

2021 Beginning of Year Report

It has been almost three years since I have penned one of my semi-annual reports. All of those reports, of which there have been seven, have been retrospective in nature. This report will be prospective in nature. While I will use some historical facts and figures, my intention is to share with you things that I think are likely to happen this year and next and about which I believe we can be hopeful and optimistic. Thank you for your time. I hope to use it wisely.

Goodbye 2020

On the economic front, there are three items which I believe portend positive results for this year and next. The first is, of course, the development of vaccines to battle the coronavirus. Last year, the Federal government entered into contracts with eight major pharmaceutical companies, both here and abroad, to develop what is hoped to be an array of vaccines to fight Covid-19. In an effort to eliminate for these companies the financial risk typically associated with the research and development of various drugs and vaccines, the United States government issued to them checks totaling more than \$11 billion dollars. In return for eliminating the financial risk, the U.S. Government would receive a guaranteed number of doses for a lower price for any approved vaccine.

To date, two companies, Pfizer and Moderna, have received emergency use authorization from the Food and Drug Administration (FDA). A third company, AstraZeneca, working in conjunction with scientists at Oxford University, is relatively close (one to two months) to applying to the FDA for emergency use authorization as well. The other five companies are in the latter stages of research and development. Noteworthy is the fact that both Pfizer and Moderna developed their vaccines using a never-before used technology called messenger RNA

(mRNA). Messenger RNA is faster and less expensive to produce than the more traditional ways that have been used to develop past vaccines.

When the FDA set the parameters for a vaccine that they would deem to be viable, they set the minimum efficacy rate at 50%. To put that number into perspective, in a typical year that is roughly the average efficacy rate of the annual flu shot - it helps about 50% of the people vaccinated, not the other half. Pfizer's efficacy rate came in at a stunning 95% and Moderna came in at 94.5%. Both of these companies literally knocked the cover off of the ball right out of the gates. To put those numbers into perspective, that puts these two vaccines on par with two of the most successful vaccines ever developed, measles and the shingles. While Astrazeneca has yet to apply for emergency use authorization, their trials show an efficacy rate of 90%.

All three companies involve a two-shot regimen. Due to the makeup of the messenger RNA vaccine, the vaccine must be stored at ultra-low temperatures: Pfizer at -94 degrees Fahrenheit, Moderna's at -4 degrees Fahrenheit. This has created some logistical challenges, but these can and will be overcome. The AstraZeneca vaccine can be transported and stored at normal refrigerator temperatures.

Due to the rapidity with which these vaccines have been developed, for many people this has generated quite a bit of skepticism. The previous record for bringing a vaccine to market was four years. Surely, the thinking goes, in order to produce a vaccine so quickly, corners had to have been cut. I have read various surveys over the past six months indicating that 40-60% of people polled in the U.S. would not take the vaccine – or at least not initially, due to concerns over safety. This could be problematic in fighting the coronavirus, because scientists and researchers project that for us to achieve “herd immunity”, 70-80% of the over age sixteen population must be vaccinated.

Very broadly speaking, there seem to be two groups of skeptics. One group tends to be older and their basic concern is based on how fast the vaccines were developed by Pfizer and Moderna and whether or not they might have longer-term side effects. The other group, which tends to be younger, the media has labeled the “anti-vaxxers”. These are people, who, for various reasons, believe that no one should ever be given a vaccine.

Regarding the first group of people: I was very happy to learn that the United Kingdom would begin their vaccinations a week or so before we began the process here. For many of us on the other side of age 50 or 60, I think it will help many of us who might be “sitting on the fence” regarding whether or not we would take the vaccine, to see data coming in from abroad showing the numbers going down – rates of transmission, serious illness, hospitalizations and death – without the side effects that many people understandably fear.

Regarding the second group of people: You may have read that The Centers for Disease Control has created guidelines for the states to use for purposes of allocating the vaccine as more and more doses are manufactured. These are guidelines. Each state will be allowed to determine how the vaccines are allocated.

While you may see states differ in terms of who gets vaccinated and when, I think that it is unlikely that you will see much variance from state to state. In most states, the first priority will be healthcare workers. Because about 40% of all deaths have been in nursing homes across the country, nursing home residents and workers will most likely be second. The third most likely group are essential workers such as grocery store workers, police officers, fire fighters, EMT's, teachers and people who work with large concentrations of other people such as factory workers. Group number four will most likely people who are age 65 and older who have one or more of the underlying co-morbidities that lead to an increased risk of serious illness, hospitalization and death. Because approximately 85% of people who have died are above 65, group number 5 will most likely the rest of people who are above 65. From there you go to younger groups. So, a large percentage of “anti-vaxxers” tend to be younger and healthier. It is most likely that they would not be eligible to get vaccinated until late May or June. That gives these individuals five or six months to see data coming in from both here and abroad, hopefully with numbers going down, without the side effects that many fear.

I have tried to think very carefully through the idea that the FDA has allowed corners to be cut. There are three reasons why I believe this is highly unlikely. The first reason is that it doesn't pass the intellectual "smell test". The core of my thinking is indicated in the FDA's very own mission statement: "The FDA is responsible for protecting the public health by assuring the safety, efficacy and security of human and veterinary drugs, biological products, medical devices, our nation's food supply, cosmetics and products that emit radiation." If the FDA were ever to knowingly allow for corners to be cut and fail in their mission, their credibility would be cut to the bone, leaving the citizens of this country with no viable alternative to determine what is safe and what is not.

The second reason is this: For all past drugs and vaccines that have been approved for use by the FDA, there are three trial phases, each with a very precise set of steps that must be taken. Historically, the companies themselves have had to pay for their own research and development. By the time a company has made it to the end of their phase three trial, it is not unheard of for a company to have spent billions of dollars *of their own money*. A CEO of any of these companies wouldn't dare spend any money on production until such time that they had received their final FDA approvals.

The one thing that the federal government is allowing for the pharmaceuticals to do differently this time is that they are allowing the eight companies with whom they have contracts to begin production of their vaccines early in their phase two trials. The government's thinking was very straightforward: If the company in question receives emergency use authorization, they wanted the company to be able to ship and distribute millions of doses on an immediate basis to prevent more deaths, as did Pfizer and Moderna. To date, Covid-19 is the fourth most deadly event in U.S. history. First is the 1918 flu pandemic, followed by the Civil War and World War II. Both Pfizer and Moderna and any other of the six companies that receive emergency use authorization are still considered to be in the latter stages of their phase three trials. As such, they are required to keep track of copious amounts of data from people who have received their vaccines.

Which leads to the third reason why I think it is unlikely that corners have been cut. The distinct possibility exists that one or more of the remaining six companies might not receive emergency use authorization or approval, in which case however many millions of doses that they may have produced will need to be *thrown away*. But it is not that particular companies' money that has been lost – it is the taxpayer's money. These companies have no financial incentive to fudge data in order to protect the money they spent, because it is not their money.

Everything that I have read and researched indicates that if we only ever have just the two vaccines produced by Pfizer and Moderna – this doesn't include the other six companies the U.S. Government has contracted or any of the other hundreds of companies and organizations globally who are also working on vaccines and treatments – logistically by the end of June, we will reach the 70-80% vaccination rate that scientists believe we need to have to achieve herd immunity.

By the time summer gets here, while many people will continue to mask and distance, I think that most people will feel comfortable going out and about and they will be very happy to be doing so after more than a year of isolation. Guess what people do when they are out and about and they are happy? *They spend money*. That will be very good for the economy as we approach the summer and move into the second half of this year.

The second thing that I believe bodes well for the economy for at least this year and next are the results of the most recent general election. As you're probably aware, while the Democratic Party did lose some seats in the House of Representatives, they held onto a very slight majority. As a result, they will continue to control the agenda in the House as they have done over the past two years. Regarding the U.S. Senate, with the final results in from Georgia, we now have 50 Republican Senators, 48 Democratic Senators, 2 independent Senators who caucus with the Democrats, leaving the potential, with certain legislation, for a 50/50 tie, which could be broken by the President of the Senate (the Vice President of the United States) who is a Democrat, giving the Democratic Party a slight majority of 51 to 50. Because of this, for the next two years, the Democratic Party will also control the agenda of the Senate.

Here is where it gets interesting. For most of us, it's been a long time since high school and Civics 101. Many are not aware that the Senate has very specific rules which determine whether or not legislation is advanced. With the exception of budget legislation, most other bills must enjoy the support of 60 U.S. Senators in order to make it to the floor of the Senate in order to be voted upon. This is called the Filibuster Rule.

Many are concerned that somehow legislation from what the media calls the far left or progressive faction of the Democratic Party will somehow turn into law. Examples of such legislation would be something like the Green New Deal or major changes to the 2017 Tax Law. In order for that to happen in the Senate, the Democratic Party would have to convince at least ten Republican Senators that that would be a really good idea. If they can't, then the bill dies in the Senate and never makes it to the President's desk for him to sign into law. I've heard some people say that the Democrats will suspend the filibuster rule. While I can't say for sure whether or not that would happen, I think that that is also very unlikely. Mr. Biden spent 36 years as a United States Senator. He spent an additional 8 years as President of the Senate. He understands the rules of the Senate and why they exist. He understands the role of the Senate as the older sibling of the House of Representatives and the importance of that role. As the new leader of the Democratic Party, I think it unlikely that he would encourage the leadership of the Senate to suspend the filibuster rule.

With the makeup of the new Congress, I think that, other than budget items, very little will happen legislatively over the next two years. There is always the possibility of something large, something like a new fiscal stimulus package that is in the political best interest of both parties which might make it to the President's desk. But nothing that the opposing party would consider extreme which strays too far from Republican Party doctrine.

When you look back to World War II, the times when our economy has performed the best is when the structure of the Congress is such that the most likely result for controversial legislation is gridlock, just like now. The reason is pretty simple, but also counterintuitive: Absent legislation that might negatively impact business, business people focus on one thing: Growing their businesses.

The third thing that is important for the economy is also very significant. Since May of last year, as I have been meeting with clients, I have spent time with them comparing and contrasting what we are going through today on the economic front as a result of our response to Covid-19 versus what we went through twelve years ago as a result of the housing bubble, financial crisis and Great Recession. Many of you may remember that the distinguishing difference between then and now boiled down to which sector of the economy was negatively impacted by these separate and very different events.

Twelve years ago it was housing. Many people are unaware that housing and affiliated industries (think homeowner's insurance, mortgage servicing, etc.) account for 25.2% of our country's entire economic output, by far the single largest and most important sector of the U.S. economy. Over about 18 months, a then-record 9 million people filed for unemployment. Fast forward to march of 2020. Over the next five months, as Governors began to issue shut down orders and began to reopen, 57.4 million people filed for unemployment – more than six times as many! Since then, the majority of those people have found work. We are still roughly 10 million jobs shy of where we started last year – which is not a small number. Nevertheless, at the apex, 67% of those who did file for unemployment were in leisure and hospitality – think hotels, restaurants and bars. Leisure and hospitality account for just 4.1% of our entire country's economic output. So it takes about six times as many people to produce roughly 1/6th of the economic output as housing does.

The third significant positive thing for the economy that is on our side is that interest rates – short and long term (think mortgage money) – are at record lows. This has allowed individuals and businesses to borrow enormous amount of money for a very low monthly payment and the lion's share of this capital is being allocated to – *housing*. I know a dozen or so guys who are in the trades and every one of them tells me that their business has never been better and this past fall many of them were booked up until later on this summer. Twelve years ago, unless you were the very best carpenter or electrician in your area – *you couldn't find work*.

So what we have today are record low interest rates, in a very real, material and concrete fashion, supporting the single largest, most important sector of the U.S. economy. Accompanying this are a banking and financial system which are in very solid shape as a result of the actions that were taken twelve years ago to repair them.

To be clear, I am not predicting any type of economic boom. For the past ten years (excluding Covid) our economy has been growing at about 2-2.5% per year, due mostly to our aging demographics. Since World War II, the greatest rate of growth that we enjoyed during any decade was 1990 to 2000 with a compounded annual growth rate of 5.57%. Due to our aging population I anticipate a return to the modest-but-solid 2-2.5% range for this year.

The other potential benefit of interest rates being so low has to do with investment returns. The truth is that investors want to earn a reasonable return on their money. If we have an unexpected negative event this year, like always, investors will become fearful and stock prices will drop. The difference will be, I think, that interest rates being as low as they are should hasten the recovery of stock prices. The best I have seen on a five year C.D., for example, is 1%. At a 1% return, assuming no taxes, it would take 72 years for you to double your money. I don't think investors are that patient.

As for the stock market for 2021, that's anybody's guess. Analysts say that the stock market is forward-looking. Since the fall of 2020, investors have contemplated the successful creation of vaccines and the subsequent economic recovery. Believing that things would improve, they began to drive stock prices up because they didn't want to be last in line and buy things at higher prices. Unless we have some type of unexpected negative event in the latter part of this year, I don't expect the stock indexes will have a negative year. The other possibility is that returns could be anywhere from so-so (because prices are as high as they are) to a great year should investors become greedy. Time will tell.

So those are the three reasons why I think that people, barring the unforeseen, have every reason to be hopeful for the economy for this year and next. As the preacher said, "I could write shorter sermons, but once I start, I get too lazy to stop."

I wish everyone a healthy and happy New Year. I woke up the day after Christmas not feeling particularly well and over the next 4 days developed 9 of the 11 most common symptoms attributable to Covid-19. 4 of the 9 symptoms were severe and absolutely miserable. I tested positive for the virus. I didn't eat for 6 days and I lost 20 pounds in a week. I have never been so sick.

Over the past 4 years, I have lost 4 of the most important people in my life, including both of my parents. You are the most important person in the lives of the people who love you. So I hope you will continue to exercise caution in your interactions with others. If Mom were here, her advice to me regarding Covid-19 would be, "son, you have to be patient just a little while longer." I wish patience for a little while longer for all of you.

Thank you for the privilege of your time. I hope it was well spent.

Yours most sincerely,

A handwritten signature in black ink, appearing to read 'Scott Eglseder', with a stylized, cursive script.

Scott Eglseder

Note: Unless otherwise indicated, Bloomberg is the source of the information contained in this report. All indices are unmanaged and investors cannot actually invest directly into an index. Unlike investments, indices do not incur management fees, charges or expenses. Past performance does not guarantee future results.

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