Fairway Wealth Fireside Chat with Liz Ann Sonders 5/12/2021

Mark:

Hi. Good afternoon everybody. Thank you for joining us today. For those of you who don't know me, I am Mark Weiskind, one of the partners and founders of Fairway. And while we have done a few live events over the years, it has been difficult for us to get broad client involvement given the dispersion of our clients across so many parts of the country. We are really excited to host this afternoon the first in which we hope will turn into a regular series of online events in both investment and financial related as well as other areas of interest. We are really excited today to have Liz Ann Sonders as our guest. Liz Ann is a Senior Vice President and Chief Investment Strategist at Charles Schwab. She has a wide range of investment strategy responsibilities at Schwab from market and economic analysis to investor education all focused on the needs of the individual investor. Liz Ann is a frequent guest on CNBC, Fox Business, and other news media. You may have seen her out and about today. She says she has a little bit of voice left for us this afternoon. She's also a regular keynote speaker at numerous conferences. I know I've heard her speak many times and have always come away both much more knowledgeable as well as entertained after hearing Liz Ann speak. She has been named as best market strategist, most 100 influential women in finance list and investment advisor magazine has included her on its list of the 25 most important people around the financial advisory profession. Our format today is going to be a discussion and Q and A facilitated by Matthew Garrott, Fairway's Director of Investment Research. All participants will be in a listen only mode, but you do have the ability to submit a question using the Q and A button which you should all be able to see at the bottom of your Zoom screens. Matt will be reviewing those questions as we go. We will cover as many of them as we can over the next 45 minutes to an hour. So, with that, I'm going to turn things over to Matt and Liz Ann.

Matt:

Thank you Mark and thank you for joining us today Liz Ann. It has been an unusual year so far to say the least. Bear market came in and went with a flash. With the market now rebounding, could you start off by explaining the concept of a K-shaped recovery? Are we still in recovery? Or is this an expansion now?

Liz Ann:

Sure, so I'll answer the second part of that first because it's the easier, quicker answer. We are not quite there yet at least as measured by Real GDP. Nominal GDP did pop right above pre-pandemic levels. That being said, even in the case

of Real GDP, we are probably there now in terms of GDP, but we haven't finished the second quarter yet. And of course, we will get the read on Real GDP end of July. We will still have a wait before it is official but yes, we have seen it. There is certainly sub metrics like retail sales way above pre-pandemic levels. So really it is a function of which metric you talk about. Payrolls is the example of where we still have quite a ways to go. The notion of the K-shaped recovery I think, I wasn't the first one to come up with using a K, the momentum in using that letter to describe what was happening really took on a life of its own because it was so descriptive and really pointed to the divergences that came out of COVID. And the wide gap between the haves and haves not and it was on lots of different levels. You had sector haves and have nots, economic haves and have nots, income haves and have nots, and even transcended into the health side of things. Unfortunately, in areas that were sort of the double whammy of the K where those that were on the lower income end of the spectrum were tended to also be those that worked in jobs where they didn't have the flexibility to go home so they were more susceptibility to the ravages of the virus itself. Lots of divergences, even in segments of the economy that normally tend to move in conjunction with one another- real estate being a perfect example. Think about the boom in housing over the past year versus the carnage in commercial real estate. Really across the spectrum of economic, personal, health, demographics, you saw these massive divergences. Some of them are starting to converge which is good news. Others I think are going to stay in a fairly wide gap. Mall based retailing versus online- that genie is out of the bottle that's probably not going back in. Others will start to narrow. I think, yes, in general we can call it a K it's just not as stark as it was a year ago when we were in the worst part of the pandemic.

Matt:

Could you share with us your outlook for the rest of this year?

Liz Ann:

On the economy, market, or both?

Matt:

Both.

Liz Ann:

Obviously, they are related, but the timing in terms of what goes on in the market cycle and what goes on in the economic cycle, especially if you are talking about a dual cycle, when you have a bear market and a new bull market and a recession and a recovery. There is plenty of times where we had a bear market that had nothing to do with an economic recession. Clearly this was a dual cycle. With almost no exceptions, dual cycles in the past the time frame have not been

aligned. With only one exception in the history of the S&P 500, the market has always peaked first before the recession began and bottomed and started to move higher before the recession ended and well before you really started to see improvement in the economic data. We've seen these fits and starts, obviously the market rebounding in March of last year well ahead of not just the improvement in the economy it was while the data was actually still getting worse. We were still in descending mode for economic data at the market because of primarily the unprecedented double-barreled nature of monetary and fiscal stimulus which has carried us to the point we are today. 27% year over year growth in money supply which is unprecedented save for the period during World War II. And again, massive on both the fiscal and monetary side which is distinct from the financial crisis where the stimulus was almost solely concentrated on the monetary side. This time it was double barreled. That is part of the reason why we are seeing in most economic metrics notwithstanding the jobs report last Friday, the unbelievable surge in economic activity. It's being boosted by a massive amount of stimulus: how much liquidity has been pumped into the economy which is also called the base effects. Data that is measured in the year over year terms we're in that sweet spot now essentially where that comparison a year ago April, May, June when we were essentially in lockdown mode. That's why again notwithstanding the weak jobs report, we are seeing and continue to see eye popping numbers including inflation which we have been talking about and have the exclamation point on that today with the CPI report. I would say the consensus is gelling around we're not going to continue the pace of gains we are going to see over the next couple of months, but that we are launching into a sustainable period of above average growth. Then I would say there are tails to that consensus. There is the more optimistic tail that one would describe as the roaring 20s view that is gaining adherence and making the cover of magazines which always troubles me that is usually the death knell for whatever the story is by the time it makes it on the cover. That on the surface would seem like a great outcome even better than slightly above average growth but that outcome would come with potential peril for both the economy and the market. In that if it is viewed as over-heating and the hot inflation numbers we're getting right now are more persistent that brings the Fed back into the equation maybe sooner more aggressively and that is usually what ends expansions and bull markets. There is that optimistic tail in terms of economic growth but with it comes a risk. The other tail that is one that is not being discussed at all I wouldn't suggest it is my base case, but I am at least intrigued by stories that no one is telling as I am stories that everyone is telling. I would say that curve, the lump of the curve is the consensus and I talked about that right tail. The left tail is that, yes, we are seeing a pop in economic growth, but it will be incredibly short lived and the forces that conspired to mean that the last recovery which was the longest in history from 2009 to the beginning of last year was by far the weakest in history. The other tail risk is that growth just has a pop and for whatever

reason settles not just back down to Goldilocks 2-3% growth but something significantly worse. Even without the effect of tighter monetary policy. That would be a risk obviously not only for the economy but also for the market. The last thing I would say about the market, and we can dive into any of these tangents in more detail. I have been saying for a few months now that I think the greatest risk for the market was born out of the success of the market over the past year which is the excess sentiment frothy speculative behavior that has come out of success of the market. As I have always said when sentiment gets really frothy in and of itself it does not mean the market is going to move in a contrarian fashion. We know sentiment at extremes is a contrarian indicator. But the timing aspect is always tricky. The late 90s taught us that sentiment can stay frothy and overly-optimistic for years before the market moves contrary to that sentiment. It typically needs a catalyst. Whether this pop in inflation and some of the weakness we are seeing recently in the market is that catalyst? It might be. That does not necessarily mean the end of the bull market. We are overdue for a period of choppiness and heightened volatility and maybe even God-forbid an actual correction.

Matt:

Thanks. Let's run with the inflation issue for now. Our clients are hearing more about inflation in the news. You retweeted a great infographic from Visual Capital that showed a 377% rise in lumber prices. We saw that inflation is up 4.2% from the extreme low a year ago. Bond managers that we have talked to anticipate a short-term pop inflation which we have gotten or started to get, they expect to return to pre-pandemic levels shortly afterwards. What are your expectations for inflation and how should investors be thinking about it? And should I ask Mark to start paying me in lumber?

Liz Ann:

I'm glad you didn't say start paying me in Bitcoin. In terms of commodity prices, I don't remember who first said it, but the best cure of high commodity prices is high commodity prices. Eventually, the price gets so high that it starts to squeeze the demand side of the equation. And also, not just with regard to commodities but any measure of inflation there are demand driven cycles of inflation and supply driven cycles of inflation. When it is supply driven, where you just have whether it is weather related in agriculture commodities or there is something else that is an out of the blue disruption that constrains supply, those also tend largely to solve themselves over a more condensed period of time than if you're dealing with a demand-driven surge in inflation. The rub with this COVID environment is that we have had disruptions in both supply and demand. It is a bit more double barreled than it has been in the past. You almost have to break it into the various component parts. Starting with the short-term impacts. I talked about base effects, the year over year comparisons. But I was speaking then two

questions ago about economic data. The same thing is happening with inflation data. If you look at the CPI and you look at the level, and you see that the level actually dipped for 3 months in a row. March into April it went down, April into May it went down, May into June it went down, and then after June it started to work its way back up. We are now in that 3-month span where we were seeing declining levels of inflation almost into deflation territory depending on what metric you're looking at which means these year over year numbers like today 4.2% year over year for CPI are high popping and a significant jump from the much more benign levels we are seeing. That should start to fade in June and that is just simple math, not just my opinion on that- that piece of it. Then you've got the well-publicized supply chain disruptions, supply/demand imbalance issues. Lumber would be one of those, semiconductors is another one, and the vast use of semiconductors in newer cars is part of the reason why one of the biggest spikes in CPI was for used cars. The demand can't be satisfied by the supply on the new car side so that pushes up the used car prices. Lumber has caused prices of housing to go up. That gets indirectly reflected in the CPI. You really have to look at the component parts. I think some of these supply chain demand imbalances will work themselves out over the next several months or so. We will start to put those shorter-term impacts in the rear-view mirror. Then you have to look at the long-term impacts- you look at demographics. Demographics as they sit right now with aging population essentially puts upward pressure on inflation. That is a tail wind behind inflation. Now if productivity stays high that would be an offset to that. Deglobalization also puts upward pressure on inflation much as globalization over the last 20 years but downward pressure on inflation. On the other hand, you have forces that are putting downward pressure long term on inflation- the lack of union representation which was clearly a much bigger issue in the 70s. We were a much more closed economy in the 1970s. Demographics were a lot different, through demographics and unionization and closed economy meaning lack of ample labor supply at lower wages which has existed more recently. You developed that wage price spiral that turned into the systemic inflation that we have in the 1970s. I think the risk of that style of inflation is still relatively low right now because we have so much labor market slack. We are still 8.2 million payroll jobs shy of where we were pre-pandemic. We are not seeing that upward pressure on wages that feeds in. That is clearly one thing to watch. You want to look at labor costs and see this stickiness of salary, and wage increases. If it starts to get embedded in expectations that's when it feeds into higher prices. It emboldens corporations to pass on higher costs so that they maintain their profit margins and it just feeds on itself. We don't see those conditions as amply in place right now, but we know the factors to look for to get a sense of whether we are going to see this "transitory". By the way I joked about it today on my TV network appearance that I looked up the Oxford definition of transitory and it's a two-word definition: not permanent. And I felt well by that definition even the 70s inflation was transitory. Just a question whether

you consider transitory a couple of months or many years. I think it is that time frame piece that is yet to be decided. We'll have a better sense of it over the next few months and we collectively know what to look for.

Matt:

This will be a several months issue as opposed to a period of time right now we can't really tell?

Liz Ann:

I don't think today's CPI number gives us any indication of what the trajectory looks like over the next couple of quarters.

Matt:

I'm glad you brought up the Fed because that seems to pop its head in every story like this. Do you have any comments on them changing their inflation target to an average of 2%? Maybe you could expand on M2 and maybe the velocity of money.

Liz Ann:

I'm glad you brought up the Fed because one difference between now and the 70s that I didn't mention that I think is an incredibly important difference is that the Fed is purposely trying to ignite inflation. We have never seen our or any other central bank have that as a stated purpose. That is in essence what was behind the change or the adjustment to the 2% inflation from being a target to an average. I think one of the better ways to think about that and what it means is to use a combination of the two words that start with O that Jerome Powell has been using which is saying they move from an Outlook based decision-making process when it comes to inflation meaning as inflation was approaching that 2% target in the past that's when they would start to tighten monetary policy and changed it from an Outlook to an Outcome based. I think in lay terms basically means the Fed used to change monetary policy based on what they saw through the windshield and now their change to monetary policy will be what they see in the rear-view mirror. They want to actually see it arrive. They have expressed a comfort level in letting it run above 2% with some symmetry such that they end up at an average of 2% instead of that being an upside target. The criticisms ot at least questioning is can be so nimble to engineer that with anything resembling not just perfection but not calamitous. We don't know. But also important is that they also changed their other mandate of the dual mandate. The Fed's always had a dual mandate basically full employment and price stability. The unemployment rate and inflation rate. They also recently changed their view about employment, and it is not just a simple decline in the unemployment rate to in this case sub 4% which is what the summary of economic projections suggests would be full employment based on current economic conditions but breadth and

equality with that move down in the unemployment rate. Not just concentrated in one segment of the economy or not just concentrated among people that are on the higher end of the wage or income spectrum. They want to see employment improvement and gains and decline in the unemployment rate that is widely spread. The rub essentially with the combination of what we are talking about, and well-known hedge fund manager Stanley Druckenmiller made a lot of waves this week and garnered a lot of attention for an essay he wrote that I think was in the Wall Street Journal and some interviews he did earlier this week in saying that inflation is really toxic for those on the lower income end of the spectrum. Particularly if it is not accompanied by robust wage increases for that same category. It is admittedly a bit of a pickle for the Fed because they want to generate some real economy inflation. All they have done this month is increase asset inflation which is only to the benefit of asset owners. They want to generate more of that real economy inflation but if it gets out of hand and isn't matched by wage increases at the lower end- inflation in the day to day living and goods that hurts lower income people way more than upper income people. They are really threading a needle in this environment. That is an aspect of this that is not as discussed as much as it probably should.

Matt:

Speaking of the Fed with rates as low as they are and now uncertain inflation expectations, this is probably the question we are getting the most- what is the case to allocate to bonds today and is diversification dead?

Liz Ann:

There is a case for allocating bonds and no, diversification is most certainly not dead. My colleague Kathy Jones who is my counterpart at Schwab on the fixed income side. My focus is largely on the equity side of things hers in on the fixed income side of things. Like everything that I do- written reports, videos, etc. All of our research is on the public site of Schwab.com. It is on the insights tab. Kathy Jones if you want to do any kind of deep dive on the fixed income side- in fact, I think she might still have a recent report that was published on what happens to the bond market when rates are going higher. What are the characteristics of a bond bear market. Points out very importantly that the nature of a bear market in bonds is entirely different than the nature of a bear market in stocks. It is pretty rare that over the course of a full calendar year to basically lose a lot of money on the fixed income side. Particularly given there are strategies that investors can apply to move down the duration spectrum or maybe take a laddered approach and save for securities like Treasurys where you have a higher frequency of securities that are rolling off and maturing and then you are rolling into higher yielding securities there are other place you can pick up yield. A recent area of recommendation for us is emerging market bonds. There is a lot that can be done on the fixed income side that is beneficial absolutely from a diversification

standpoint. Everything from volatility, anchor to windward, when the equity market environment gets tricky. Diversification outside of just the first part of the question on fixed income side. We think diversification has never mattered more than does it right now. We are seeing a big decline in correlations. We are seeing a significant widening out in term of dispersion within asset classes across asset classes. It is one of the reasons why this year the equal weighted S&P is outperforming the cap weighted S&P. Active money managers on the mutual funds side, active exchange traded funds, a greater percentage of them are beating their benchmark than any time in the last decade plus because these dispersions are widening out and there is more opportunity for diversification to be to your benefit. Whether it is within the equity asset class, at the factor level, sector level, size level, or across asset classes- US vs. developed international vs. emerging markets. If anything, people who thought diversification is dead we are in this rebirth of diversification being in the easier sell now than it might have been a few years ago.

Matt:

What are your thoughts on the various stimulus packages and the increasing government spending now? How worried should we be about metrics like America's debt to GDP ratio?

Liz Ann:

We are clearly in the midst of a fiscal blowout right now. We are looking at somewhere between 15-20% in terms of the deficit as a share of GDP. I will start with the deficit first then I will get to the debt part of the discussion. Interestingly, this is simple historical fact and math, this is not me Liz Ann Sonders saying deficits are great! Don't worry about it! For what it's worth, in history, as the budget deficit has been getting worse, deteriorating, getting bigger, that has typically been accompanied by better stock market returns- not worse. Maybe a lay person way to think about that is somebody's deficit is always somebody else's surplus. That's the nature of deficit and surplus. What tends to happen is in a rising deficit environment particularly if it is dramatic government spending. That tends to accrue to the benefit of corporate earnings. When corporate earnings are going higher, that accrues to the benefit of the stock market. Just starting there with the deficit. Debt is a cumulative effect of running deficits. The CBO, the non-partisan think tank that comes up with these budget and debt projections, now puts because of the trajectory of the deficit just government debt jumping above 100% GDP this year. That is just federal government debt. That is not total credit market debt, Total credit market debt is Federal, state, local debt, all household debt, all corporate sector debt, all financial sector debt, that by the way is about 400% of GDP. That is too big of a number to worry about. I get versions of questions- isn't this an inflation accident waiting to happen? The answer is no. Not based on history. If you get feedback in the question and

answer here, just let me know because I can send you an interesting scattergram showing that as the debt rate has gone higher inflation has actually been lower. Part of the reason for that is a high and rising burden of debt is a wet blanket on growth. When you have this big wet blanket on growth, across growth metrics, as you see debt go higher you typically see higher numbers of nominal growth, real GDP growth, productivity growth, job growth, capital spending. That isn't the breeding ground for higher inflation. It tends to be the breeding ground for lower inflation. This is not just a US phenomenon, you can look at Japan as a poster child, with that 2 ½ higher times larger than us. They are still trying to climb their way out of a deflation problem and have had almost no economic growth. When I get the question asked sometimes when are we going to hit the wall? What is the end game here? I don't know that it is some perspective point in time I think the most important implication of the higher debt, given that every additional dollar of debt is not only generating not just way less than a dollar of growth but a declining amount of growth that we get for each dollar of debt. The weight that puts on economic growth is a force that has been with us for the last 2 to 3 cycles. For all the cheering pre-pandemic about longest expansion in history. Factually true. From June of '09 to February of 2020. Yes, longest in history. But by far the weakest in history. There is no comparison. By far at the bottom of all other recoveries, expansions, that we have had in the post-depression era. I think the burden and weight of debt has been a factor in that. We are already living with many of the consequences of a high and rising burden of debt. The last thing I would say is what I find sad is that there seems now to be rampant bi-partisan support for not talking about this and kicking the can down the road. Sort of we're all MMT'ers now. There could be a reckoning. I don't think the reckoning by the way is China is just going to dump all their Treasurys one day- that's another refrain that I hear. If they want to aim the gun squarely at their own economic foot, that would be one thing. They would do at least as much damage to their own economy as would other major holders of US debt as they would to our economy. This retaliation that foreigners are going to dump Treasurys- we don't buy that. They are diversifying away from Treasurys as being so dominant but that is a very different story than figuratively waking up one day and say were going to dump all our Treasury holdings.

Matt:

I think we see a lot of that in some of the communications that our clients get forwarded. These big "they are going to dump all of the Treasurys" or something big like that, do you really believe we are all MMT'ers now or is this a slow-motion train wreck heading towards that?

Liz Ann:

I think it is more slow motion and there is that quip out there including what I just said, what the monetary and fiscal authorities are doing right now is not

accurately or officially Modern Monetary Theory. It is being criticized as being a path toward that as it is known and structured. The theory is actually not really modern, the theory has been around for a long time but in its practical application it is an almost full breakdown between the wall that divides the government, the Treasury department, and the Federal Reserve and its independence and that still exists. Whether you believe that the Fed is actually beholden to the government there is always that crossover that happens. I don't think that we are operating MMT, but we may get a test at some point this year of the other components of MMT which is the base theory is– when you have the exorbitant privilege of possessing the global monetary standard as a currency and the ability to print that currency and the vast majority of global trade reserves and US dollars, why not just let the spigots open and if an implication of that is inflation that can be tackled by tax policy. We may face an inflation problem I don't think the decision is "this is MMT so let's tackle it with tax policy", but it will be interesting to see the resilience and comfort level with the Fed potentially needing to step in knowing they might squash the recovery but do it for the benefit of bringing inflation down a la Paul Volcker- I don't think we will have that extreme of an example but that is something to consider.

Matt:

Thanks.

Liz Ann:

But adults in the room in Washington having an open and honest conversation about the implications of the deficit and debt? That has not happened. And I'm an equal opportunity critic.

Matt:

Right. I get that feeling for sure. With the internet and social media, we have access to more data than ever before, and we are also bombarded by other human's opinions on that data. How important is macroeconomic data to an individual investor and do you have any tips on sorting the data from noise?

Liz Ann:

It is quite important, and I think for an investor to not just be successful but to have a robust understanding of the drivers of the economy and the drivers of the market and how they interact. You have to have a healthy grasp of how macro forces impact the economy. Importantly, when you look at economic data, understanding what falls in the leading indicator bucket, what falls in the coincident indicator bucket, and what falls in the lagging indicator bucket. And not only how those interact with each other but how they collectively interact with what the stock market does. I think it's necessary. That doesn't mean it's been a driver of some of where we are seeing some of this speculative froth and

momentum driven trading. I think a lot of the moves and the meme stocks- there has not been deep analysis of leading, coincident, and lagging indicators and the implications for it. It's gambling. There is that big differentiation. The leading coincident lagging piece of it is so crucial and it is important to know or remember that the stock market is a leading indicator. If you can understand the buckets between leading to lagging- understand that the market is also leading in nature it helps to explain why you get these perceived disconnects like was the case last summer when in the case of September 2nd S&P and NASDAQ hit new all-time highs. Of course, we did not have the benefit of 3rd quarter GDP because the quarter didn't end until September. So, all the economic data we had was Armageddon-like, Depression-like, yet the market rallied to new all-time highs. That is the leading nature of the market. It has an unbelievable ability to sniff out inflection points in the data. The launch point tends to be at those inflection points- by definition if you think of an inflection point when the data stops getting worse and starts getting better, you're at the bottom of the V. By definition of the math at the bottom of the V in level terms the data is as ugly but the market senses because of tracking the leading indicators it is not getting worse anymore. I have always said, I have been saying this for my 35 years in the business, when it comes to connecting the dots between economic data and the stock market, the stock market cares more about better or worse than it does good or bad. Yet, it is human nature for us as we are looking at economic statistics whether it's job growth or the unemployment rate, whatever it is, we look at it in terms of good vs. bad, strong vs. weak, but the market keys off of better or worse. That is why by the time the economic data is booming it is already in the market. The same thing works in reverse.

Matt:

The S&P 500 and other indexes are seeing concentration in their top holdings to such an extent now that some mutual funds are dropping the diversified label. Hopefully to keep up. Is this something that we should be worried about?

Liz Ann:

I think this phenomenon is already starting to ease or correct itself. In the case of the S&P 500 I mentioned that early September period of last year, specifically on September 2nd. That was the peak in the relative outperformance of the big 5. Or the mag 5 as some call it. It is the 5 largest stocks in the S&P 500 which are Apple, Microsoft, Amazon, Google, and Facebook. Today by the way they are still the 5 largest. For a little while Tesla took over Facebook, but it's back down. Big 5 are the same last September as now. But on that September 2nd date when we had the maximum spread of outperformance those 5 stocks alone accounted for 26% of the S&P 500. They are only 5 stocks out of 500 which is only 1% of the index numerically, but because it is a cap weighted index became 26% of the index. If you compare that to circa 2000 where there has been a lot of

comparisons between now and 2000 because there has been a lot of similarities between speculative excess and frothiness around IPOs etc. The big 5 stocks back in 2000 were only 18% of the S&P. The concentration and the weight became much bigger this time, but that has been steadily moving down. I think we are down around 22 or 23% that is still not low by any means, but I think through this process of rotation we are somewhat subtly correcting some of that unbelievable concentration. Very consistent with what I said earlier- which is this year the equal weighted S&P is outperforming the cap weighted S&P. Where more of the weakness is recently is in the areas that are those concentrated larger parts of the market. We are seeing this process of rotation correct some of those excesses. This is a little bit of an aside but because I mentioned the concentration relative to circa 2000, the one I think important difference that puts the current environment in a better light than the circa 2000 period is that the big 5 which were different stocks in 2000, but interestingly enough Microsoft was in the big 5 in 2000 and is still in the big 5 right now- talks about the longevity of that as such a behemoth company. The big 5 average P/E for the big 5 back in 2000 was about 62 and at the most recent peak last September the PE of the big 5 was half of that. That doesn't suggest that's cheap but the extreme over-valuation that defined the peak of the bubble in 2000 was actually in the largest dominant leadership names in the market. Most of the extremes we have seen in terms of froth and speculative behavior and even valuations have been in the lower quality more arcane segments of the market the meme stock, the thematic stocks, the non-profitable tech companies, the most shorted stocks. Given that I pointed out a negative comparison to 2000 I wanted to provide a positive offset so that your clients don't think, oh no! The bottom is about to fall out!

Matt:

Speaking of P/E ratios, do you expect that they will remain elevated, or do you think they are going to come down as earnings rebound?

Liz Ann:

They have already come down quite a bit. At the end of last year, we did hit a high of 27 on for the P/E of the S&P 500 which was about dead even with where it ultimately peaked in the 1999/2000 period. That really elicited a lot of concern. The huge difference between now and then is- what was going on with the denominator the E, or earnings. Into the peak in 2000, both prices and earnings were rising, it's just prices were rising more rapidly than earnings which is why the P/E went up as much as it did. What we know now with the benefit of hindsight is that earnings were rising but they were rising into a fairly imminent peak. It is the complete opposite situation in the current environment. The reason for the spike and it literally was a parabolic spike last year to a 27 P/E was because of the collapse in the E. Now we are on the upswing. Even just as you turned the calendar page from 2020 to 2021, and all the calculations that are

done on forward P/E, the expected 12-months future earnings, incorporated one additional quarter ahead in an environment where expectations for growth are skyrocketing. Literally overnight – it happened with the FactSet calculation and the Bloomberg calculation - the P/E went from 27 to 22. 22 isn't cheap, but that was a significant rerating with all the power of that driven by earnings. More broadly I also think what we are seeing is akin to what you typically see coming out of a combo bear market recession- one of these dual cycle things we talked about earlier. Year one coming out of those tend to be characterized by rising multiples or rising P/E ratio and still falling earnings because the market moves ahead of the change in the economy which means it also tends to move ahead of the change in earnings. Year one tends to be characterized by rising multiples, falling earnings, year two tends to be characterized by falling multiples or flat multiples, and rising earnings and that's the mode we are in right now. The only potential issue is that second quarter of this year is very very likely to be the peak growth rate in earnings. That doesn't always trip up the market, particularly if earnings growth is still strong, you're still adding to earnings, but the growth rate in earning is expected to be more than 60% in the second quarter, that's not going to be repeated. That is another potential, at least psychological risk factor because we are going to see that it is no longer getting better and starting to get worse which could explain some of the volatility and weakness in the market recently.

Matt:

I think you touched on this before, are you seeing a rotation away from those growthier, work from home type of...?

Liz Ann:

Yes. You're seeing lots of rotations you're definitely seeing a rotation from the pandemic winters to more of the reopening type of names, but I think the real rotation that matters that has been pretty long-lasting meaning really since November of last year when we got the positive vaccine news, value factors have been consistent outperformers. Notice I emphasized the word 'factors'. I think there is a too simplistic a narrative these days about growth vs. value. In a world where we become very index oriented and passive investment oriented when you hear people talk growth vs. value it's often thought of "I think value is going to outperform" just blindly buy the Russell 1000 index or Russell 2000 value index. We are talking about the factors of value. The range of where a stock sits on free cash flow yield, price to book, price to sales. What is interesting is that the value factors- some of those that I just mentioned, have been handily outperforming those that look good on long term growth factors. But they have been outperforming even in the growthier parts of the market. So if you apply a free cash flow yield versus long term growth to the overall S&P the value 'stocks' have been handily outperforming the growth stocks, but you can apply it to all 11

S&P sectors including tech, consumer discretionary, communication services, where all the perceived growth stocks are but those with more attractive value characteristics have been outperforming those that just have the growth characteristics and higher evaluations. I think for stock pickers out there, you want to be more factor oriented than sector oriented.

Matt:

I don't think I can let you get away without asking you about crypto, Bitcoin, what do you think about this space?

Liz Ann:

I'll admit that what I know could probably fit in a thimble with a bit of room left over but were all forced to know probably more than we would have ever thought or at least try to understand more than we ever thought we would. We don't have it as a part of Schwab's strategic asset allocation models. We don't publish tactical recommendation whether overweight or underweight on Bitcoin or any of the other cryptos, but we are certainly asked about it a lot. It is not a currency, plain and simple. Period end of that discussion. It is arguably not a store of value, I guess it depends on how one would define store of value. It is not really backed by anything. The issues that I think don't get the attention that they should are the electricity consumption issues, the fact that 60% in the case of Bitcoin of mining is done by Chinese miners. When I talk to people about cryptocurrencies Bitcoin or otherwise, I say look- I kind of sympathize with the view that it is more of a religion than it is an investment- that it is faith based. The retort that I often hear back is "well so its traditional fiat currently it is faith based". My comment back to them is at this stage in the game, and maybe I'm wrong, I still have more faith in the US financial system, the government, the Treasury department, monetary authorities, and the banking system than I do on miners in China. I'm still biased on the faith side to where we put the full faith and trust, not to mention the lack of any regulatory oversight and no investor protections. There is no FDIC, no fraud protection. That doesn't mean that Blockchain and DeFi aren't viable platforms and technologies that might be life changing just like the internet was. That doesn't mean that everything with a .com slapped to its name back in 1999 and 2000 was a viable company. You can have asset bubbles even tied to epic lifechanging technology and infrastructure and backbones of how industry or finance works. People can speculate. The last thing I say that gets almost no attention that should be getting more attention, especially given what we saw with GameStop, and basically the implosion of Melvin capital, multi-billion-dollar hedge fund that got caught on the wrong side. They had a hugely concentrated position on the short side of GameStop. More recently we had the Archegos implosion, 12-billion-dollar family office because of concentrated positions in one case (in CBS Viacom) and basically wiped out multi-billion-dollar family office pseudo hedge fund. What a lot of people don't realize about Bitcoin is, and you

don't know who they are, but you can measure the wallet size, 2% of all Bitcoin holders own 95% of the value of Bitcoin which is the basis for some of the "this a Ponzi scheme" view. I have not done enough work on it to say I also think it is a Ponzi scheme, but the basis of that view is the whole pyramid structure that you've got a couple holders that really dominate the value and what happens if they decide to sell for whatever reasons. It's been an unbelievable trade and kudos to people that got in and made a ton of money, but one I'd be mindful of is Gary Gensler knows a heck of a lot about cryptocurrencies. He is now head of the SEC people assume because he taught class on crypto's at MIT that he is a fan boy and that he is going to be light with his regulatory touch. What he said last weekend I think dissuaded the notion that he is going to approach this with a light touch and then you add to it the regulations that the Fed might consider, and I just think the regulatory structure is set to change and that is just something holders should be aware of.

Matt:

Thank you. I think you are sort of shortchanging yourself on your knowledge base there. That was excellent.

Liz Ann:

That's it! That's literally all I know!

Matt:

I think we have time for one last question, and you already touched on this. How should investors approach fad investments whether it's cannabis, or SPACs, or Robinhood- flavor of the month type of trades.

Liz Ann:

Really really carefully especially if you are jumping in simply because of the price appreciation that has already happened. YOLO, FOMO, whatever cute acronym you want to use- those are not investing strategies. That is just gambling on momentum which in many cases in areas that have no fundamental justification. They really just represent almost Greater Fool Theory. I am going to buy in the hopes that somebody buys at a higher price. And you are already seeing significant dislocations in many of those areas. The major index that tracks SPACs, ISPAC, down 30% from a recent high. The top 10 holdings in that down closer to 40% from a recent high. You are seeing it across the other areas of low-quality weak balance sheet companies, heavily shorted stocks, some of the EV categories and green energy categories, the nonprofitable tech companies, 1 by 1, or sometimes collectively at the same time, you are seeing 20, 30, 40% declines. Now that's still nothing compared to the 2, 3, 400% gains you saw in these areas off the March 2020 lows. The problem is a lot of the money that chases this stuff comes in toward the end of that acceleration. Most of that

money didn't come in on March 23 of 2020 and rode them up 400% and now say you know what I can handle a little bit of consolidation here so that's always the rub with speculation. If you want to carve out a portion of your portfolio to kind of play that speculative game- understand that that's what it is, speculation. There can be tons of upside, but the entry and exit points get really really tricky.

Matt:

Thank you. I probably have a dozen more questions, but I think we have to end it here. Liz Ann, on behalf of myself, Mark, the rest of Fairway Wealth as well as our clients, thank you so much for sharing your time with us. Finally, a big thank you to all of our attendees, if you had a question that wasn't answered, feel free to get in touch with me or your adviser and we will be sure to address it. Thank you.