# Manole Capital Management
# 2nd Quarter Investor Newsletter
June 2021

MANOLE CAPITAL MANAGEMENT

## Introduction:

Spring has come and gone and we in the middle of a long stretch of heat and humidity here in Tampa. Summer in Florida often means 93 degrees, pesky mosquitos and an occasional tropical storm (Elsa) or hurricane.

Earlier in the 2nd quarter, we heard some pundits say that it is time for the "sell in May and go away" adage. This type of market timing has not proven itself to be profitable. Going back to 1925, the six-month average return (from May through October) was +4.3% and the market was up 73% of the time (69 of 95 years). Over the last ten years, the average return for these six months was +3.8% and it was up in 8 of the last 10 years. We are active, research-driven stock pickers, focused entirely on the emerging FINTECH industry. We know that stocks do not follow calendars, and neither should long-term equity investors. As such, we do not try to time the market by season or any other arbitrary date. We have found that long-term success (and share price appreciation) is strongly correlated to earnings and free cash flow growth.

We constantly are asked, "Are we in a bubble?" or "What do we think about valuations?" Yes, many stock market indices are up, with the S&P 500, Nasdaq, Dow and Russell 2000 at all-time highs. In fact, the 1st half of 2021 saw the overall market make all-time highs on over 25 different days. The current S&P 500 P/E valuation is 23x and 20x based upon next year's estimate of 11% growth. There absolutely are areas of the market that are overpriced. Certain segments are pricey and well above their historical averages. However, one must analyze each investment separately and on its own merits. To simply state that the stock market is pricey, fails to capture the individual valuations of individual companies. Some valuation calculations are more appropriate than others. For example, we use a combination of P/E, EV/EBITDA and P/FCF. In our opinion, "one size (or valuation) does not fit all".

If we were to summarize company management commentary following 1st quarter earnings, we would say it was "cautiously optimistic". We anxiously wait to hear results from the 2nd quarter (starting in mid-to-late July), and we imagine that most management teams will highlight how promising the 2nd half of the year and 2022 look. The data is pointing towards a "grand re-opening" and an excellent opportunity for our investments to grow.

There is a lot of excitement about the economy, as the distribution of COVID-19 vaccines has successfully been rolled-out. Also, a loosening of restrictions across the country allows more and more people to go about their lives, like they did before the global pandemic. While recent data show how strong demand is right now, there remains an abundance of unusual crosscurrents and statistics making it incredibly hard for professional economists and analysts to predict the future. From our perspective, we love it when the outlook is a little bit opaque and that the market is searching for differentiation among competitors. In terms of our forward outlook, we liked some recent comments from Jeremy Grantham, co-founder, and Chief Investment Strategist of Grantham, Mayo & Otterloo. He said, *"all of the previous bubbles occurred when economic conditions looked nearly perfect. This has been quite different because the market started its incredible surge in a rather wounded economy."*

2021 has so many unique factors to consider, when one considers the global pandemic, lockdowns, stimulus payments, employment, inflation, and numerous other macro issues. Before we address each of these macro issues, we thought we would start how we define "success" and recent performance.

## Performance:

The first half of the year and the 2nd quarter of 2021 are officially in the books. Through the first 6 months of 2021, the stock markets have been solidly positive. For the 1st half of the year, the S&P 500 was +14.4%, the Dow was +12.7%, the Nasdaq markets were up +12.5% and the Russell 2000 (small cap) was up +17.0%. This was the second-best start to a year since 1998. After a sluggish start in January (down 1%), the S&P 500 has increased for the last 5 consecutive months. Across the board, the markets have been on a tear. Overall, the 2nd quarter was strong for US equities and the S&P 500 reached a new all-time high in late June and early July.

Almost all sectors made gains last quarter, with the three best performing sectors being Technology up +13%, Real Estate up +13% and Communication Services up +11%. It is hard to identify the worst performing sectors, as they were up too, but Utilities was only up +0.2% and Consumer Staples was only up +3%. If we go back for 6 months and look at 1st half of 2021 performance, we see many similarities. Leading the way is the Energy sector up +46%, followed by the Financial sector up +26% and Real Estate up +23%. Once again, Utilities and Consumer Staples were the laggards, up only +2% and +5% respectively.

From the stock market's perspective, the first 100 days of the Biden administration were wonderful. While we always prefer to use the S&P 500 are our US stock market benchmark, we saw an analysis from LPL on the performance of the Dow for each President's first 100 days. The Dow, under President Biden gained +9.3%, which outpaces every recent President since Franklin D. Roosevelt's 1933 +75% stock market rally. If we look at the first 100 days from Election Day forward, the Biden administration is equally impressive. Biden's stock market gained +24%, which exceeds every prior President from Eisenhower forward. Only the Kennedy administration was close at +19%.

The first 6 months of the year witnessed the rise of the meme trade too, not once, but twice. Shares of GameStop (ticker GME) have gained more than +1,000% this year. Another meme darling is AMC Entertainment (ticker AMC). In a recent SEC filing, AMC said *"under the current circumstances, we caution you against investing in our Class A common stock, unless you are prepared to incur the risk of losing all or a substantial portion of your investment."* That warning did little to scare investors and the stock has gained more than +2,000% this year.

The frenzy is not just with conventional markets, but commodities, foreign currencies, and digital currencies too. Commodities prices have been soaring, with the S&P GSCI moving materially higher. This has been led by strong growth in energy prices, fueled by optimism for a global economic recovery. Energy was the best performing component of this commodity index, with strong gains in crude oil and natural gas. Industrial metals like aluminum, lead and nickel also rallied. In addition, agricultural products like coffee, sugar, wheat, and corn were higher. On the other end of the spectrum, soybeans, live cattle and hogs were weak. Building materials like lumber were initially up over +400%, but have declined recently. With low interest rates, US residential home prices are at levels last seen in 2006. Demand for certain items have caused outsized price increases, like used cars, rental cards, chlorine, truck drivers and shipping containers.

Bitcoin and Ethereum started the year on a tear and reached levels where they had doubled year-to-date. The price of Bitcoin topped $60,000, but then dramatically declined. There were several issues that weighed on the digital currency. First, the US government was able to track and seize some Bitcoin, proving that it may not be untraceable and 100% anonymous. Then, Coinbase went public on April 14th and Elon Musk appeared on Saturday Night Live on May 8th. Both of these milestone events were not positive for many digital currency prices. Lastly, numerous countries have enacted rules to restrict the growth of digital currencies and mining. Although a (35%) to (40%) decline is sizeable, the price of Bitcoin is still above every other quarter end, except for 1q'21. Despite this price volatility, we expect trading volumes will be at or near record highs, when officially announced by Coinbase.

For more details on the dominant digital currency exchange, click on our COIN note here. We like James Grant's (of Grant's Interest Rate Observer) recent quote that "Bitcoin is not money. It is an expression of the world's rejection of fiat currencies." Is Bitcoin truly a currency? Is it the money of the future? For more of an understanding of our opinion on digital currencies, click on our note here.

## Success:

Our monthly portfolio tear sheets show performance, top holdings, large exposures, and other interesting metrics. Also, on the top right of these 1-page documents, we recently added a couple of definitions. One is our definition of FINTECH, which most of you know is ***"anything utilizing technology to improve an established process."*** We added on the definition of success onto each of these tear sheets. Why? We think it is critical to properly set the stage for our investors.

We continuously state that we are not short-term traders, but we prefer to consider ourselves long-term investors. Also, we define success not as an absolute performance return goal, but rather as "***generating excellent long-term returns and limiting a material loss of capital."*** This is intentionally multi-faceted. We certainly want to produce and generate solid returns, but we also believe successful investing involves limiting one's downside.

One of the positive byproducts of our investment style and philosophy, is that we tend to outperform (on an absolute and relative basis) when the overall market declines. Evidence of this can be seen by looking at our downside capture or our performance in the 4th quarter of 2018 or 1st quarter of 2020. If one suffers a painful and sizeable market decline, it can be an insurmountable hole to escape from. For example, if an investor loses (10%), he/she needs a +11.1% for 1.11 years to breakeven. Losing (20%) requires a +25% return for 2.34 years to get "back to flat". This is why we like to stress the downside protection our portfolios provide.

In many of our notes, we have shown some of the business orientated pictures from *Behavior Gap* and Carl Richards. We just saw this diagram and thought it was worthy of including. Obviously, nobody likes losing and this picture highlights what academics call *loss aversion*. The reason investors are so averse to losses is the associated pain one experiences is greater than the satisfaction or pleasure we get from a gain. While everybody likes to win, most hate to lose.

Within our flagship ***FINTECH*** portfolio, and even our super concentrated ***PURE PAYMENTS*** portfolio, we strive to keep our weights manageable. We are not making outsized bets on our holdings and use a disciplined risk management system to keep our portfolio weights modest. Maybe we are a "big chicken"? We've been called much worse! The reality is that we never like to lose money and understand how hard it is to earn back that capital.

One of our key investment tenets is that we attempt to remove emotion from our investment decisions. While we hate to make mistakes, we understand that they are inevitable. We attempt to admit our errors quickly and move on from these mistakes. Our goal is to wake up each day and assess the merits of each position in the portfolio looking forward, not backward. Every day, we have the choice to buy, sell or stick with our positions. We feel this philosophy provides us with discipline and some emotional clarity.

## The Moat & Market Share Gains:

One of the key characteristics we are always looking for in a company is market share leadership. We like our FINTECH holdings to be market leaders, with enduring competitive advantages. This is what Warren Buffett describes when he discusses "moat investing". Ideally, a castle (or business) has a sizeable moat, preferably one with hungry alligators, that can protect it from intruders (or pesky competitors).

One of favorite aspects of the secularly growing digital payments industry is that it continues to steal sizeable market share from cash. Over 80% of global purchase transactions are still conducting with cash, but this is gradually declining. We envision that paper currency will always be an option in our lifetime, but its usage as a "medium of exchange" is steadily declining. In the US, 55% of transactions under $10 in size are still done through paper currency. As we have discussed several times, we believe these smaller-sized transactions are ideal to migrate from cash over to contactless card or mobile-based payments.

In our 2nd quarter investor newsletter, we discussed the public transportation system in New York City adopting OMNY for contactless payments. Now, the city of San Francisco and their MTC (Metropolitan Transportation Commission) is rolling-out a mobile payments app, called ***Clipper***. Just like Washington DC, Chicago, Los Angeles and New York, San Francisco is looking to increase ridership and enable its consumers to easily access the public transportation system via their smart phone.

The application is being white labeled from Cubic Transportation Systems, which currently enables contactless fare systems in Atlanta, Boston, Miami, New York, London, Vancouver, Sydney and Brisbane. In San Francisco, consumers can now use their iPhone or Apple Watch to purchase tickets from any of the 24 transit agencies (subway, bus, ferry, and light-rail systems) and Google Pay will be enabled by May of 2021. The Clipper app allows consumers to view a card balance, plan their trip, see prior transaction history and automatically re-load value by linking a credit card. Matt Newsome, who works at Cubic Transportation Systems, recently said, “We feel contactless payments are a way to help bring back ridership and help consumers rebound from the pandemic by reducing physical contact and standing in line at ticket-vending machines and eliminating touchpoints.”

## The “Roaring 20’s”

What is driving this stock market to record highs? Well, the market is always looking forward and it is expecting a much better economic outlook than a year ago. Some optimists have dubbed our economy the second coming of “the Roaring 20’s”.

Consumer confidence just registered its highest reading since before the pandemic. The US economy is expected to grow at the fastest pace in decades, as there is significant pent-up demand. We are very optimistic about the economy, the capital markets and the outlook for the US consumer. We've quickly gone from an economy on an unprecedented lockdown, triggered by a pandemic, to one that is rapidly re-opening.

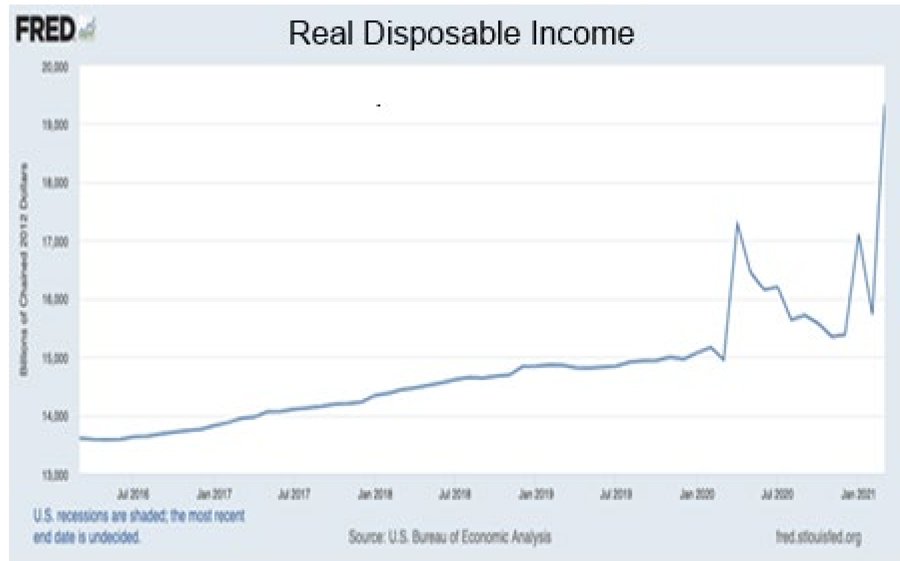
Vaccine distribution is rolling out smoothly, with nearly 3 million shots per day (during the 2nd quarter). We are quite optimistic about a strong economic rebound in 2021. As of today, 158 million Americans have been fully vaccinated, representing roughly ½ of our population. Nine states (Connecticut, Hawaii, New Hampshire, New Jersey, New Mexico, Maine, Massachusetts, Rhode Island and Vermont) have inoculated 70% of their adult population with at least one dose. To get back towards our roaring economy of late 2019, we would like some other states (Mississippi, Alabama and Arkansas) to increase above the 1/3rd vaccinated rate.

The Fed has backstopped our economy and interest rates are remarkably low. With improving corporate earnings, we believe the backdrop is quite positive. There will be fits-and-starts and this re-opening will not be without its hiccups. The rush of demand for goods and services has led to supply chain bottlenecks and labor shortages. Following a year-long global pandemic, stop-and-start lockdowns and $5 trillion of governmental stimulus, the economy is poised to march higher. The prospect of a fully reopened economy, coupled with the past year of strong stock market returns, has pushed growth expectations considerably higher. Many investors wonder if everything has moved “too far, too fast.” This is certainly a valid concern, but we also believe it is important to understand and appreciate the fundamental backdrop, with a focus on the emerging US consumer. The US consumer is ready to re-engage fully in our economy and they are also in a good financial position to do so.

## The US Consumer:

The US is a service and consumption-based economy. It is estimated that consumption makes up roughly two-thirds (over 68%) of our entire economy, a percentage that has consistently moved higher since the mid-1960s. The US is the largest and most diverse economy in the world, so it makes sense that the US consumer is the biggest contributor to growth and one of the most important factors in this global economy.

As this US Bureau of Economic Analysis and Federal Reserve Bank of St. Louis chart shows, the percentage of real (adjusted for inflation) disposable personal income Americans have at their disposable is at an all-time high. Our economy of newly inoculated consumers, armed with plenty of savings, are poised to spend.




IHS economists are forecasting real or inflation-adjusted GDP for 2021 to equal +6.7% (4th quarter, year-over-year). The Treasury market appears to be pricing in roughly +6.0% GDP growth this year and the Fed is forecasting an even rosier +6.5%. In 2022, the Fed is currently expecting GDP to be a strong 3.3% with unemployment falling to its pre-pandemic low of 3.5%. A labor market returning to full employment by mid-to-late 2022 would be ideal. As we emerge from this pandemic, we will not be surprised to see GDP forecasts approach 7% to 8%, with the 1st half of 2021 approaching double-digits. The US consumer is in a very strong financial position, just as our economy is set to reopen. There may be a time to bet against the US consumer, but we do not think that time is now.

## The Savings Rate:

We are particularly intrigued with how high the US consumer savings rate has been. For the back half of the 20th century, Americans saved roughly 10% of this income. By the late 1980s and early 1990s, it had fallen to only 3%. Following the pandemic, the savings rate is surprisingly high. Most of the COVID-19 stimulus was in the form of direct payments to American businesses and households. According to the Federal Reserve Bank of New York, consumers on average only spent about a 1/3rd of their stimulus checks, with many households either saving their money, paying down debt, or both.

At the end of last quarter, Moody's Analytics estimates that global households have $5.4 trillion in pandemic-related savings. US households currently have a 35% allocation towards equities, but cash balances, despite record low yields, remain quite high. Goldman Sachs predicts there is $200 billion of money market assets that could flow into equities in 2021. In March of 2021, US mutual funds and ETFs experienced $98 billion of inflows, the most in a single month ever (according to data provider Refintiv Lipper).

History does not provide a ton of insight into this exact environment. The last time GDP was this high was 1983, when the economy was just emerging from a deep recession. The economic environment is very different today than in the early 1980s. Back then, the US was dependent upon manufacturing. Today, services account for about 60% of US GDP. Because of this transition to a service economy, the global pandemic had a crushing impact on areas like travel, restaurants and lodging.

US household debt-to-GDP is still at a very low level, compared to the pre-Financial Crisis expansion. We believe that US consumers have strengthened their balance sheets over the last year.

In addition to a healthy US consumer, companies should be expected to return to buybacks this year and next. Over the prior 11-year bull market, stock buybacks were given credit for supporting and/or lifting the overall market. Between 2010 and 2019, S&P 500 companies re-purchased nearly $5.3 trillion of their own stock. We anticipate that many of our FINTECH

companies, especially those that generate significant free cash flow, will look to return capital to shareholders through increasing dividends and stock buybacks. Want more fundamental evidence of a rebound? Let's now dive into some specific data points we like to track.

## Industry Data Points:

One of our long-term positions is Intuit (ticker INTU). They dominate two different businesses, both through the use of scalable software and cloud-based technology. The Turbo Tax franchise is the leading method for US consumers to file and pay their taxes. The QuickBooks (QB) franchise handles the administration, infrastructure, accounting for millions of small-to-medium sized businesses.

QB provides some anonymized revenue data from 800,000 to 1.1 million of its customers. Working with Sand Hill Econometrics, QB is able to provide a snapshot of how small businesses are doing, post pandemic. We believe this regional and industry specific data is an excellent source of real-time information on our economy. "Intuit QuickBooks data has provided extraordinary insights into the pandemic's effect on small businesses, for worse, and for better. We can see where the recoveries are, and are not," said Susan Woodward, founder of Sand Hill Econometrics. "Only QuickBooks can see genuine small company revenues, monthly, by industry and location with such accuracy and timeliness."

In April of 2020, during the height of COVID-19 uncertainty, small businesses were experiencing revenue declines of 22% or losses of roughly $4.6 billion per month. Now, a full year later, 61% of businesses that QB analyzed are showing annual revenue increases above their pre-pandemic levels. Alex Chriss works for Intuit's QuickBooks and recently said, "Despite these challenges, our data shows that small businesses are on a path to recovery, demonstrating the resilience and tenacity that small businesses embody for all of us. The spirit of resilience and recovery is evident across the entire QuickBooks platform."

Consumer strength and confidence have been showing up in retail sales. According to the Census Bureau, April retail sales were up +51% year-over-year, but this explosive growth is expected given the low comparison to April of 2020. We feel a better view of sales comes from looking at the month-over-month increase from February 2021 to March 2021, which showed a +11% increase.

To gauge the US consumers health, we like to monitor overall spending and payment data. Visa recently published payment data for April and May. Year-over-year growth for US credit and debit payment volumes were up +50% and +46% respectively. Since 2020 captures the big downdraft from the pandemic, it is probably a decent idea to exclude this in our comparison. If we look at US payment volumes for April + May of 2021, compared to April + May of 2019, it is still up an impressive +31%.

Also, we like to look at Mastercard's SpendingPulse data and we just received their June update. Mastercard indicated that US retail sales have increased for the ninth consecutive month, improving +11% year-over-year. By sector, looking at annual growth in June, lodging was +107%, restaurants were +55% and apparel was +63%. Once again, we like to look at how current spending compares to 2019, which was our last pre-pandemic period. Impressively, total US retail sales are up +10.4% versus 2019. Looking at brick and mortar versus eCommerce sales also shows interesting results. eCommerce sales are up +95% versus 2019 and up +8.3% versus June from a year ago.

What does the data tell us? It clearly shows that the global pandemic had a significant impact on the financial health of both American consumers and businesses. We like a local Tampa-based business that has a new motto, post pandemic. They say *"You gotta survive to thrive"* and we believe this is apropos for today's economy. Those that were able to survive the worst of the pandemic, are now in a position to benefit.

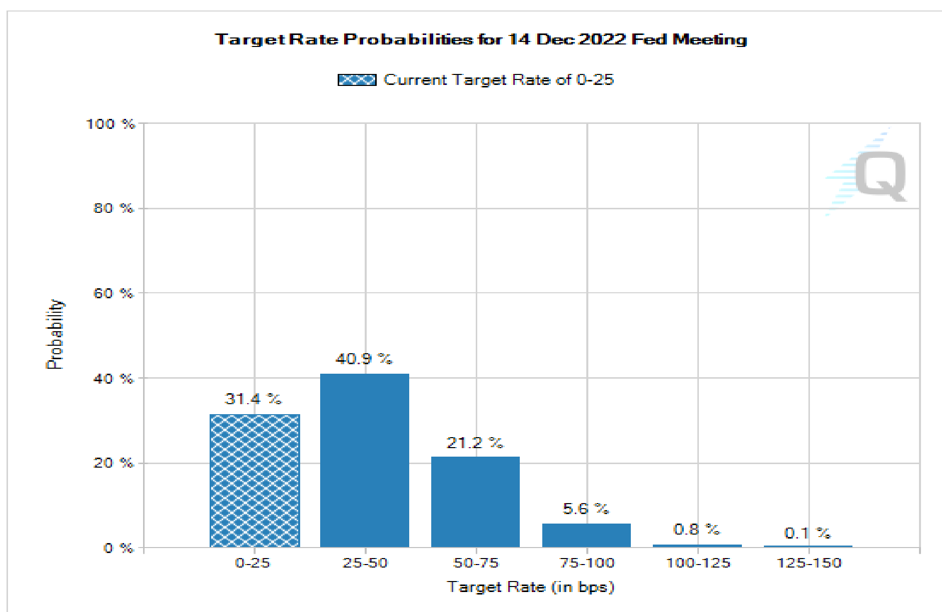
The metrics mentioned above paint a picture of an impressive US economic rebound and a re-engaged US consumer, but how long will this boom last? How quickly will employment snapback? Will this massive stimulus spur runaway inflation? Let's spend a few pages discussing some of these bigger picture issues.

## Interest Rates:

Reading official Fed commentary is a wonderful cure for insomnia and something we enjoy doing. Looking at press releases and reading interviews of various Fed officials leaves us with one clear conclusion. We do not expect a Fed Funds interest rate increase for quite a while. The Fed "dot plots" are modeling in increases by 2023, but that might even be aggressive.

We like to look at what the market is thinking about future interest rates changes and believe the CME and its FedWatch Tool is the best place to gauge the market's pulse on interest rate changes. On their website, investors can see that there is a 100% probability that Fed Funds stays at 0% to 0.25% at their next meeting on July 28th, 2021. If one goes out to the end of this year to December of 2021, the expectation remains that interest rates will remain unchanged.

If one go out 12 months to July of 2022, the probabilities begin to change, but just a little. In a year's time, 2/3rd's of the market still believes that interest rates will be 0% to 0.25%. 29% expect a 25-basis point increase, and only 4% expect a 50-basis point increase or higher.




As you can see in this chart, if we go out to December of 2022, the probabilities still have no changes in interest rates at 31%. 41% expect a modest 25-basis point increase and 28% are forecasting more than that.

Investors might worry about higher interest rates, but bear markets typically start after the ***last*** Fed increase, not the ***first*** one. Overall, we anticipate that interest rates should stay fairly low for the next one to two years, which should support a healthy equity market.

Before interest rates rise, we would expect the Fed to begin to gradual lower their debt purchase. Every month, the Fed is buying $80 billion of Treasuries and $40 billion of mortgage-backed securities. In the midst of an economic crisis, those purchases helped stabilize the markets. During a strong recovery, it might make sense to gently take the Fed's "foot off the QE accelerator." We worry that purchasing debt for longer than necessary might create excess imbalances.

## Inflation:

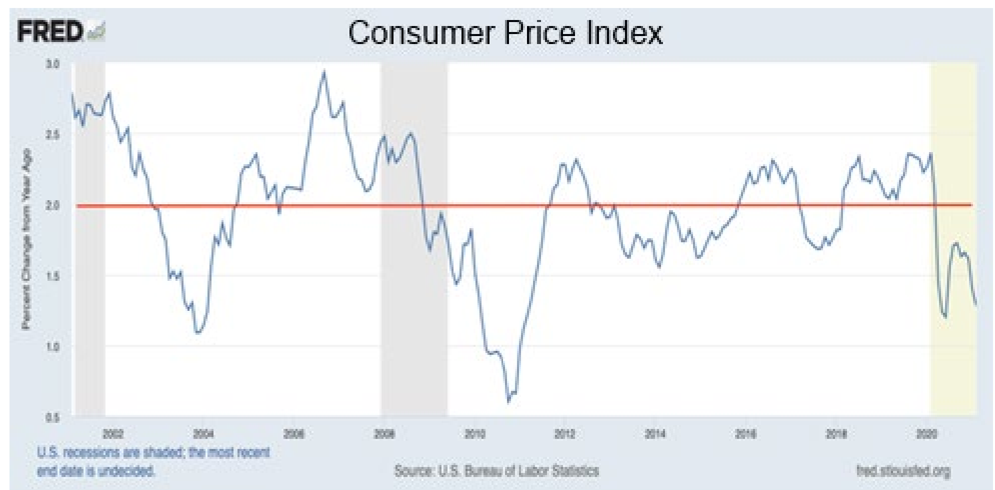
Governments around the world have been keeping their currency printing presses running 24 hours a day, 7 days a week. Last year, the US Federal Reserve printed an unprecedented amount of dollars, roughly 1/5th of all US dollars ever printed. On a daily basis, the Bureau of Engraving and Printing produces over $500 million over 38 million notes. There are countries that have taken the printing of fiat currency too far. Zimbabwe is but one example of runaway inflation. Here's a picture of one of their 100 trillion bills. Yes, that's a 100 trillion. Do you want to be a trillionaire? Simply buy one on eBay for $8.99, by clicking here.

The ability of countries to simply print money should inherently be inflationary. A few weeks ago, the Biden administration announced an infrastructure bill, called the American Jobs Plan, with a $2 trillion spending target. In March of 2021, US government passed a $1.9 trillion stimulus package. This followed a December of 2020 stimulus package of $900 billion, as well as a CARES Act in March 2020 bill of $2.2 trillion. We are not making a statement about the merits of any of these packages and stimulus programs. We simply are trying to point out the massive amount of money that is getting printed and fears of rising inflation are not entirely unwarranted.

US stocks have been volatile lately, as inflationary data rose to its highest levels in a dozen years. Data is always hard to interpret, which is one of the reasons why we only model our company estimates 2 to 3 years out, not 10 to 20 years forward. The CPI (consumer price index) jumped +0.8% last month, the largest gain since June of 2009. Food prices increased +0.4% and there was a +10% surge in prices of used cars and trucks (the most since 1953) which accounted for almost 1/3rd of this increase. For the 12-months ending May 2021, the annual US inflation rate was +5.0%. While this is unusually high, we believe it is temporarily elevated. For all of 2020, annual inflation was 1.2% and it was only 1.8% in 2019. A key question facing investors, and policymakers too, is how persistent and elevated inflation will be. Inflation data is swinging wildly, as there are dozens of unusual items impacting it. Are wages heading materially higher? Can businesses find necessary and skilled labor? Are supply chains permanently damaged or simply slow to adapt to a global footprint? While there will be pockets of higher prices across certain asset classes, we expect inflation to remain modest.

Mary Daly is the President of the Federal Reserve Bank of San Francisco, and she had some very interesting comments about inflationary pressures, or lack thereof. “We have struggled for a whole decade - when we had a robust economy and a strong, sustained expansion - to get inflation up to our 2% goal. All central banks are facing this challenge. We’re also constrained by the zero-lower bound [on interest rates]. We always have the tools to pull inflation down if it gets too high. I’m much more worried about regaining full employment and lifting inflation up to our 2% average inflation target.”

In this chart from the Federal Reserve Bank of St Louis, the red line shows the Fed’s target 2% rate of inflation. As one can plainly see, the US economy has been running underneath this target for years. The Fed continues to state that they are comfortable with inflation running above this 2% target for a few quarters, as the US economy recovers.




It seems like the headlines about inflation are painting it as an inevitable killer of our economic growth and this new bull market. The issue over the last 20+ years in the US has been not enough inflation and we think the media attention might be a little bit overdone. The Fed has repeated its support of the economic recovery and stated that it will be “some time” before the US economy is “healed enough” for removing its support.

Fed officials have stated that they are not yet discussing raising interest rates, but will wait until the economy returns to “full employment”. With the recent June jobs report adding 850,000 new payrolls and taking the unemployment rate to down to 5.9%, it looks like this will be a slow and steady process. In her model forecast, Daly does not see a return to pre-pandemic labor market until the end of 2022 or into early 2023. Until the economy is back to its pre-pandemic levels, we anticipate the Fed will remain accommodating. The debate is ongoing, as short-term inflationary pressures and gyrating

wage data confuse economists. Perhaps by mid-to-late summer, when those stimulus checks are long since spent, some additional clarity can emerge.

The Fed has ample weapons at its disposal if inflation and our economy begin to overheat. The Fed could start by raising the interest rate paid to banks on excess reserves or it could reduce or even end its bond purchases. We do not want another "taper tantrum", like the market experienced in 2013, but QE cannot be a permanent monetary policy.

Being concerned with inflation is a legitimate worry, but we believe this widespread alarm may be overdone. Over the last year, companies and workers proved to be remarkably resilient. Companies have adapted to WFH (work from home) and invested in productivity-enhancing technology. Even as the US GDP fell by (2.4%) in the 4th quarter of 2020, business investment in consumer equipment rose by +17%. Companies invested in automation, videoconferencing software and enterprise cloud services. We believe the US is poised to re-emerge in 2021 and 2022 and recover from this awful pandemic.

## Conclusion:

We live in interesting times; they will certainly get more interesting in the coming months. The COVID-19 bear market ended just over a year ago, on March 23, 2020. Needless to say, the twelve months that followed delivered no shortage of economic and political twists-and-turns. But for equity investors who kept a steady hand and a long-term mindset, it also delivered a +75% return on the S&P 500 (from March 23, 2020, to March 23, 2021).

We absolutely understand the risk of rising inflation, as it has the potential of counter-acting a strong US consumer. If consumer prices rise too much, then consumers could be discouraged from spending. It is a valid concern, but we believe that inflation will not get "too hot" to handle. If Treasury yields rise (due to inflationary concerns), but corporate earnings exceed expectations, the stock market should steadily march higher, especially for our growing FINTECH companies.

Some industry experts are pessimistic, expecting inflation to emerge following massive stimulus and government spending. Gary Shilling of Shilling & Co is one the market's doomsday prognosticators. Shilling worries about the actions of the Fed and Treasury, which he claims are "pumping up asset prices" and "dismissing the threat of higher inflation". Shilling is suggesting investors resist the equity market and was quoted as saying, *"the money pumped out by the Fed and all the fiscal stimulus hasn't gone into spending, it's gone into savings and asset inflation. It's really responsible for things like dogecoin and Bitcoin and other cryptocurrencies, and all these speculations. It's pushed stocks to unbelievable highs in relation to earnings, in relation to anything else, and made them very overpriced. There's too much money floating around, and people don't know what else to do with it. It's like the sock-puppet thing we saw back in the dot-com era. Absolutely no logic to the thing, but everybody's having a wonderful time as long as it lasts."*

We are more optimistic than Shilling and expect an impressive snapback to a more normalized environment in 2021 and 2022. We are still very interested to understand how the work-from-home revolution will unfold. When will companies begin to require employees to return to the office? How will the commercial real estate market be affected, if some companies decide that WFH is more economically efficient than renting office space? Will they require employees to be vaccinated, should they come back to the office?

Some businesses have been able to see productively gains, while others are struggling to manage certain supply chain problems and are finding it challenging to scale services back up, to meet demand. As we look forward, we see more positive growth and opportunities (especially in our FINTECH space) than some market participants. With the population getting vaccinated, more people will be comfortable going out, heading back into the office, gathering with friends and family and taking trips. All parties must eventually come to an end, but we believe this one is just getting started.

History has proven that stocks are the best long-term investment option, generating an average of 10% to 11% over the last century and roughly 8% over the last 60 years. Do you really want to invest in fixed income, with the US 10-year Treasury less than 1.4%? If inflation runs at 2% or higher, these debt investors will incur double-digit annual losses. Investors looking to build wealth should find stocks an attractive option, even if taxes on capital gains rise. While some may look to do a short-term trade to get ahead of higher taxes, we believe market timing is a fool's game. We continue to expect equity allocations to rise, most likely at the expense of surprisingly high cash balances. The US should enjoy a quicker, consumer-led recovery as vaccination goals are reached. Which asset class provides investors with the most attractive risk-adjusted returns? For us, it is equities, with a focus on the emerging and high growth FINTECH industry.

We look forward to speaking with you soon!

**Warren Fisher, CFA**
CEO of Manole Capital Management

## Cliff Clavin:

In the 1980's, one of our favorite TV shows was Cheers. The know-it-all postal worker was named Cliff Clavin, played by John Ratzenberger. This segment of our quarterly newsletter highlights some useless information that Cliff would be proud of.

The NHL or National Hockey League is 104 years old. This year, the Stanley Cup Finals matched the Tampa Bay Lightning versus the legendary Montreal Canadians. The Montreal Canadians have won 24 Stanley Cups and won 5 championships in a row, from 1955 to 1960.

On July 7, 2021, the Tampa Bay Lightning won the Stanley Cup, and it marked their 2nd championship in a row. Only nine franchises have won back-to-back Stanley Cups. Goalie Andrei Vasilevskiy won the Conn Smythe Trophy (best player in the playoffs) and recorded his fifth straight shutout in a series-clinching game. With the Game 5 win, the Lightning improved to 15-0 (over the last two postseasons) following a loss. That is the longest streak in NHL history.

On the Lightning's 4th line, Pat Maroon or the "Big Rig" (pictured), is known more for his toughness and fighting, than his skating or scoring skills. However, Maroon has now become just the fourth player in the history of the NHL to have won 3 consecutive Stanley Cups with two different teams (2 with the Lightning and one with the St. Louis Blues). Go Bolts!

One of our favorite movies is *Trading Places*, starring Eddie Murphy and Dan Ackroyd (see below). In that movie classic, Billie Ray and Lewis trade orange juice contracts "in the pits". For over 100 years, the Chicago Mercantile Exchange has been a leading place to buy and sell various assets (interest rates, equities, f/x, commodities, energy, and metals). On its first day of trading in 1919, three lots of egg futures traded hands.

CME Group, the world's largest derivatives exchange, announced on May 4th, 2021, that it will <u>not</u> reopen many of its physical trading pits. The showmanship of open outcry trading is slowly fading, as electronic trading replaces it.

Open outcry trading is less than 1% of CME's volumes, as hand signals and telephone trading has been replaced by computerized networks and electronic trading platforms. This migration perfectly fits our description of FINTECH or the "***use of technology to improve an established process",*** even if it makes us a little bit sad.

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