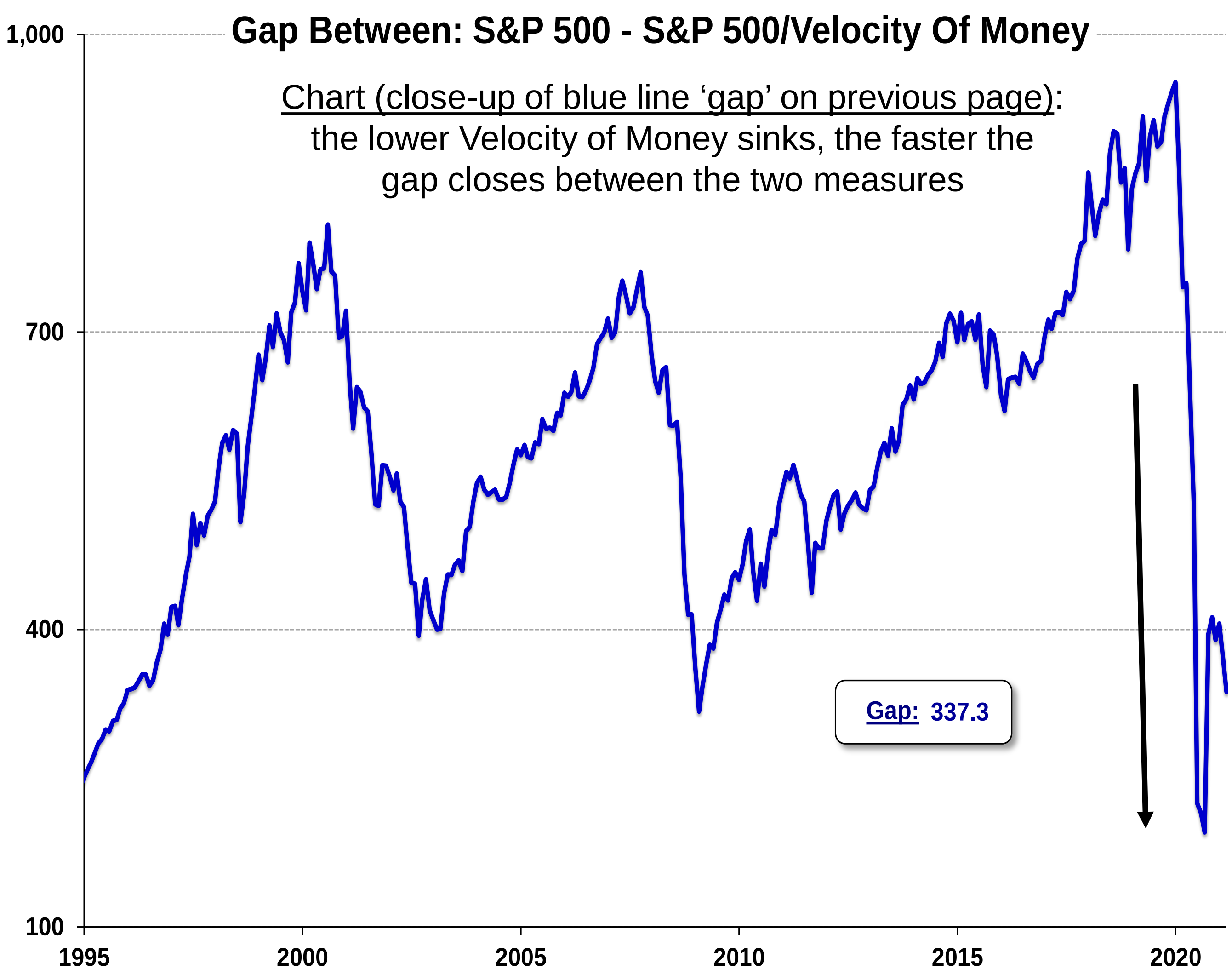


Stunning as the this collapse is, we thought to make it a bit more relatable by looking at S&P 500 performance *relative to* Velocity of Money. The stock market historically moves in tandem with Velocity of Money through ebb and flow of economic cycles. This correlation broke down beginning in 2009 and has completely shattered in the last year. Since March 2020, the S&P 500 is up 54% and the ratio of S&P 500/Velocity of Money has nearly doubled….thus narrowing the gap between the two measures. Said differently: the S&P 500 soared into thin air as economic activity imploded, sending S&P 500/VM ratio surging toward parity with the S&P 500.

S&P 500 vs. S&P 500 *relative to* Velocity of M2 Money Supply

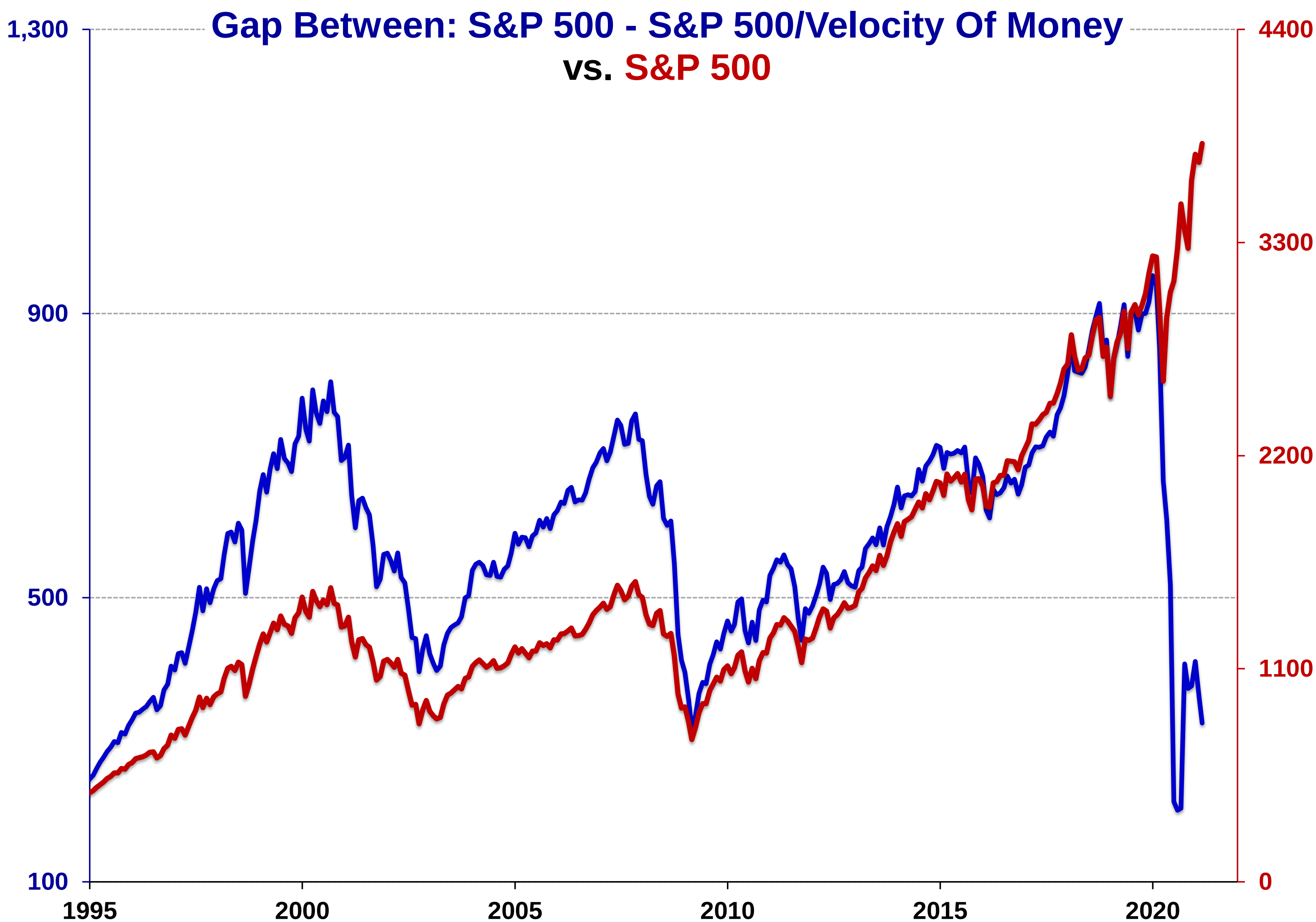


Should stocks hold at record highs and Velocity of Money (currently at 1.09) tumble to 1.0 (which would be hard to imagine as it would mean M2 = GDP), **the S&P 500/Velocity of Money ratio would = S&P 500 for the first time on record**. A 1:1 correlation would suggest the S&P 500 can no longer effectively be considered a benchmark for the state of the US economy. The market has been in process of decoupling from reality for some time now, however a potential 1:1 correlation of these measures would mean the stock market has finally severed all relationship to economic fundamentals and gone completely 'rogue'. A convincing argument could be made we're already there, but this would confirm it beyond a shadow of a doubt.

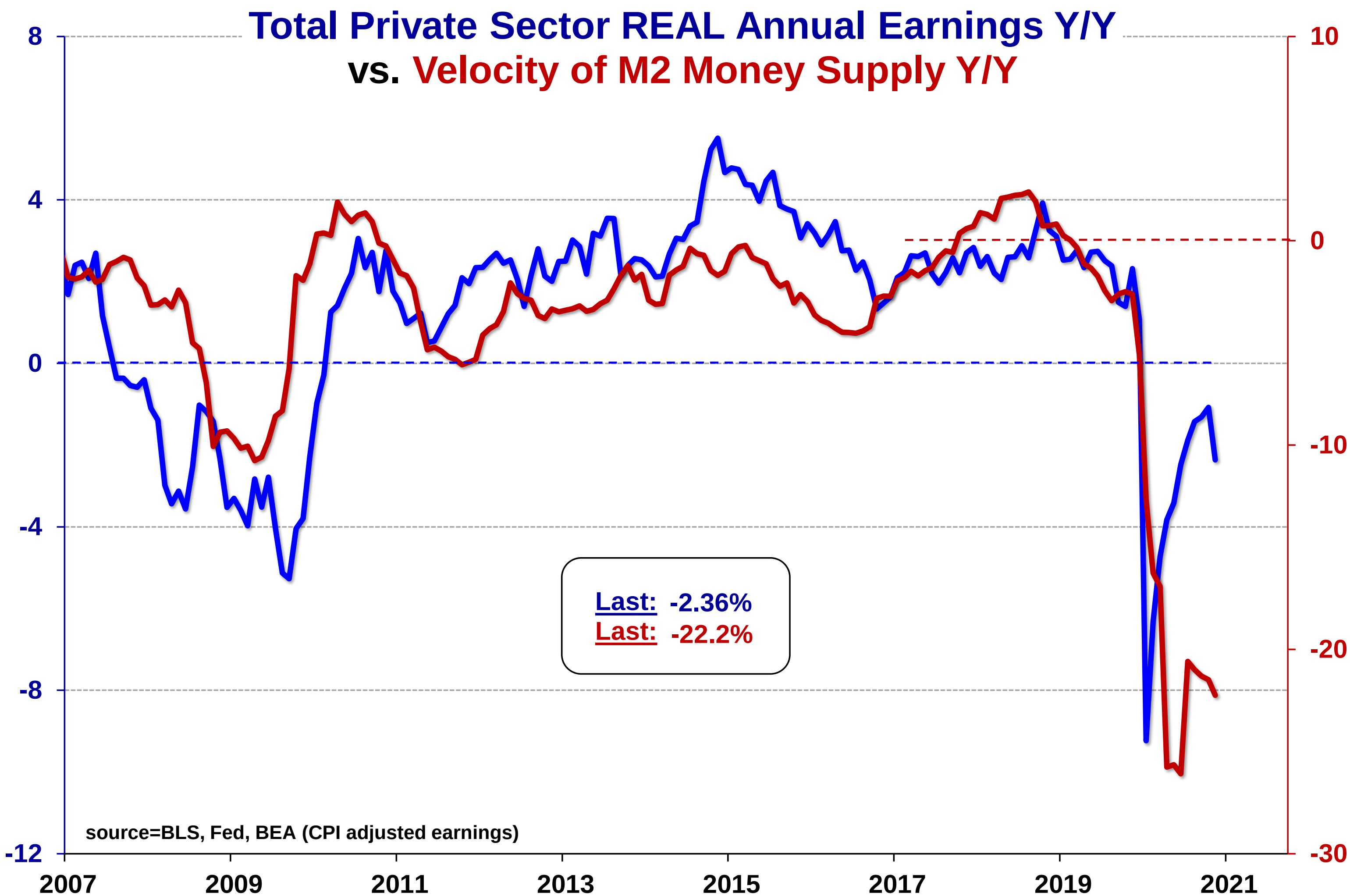


The chart on next page shows the gap illustrated here (a close-up of blue line gap on previous page chart) vs. the S&P 500…giving us a final look and the clearest picture of how far stocks have decoupled from economic reality over just the last year.

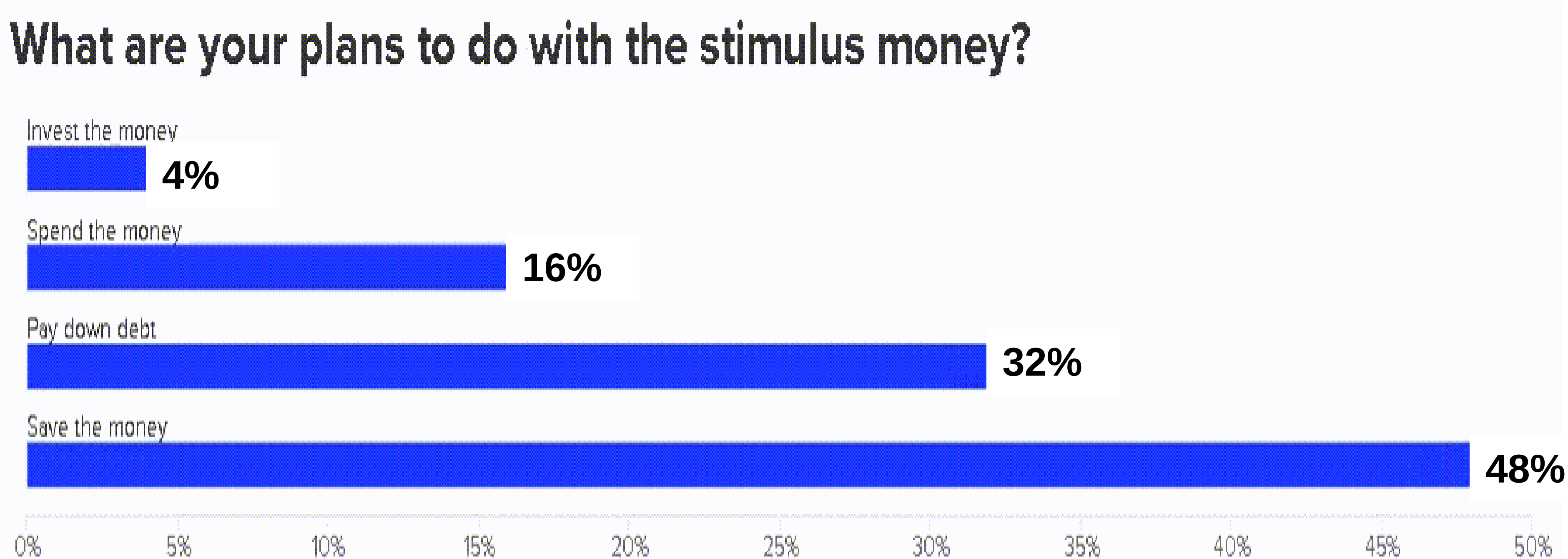
Velocity of Money collapse has produced the single most spectacular chasm between asset prices and economic fundamentals on record. Dallas Fed President Robert Kaplan summed up the environment rather nicely this week: *“There’s no question that financial assets, broadly, are at elevated valuation levels.”* Indeed. And then some.



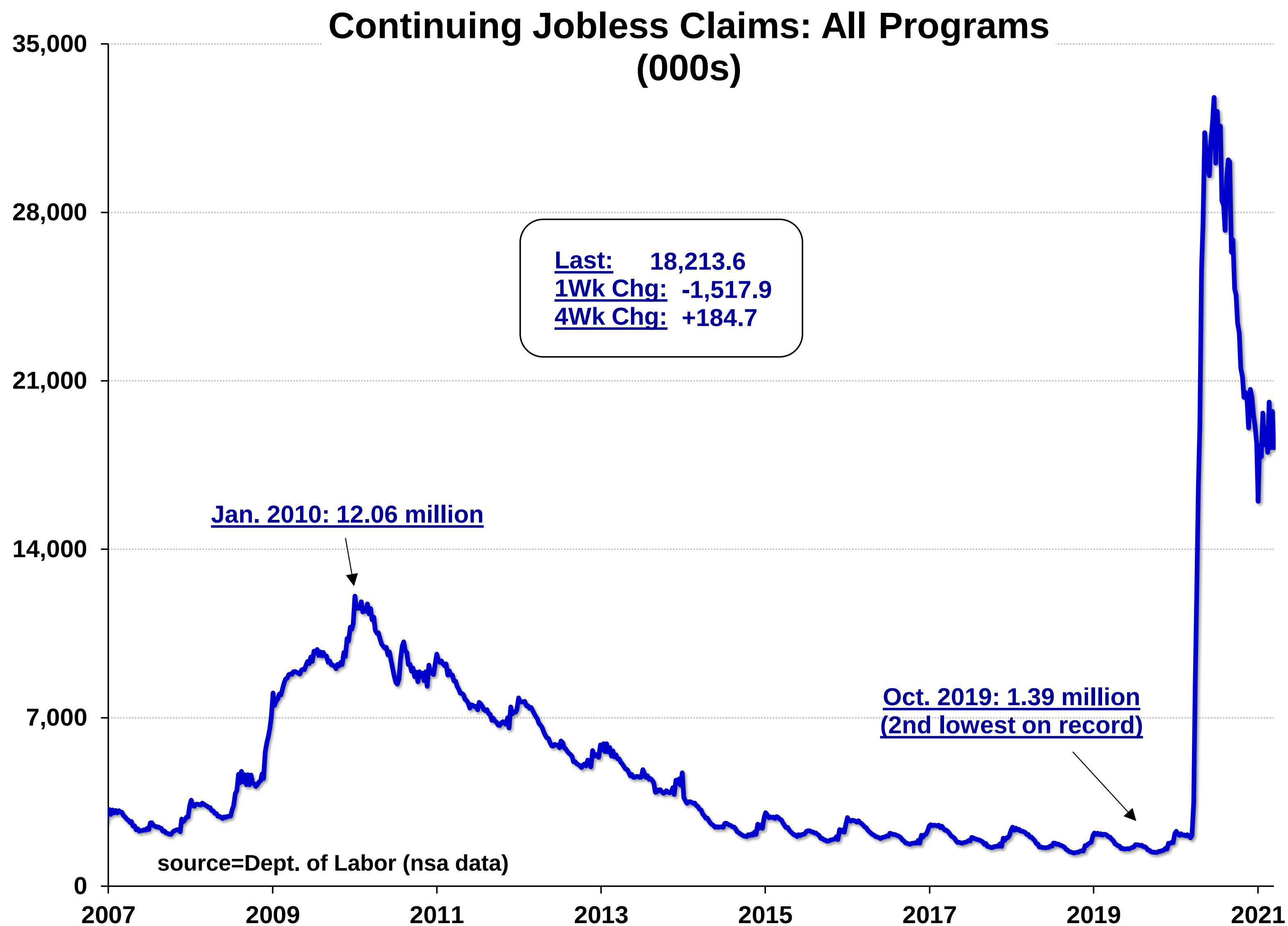
The question now is: should Velocity of Money turn higher again (which we expect it will as jobs return and consumers turn from savers to spenders again, thus increasing money flow through the economy), what portion of this move will be based on real growth vs. money printing/stimulus check growth? We look to employment data for answers as we wait to see the degree of permanent job losses…and whether economic activity and labor market conditions can show marked improvement without stimulus 'training wheels'.



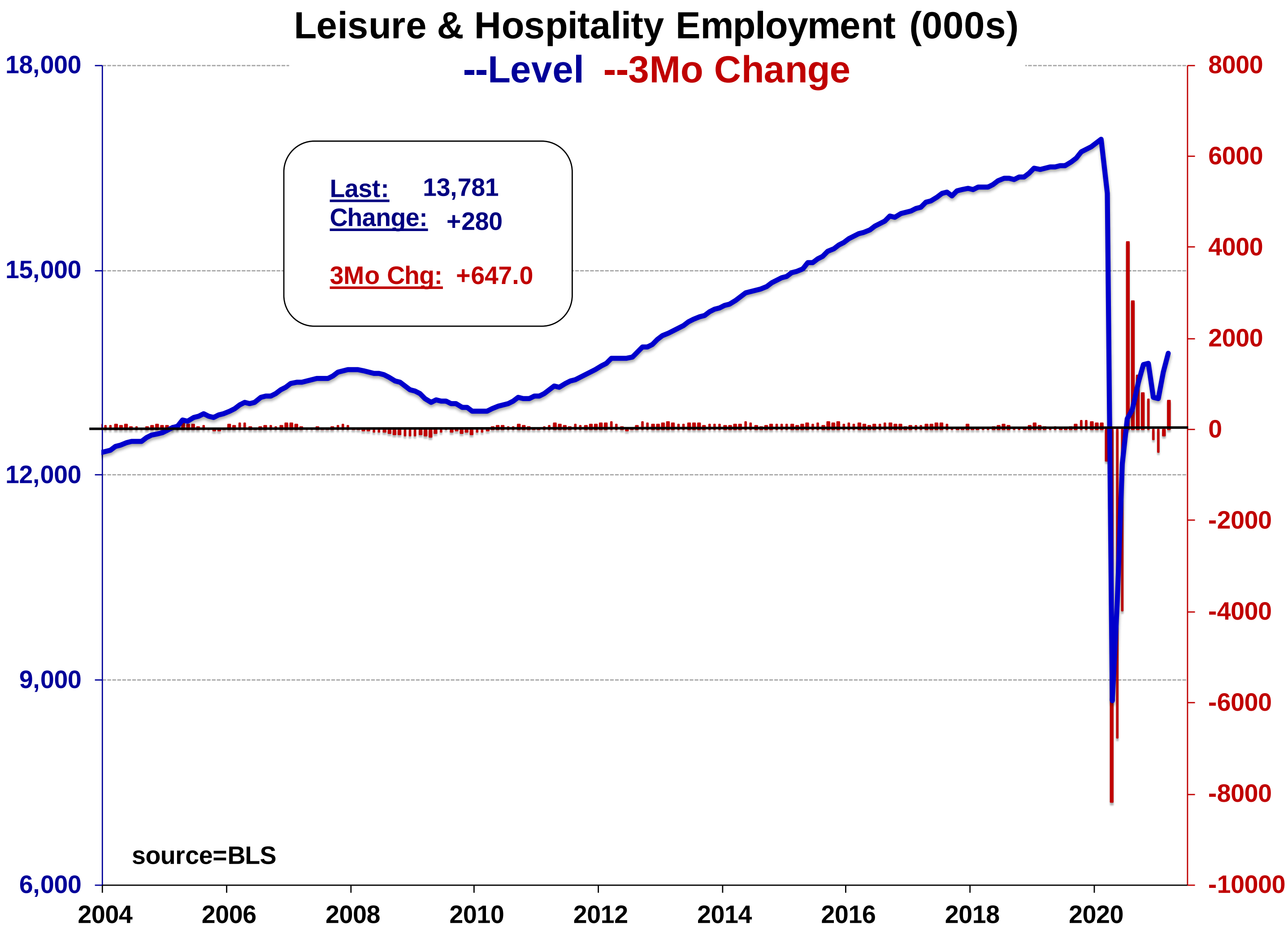
As noted earlier, consumers continue to use stimulus money to save and pay down debt. In fact, according to a March 24th Maru Public Opinion survey, 80% of respondents said they would either save the money (48%) or use it to pay down debt (32%). As we've seen a record reduction in credit card debt over the last year (+ record savings rate numbers), we can conclude the massive stimulus check programs have effectively amounted to a consumer bailout. While this may weigh on spending and growth near-term, consumers will be in a stronger position to spend (and ramp up card debt again) when labor market / job security situation improves. These stimulus measures have resulted in significant debt expansion, and we've yet to know when or how they will end. There's been some hints of a fourth round of stimulus checks, student loan debt forgiveness, and rumblings of some form of permanent support programs…aka: Universal Basic Income. According to Pete Earle of American Institute of Economic Research, *"There's a view out there that these ongoing payments, especially to the extent that now there are whispers about ongoing payments in perpetuity, they sort of represent a stealth implementation of UBI or universal basic income,"* Earle said. This would send our national debt skyward and the Dollar moving swiftly in the opposite direction. The 'upshot': the Fed will get their inflation.



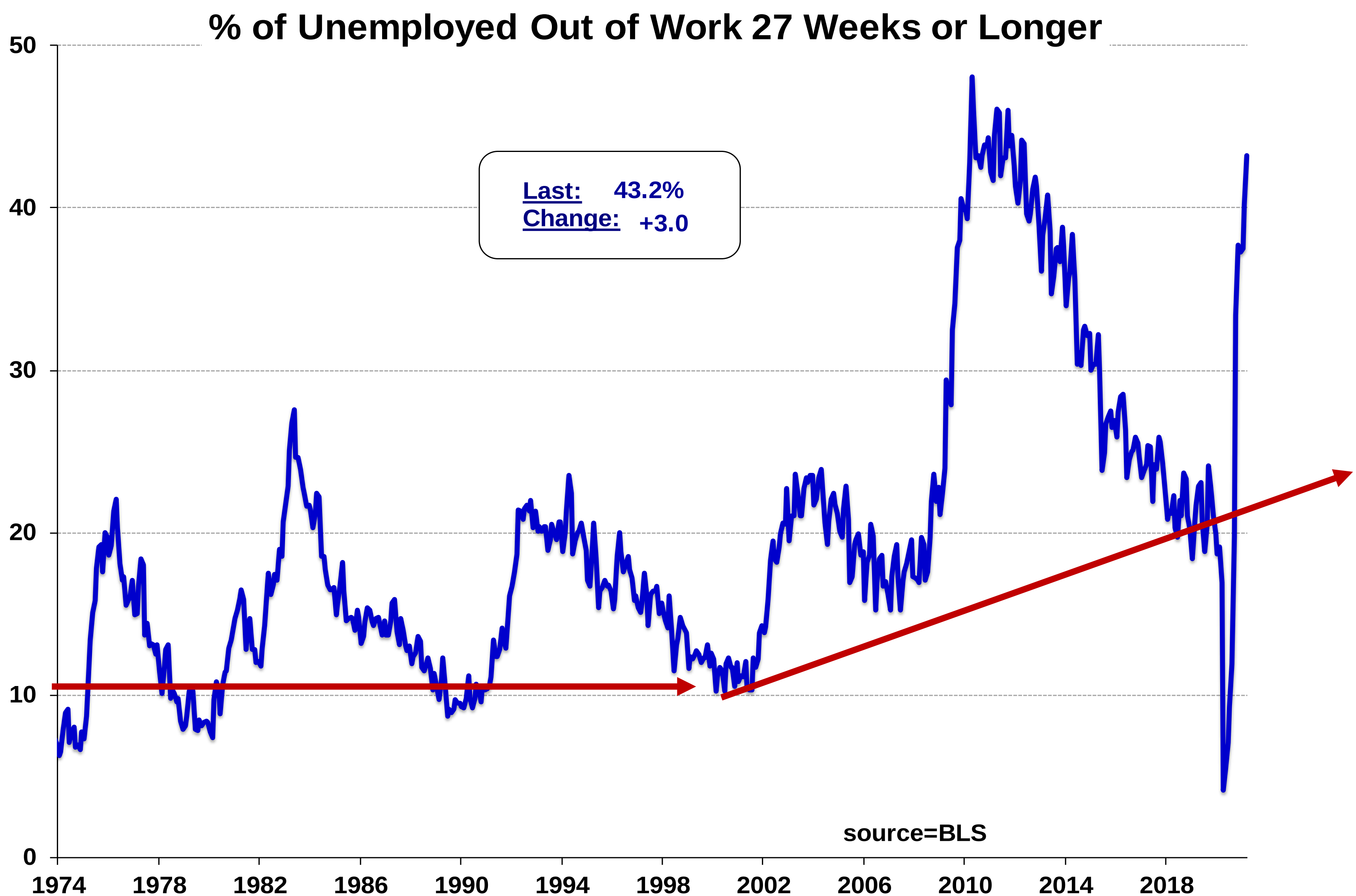
Major headwinds to recovery still in place: 18.2 million persons remain on some form of government assistance, 50% higher than worst levels of the GFC.



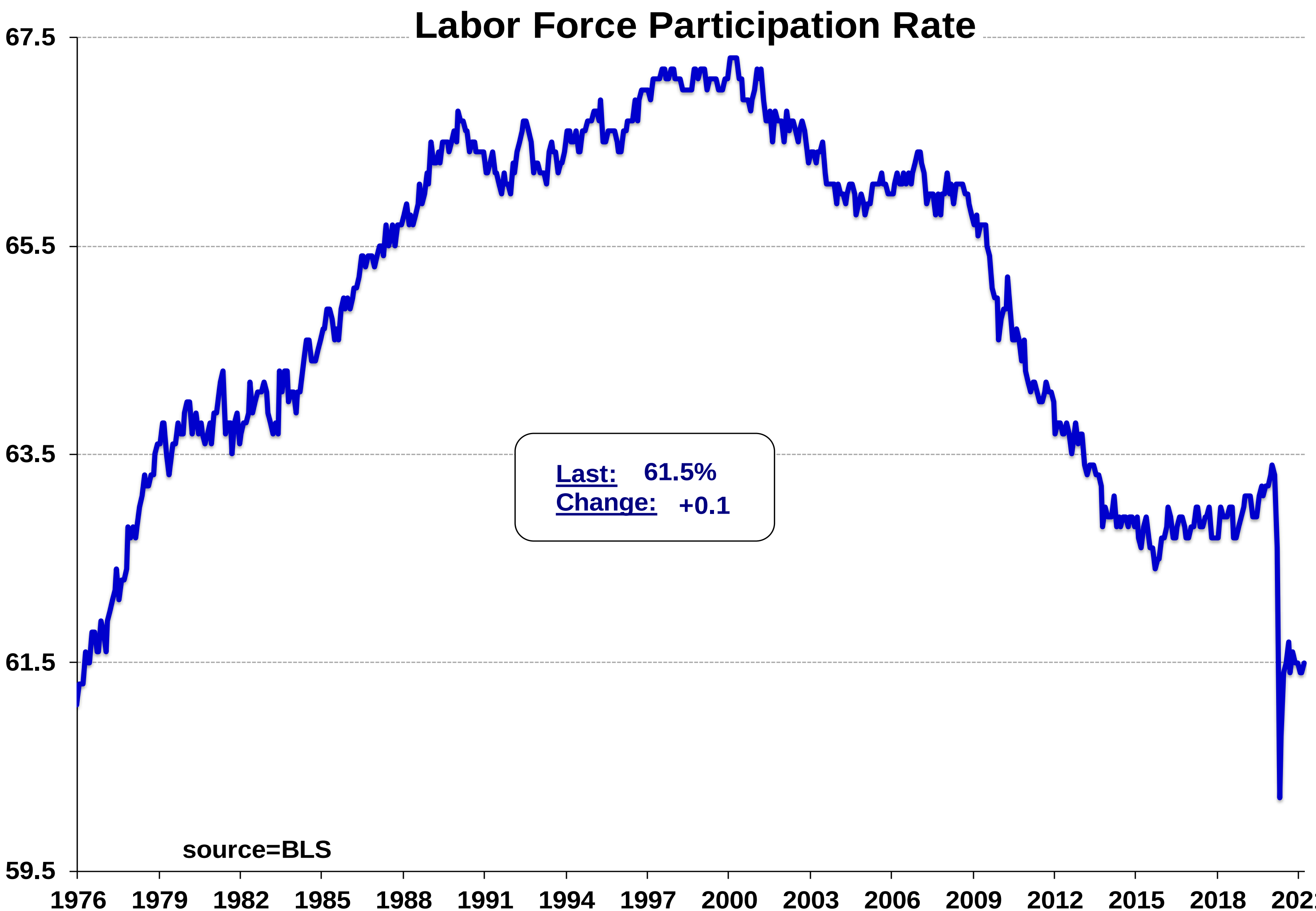
However, signs of a turnaround are indeed showing: March payrolls handily beat expectations (+916k private payrolls vs. 660k estimate), with Leisure & Hospitality adding 280k jobs…no doubt welcome news for the hard-hit service sector. The sector has added +647k in last 3 months, accounting for 44% of YTD private payroll gains. This will be the main sector to watch re: the number of permanent job losses (as it stands today, 3.1 million jobs remain lost in the sector vs. 2019 high).



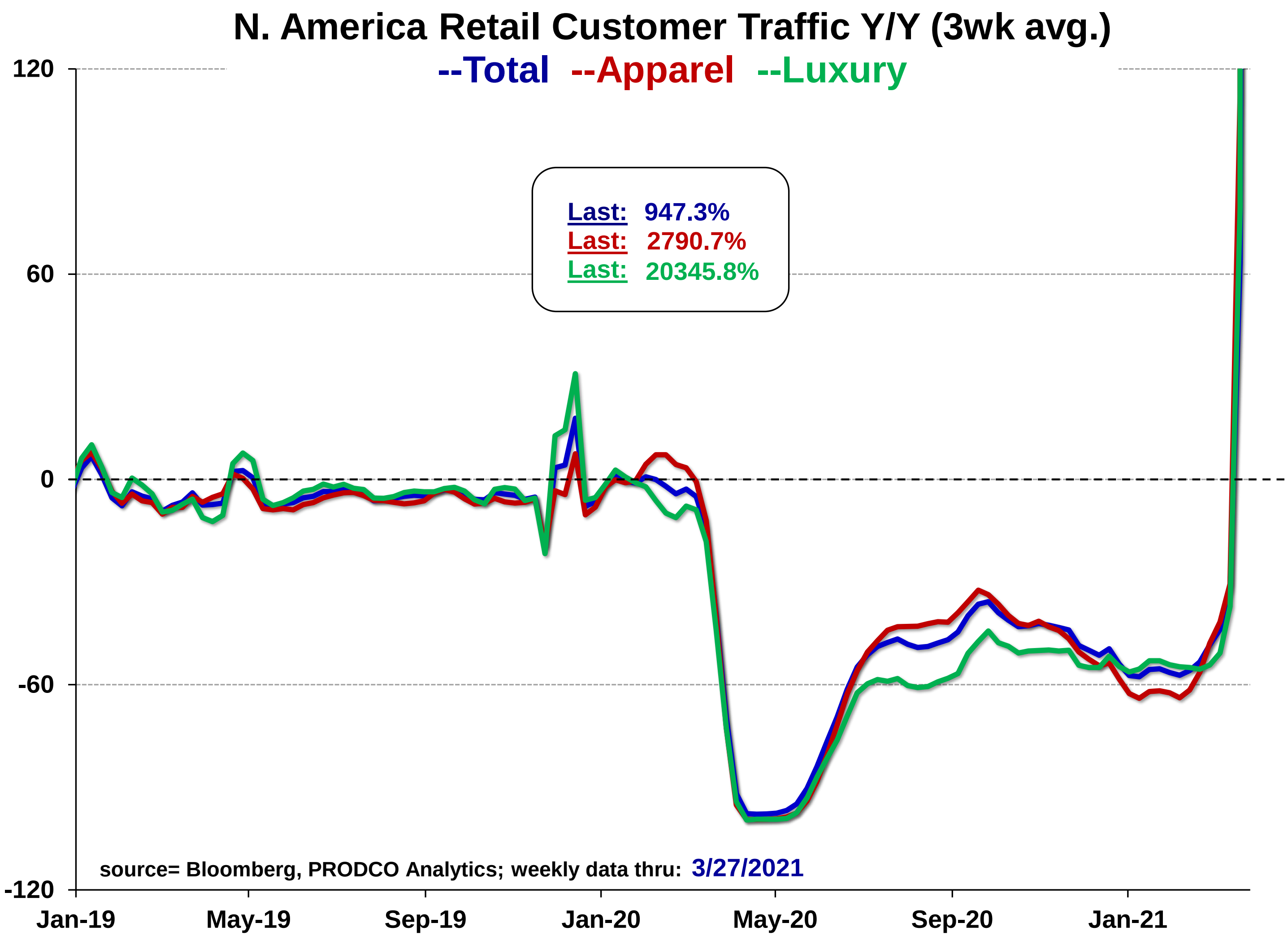
Bad news: % of Unemployed out of work 6-months or longer rises to highest since 2011. This should start to come down soon, however if permanent job losses are in the cards this could settle at a permanently high plateau.



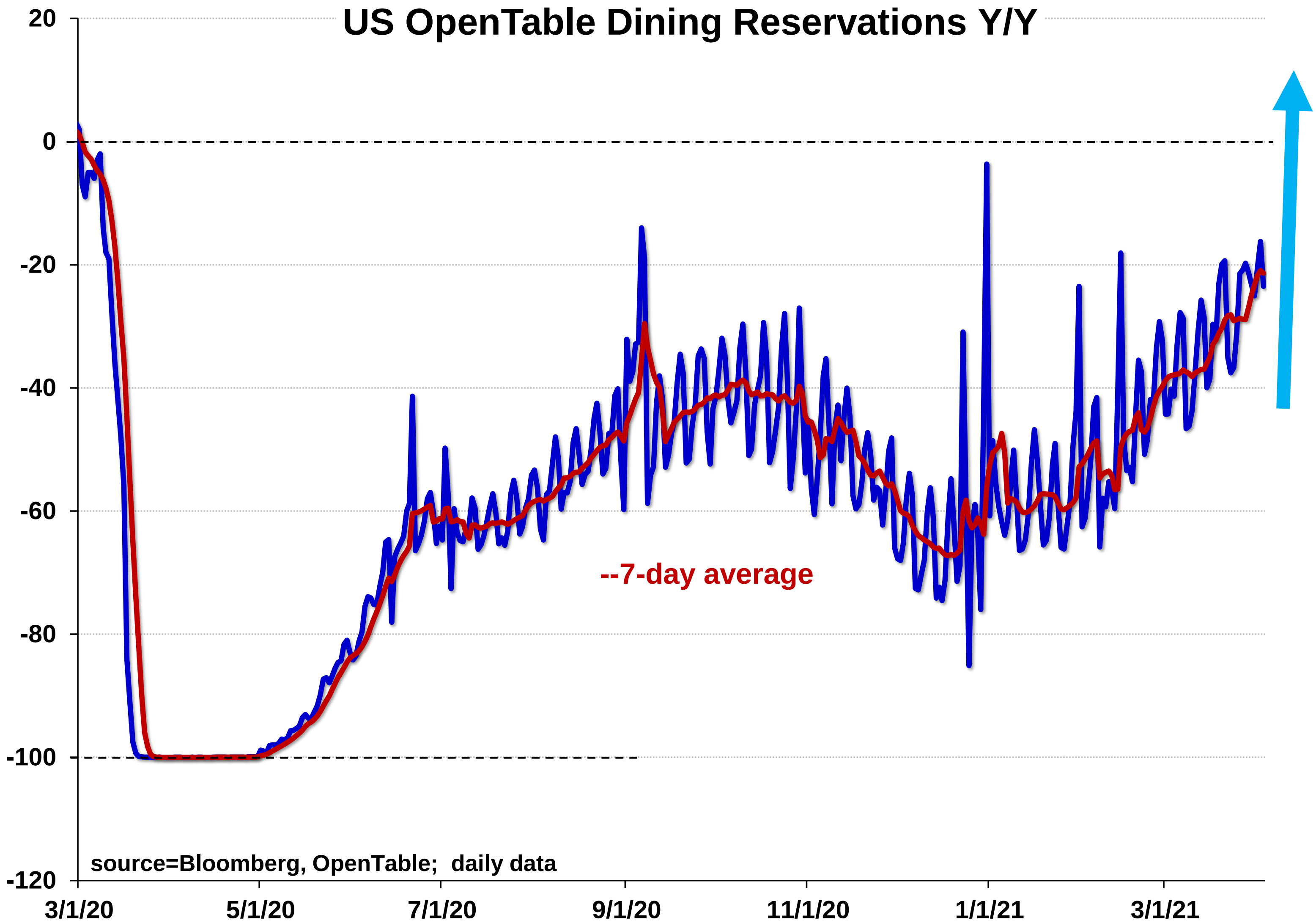
Labor Participation Rate holds at 45-year low.



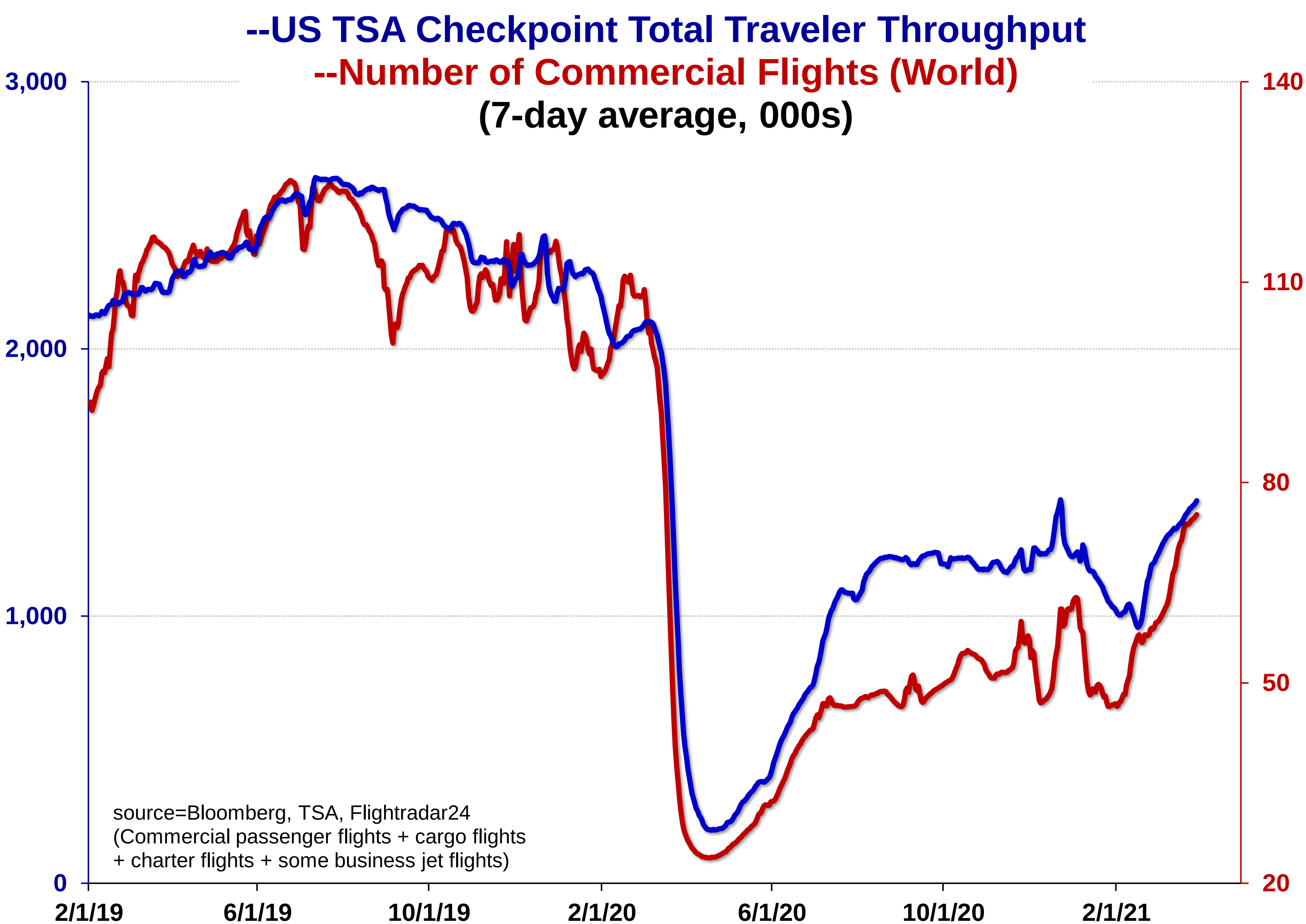
Meanwhile, we're beginning to see y/y data comparisons turn positive (even soar)…which is great news of course, yet to be expected given the economic flattening this time last year. What is needed is a long stretch (up to a year) of positive y/y results before this can be considered a 'full' recovery'. Should y/y comps rise for just a few months and turn negative again for a period, this would certainly raise concerns the recovery is stalling and perhaps require ramping up of stimulus measures.



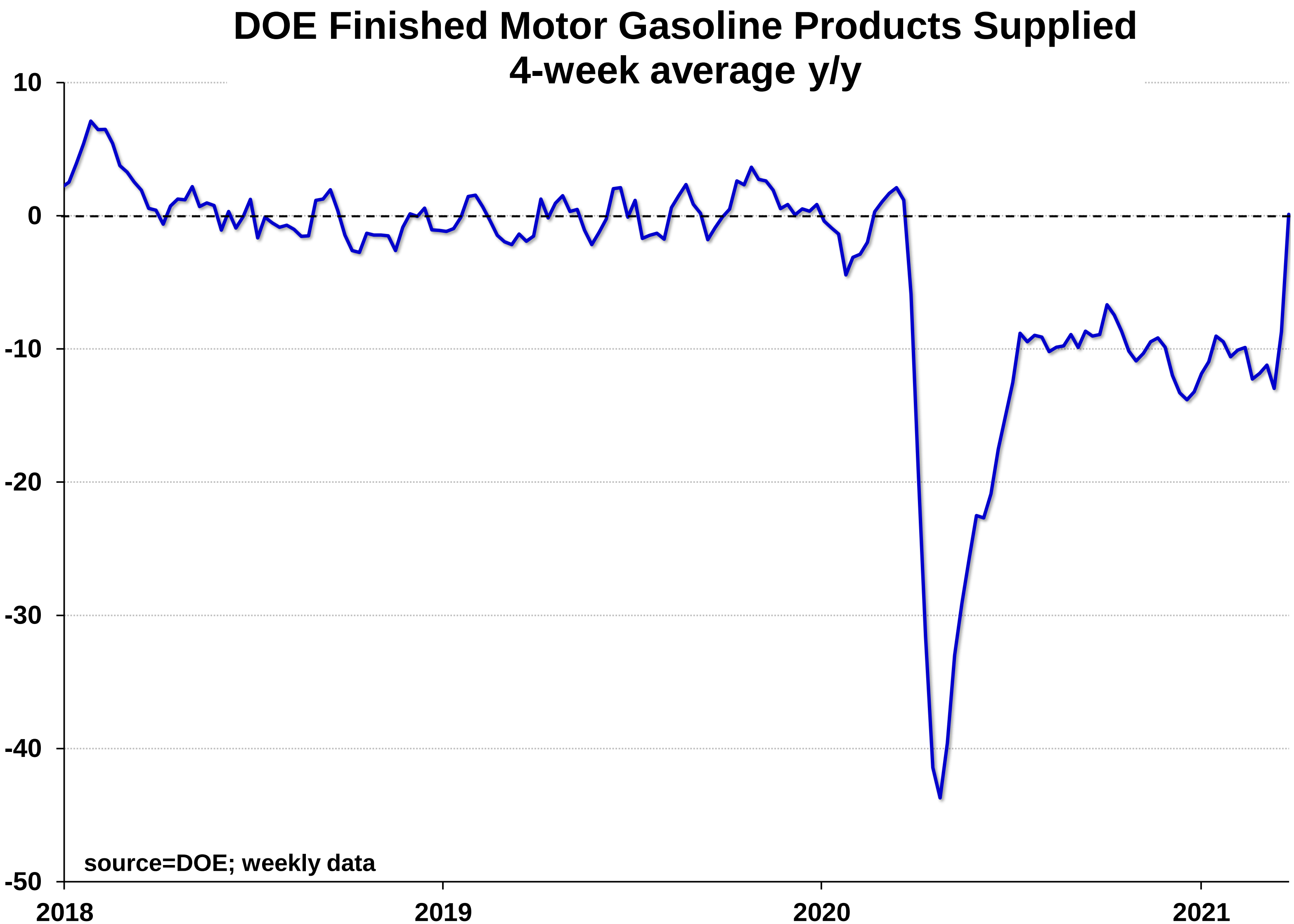
Dining activity gathering upside momentum. Again, we should see y/y activity turn positive soon…good news of course…yet the next few months will be critical to see whether the positive y/y comps can be maintained.



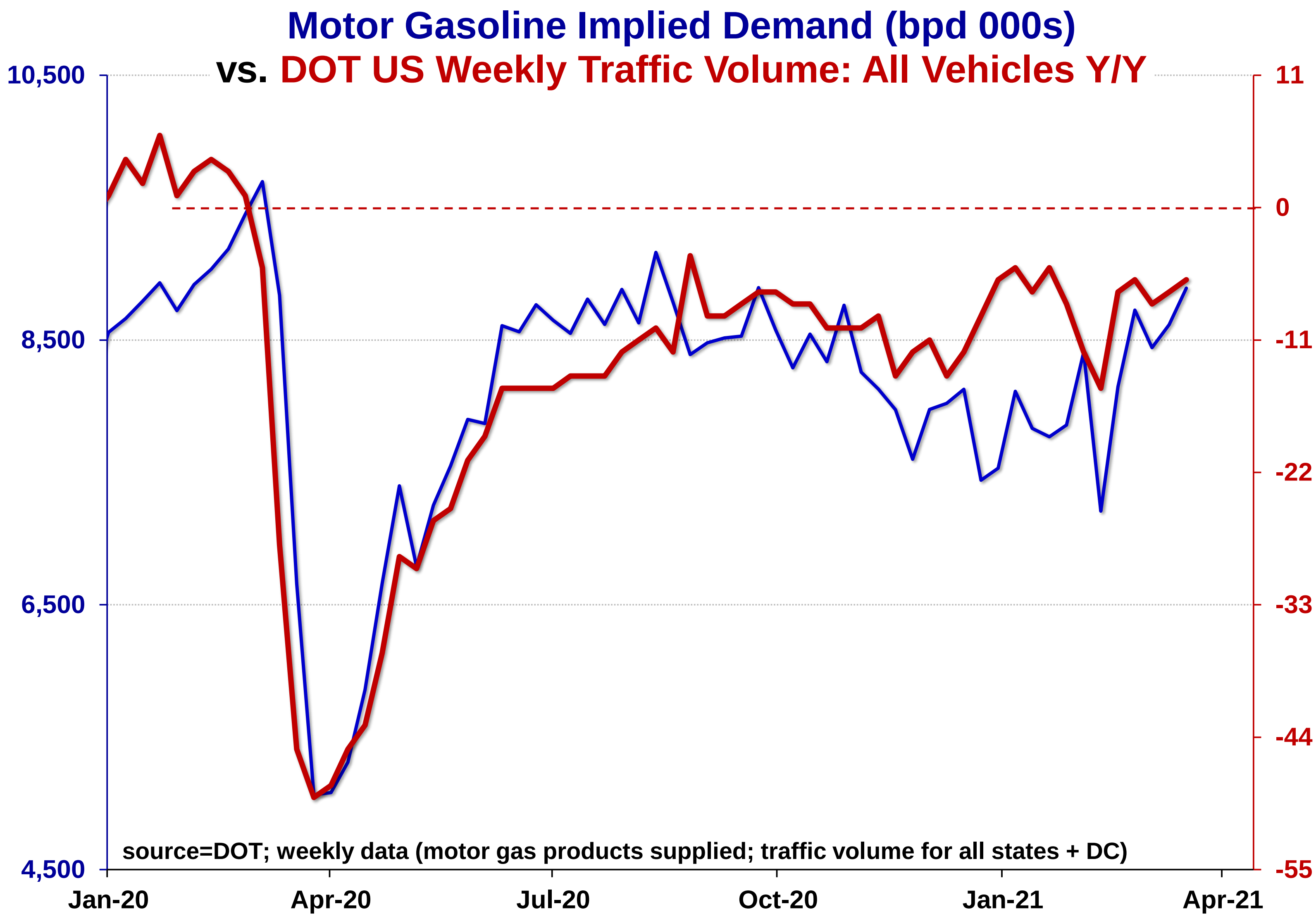
Good News: Air passenger traffic continues to improve along with number of active commercial flights.



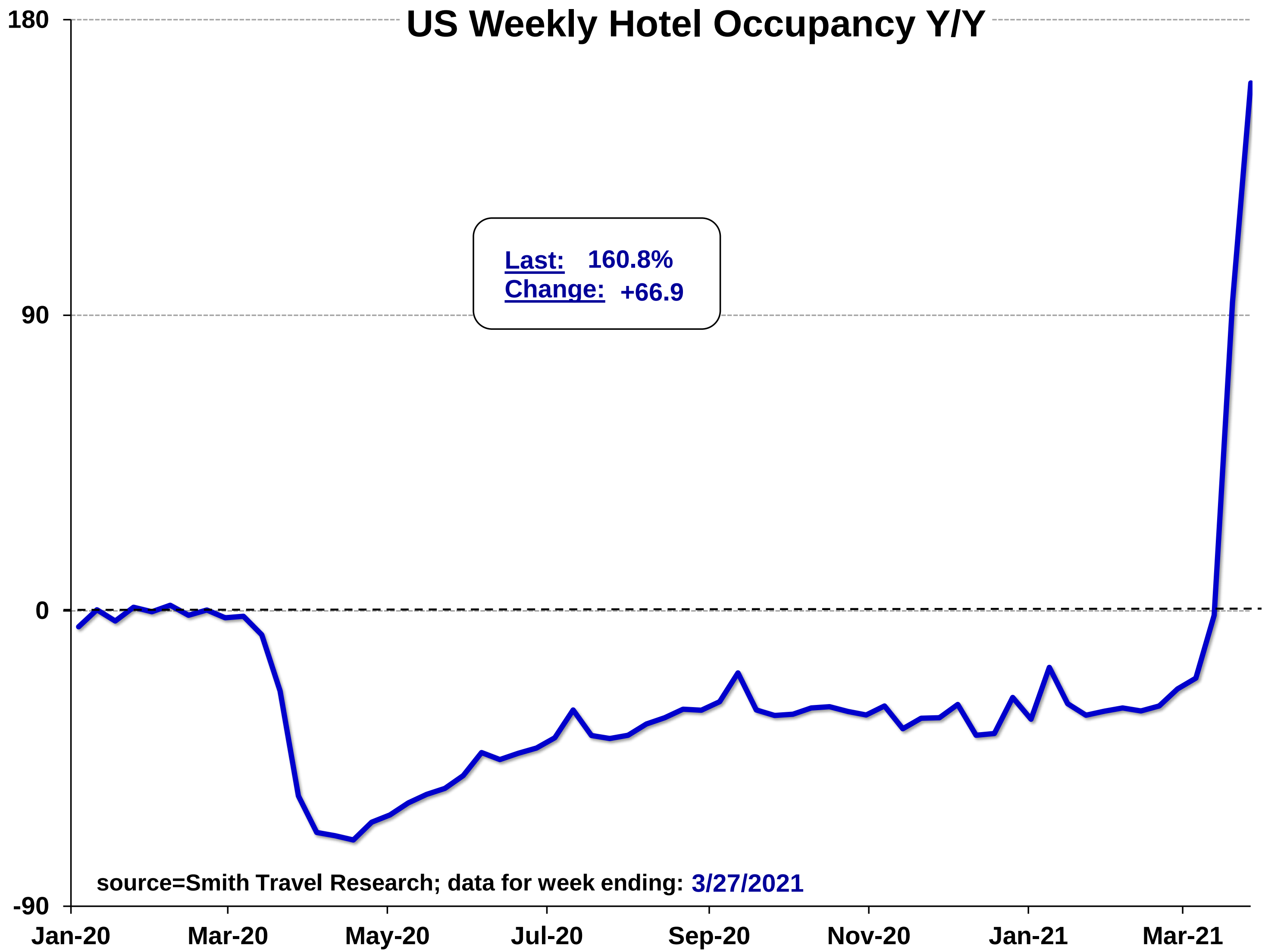
Motor Gasoline implied demand turns positive y/y…to be expected from year-ago shutdown.



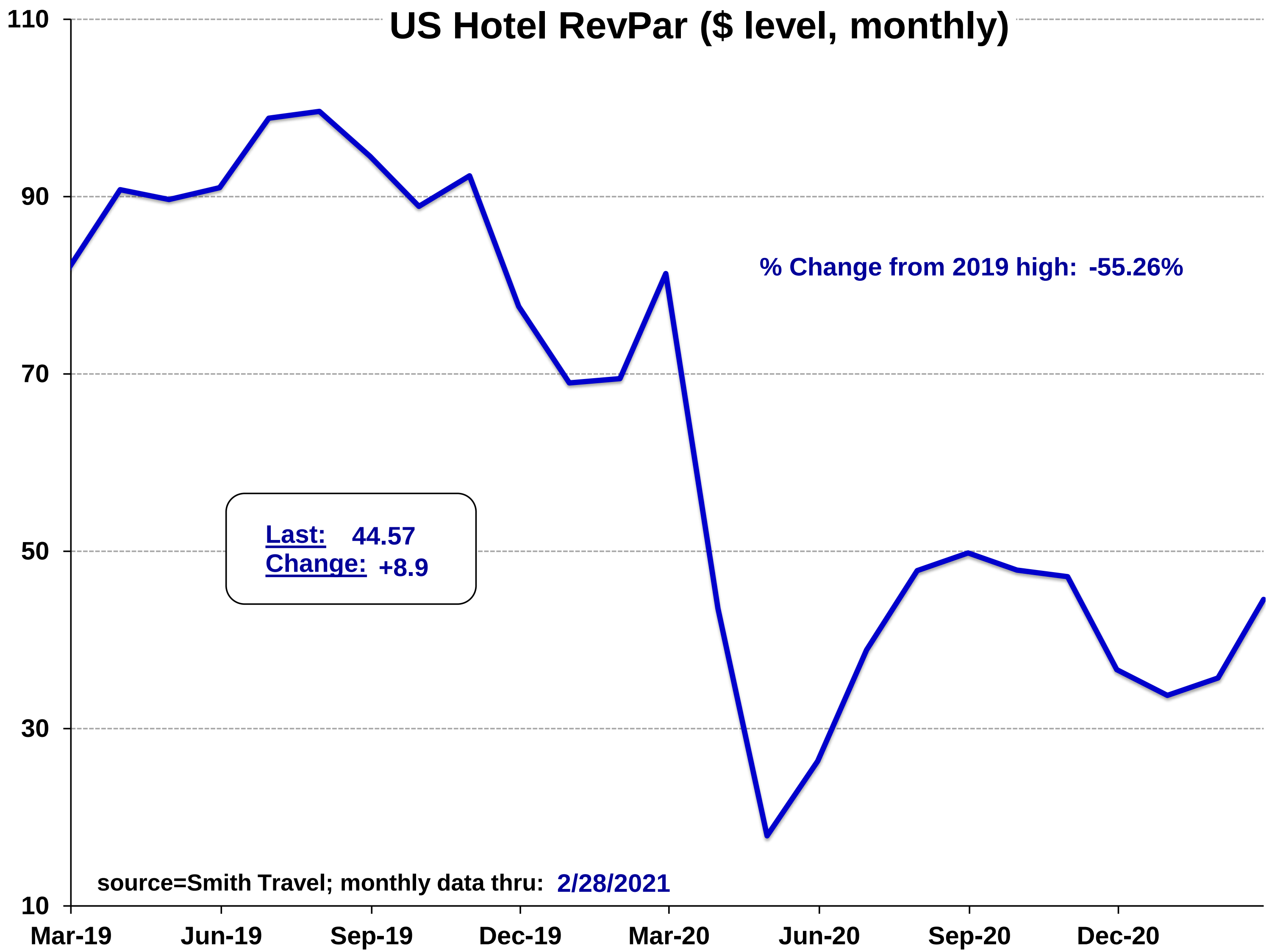
Overall traffic volumes and gas demand remain weak yet have shown clear improvement in recent weeks



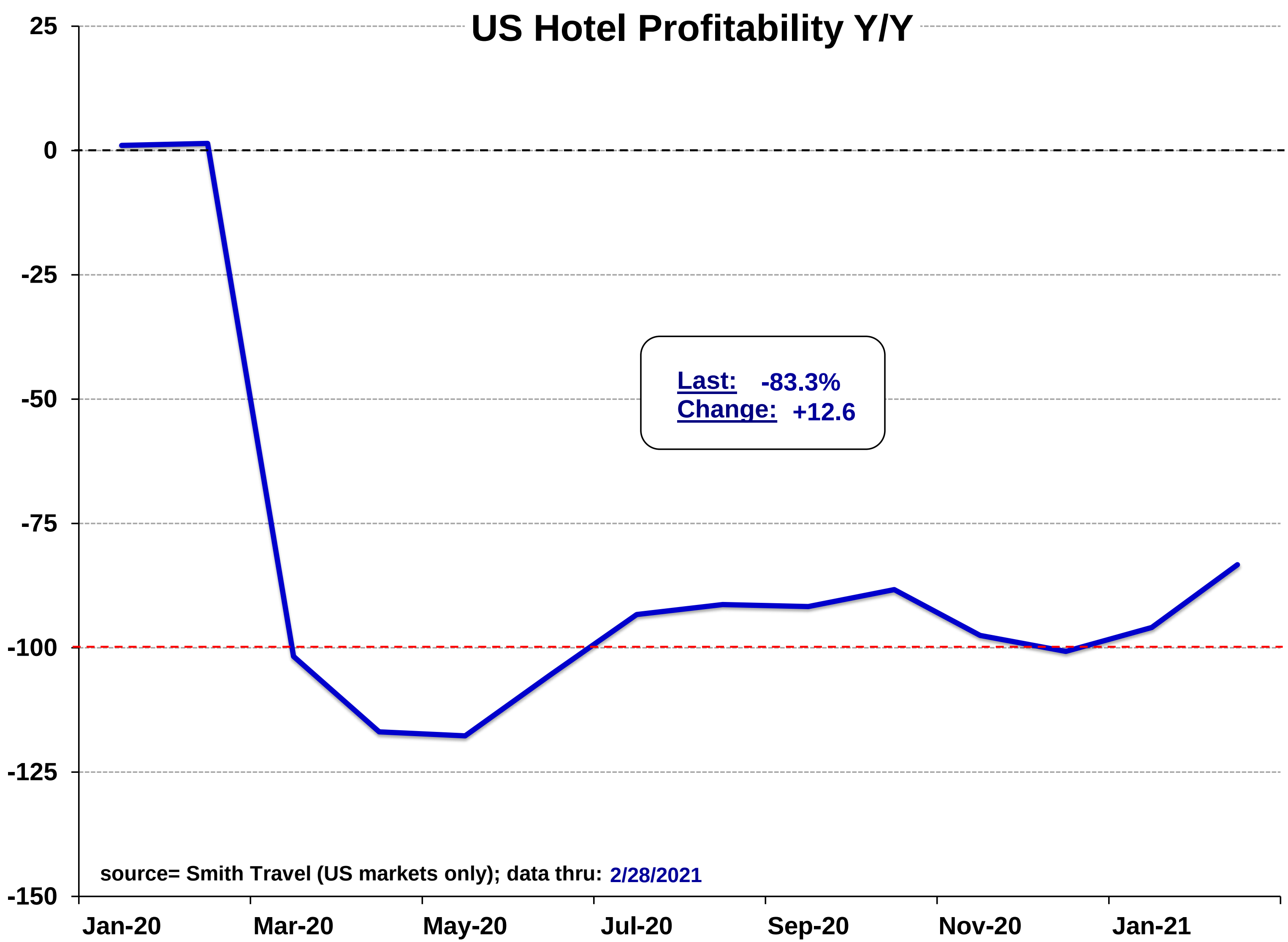
Hotel Occupancy soars 161% Y/Y, an expected bounce vs. year ago.



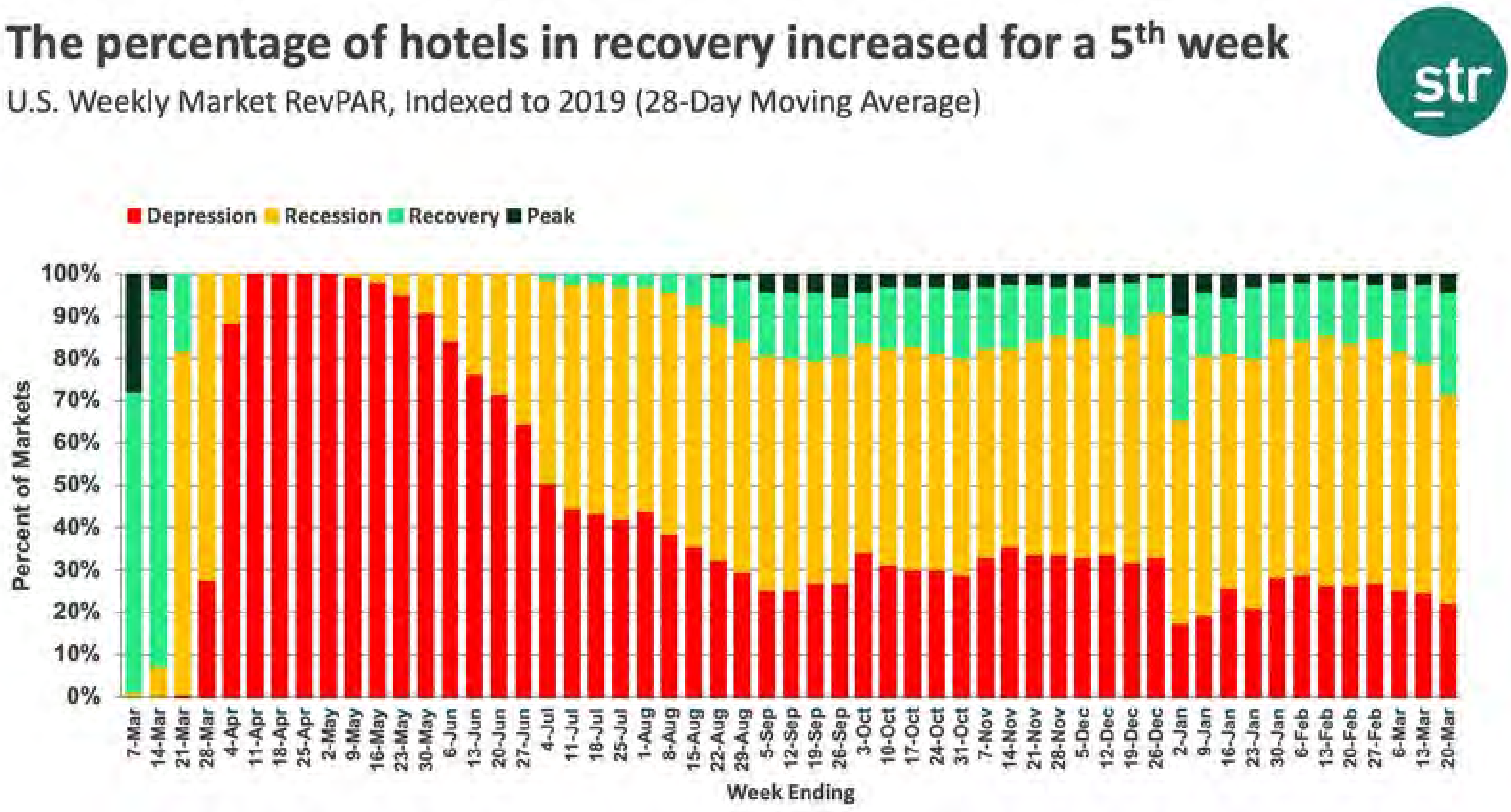
Occupancy turning higher is no doubt good news, however actual RevPar and Profitability remain weak.
Chart: RevPar down -55% from 2019 high...



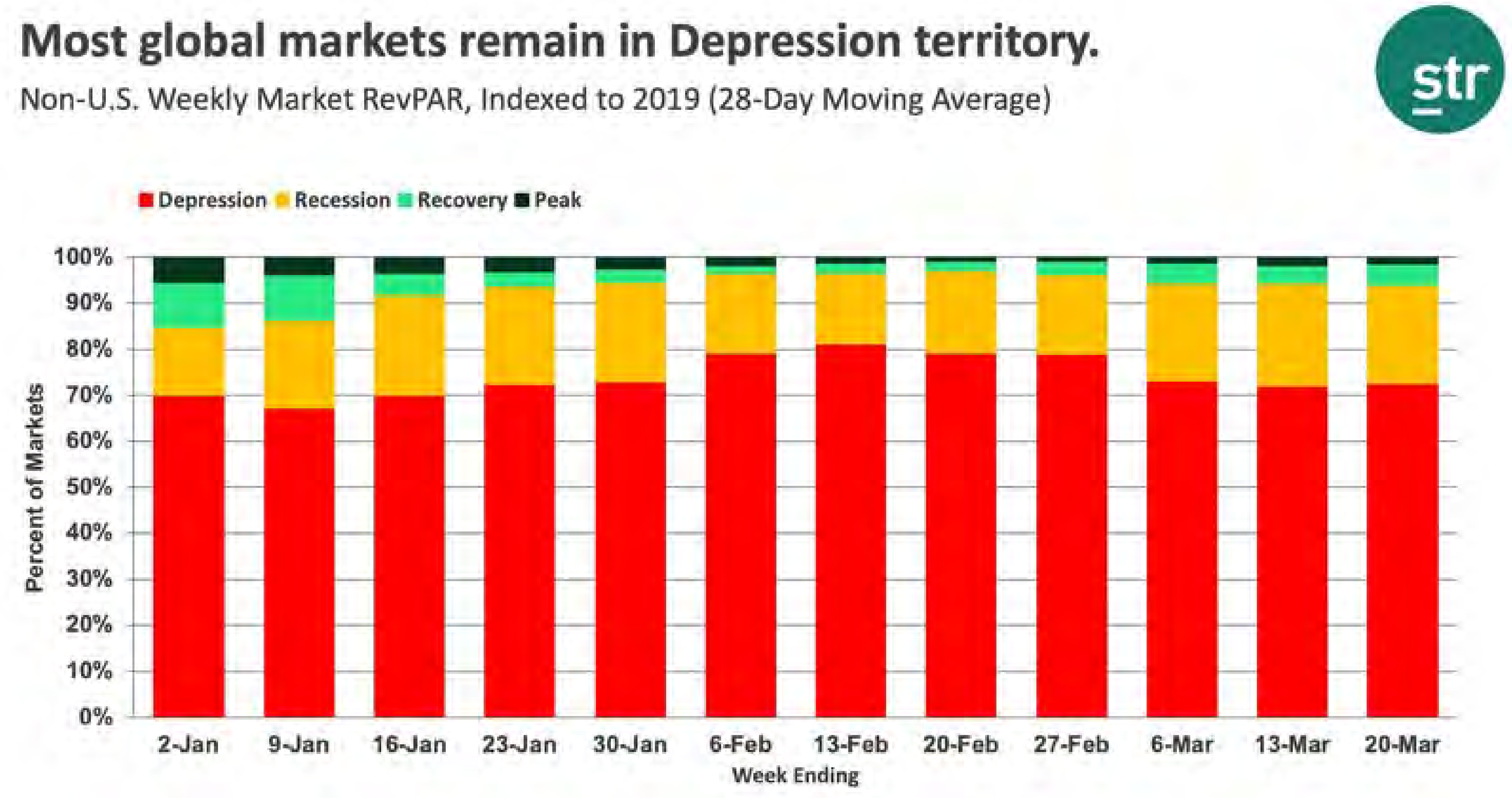
…and profitability remains decidedly weak/recessionary, down -83% y/y



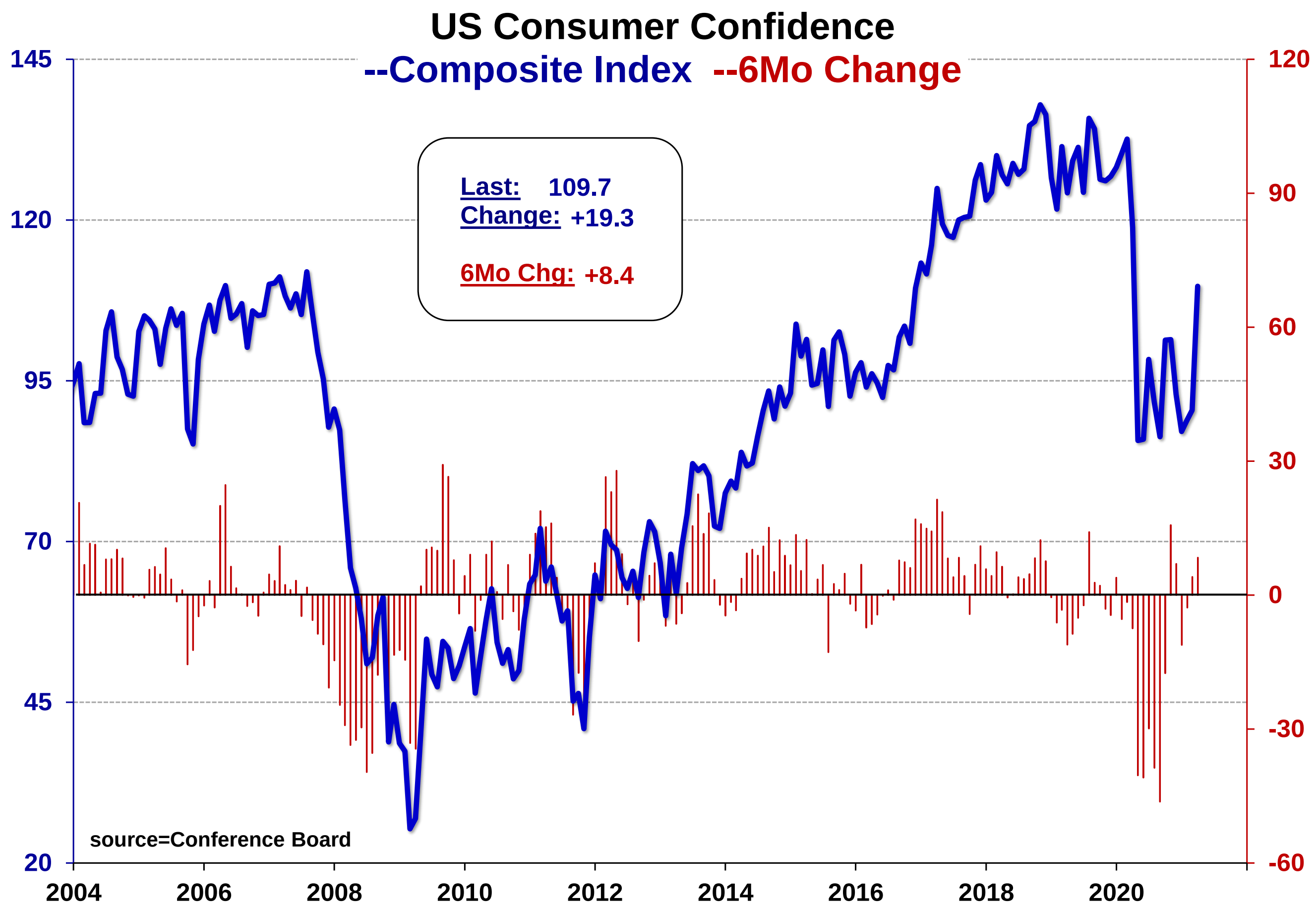
The recovery continues, yet just over 70% of US hotels are still in either recession or depression territory.



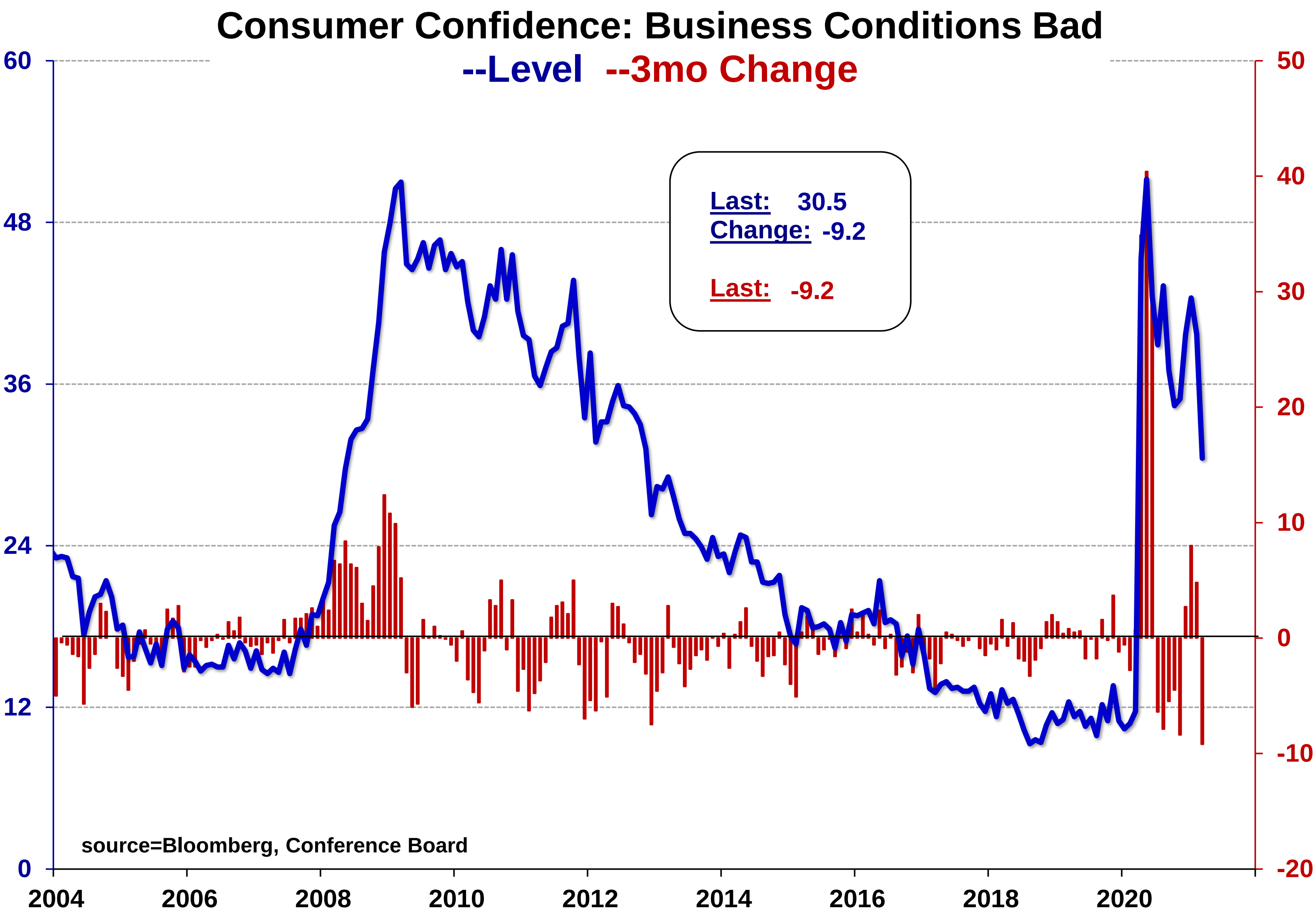
Non-US Hotels faring worse, with over 90% in either recession or depression territory.



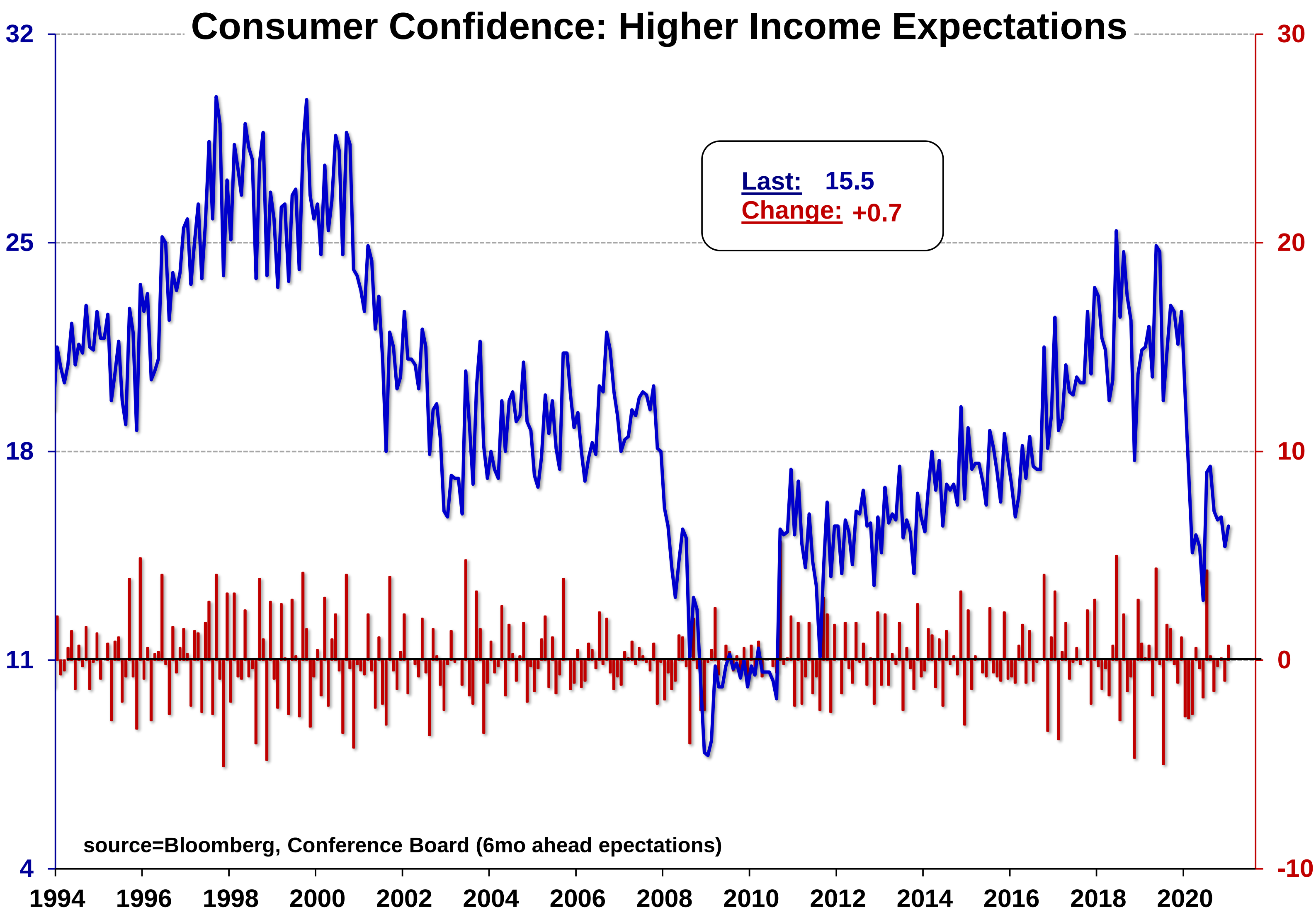
Consumer Confidence beat expectations in March: composite index jumped 19.3pts to 109.7 vs. expectations of 96.9. From the report: *“Consumer Confidence increased to its highest level since the onset of the pandemic in March 2020,” said Lynn Franco, Senior Director of Economic Indicators at The Conference Board. “Consumers’ assessment of current conditions and their short-term outlook improved significantly, an indication that economic growth is likely to strengthen further in the coming months. Consumers’ renewed optimism boosted their purchasing intentions for homes, autos and several big-ticket items. However, concerns of inflation in the short-term rose, most likely due to rising prices at the pump, and may temper spending intentions in the months ahead.”*



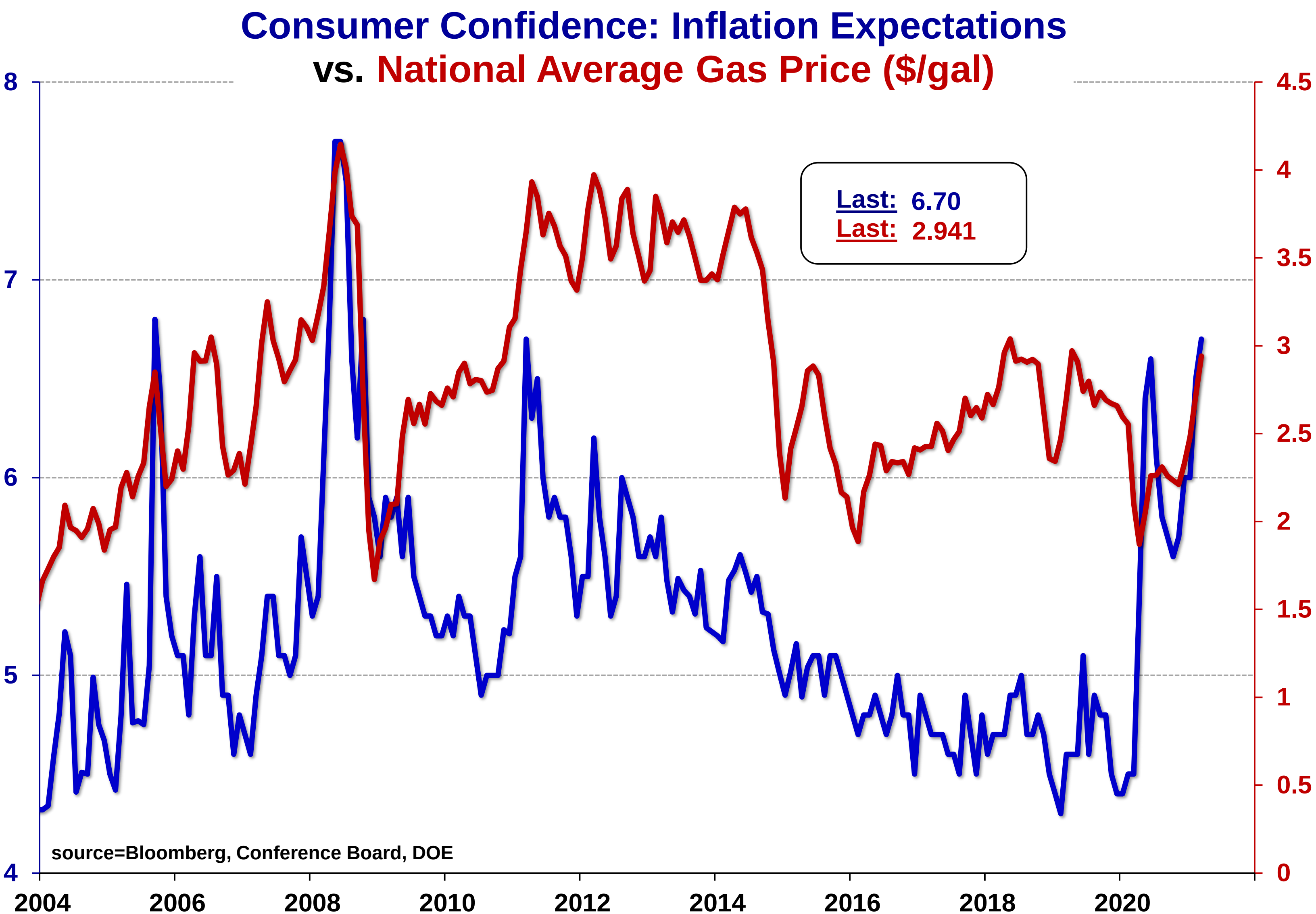
Respondents saw business and labor market conditions improving…



..however, income expectations remain muted. From the report: *Regarding short-term income prospects, 15.5 percent of consumers expect their incomes to increase in the next six months, up modestly from 14.8 percent in February. However, 13.3 percent expect their incomes to decrease, up slightly from 12.9 percent last month.*



And finally, inflation expectations rose in sync with gas prices.



Shortly after sending our 3/21 Macro Weekly in which we discussed the unsustainability of exploding debt and soaring interest payments, a paper came out from the CBO titled: The Economic Effects of Financing a Large and Permanent Increase in Government Spending**.** From the report: *In theory, a large government program—defined here as one that would spend 5 percent to 10 percent of baseline GDP each year—could be financed by reducing existing spending, borrowing (deficit financing), or by raising additional revenues through taxes. First, financing a new, large, and permanent government program through reductions in existing spending would be extremely challenging. In 2019, total mandatory and discretionary spending was 19.2 percent of GDP, which suggests that the reductions needed to finance the new spending would be approximately a quarter to a half of all spending under current law. Second, financing a large and permanent increase in government spending through perpetual borrowing without any corresponding adjustment in spending or revenues at some point in the future is unsustainable.* (report link here)

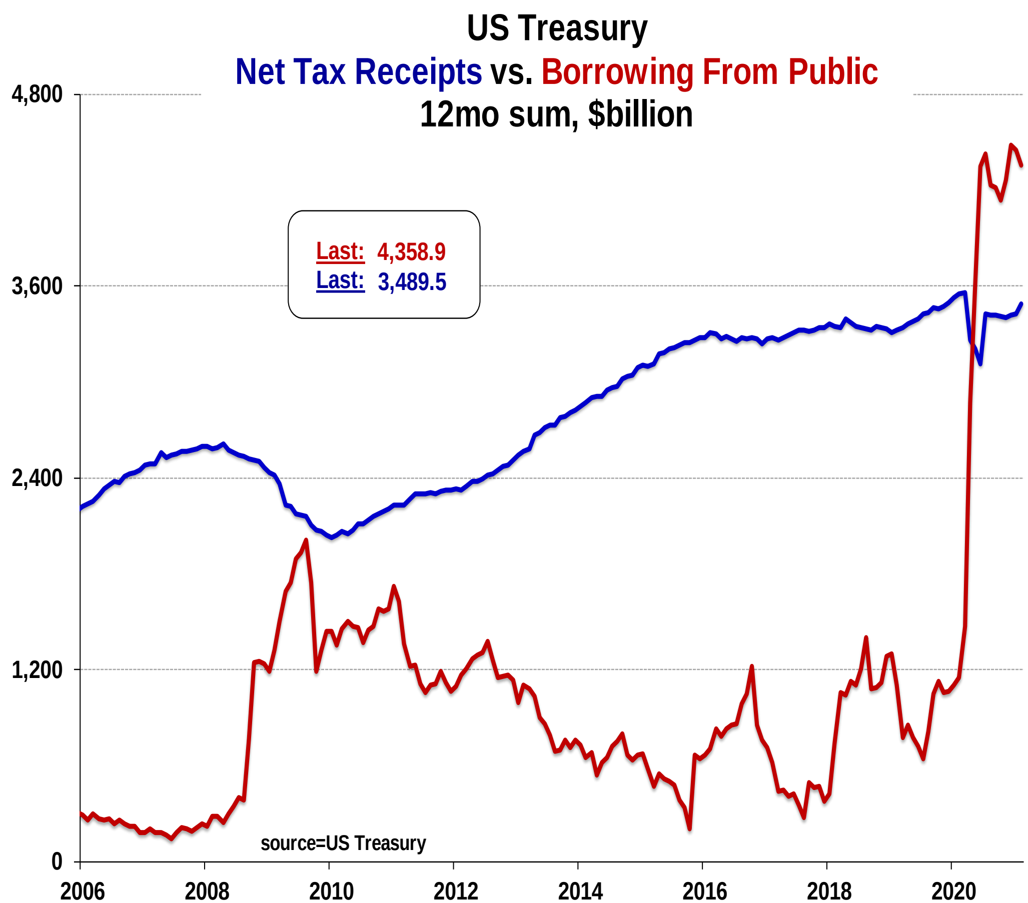
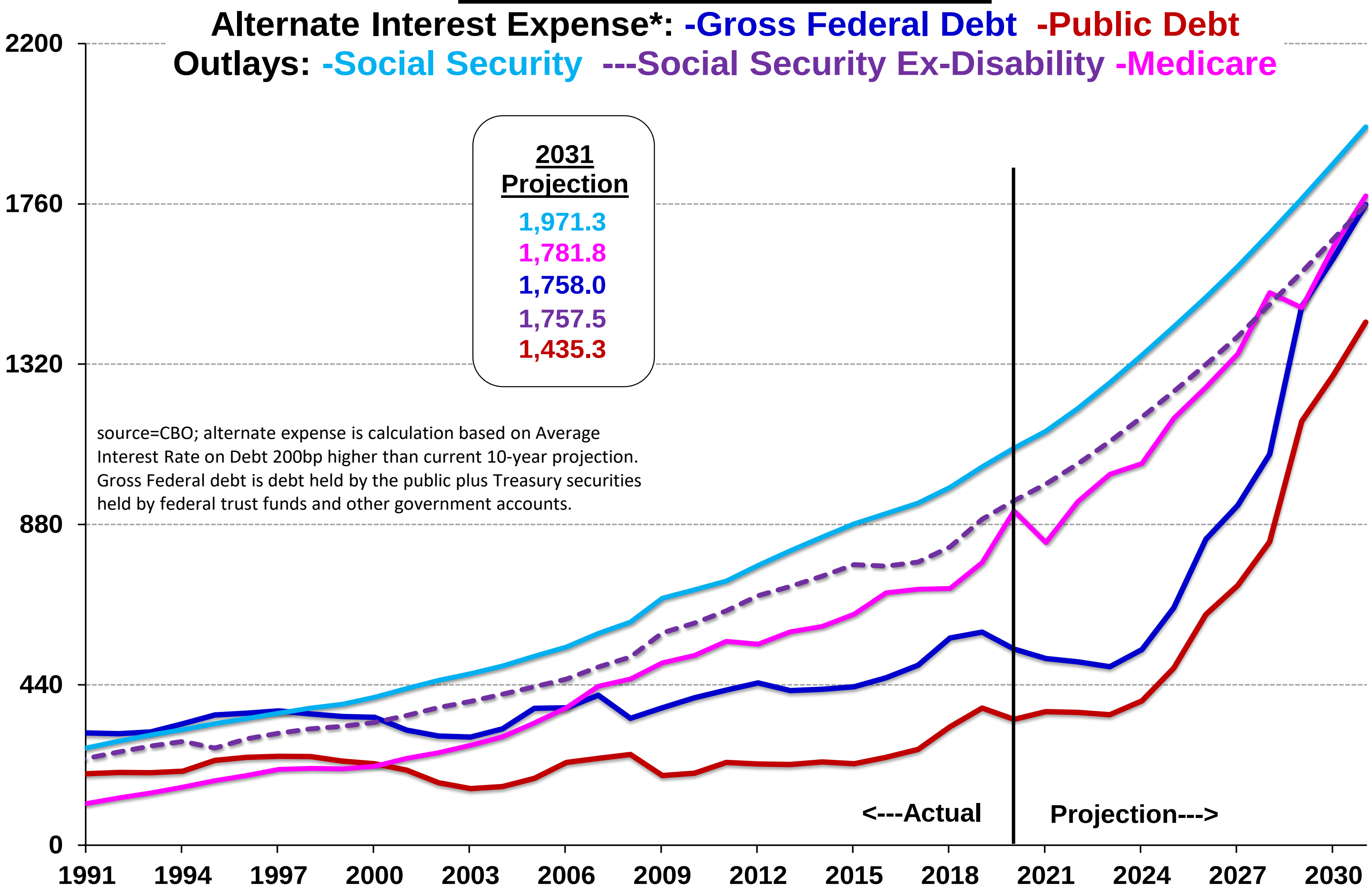


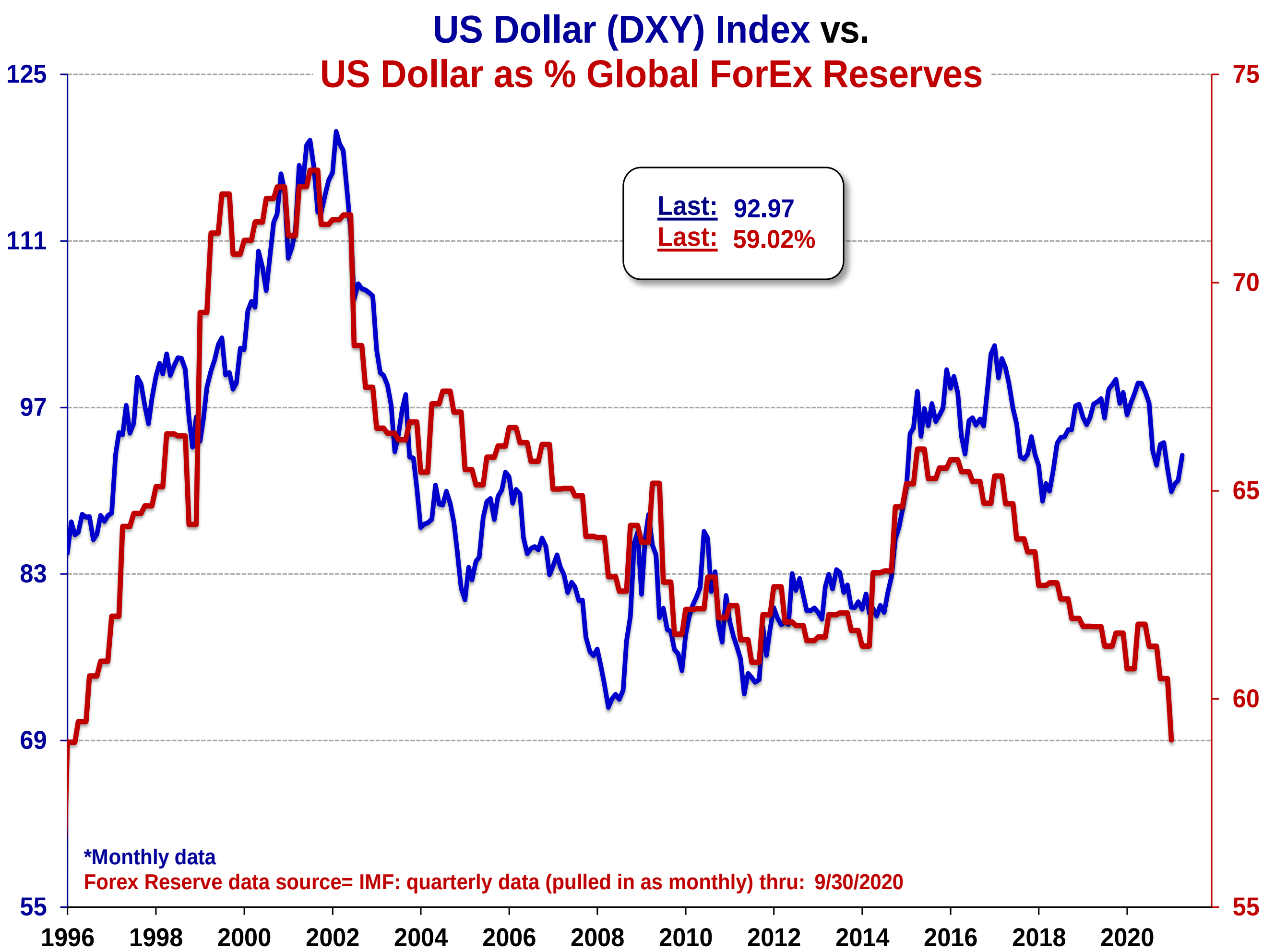
Chart: while these extreme levels of borrowing will surely subside, high levels of borrowing will be required as spending programs ramp up. Tax increases will do little to offset the cost of these programs… and may result in lower consumption. As such, a 'higher taxes and borrowing' (emphasis on borrowing) scenario seems most likely, with debt growth set to pull away from economic growth, something the CBO is already expecting in the years ahead before factoring-in even the latest $1.9 trillion stimulus measure.

The Fed is clearly in a box and cannot raise rates (much less pursue rate normalization) or allow financial conditions to tighten given continued stimulus programs and growing debt pile. Should average interest rate on debt rise to 4.4% by 2031 vs. current projection of 2.4%, interest expense on Gross Federal Debt will exceed Social Security Outlays (ex-disability insurance).

10yr CBO Projections ($bln):



With a $1.9 trillion stimulus in the books, a $2.25 trillion infrastructure proposal on the table, and a 10yr/$10 trillion infrastructure plan (including 'green economy' programs, and more) being pushed (not to mention the potential for additional rounds of stimulus checks and perhaps some form of UBI), the open-ended spending looks to be just getting underway. Along with the corresponding debt explosion we should expect the Dollar to weaken considerably. Chart: US Dollar as % Global ForEx Reserves drops to 59% in Q4, a 25-year low.



The CBO sounded the alarm bell back on March 4th: *"A growing debt burden could increase the risk of a fiscal crisis and higher inflation as well as undermine confidence in the U.S. dollar, making it more costly to finance public and private activity in international markets,"* *the C.B.O. report said*. *The outlook also does not reflect the additional spending that Congress is expected to approve this year, which will likely include a $1.9 trillion stimulus bill and a large infrastructure package. That package, which will be financed with borrowed money, is expected to exacerbate the budget deficit in the near-term, according to previous C.B.O. estimates.*

With the Dollar set to weaken going forward (potentially losing its standing as world's reserve currency), the setup for Gold & Silver could not be better and we expect significant gains in the months and years ahead.