KCM CLIENT NEWSLETTER

JULY 2021

Another "Tantrum" in 2021 or 2022?

In financial history, the term "tantrum" most often refers to the 2013 "taper tantrum". This period of high volatility occurred when the Federal Reserve (the "Fed") sent an unexpected signal that it would soon begin shrinking its balance sheet. While viewed as a black mark on Fed policy, as we will discuss below, the impact on the market was minor and short-term in nature.

The 2008-09 recession led to a decline in Gross Domestic Product (GDP), high unemployment, lower home prices, a stock market crash, and a near meltdown of the entire financial system. A collapse in market liquidity, near-zero risk taking by banks, and the bankruptcy of Lehman Brothers called for quick action. As mapped out by the U.S. Treasury, the Fed and the heads of leading banks, the integral piece of the short- and long-term recovery plan involved the Fed. They would use their balance sheet to buy treasury bonds, mortgage securities, and corporate bonds, as well as inject equity into vital companies. The plan was to restore liquidity and confidence, improve bank balance sheets, and keep interest rates low.

The Fed expanded its balance sheet from $1 trillion in 2008 to $3 trillion in 2013. Looking back, the plan worked and by 2013 the economy had settled into a period of slow but steady GDP growth. The unemployment rate dropped below 6.5%. However, because the numbers were unspectacular, there was considerable debate among investors as to when the Fed would begin to scale back or "taper" its monthly bond purchases. Thus, the table was set for a "taper tantrum".

Ben Bernanke, the Fed chairman at that time, met with Congressional leaders in May 2013. At that meeting he said U.S. economic growth appeared sustainable and it was time to take a step down in the pace of purchases. Because the market had never gone through a "tapering", much less one that was unexpected, long treasuries were hit hard with the 10-year yield almost doubling *(see Graph 1)*.

Graph 1:
U.S. 10-Year U.S. Treasury Yields During 2013 *(in %)*

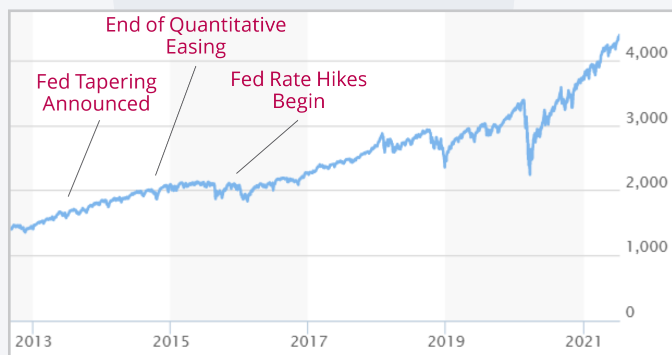
Source: FactSet

Emerging market debt experienced pain as well, with some currencies like the Indian Rupee falling 15% or more. Meanwhile, U.S. stocks experienced greater volatility, but ultimately rose sharply for full year 2013 (S&P 500 +28%). Investors correctly assessed that U.S. GDP would improve in 2014 with lower inflation. This started a multi-year run up in the stock market. *(see Graphs 2 and 3)*

Graph 2:
S&P 500 Index *(Calendar Year 2013)*

Source: Federal Reserve Bank of St. Louis

Graph 3:
S&P 500 Index *(2013-2021)*



Source: Federal Reserve Bank of St. Louis

Why are we talking about taper tantrum again? There are definitely parallels between the recent deep COVID-19 led recession and the 2008-2009 version. In both cases, central banks and governments pumped money into their economies through various stimulus measures. And in both cases, as the economies recovered, there were concerns about the Fed turning off the tap and the risk of rising inflation.

We saw in 2008/2009 this risk was misplaced as there was a brief down phase followed by new market heights *(see Graph 4)*.

Graph 4:
S&P 500 Index

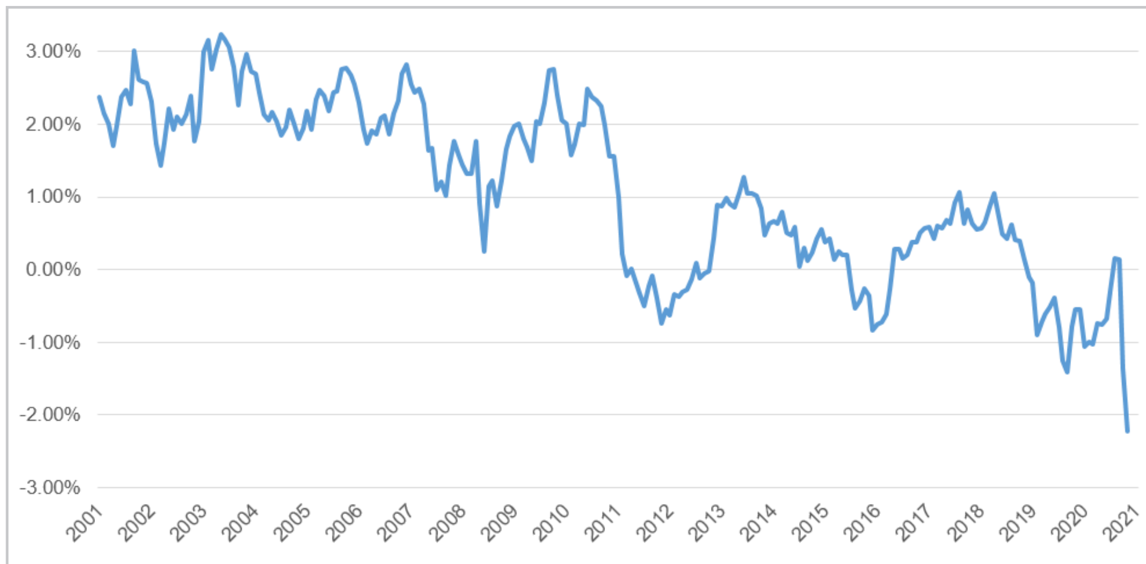
Source: FactSet

We believe the main difference in the COVID-led recovery is the extremely wide difference between the 10-year treasury yield from 2008-2009 and it's intrinsic value *(see Graph 5)*.

Inflation is rising and the 10-year treasury actually is trading with an all-time low real rate of return. This valuation risk could begin to be re-evaluated by the market when the Fed stops buying treasuries and true investors must make up the difference in demand.

Graph 5:

U.S. 10-Year U.S. Treasury Yields Less Core Consumer Price Index Year-Over-Year Change



Source: FactSet

At present we would view a meaningful correction in the stock market as a buying opportunity. However, some worry exists if treasury yields were to rise much higher than our current thoughts. We will be monitoring the treasury market carefully as 10-year treasury yields much above 2.00% – 2.25% could force us to become more cautious on equities.

We again thank all our clients for your trust and confidence in KCM to manage your investments, and we are proud and excited to show our continuing commitment to you by introducing the new personnel summarized on the next page.

NEW HIRES AT KCM

Please join us in welcoming the following new hires to the Kornitzer Capital Management team:

Brian Gerber

Brian has joined us as a research analyst for the Buffalo Funds. He was previously with Prudent Money Financial Services in Dallas and has over 36 years investment experience. Brian received a Bachelor in Business Administration – Finance from the University of Texas – Austin and MBA from the University of Texas – San Antonio, and he also holds the Chartered Financial Analyst designation.

Matt Ison

Matt has joined us as a Portfolio Manager of Private Clients. He was previously with RubinBrown Advisors working with private clients and has over 14 years investment experience. Matt received a Bachelor of Arts from the University of Iowa and an MBA from Rockhurst University, and he also holds the Chartered Financial Analyst designation.

Tim Jenkins

Tim has joined us as a research analyst for the Buffalo Funds. He was previously with American Century Investments and has over 25 years investment experience. Tim received a Bachelor of Science in Finance and Banking from the University of Missouri and an MBA from Saint Louis University, and he also holds the Chartered Financial Analyst designation.

Nathan Soulis

Nate has joined us as a research analyst for the Buffalo Funds. He moved over to KCM from Great Plains Trust Company, where he was an Account Executive for the last 9 years, and he has over 18 years investment experience. He received a Bachelor of Science in Finance and Banking from the University of Missouri and an MBA from UMKC, and he also holds the Chartered Financial Analyst designation.

Pat Srinivas

Pat has joined us as a research analyst for the Buffalo Funds, working primarily on the Buffalo International Fund. He was previously with Chiron Investment Management and Waddell & Reed, and he has over 14 years investment experience. Pat has an MBA from the University of Chicago and Masters in Computer Science from the University of Texas – Dallas.

Experience Our Service for Yourself

Contact one of our Relationship Managers and learn
how KCM can help you achieve your financial objectives.

5420 W 61st Place
Mission, KS 66205
(913) 677-7778
info@KornitzerCapitalManagement.com