KLCM Advisors, Inc.

April 2021

On Your Marks - Get Set - Spend!!

One year ago, as markets were crumbling and the pandemic was accelerating, we introduced the following chart and wrote, “This data provides hope…..”

“Remaining invested during big drawdowns is difficult, but it also allows investors to participate when the markets rebound quickly. While we do not know if the March 23rd nadir will ultimately be the final lows for this cycle, significant incremental damage would appear unlikely if health experts’ forecast for the peaking of the virus in the next several weeks is reasonable. Therefore, we think it is time to begin repositioning portfolios and improving the cards in our hand for the recovery that we expect later this year.”

Equity Bear Market Statistics Through History (S&P 500)

Bear Market Start	Bear Market End	Time (months)	Max Loss	Recovery 12-Months After	Recovery 24-Months After
February 2020	March 2020	1	-34%	**78%**	?
October 2007	March 2009	17	-57%	69%	95%
March 2000	October 2002	30	-49%	34%	44%
August 1987	December 1987	3	-33%	21%	57%
November 1980	August 1982	20	-27%	58%	61%
January 1973	October 1974	20	-48%	38%	67%
November 1968	May 1970	17	-36%	44%	60%
February 1966	October 1966	7	-22%	33%	42%
December 1961	June 1962	6	-28%	33%	56%
August 1956	October 1957	14	-22%	31%	44%
Average		**14**	**-36%**	**44%**	**58%**

Source: Bloomberg

While the equity markets did bottom in March and rally significantly from those low levels of the 23rd, belief in starting a new economic cycle did not occur until we began to receive vaccine efficacy data in early November. The announcements and subsequent FDA approval of multiple, highly efficacious vaccines provided light at the end of the tunnel. We believe as we put “shots into arms,” the economy will begin to reopen, leading to a significant rebound in economic activity.

Uncertainty still surrounds many facets of this recovery: the pace of vaccinations, the need for additional fiscal and monetary stimulus, the need to increase taxes to pay for these programs, and finally, whether the totality of previous and prospective spending to fight the pandemic and blunt its economic impact causes inflation to accelerate. Rather than resolve each of these arguments, we would like to focus on our core belief that intersects each of these debates**. As people are vaccinated and the economy reopens, economic growth will accelerate sharply, driven by significant pent-up consumer demand and record levels of consumer savings.**

This recovery is unlike any we, or others, have seen before just as the recession was unlike any other. Typically, a recession is caused by a buildup of excesses in one part of the economy that corrects and bleeds into the rest of the economy, causing a decline in broader economic activity. It is usually a slow grinding process from which growth starts slowly and builds momentum. This time, there were no large signs of excess in the system. In fact, we had been stuck with middling economic growth for most of the past decade. The recession, triggered by the pandemic, was a hard stop on economic activity. The country was literally locked down, and the opportunity to produce, spend, and consume was removed. With this constraint's removal, we believe this recovery will be led by consumers who will start with a full head of steam and bank accounts to match.

As vaccines continue to be rolled out and made available to more people, we already see increases in travel and leisure spending by consumers. Planes are filling up, hotel prices are rising, and restaurants are reopening. **It is going to be a good year to be a grandkid!!** The only other throttle on what we believe will be a significant increase in economic activity is the supply of goods and services that producers and consumers are chasing.

The sharpness of the slowdown, which caused marginal capacity in many industries to idle, combined with the synchronized nature of this global recovery, is causing havoc in supply chains around the world. Capacity is constrained, and the demand for products ranging from 2X4's to semiconductors is outstripping supply. This leads to rising prices for many commodities, increased use of expedited freight services, and restricted production of final goods. For example, Ford is currently building trucks without specific electronic modules and storing them until they can get the semiconductor chips to complete the vehicle. In essence, we are witnessing one of the largest positive demand shocks to the economy in history.

This demand shock, resulting from the reopening of the economy, is **BEFORE** considering the additional $1.9 trillion fiscal package recently passed or the prospect of additional federal spending to support the recovery. Both appear to be significant economic accelerants that will be applied to what is already a rapidly strengthening economy.

Increased demand combined with reduced supply always leads to increased prices in the short term. The pricing power that many industries are experiencing is a significant change from past economic cycles where overcapacity caused a seemingly endless chase for market share at the expense of profitability. Many of these industries have now consolidated to the point where we believe they will not expand capacity quickly, especially as the durability of this increased demand remains questionable. This should lead to a more profitable cycle for those industries and higher valuations for their businesses.

This environment of accelerating, broadening economic growth combined with improved profitability for many industries should lead to an investment landscape that is more accurately characterized as a market of stocks rather than a stock market. We spent last year improving our hand for this recovery, and that work is not done. We now must monitor the recovery and harvest gains when appropriate while upgrading our portfolios when opportunities present themselves.

We stand by the conclusion from our January letter: "Financial conditions are changing quickly. The investment implications are wide-ranging. Equity index returns will likely moderate, and interest rates are headed higher, meaning returns in fixed income will be limited at best. Despite those headwinds, we are optimistic that the very recovery driving inflation and rates higher will allow our companies to shine as their businesses return to normal. We have already started to see a change in market leadership and are positioned to win as this new economic cycle unfolds."