Marble Harbor Investment Counsel, LLC
First Quarter, 2021 Letter

We are pleased to send an excerpt from our first quarter client letter that discusses our current thinking. We welcome your thoughts.

Sincerely,

Paul Davis, L.J. Harrington, Eric Robb and Daniel Rosenblatt

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In the 1980s, I had a passbook savings account at the Boston Five Cent Savings Bank that paid 10% interest. It was a thrill to visit the bank and see that I had earned $10s of dollars interest. That was plenty of money for popcorn and the movies.

Today, the Boston Five Cents Savings Bank is a part of Citizens Bank, and the passbook is long gone. I have a lot more in my savings account, but I'm not even earning as much in interest as I was then. That 10% in interest in the '80s has shrunk to .01% – 1,000 times less!

An interest rate of .01% is truly a pittance. That's $10 in interest for every $100,000 in principal, and you get your principal back. That is not the case this year with long bonds. Pity the poor souls who own ten-, twenty-, or thirty-year bonds. Interest rates seem to have bottomed at 0.5% on the ten-year and now have risen to 1.74%. Since the beginning of the year, ten-year bonds have lost 6% of their value, and 30-year bonds have lost 14%. This is the worst quarter for bonds since 1980. For the past several years, we've been consciously avoiding buying longer bonds in your portfolio. This recent carnage has offset *years* of interest and has burned investors reaching for yield.

Since peaking in the 1980s, interest rates have dropped steadily until this quarter, when they finally reversed course due to market expectations of more widespread vaccinations leading to a post-COVID economic surge. Record savings rates, an additional $1.9 trillion stimulus and a public raring to spend after a year in lockdown could combine to create an economy like we haven't seen... since the '80s. The economy hasn't grown at 6% since Lionel Richie appeared in Casey Kasem's Top 40 list. With a surging economy, easy earnings comparisons and a healthy consumer, this could be an auspicious time for stocks, although the post-COVID winners likely won't be the same work-from-home darlings that got us through the pandemic.

Over the past year, "story" companies with no earnings whose payoff is far off in the future are the equivalent of long-dated bonds. Why not buy Tesla, why not take a flier on GameStop or buy an NFT of a dancing mouse? When borrowed money has no cost, it's easy to speculate because no one believes there is an alternative – at least in the short term. Now that rates are rising, the market has begun to shed these speculative bets on the future in favor of companies with actual earnings and cash flow.

For example, energy stocks had been left for dead with oil and gas trading as cheaply as they ever have during the worst of last year's downturn. It's hard to make money when there is no demand for your commodity. This was also true of financial services, whose stock-in-trade is buying and selling money. With interests rates close to zero, turning a profit was a tall order. Now that there is a slope to the yield curve, that is, longer term rates are higher than short term rates, banks can make a profit once again. Both oil stocks and financials have come back nicely after a dismal 2020.

There have been some supply chain disruptions caused by the pandemic, notably in automotive semiconductors. New cars are in short supply, pushing up prices in the used car market. However, this period of low inventory may be relatively brief. As supply chains adjust to a rapidly expanding economy, we'll likely see episodes of shortages, inflation and other imbalances. Demographics, technology and globalization have ruthlessly mitigated inflation for the last ten years in the U.S., Japan and Europe, and we expect this condition to eventually take hold once again.

The end of the virus appears likely to bring about a resurgence in the economy that we haven't seen in decades. Interest rates have normalized from negative real rates and may rise as markets digest transient inflation. This may create some buying opportunities in fixed income, where pickings have been slim. Your companies should fare well in this environment, as a modicum of inflation allows them to raise prices, leading to higher sales and earnings. Here's to a post-pandemic boom. Enjoy the reopening.

Please don't hesitate to contact us if you have any questions.

Sincerely,

Paul, Eric, LJ and Dan

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