



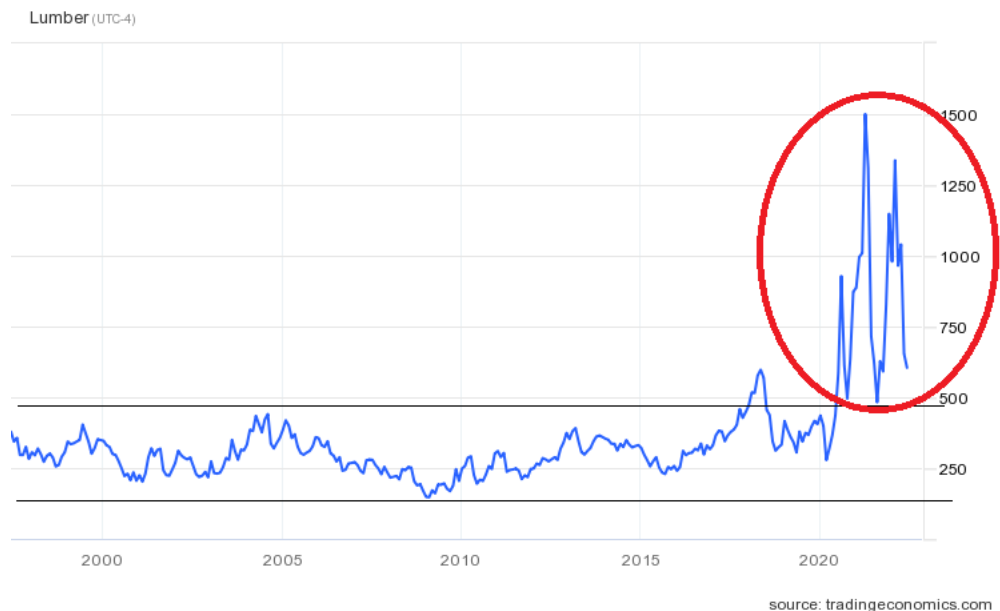
Market Commentary: How Long Will We Feel Covid Reverberations? May 2022

Throw a pebble in a still lake and you create a ripple. As one moves further from the center, the ripple calms to one barely perceptible to the human eye. Throw a stone instead, and that initial ripple may actually be a wave. The wave will eventually turn into a ripple and ultimately there will be little to no evidence of the initial stone thrown.

Covid was a boulder. Russia – Ukraine is still to be classified...

Lesson learned is that the initial boulder, stone, or pebble has a cascading effect. One of the fallouts in the U.S. was the lumber market, as evidenced by the lumber market pricing for the last 25 years:

For roughly 23 of those 25 years, lumber traded in a relatively tight channel (between the black lines). The boulder that was Covid resulted in prices more than tripling in a short time frame and general volatility reaching unprecedented¹ levels (circled in red). After three distinct spikes, lumber has plummeted as of late despite going into peak construction season at a time when housing units under construction are at multi-decade highs. Covid-related shutdowns and the ensuing supply chain issues contributed to these spikes. Those issues being ironed out, in addition to increases in mortgage rates and interest rates generally are reasons given for the recent decline.

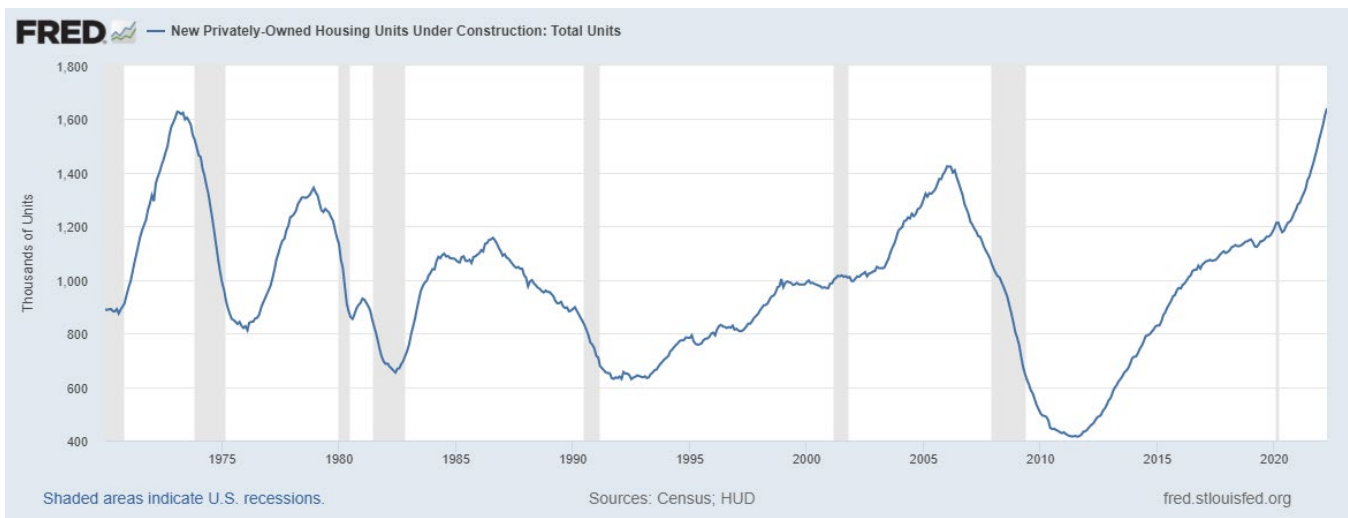
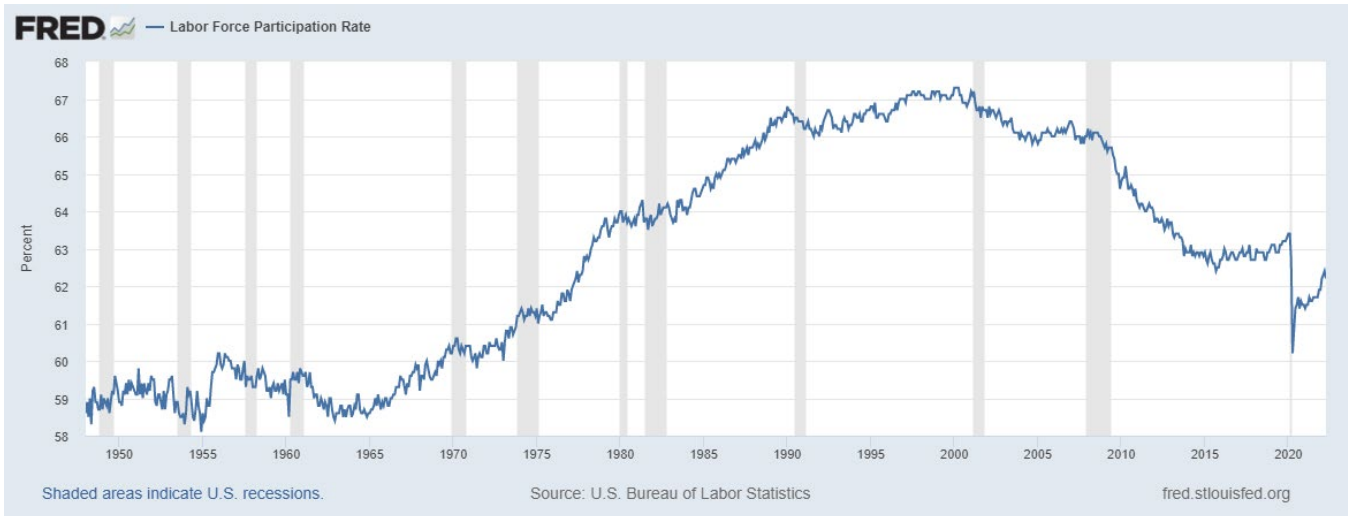


When lumber prices spiked, economic terms rapidly shifted for both the supply and demand side. If you are a supplier, you are doing anything you can to produce and sell lumber. However, if you can't find workers or shippers or a means to get your product to the buyer, it may be for naught. For buyers, demand, at least initially, may have been less elastic² than typical. More money to spend + more time at home most likely created a higher threshold to spend on home improvements while home builders looked to take advantage of major population shifts, higher home prices and a lack of available housing.

One can see interlocking disruptions everywhere. Sticking with the lumber story, there is a lack of workers. Yet, when looking at the long-term labor force participation rate (chart 1 below), we are at multi-decade lows for a variety of reasons both related and non-related to Covid. Construction on an absolute basis (vs % basis) is at multi-decade highs, but this being after the period post-2008 being at multi-decade lows combined with elongated construction completion times due to supply constraints (chart 2 below).

¹ Relative to the last 45 years – the data we have seen.

² Elastic is an economic term with elastic demand being one where a change in demand due to a change in price is large while inelastic would be the opposite – little change in demand based on changes in price.



The labor force is projected to expand as savings dissipate and as Covid-related danger hopefully dissipates as well. The Fed tightening currently underway is further increasing the cost of housing, as supply chains are (very) slowly getting mended and as a large supply of new houses are expected to come onto the market. The laws of supply and demand, perhaps assisted by the artificial hand of the Fed (their jobs after all!), will play its roles.

We cannot tell you how long volatility will last but we have a high level of conviction that this volatility will dissipate as laws of supply and demand play their parts. And it will dissipate faster than relatively similar events historically have due to innovation. Innovation can come in many forms: Quicker methods of producing wood? Replacing wood with other materials? Alternative methods of getting wood from one location to another?³ We are in an age, at least in our opinion, where the speed of innovation is unprecedented relative to history.

³ I just read Elephant Company by Vicki Constantine Croke – a great summertime read. A century ago, Teak wood was harvested in Burma by material use of Elephants who would pull down trees and set the lumber up for seasonal monsoons that pushed them down river. The death rate amongst those working among the elephants was astronomical. There were most likely modest adjustments in the centuries past to the practice, but I can ensure you it is not done this way any longer.... Innovation!



FOUNTAINHEAD INSIGHTS

Like the receding ripples of the thrown pebble, or in this case a boulder, this too shall pass. Supply chain issues, while stubborn at the moment, will work itself out. The workers shortage, whether through the participation rate increasing or robots / AI taking over, will end as well. There will be new innovations that result in increased wealth for humankind. And there will be the next pebble, stone and boulder that throws us all in disarray once again – after all, it is the way of the world.

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