Quarterly Commentary

First Quarter 2021

Market Review with Ted Halpern

What a difference a year makes!

"Never give up. No one knows what is going to happen next." – L. Frank Baum.

It is hard to believe a year has passed since the "two weeks to flatten the curve" lockdown. It was this time last year we were writing about the remarkable Bear Market performance of Q1, 2020. The period of February 12 – March 23 of 2020 offered a record speed Bear Market and left us with the worst First Quarter ever for U.S. Markets! Fear and uncertainty ruled that very uncomfortable time.

The past 12-months has been an incredible period, a historic cycle that seems to have left time undefined. Perhaps it is because we did not experience the usual mile markers in our lives. Without these events, experiences and usual deadlines, time is left up to very different interpretations. In many ways, the impact of Covid-19 blew through markets like a tornado.

As I had written in the Q1 2020 Investment Commentary, 'Event' driven bear markets, while sudden in appearance, tend to exit far quicker than many predict. Despite the terrible unknowns during this crisis, markets have proven their remarkable resiliency time and again. In fact, equity markets closed Q1 this year at even higher highs than they reached on their pre-pandemic peak February 12, 2020 of 29,551 for the DJIA. The DJIA closed Q1, 2021 at 32,981.

The first quarter of 2021, was quite bullish as both novice and professional investors welcomed risk. Much of this was due to the brains of science, bringing about vaccines in absolute record time. The innovation was absolutely extraordinary and has delivered the ability of our economy to begin to open for business. It is anticipated we will have enough vaccines for all adults in the U.S. by the end of this May or even sooner! In addition, vaccine makers are ready with boosters once initial doses are administered. These vaccine programs provide the confidence required to facilitate economic and market recovery.

Companies are on track to report record earnings over the next couple of quarters. Certainly, the vaccine effort has optimism front and center once again. The sheer adaptability of everyone during this pandemic is a wonderful illustration of the impact of technology throughout our personal and professional lives. The ability to work remotely, educate remotely and stay connected within our daily lives has been incredible and proven 'there is no place like home'. This feat would not be possible without relentless passion. The heart to figure out how to reinvent the way companies work and the adjustments to participate in these changes amidst strict guidelines to just keep going was very special.

Of course, we should recognize the courageous role front line workers played throughout this ordeal, and continue to do so. This uncertain time leading to a vaccination was a difficult journey and thank goodness for the bravery of workers and volunteers everywhere who made this even possible!

The combination of Fiscal and Monetary policies acted behind the curtain to greatly assist the economy and markets over the past year. Massive stimulus efforts and government spending programs help our economy heal faster. The Federal Reserve has been vocal about maintaining rates near zero while the Treasury assists with adding much needed liquidity to bond markets. All of this colossal effort has helped put air back into the economy and markets have responded with forward looking enthusiasm.

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Looking ahead, inflating a bubble?

The tremendous efforts over the past year were needed to reflate the economy. The question is though, what will all this mean going forward? The recent $1.9 trillion stimulus bill that passed brings the total government spending on this effort to nearly one-quarter of our entire GDP. To compare how incredible this is, according to Haver Analytics, the financial support has been four times greater than what was done during the Great Financial Crisis! Yet, the impact from the pandemic has actually been one-fourth the shock to U.S. GDP.

While spending during the Financial Crisis did not yield inflation, this time is shaping up to be vastly different. In 2008-2009, measures like quantitative easing (QE) and many other liquidity programs were designed to recapitalize banks after the impact from the financial crisis. The stimulus efforts then focused on bank balance sheets – the money did not move around in the real economy. Now, banks are very well capitalized and the overwhelming majority of the stimulus efforts this time have come in the form of direct transfers – PPP and payments directly to people. Combine this with expanded unemployment benefits, child tax credits and more. These dollars are actually moving around in the economy. The end result of this is our M2 money supply is rising at an unprecedented 25% year-over-year rate. This is actually faster than the inflationary period during the 1970s!

Early inflation indicators are everywhere. The Treasury bond market has signaled inflation with the 10-year Bond making a remarkable move during this past quarter, rising from yielding just 0.93% to over 1.7% by quarter end. The housing market hit record highs while gas prices have also accelerated dramatically. The typical patterns of inflation are appearing all over and at a healthy pace.

There is no question the probability of future inflation is strong. However, I do not believe it is an urgent concern today. The Federal Reserve has plenty of tools to fend off steep increases and more importantly, our economy has plenty of room to grow. If inflation begins in earnest, it will be a sign that our economy is returning to full health.

Rest assured, we continue to make adjustments to account for this within your portfolio. The investment commentary to follow highlights this in greater detail.

Incredible journey and it pays to be an optimist.

There is no question the current plan from behind the curtain is to lay a path of higher spending and greater taxation to help pay for the resulting rising deficits. Early on, we will see great economic numbers as the opening of our economy will produce far lower unemployment figures, increased corporate earnings and likely record GDP statistics. Markets are pricing all of this good news now.

The issue is the path to get there is likely paved with higher commodity prices, higher inflation and higher taxes. We will see this unfold over time. All of this creates hurdles to saving. I highly encourage you to take advantage of lower rate climates now, reshuffle any variable rate debts and make every effort to save now! The costs to save are very low right now – interest and tax rates are lower than they will be in the future. Position yourself to reap rewards from higher interest rates – earn them, do not pay them!

As the Wizard of Oz reminds us all, with heart, brains and courage we can conquer anything! Be an optimist, be safe and be well.

Investment Commentary with Kirsty Peev, CFP®
Summary:

Equity markets focus firmly on the future with optimism, delivering strong gains to start the year.

Investors were pleasantly surprised with very strong returns during 2020, in the face of incredible and unprecedented challenges. 2021 equity markets have taken on an even more optimistic tone, and delivered very strong returns during this first quarter. This is based largely on a few key factors:

1. Vaccines. Data showing vaccinations are incredibly effective, and are being delivered at warp speed! Confidence in, and acceptance of the vaccines have been improving and with every person vaccinated we are one step closer to herd immunity. This provides an extremely supportive backdrop for the economy reopening.
2. Personal Savings. The combination of high personal savings rates and pent-up demand will likely spur this pick-up in economic activity even further. Consumers have not been spending during the last year leaving excess cash on the sidelines. This money is ready to be deployed into the economy.
3. Fiscal stimulus and the Fed. The U.S., and indeed most of the globe, remains in an incredibly supportive fiscal environment, spurring on growth. Q1 included the passage of a whopping $1.9 Trillion COVID relief bill, and the announcement of plans for future jobs and infrastructure spending.

Equities:

Continued gains during Q1. U.S. markets rewarded investors with strong gains, with the S&P500 delivering an increase of 6.2% and the DJIA gaining an incredible 8.3% in just a single quarter! In fact, the DJIA has hit a record high 17 times in 2021 already! This quarter was certainly much more pleasant for investors than Q1 one year ago when investors lived through the fastest bear market in history. Since then, with assistance from technology, people adapted, and entire new industries popped up to meet the needs of the 'new world'. This also included innovation, cooperation and collaboration between companies and countries.

Gains based on strong fundamentals. Publicly traded companies are exhibiting strength, and are anticipated to report significantly improved earnings during the coming earnings season. Economic strength is also being seen in the labor market with initial unemployment claims falling to pandemic lows as the economy reopens, and incredible numbers of new jobs being added.

Ongoing support from stimulative fiscal and monetary policies. The Fed has committed to their 'dual mandate' of price stability and maximum sustainable employment repeatedly. Low interest rates are expected to continue for some time, supporting expansive borrowing and spending by companies. The additional combination of Government spending directly into the economy, and further spending on infrastructure, has turbo charged the recovery.

International Equities

International Equities lagged the U.S. There are many reasons for this underperformance. New variants of the COVID-19 virus abroad hampered plans for reopening and delayed the start of their economic recovery. In addition to the new variants, virus cases did see spikes in specific countries and regions which further caused alarm. There are also concerns about the speed of the vaccine rollout in many countries. For example the E.U. program has been slow compared to other parts of the globe, and has been marred by internal squabbles over vaccine distribution.

Bonds:

Bonds faced challenges from a short-term interest rate spike. Bond investors worried that significantly improved economic data could cause the Fed to start raising rates sooner than anticipated. This caused a spike in Treasury yields – with the 10 year peaking to 14 month highs. Bond yields move inversely to prices – so when yields spiked, prices fell. Within the quarter we saw that spike, followed by some stabilization of yields and prices.

Our bond strategy helped mitigate price pressures. From a broad standpoint, using baskets of bonds through mutual funds within your portfolio helps to mitigate pricing pressure a great deal. As yields spike, these baskets have the ability to reshuffle and add in higher yielding bonds to help offset price dips. We have also retained a focus on shorter-durations and higher quality bonds within each asset class which also helped smooth out the bond market gyrations experienced in Q1.

Expectations and Perceptions for the Future:

Economy anticipated to soar in the short term as the world 'reopens. The economy should continue to grow and we are likely to get very strong GDP growth numbers as a result. Corporate earnings had been lowered during the pandemic, and now begin to show excellent performance. In fact, earnings strength is very important now since so much of the optimism about the economy reopening is being swiftly baked in to prices and valuations.

Be prepared to take advantage of companies poised to thrive during the reopening. During 2020, technology led the entire world out of the crisis – whether it was adapting to working from home, staying in touch with family, educating children or innovating new healthcare solutions. Technology is very much here to stay and will continue to be a core and important asset class within your portfolio. As life returns to a more 'normal' world, your portfolio must also adapt. We are taking steps to ensure you have exposure to those companies which should benefit from this move back to a more normal way of living. This includes, large, cash-healthy companies, financials, and energy – the very classes which lagged during the last year.

Forward looking focus on fundamentals...with caution. The past years market dip was 'event driven' – meaning it was caused by an external shock, rather than a fundamental breakdown or problem within financial systems or the economy. We have seen how swift the recovery from this type of market pressure is. We believe equity markets will continue to shake off these event-driven fears and perform well in the near-term.

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We remain cautious over the longer-term. The possible specters of inflation, higher interest rates and higher taxes loom on investors' minds for now – but these will come into sharper focus as time passes. We had mentioned during our year-end 2020 commentary that the path of the recovery is likely to be erratic and uneven – and we feel strongly this remains the case.

Bonds remain an important part of your portfolio – despite interest rate challenges. The spike in rates during Q1 appears to have been a short-term blip upwards, and we have already seen some stabilization in the 10 year Treasury yield. We believe that bond markets will absorb future rate increases in a much more measured manner, and your bond funds will continue to benefit from ongoing income generation as we go.

Remember, the risk-return profile on your bond holdings is very different to that of your equity holdings. Your bond funds act as a stabilizer to equity markets, providing income and lower risk profiles as a complement to equity markets.

Inflation protection – but not your grandparents TIPS. Inflation is unlikely to be an issue in the short-term, as we work our way through a recovery. However, we must prepare your portfolio for inflationary pressures in the intermediate-to-long-term, after all inflation is a sign of an economy recovering. Over time, you will see inflation-protected bonds being gradually added to your portfolio. We are careful not to use traditional Treasury Inflation Protection Securities (TIPS), which typically have issues with duration, and negative tax-implications for taxable accounts. Instead, we utilize Institutional fund managers to include diversified bond funds which include an inflation-protection element in conjunction with high-quality, core bond holdings.