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Market Commentary

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Covid-19

Cases of Covid-19 have exploded in India. In mid-February the country was registering about 10,000 cases per day. By end of April the number of confirmed cases was running at 330,000 per day but the country has run short of test kits.

It is believed the true rate of infection could be as high as 10 million cases per day. Anecdotal information suggests it is the new variants which are spreading. These variants may be more lethal to young people than the earlier variant. If the infection rate estimate is correct, we could soon see more than 100,000 deaths per day. To put that number in perspective in the 3000 year history of European warfare the two bloodiest days of battle are Cannae (216 bc, 70,000 Roman casualties) and the opening day of the battle of the Somme (1916, 60,000 English casualties.) We are possibly observing a historic event. The cause of the explosion in infections is apparently the conjunction of new variants with super spreader events. The events will seem eerily familiar to Americans - mass political rallies and spring religious festivals. A similar wave of infections could have been set off in our country as well. India has not been neglectful of vaccination. To date, they have administered 147 million doses. This is behind China and the US, both at about 240 million doses, but ahead of the approximately 110 million doses administered by the EU. Unfortunately, only about 2% of the population has received both doses of the vaccine. Also unfortunately and similar to Italy, the cultural pattern is for large multi-generational families living together. This circumstance makes it nearly impossible to protect the elderly and creates the conditions in which the country could lose an entire generation at once. Covid remains a deadly and dangerous disease. One which can and does kill whole families at a time. We urge readers to take every reasonable precaution to protect themselves.

In the United States the Federal government continues to press ahead energetically on vaccinations. Unfortunately, about 25% of the population is reluctant to be vaccinated. Perhaps 1% of the population has a genuine medical reason or a conscientious objection to being vaccinated. The other 24% appears to be motivated by a combination of political identifications, ingrained distrust of the government and medical establishment, rational concerns about access and down time and just general laziness and thoughtlessness. The proposal has been made that vaccine passports should be issued to those who are fully immunized. Doing so would allow such persons to congregate in restaurants, business meetings and sporting events in relative safety. The governor of Florida has led opposition to this idea and has banned businesses from requiring proof of vaccination. The Federal government has shown no enthusiasm for the idea. We feel this is a mistake. The WHO has issued vaccination certificates ("yellow cards") for decades without creating a civil liberties problem. Monitoring vaccination status is a rational precaution in the face of a deadly disease. To be sure, granting the vaccinated certain liberties does disadvantage the unvaccinated and in some minds raises a fairness issue. We disagree that there is a valid fairness issue, however. Very shortly the majority of the unvaccinated will be such by their own voluntary choice. Its illogical to complain about losing advantages which you have deliberately rejected. In the case of those who cannot be vaccinated, their overriding interest is for everyone who can get vaccinated to get vaccinated as this is the only way they can gain protection from Covid. Thus, any measure which encourages vaccination works very much to their benefit. Requiring vaccination for certain jobs - e. g. medical work and elder care – is again a logical step. Opposition to logical precautions is, however, outspoken. A well known television personality recently urged his audience to confront strangers on the public street with the demand that they remove their masks. Unfortunately, the only persons likely to take advice from media personalities about personal conduct are exactly the persons who should not be confronting strangers on the public streets. For the millions of people who have lost loved ones in this epidemic, these political posturings are deeply offensive. We hope the broadcaster in question will consider the impact this posturing is having on their brand. Common decencies should be followed at all times, but especially so during times of widespread tragedy.

The Biden Agenda

Washington has been engaged in a curious triple act. The President has been developing a massive spending proposal and calling for bipartisan discussion. Meanwhile the House Democrats have occupied themselves with passing a number of political bills which have no hope of attracting the Republican support required for passage in the Senate. The Republicans, for their part, have been engaged in mysteriously earnest conversations about Dr Seuss, Mr Potato Head and other so called cultural issues. Investors will want to focus on the President's proposals.

The White House has packaged its proposals into a jobs bill and a family support bill. We prefer to reorganize the spending under a number of separate topics:

Table 1: Proposed Spending

Item	**Spending (B$)**	**% Total**
Child and Elder Care	1,475	39.6%
Capital Maintenance	588	15.8%
Poverty Relief	496	13.3%
Green Economy	355	9.5%
Regular Economy	305	8.2%
Education	199	5.3%
Government	108	2.9%
R&D	120	3.2%
Disaster Preparedness	80	2.1%
Total	**3,726**	

The total is for nearly $4 trillion in spending above the current baseline of $4.8 trillion. The government's budget will rise to 40% of GDP. Arguably some of this spending increase (notably in physical maintenance) is surge spending rather than a permanent increase in baseline. However, the facts required to parcel out this effect are not yet available to us.

The largest item by far is for assistance with child and elder care and for paid employment leave to deal with family health issues. It will take some significant weight off the shoulders of middle aged workers. Italy and Singapore are two rather different societies but also two very family oriented societies. Yet both have seen their birth rate plummet well below replacement level and they have had to resort to welfare measures to encourage child bearing. In the US the birth rate is now 1.6 children per couple – significantly below the replacement level of 2.1. As discussed in our January commentary, a low birth rate ultimately faces a country with the choice between shrinking its economy or increasing immigration. Government efforts to raise the birth rate are the more popular alternative, but must be well designed to achieve traction. Encouraging couples to have their first child sooner and encouraging successful parents to have multiple children are the basic tools. Biden's proposals are not particularly focused on raising the birth rate but rather are intended to support working mothers. If his proposals are not passed at this point, we suspect that demographic necessity will lead to something similar being passed eventually.

The second item is maintenance spending on the nation's physical infrastructure. Capital maintenance is an item which is almost universally deferred by households, businesses and government when budgets get tight. As a result problems pile up and manifest themselves as higher operating costs and lower effectiveness. The United States has built a classic pile of such problems. The prior three administrations have all pointed at the pile without actually doing much about it. Biden proposes finally to grapple with it. This is the one part of his spending program where there is significant possibility of agreement with the Republicans.

Poverty relief and support for disadvantaged communities is the third item of expenditure. Low income housing constitutes $213 billion of this spending and it directly addresses the evident problem of homelessness.

The transition away from fossil fuels (the Green economy) garners just under 10% of the spending. The spending focuses on improving the national electric grid and encouraging adoption of electric cars. If one is going to spend money on the Green economy these are the obvious candidates for immediate support.

The regular economy garners nearly equal support. There is a diverse set of programs under this heading. We would expect them to generate significant discussion about priorities.

Education at 5% of spending contains the most interesting proposal. Currently the government mandates 12 years of free public education. Biden proposes adding 2 years of free preschool at the beginning and 2 years of free community college at the end. Federal experimentation with preschool programs began with the Head Start Program in the early 1960s. Originally conceived of as an eight week program for disadvantaged youth, it has gradually grown into a program of two full years of child development. Biden is proposing to take the next step of making it into an universal access program. Participation would presumably remain voluntary. Preschool will permit a faster return to the workforce by working mothers. Community college training will better prepare students to enter the modern economy. We wonder how one can make the two year college degree free without also providing two years of support to those engaged in the four year program. There seems to be an inconsistency there which students will arbitrage by enrolling in two year programs and then transferring into four year programs. Overall, this proposal seems a reasonable reform of publicly supported education to adapt it to current circumstances.

Finally there is 2.9% of spending on the government itself, 3.2% of spending on R&D grant making institutions and 2.1% of spending on disaster and pandemic preparedness. Certainly the last item is uncontroversial. In the proposal for government support included is $80 billion for IRS enforcement action. This will probably be the least popular of Biden's proposals. Boosting R&D to counterbalance China's aggressive push on emerging technologies is likely to gain bipartisan support. In his address to Congress Biden made a special plea for cancer research. While clearly a very personally felt issue for Biden, it is also being made at a time of rapid progress on cancer treatments. This issue also is likely to enjoy bipartisan support.

Biden proposes to fund this spending with a combination of tax increases and borrowing. Cutbacks in existing government programs are not anticipated. One of the proposed tax increases is an increase in the corporate income tax to a point half way between its current level and the level it was at before the Trump tax reduction of 2017. The Federal government funds dozens of programs to support businesses: providing catastrophe insurance, financing exports, propping up crop prices, carrying out safety inspections of dams and mines, collecting and disseminating economic data and so forth. Historically the corporate income tax has been the primary source of funding for these programs. Applying corporate income taxes to the portion of the proposed spending which benefits business is squarely within this historical precedent. That spending includes capital maintenance, workforce training and perhaps paid family leave. The other tax proposal is an increase in the personal income tax for taxpayers with income over $400,000 and an increase in the capital gains tax rate which would apply to all taxpayers. The top bracket increase would apparently restore the Obama regime with its 39.5% top bracket and surtaxes on earned income and investment income. This regime was quite onerous and may have helped slow the economic recovery of the Obama years. In addition, Trump has eliminated certain deductions of the Obama regime – notably the unlimited deduction of of state and local taxes. Combining Obama rates with the Trumpian deduction limitations will result in the heaviest tax levy in many years. States with high state or local taxes are pressing for restoration of this deduction. With regard to capital gain the proposal is to tax it at the same level as ordinary income. We regard this proposal as ultimately not viable. Push back is likely to come in the form of a demand either for indexing basis for inflation or introduction of a reduced tax bracket for holdings longer than five years. In any case, increases in capital gain tax rates are notorious for producing less revenue in practice than was projected by the authors of the increase. Coupled to the increase in the capital gains rate is a confusing change in the treatment of capital gains on death. Currently at death the basis amount is reset to current market value for all taxpayers and a tax is levied on the total value of large estates. Biden proposes eliminating the step up in basis on death, which would appear to be a backdoor approach to imposing the estate tax on smaller estates. To offset this, the first million dollars in gain would be exempted. We find this proposal confusing, rife with fairness issues and very uncertain in its objectives. Hostility to capital income is a long standing theme of progressive politics and this point seems as much an indulgence of the progressive mentality as a serious revenue proposal. Finally, Biden is relying on improved enforcement and loophole closing for additional funds. This is another perennial under performer in the collections department. Inevitably borrowing will be needed to close the gap. Borrowing is a reasonable way to fund capital additions and maintenance, as the benefits of the spending is spread over the long lives of the projects and financing the projects with debt leads to a matching of costs and benefits. Borrowing is a much less credible source of funding for continuing welfare expenses.

At this point our assessment of the Biden program is:

1. Spending objectives are for the most part reasonable and politically moderate.
2. Financing proposals engage in the usual amount of political wishful thinking.
3. The sheer size of the program is going to make it difficult to give specific initiatives the vetting which they should receive.
4. The press has hailed the program as either a giant step forward for the progressive political program or else as the start of a death march to socialism. We find it a good deal duller. It is, as advertised, a jobs program coupled to a package of supports for family life. The jobs program focuses on capital maintenance and the green economy. The family support is largely implemented through tax credits and support to state and local government. It does not involve standing up new Federal agencies. These are measures which have been under discussion for nearly a generation.

Our concerns with the program both revolve around its size. One way to get a big tent coalition to line up behind a bill is to give everyone whatever they want, rather than undertake the work of hammering out a focused program. The size of the Biden program concerns us that coalition politics has bloated the bill. The White House needs to explain why each component of the bill is essential to the policy goals which are being sought. The second concern is that the financing plan may not be adequate long term.

It is unfortunate that Senator Sanders, a voice well out of the mainstream, will lead the discussion of taxes in the Senate. Launching programs on a wing and a prayer and leaving it for successors to sort out the mess has been a bad habit of both parties. It is not good government.

Republican assessments will recall Biden's reputation as a velvet shiv. The Republicans had hoped to reposition their party as the champion of working class families. Biden is proposing a number of items which they have talked about but not done. (To be fair, Trump did extend paid family leave to Federal employees.) Are Republicans to go on record as voting against jobs and families or are they to take a supporting role in the story where they had hoped to be the main star? Best to shuffle ones feet and talk about irrelevancies. We expect the Biden program to get batted around for a few months in Congress and then get passed on a party line vote under reconciliation process rules.

International Politics

China and Russia have mounted pointedly simultaneous military demonstrations. Russia deployed significant forces to the de facto border with the Ukraine. China sent ships and planes to surround Taiwan as if for an invasion. Neither demonstration quite persuaded one that war was imminent. In Eastern Europe the campaigning season traditionally starts in June as the mud is too deep and clinging during the spring for ground operations. Were China actually to be invading Taiwan they would not be deploying their aircraft carrier to the east of Taiwan as was done here. Whatever they may tell their political masters, China's admirals know their fleet is not ready for blue water conflict. In addition to threatening Taiwan, China sent its naval militia to appropriate reefs from the Philippines and allegedly reinforced its troops which are intruding into India in the region of Ladakh. Biden's response was measured. In Europe he canceled the withdrawal of 25,000 troops that Trump had ordered and instead deployed a 500 man specialty team to Germany. In the Pacific, the UK is deploying a carrier task force in support of US "show the flag operations". The powers ruffle their feathers and circle one another but step back from escalation. A deepening of international conflict is a greater threat to Biden's domestic program than Republican opposition or Democratic disunity.

Market Overview

Economic reopening has produced stronger than expected corporate earnings, in all major economies save Japan (which struggled anew with the pandemic). At this point it is hard to distinguish pandemic bounce from stimulus effects: for instance, the most recent US inflation reading at 4.2% (CPI headline) reflects a "base effect" from last year's deflationary shutdown, but also feeds fears of over-stimulated rises in prices and wages that will test the Fed's sanguine dovish pose. So far, calm has generally prevailed, causing the 10-year US Treasury yield to settle around 1.65%, down modestly from its quarter-end level of 1.74%, while still materially higher than 0.93% at year-end. Such yield declines resulted in higher prices for bonds during April, in rare sympathy with stocks that generally also rose.

Market Index	April 2021	Jan – Apr 2021
S&P 500	5.3%	11.8%
Russell 2000	2.1%	15.1%
MSCI EAFE	3.0%	6.6%
MSCI EMG	2.5%	4.9%
Bloomberg Barclays US Aggregate Government	0.7%	-3.5%
Bloomberg Barclays US Aggregate	0.8%	-2.6%
Bloomberg Barclays US High Yield	1.1%	2.0%
BofA/Merrill Lynch European non-financial High Yield	0.6%	2.2%
JPM EMBIG	1.9%	-2.9%

Outlook & Guidance

We are now on track for US GDP growth at a clip not witnessed in decades. The Fed has assured that it will "do everything we can to support the economy for as long as it takes to complete the recovery" which at this point is taken to include all of 2022. Looking out over the coming months, investors must now grapple with a 3-way race, among prices and wages in the first lane; growth and earnings in the second; and yields and valuations in the third. This is a difficult race to handicap. As before, emerging market equities – particularly in value sectors – offer relative safety.

It is prudent to expect turbulence in covid, in Congress and in international politics. But we do not expect this turbulence to change the outcomes. The economy is bouncing back dramatically and massive fiscal stimulus is set to make it boom. A booming US economy will ultimately help power the recovery of foreign economies leading to renewed broad world growth. Forward momentum in the Western alliance will nudge the calculations of revisionist powers in favor of collaboration over confrontation. Meanwhile opportunistic power plays by the revisionists have helped solidify and broaden the alliance. Clarity on the green transition will release an important brake on investment by businesses with long lived capital assets. As normalcy returns one may even hope that the abnormally energized factionalism of domestic politics may fade somewhat. The public certainly seems to be signaling that overheated politics is no longer the only game in town – Fox viewership is declining and condom sales are rising. Evidently Fox's jihad against masks is not crossing over to other personal protective gear.

In Memoriam: Sardar Avtar Singh Sandhu February 28, 1938 - April 13, 2021

Avtar was the son of Rai Bahadur Basakha Singh – one of the four contractors who built the government complex at the heart of Lutyens Delhi. As such Avtar was destined for an engineering career from the cradle. He graduated with a civil engineering degree from the Punjab Engineering College (Chandigarh.) He continued his studies at the University of California, Berkeley where he earned a master's degree in Structural Engineering and Structural Mechanics. His thesis work concerned the numerical modeling of large structures. He returned to Delhi where he married Roopinder Kaur, daughter of S. Ajaib Singh, a well known industrialist, in March 1965. He commenced an engineering career in New Delhi. In 1968 he opened his front door to find the US consul standing outside with the request that he leave for America the same day. American policy makers had decided that the further development of the nuclear power industry required construction of a secure containment structure around the reactor. After some inquiry they had determined that Avtar's thesis made him the man for the job and so the US consul was dispatched to recruit him. Avtar would go on to develop the basic designs for these structures and his designs have stood the test of time. Besides his nuclear power work, Avtar was also to develop the technology of slurry pipelines. Avtar became a naturalized US citizen and, as a hobby, developed a vineyard in Sonoma County. Grapes from his vineyard were transformed into a wine served by the White House at state dinners. Proud of his Jat Sikh heritage, Avtar wore the distinctive Sikh turban throughout his US career and was for many Americans the first representative of the Sikh community who they would know on a personal basis. Avtar returned to India as head of the Bechtel Group's business unit in the Middle East and South Asia. At that time Bechtel was black listed from working in India. Avtar succeeded in lifting the blacklist and built a substantial business for the group. In the 1990s Avtar retired from corporate engineering and devoted himself to consulting work and business development. Together with his wife, he started a private hospital in a New Delhi suburb. The hospital built a successful business in medical tourism while providing care on a charitable basis to the local residents. Avtar also devoted time to building up his California vineyard and extended it into including a winery. Wines produced under his Mushal label were to win several gold medals. Avtar and his wife were the first investors to provide capital backing to Lloyd Tevis Investments. His support and encouragement were critical in the first uncertain days of moving this initiative forward. We shall miss his warm engagement and wise counsel. Avtar passed away in April, an early casualty of India's spring surge in the Covid-19 epidemic. He leaves behind an impressive body of work and a devoted family which mourns his passing.