Quarterly Commentary

Second Quarter 2021

Market Review with Ted Halpern

A Historic Expansion is Underway

A historic expansion is underway! The Second Quarter of 2021 yielded extraordinary results and scored the fifth straight quarter of gains for U.S. Markets. The first half of 2021 produced double-digit gains driven by an economic recovery that is seemingly gaining speed! The expansion should continue as labor shortages persist, and home prices and personal savings hits record levels.

The chart below shows the incredible path of equity markets from January 1, 2020 through June 30, 2021. S&P500 (blue) and the DJIA (green).

The past doesn't repeat, but it rhymes?

This past July 4th weekend reminded me of the famous beach scene, also taking place on July 4th, from the movie Jaws. The movie was an action/horror film about a killer shark feasting on unsuspecting beach goers. Jaws was an enormous success. In fact, it practically invented what we now know as the "Summer Blockbuster". The film was nominated for Best Picture and the John Williams written theme song won for Best Original Score. Hard to believe this movie was made 46 years ago in 1975!

I am reminded of this film because of the remarkable correlations between that time, and now. In 1975, the U.S. was coming out of a major recession (1973-1975). Monumental fiscal and monetary changes were ushering in. Initially, these changes worked; the U.S. economy recovered from negative GDP and performed very well. Unemployment rates fell as the GDP rose. However, the economy later stalled under massive taxation and huge government spending. Within a couple of years, the economy was driven back into a recession under the clouds of very high interest rates.

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Our current climate has seen a historic recovery that I believe will gain speed this current quarter. I expect the Third Quarter to yield very robust U.S. Jobs GDP growth, and I believe corporate earnings will continue to produce phenomenal results. Abating unemployment benefits combined with dwindling virus fears and an ease in child care difficulties as schools reopen, should team to significantly improve unemployment numbers. In addition, personal savings figures have risen dramatically, as has the health of bank reserves. Make no mistake, the current situation is a fun day at the beach and our fun in the sun is likely to continue for a little while longer.

Changing weather ahead?

The winds may well change, though, as we face some hurdles toward the tail end of this year. Remember, markets price looking forward while economic data reflects back on past data. The question is whether markets have fully priced in the results we will see unfold or if they have further to expand. My best guess is we have a bit longer to sit in the sun but it is getting late in the day.

The second half of 2021 will see many obstacles in our way. The Fed will begin reducing its asset purchasing programs. Right now, the Fed is buying $80M of Treasuries and $40M of Mortgage Backed securities each month! As these taper off, real economic gains must provide the necessary support. The U.S. Dollar is weakening as a result of the increased money supply, which was created to provide fiscal stimulus. Finally, Tech companies, which led us out of the crisis, are coming under increased scrutiny for higher tax and greater regulation. We are in a place where the top players in the S&P 500 Index make up the highest weighting they ever have, which can do much to spur greater volatility ahead.

As we continue to see outstanding economic news, these results provide an atmosphere where current political objectives can be met. The table is set for a 'Jaws–like' feast of higher government spending, tax increases, and more regulations. It's almost as if we can hear the famed Jaws theme playing overhead. These factors combined can have a heavy hand in tipping the scales in favor of inflation….and potentially plenty of it!

Just as Jaws created a real fear of sharks and a significant drop in beach tourism, the pending risks of inflation can cause serious impacts to our economy. Inflation can be a shark, gobbling up dollar valuations and impacting security prices. A TIME magazine reviewer of the film said: "Jaws is a dread dream that weds the viewer's own apprehensions with the survival of the heroes. It puts everyone in harm's way and brings the audience back alive. And in Jaws, the only thing you have to fear is fear itself." I think this is apropos considering the inflationary fears we face today.

Inflation, inflation, inflation…

Yes, inflation is present and will likely rise further. The concern remains whether or not this inflationary period will be transitory, as Fed Chairman Powell believes, or if it will spin out of control and ultimately stall the economy. Has much of the market's optimism for an improving economy already been priced in, or is there more to go? Goldman Sachs found that since 1960, the median return for the S&P 500 has been 15% during low-inflation periods and 9% during high-inflation periods! This potential for 40% less in equity performance combined with volatility in bond markets-due to both tapering of the Fed purchasing programs and rising interest rates-has market observers puzzled about what may unfold.

In the end, I think the advice from the lead character Brody, played by Roy Scheider, upon first seeing the shark up close, was excellent – "I think we are gonna need a bigger boat!". Prepare for what is coming while enjoying the time you have during this expansion. We will do this within your portfolio by lowering your exposure to growth stocks and certain technology players that overweight market indexes. We will add to areas like Developed International markets, Emerging Markets, and Large Cap U.S. Value stocks. For bonds, we make sure to shorten the duration, keep credit quality high, and ensure we can float with coming rate changes. All of this can insulate and permit your invested wealth to continue to prosper.

I encourage you to make sure you hold a healthy enough cash reserve, be sure any debts you might have are locked into low fixed rates, and your spending habits are well within your means. Remember, the time to save with enthusiasm is during periods of low interest rates, low tax rates, and low inflation. Take advantage of the current climate! These strategies can help your boat survive the high tides of inflation and unknown attacks from hungry sharks!

Have a wonderful summer and embrace your freedoms to live without the overwhelming concerns of the pandemic era! Be well and enjoy!

Investment Commentary with Kirsty Peev, CFP®
Summary:

Continued strong gains as the global economy reopens. Another quarter of robust gains across all equity and bond segments! This led to healthy returns for the first half of the year, and follows two straight years of excellent performance within equity markets! Key factors:

1. **Global economic reopening.** The recovery across the globe continues to accelerate. The pace varies geographically as countries and regions grapple with vaccine rollout and virus variants. However, the 'reopening trade' has very much taken off.

2. **Accommodative global environment.** Countries across the globe continue with stimulative fiscal and monetary policies to help spur growth.

3. **Strong earnings and economic data.** Increased business activity reflected through healthy earnings reports from companies, and broader positive economic data on the labor and housing markets in particular.

Equities:

Equity markets soar past challenges, deliver additional strong gains for Q2 and YTD. The S&P500 is now positive by an incredible 15.3% for the YTD, and the DJIA is almost as strong – notching gains of 13.8%. This is based on Q2 of 8.5% and 5.1%, respectively. Equities thrived on the economy reopening and solid economic news. The S&P500 has now reached 34 new all-time highs in 2021 alone! This reinforces how important sticking to a long-term investment strategy is despite new market highs. Had an investor sold, or not added more to markets after the 1st new high of the year – they would have subsequently been 'wrong' an additional 33 times in just a few months!

The path to these gains was bumpy! The second quarter of the year was extremely volatile and contained many days and weeks of negative returns. Inflation concerns led the way, cryptocurrency markets imploded, oil prices spiked, markets were rattled by odd 'meme stock' trading activity, the gas supply to the entire East Coast was disrupted causing shortages and outages, and global supply chains were massively impacted by a blockage of the Suez Canal.

Strong economic data, and a reassuring Federal Reserve helped smooth the path. After peaking at 14.7% in 2020, the national unemployment rate has now dropped to just 5.9%, as household income soared. Home prices in the U.S. also continued to boom on continued low mortgage rates, and additional potential buyers due to a stronger workforce. Fed Chair, Jerome Powell eased inflation concerns, stating spikes in inflation were likely temporary, and caused by pent-up demand and delays in the supply-chain as the economy reopened faster than anticipated.

International Equities

International Equities also delivered gains, but faced greater challenges than the U.S. Variants to the COVID-19 virus became pervasive in many nations, and many developing countries are still facing a vaccine-supply challenge.

European Central Bank (ECB) remains accommodative. ECB is still highly committed to a stimulative monetary environment, with no indication of when they may begin to reduce their stimulus and bond buying programs. 5 years after the Brexit vote, and many problems still remain in the region as each party involved works through trade and division issues.

Tariff war with China re-entered headlines. Tensions have grown between the U.S. and China on various issues – including technology, trade tariffs and even the investigations around the origin of COVID-19. Starting-point meetings between the two countries have begun but the situation between the two countries remains a potential risk to global economic growth.

Bonds:

Bond funds regained solid footing after a challenging start to the year. A short-term spike in interest rates during the first quarter had caused a small temporary dip in the price of taxable bonds. Yields have since stabilized and we have seen a nice recovery within bond markets during Q2. The fate of bond markets in recent months has been closely tied to announcements and policy from the Federal Reserve. The Fed is still buying Treasury and Mortgage securities every month, which help liquidity in bond markets and keep interest rates low. Interest rate increases are unlikely to happen until this bond buying program has ended. Transparency from the Fed policy, which we believe is on a firm path, helped bond markets stabilize.

Municipal bonds more attractive than ever. Many individual States have benefited from a meaningful recovery, and a significant amount of aid. Historically when Treasury rates rise, muni prices do not adjust as much as corporates, and we saw this in the first half of the year with gains in all your municipal bond funds. Higher tax rates could make these even more attractive in the future.

Expectations and Perceptions for the Future:

Optimism dominates equity markets. Global economies are still firmly in an accommodative fiscal and monetary environment – spurring continued growth. The 'great global reopening' is deep in progress and many companies stand to benefit greatly from this. As we manage your portfolio, we focus on the adjustment the economy is making from goods (during the pandemic) to more of a service-driven environment. Economic data is strong, and company earnings continue to deliver great results.

Critically – banks are fundamentally strong, necessary for a thriving economy. The largest U.S. banks comfortably passed their annual 'stress tests' to determine how well they could withstand severe economic conditions.

Headwinds on the horizon. Stimulative spending programs have to be paid for, likely coming from higher U.S. taxes. This, coupled with the expectations for a higher regulatory environment, have the potential to slow down growth. We must prepare for inflation, as this can erode portfolio returns, or be an impediment to market growth if the Fed does not handle it well. So far, the Fed has shown themselves to be well prepared to implement the delicate dance necessary to spur growth, while keeping inflation in check – and they have communicated this clearly. We believe this can absolutely continue, but will remain fully on top of the potential for inflation and how your portfolio can handle this.

Bonds as a continued income-generating stabilizer. The Fed clarity on their projected rate path has helped bond markets back to greater stability for the YTD and we anticipate this will continue. Income generation is a great steadying force when equity markets gyrate – on the back of an extended bull market, this role is even more important.

Active management and diversification more important than ever. In a historically low, and challenging interest rate environment, your bond portfolio requires even more attention than ever. Within your portfolio you will see us continue to focus on diversification, including a variety of durations, credit qualities and bond selections. This approach is key as we approach a potentially rising rate, or inflationary environment.

Halpern Financial prepares for the future:

Halpern Financial is proud to implement stress AND strength tests. Our 'stress tests' involve testing the impact of various negative scenarios on how well you will meet all your financial goals. We then stress test the underlying asset allocation in your portfolio to determine how each asset class, and combination of classes will perform under a variety of challenging conditions. Importantly we then take this one step further to strength test each of these key features. By taking these critical steps, we have evaluated how well you can withstand negative factors, and how well you are poised to thrive during positive scenarios.

After a period of extended gains in markets, many investors begin to worry about the next correction – because there will be another correction! If history can teach us anything, it is that peaks AND troughs are a normal part of healthy markets. In fact this is why we invest in general. Because risk and return are truly inextricably linked.

When investors buy equity investments, we take on the risk of being a small 'part-owner' of the underlying businesses and with that, the fortunes of those companies, and the equity markets as a whole. This is why we, as equity investors, are so handsomely rewarded over the long term.

When we invest in bond investments, we take on the risk of lending our hard-earned money to an entity to help them prosper – and we in return prosper by receiving interest on the money we have loaned out.

None of these are without risk. A truly risk-free asset, if there were such a thing, would not generate the type of returns you expect, or need to meet your financial goals.

It is most important to remember that these gyrations WILL be a part of your investing future. Rest assured that we create diversified investment strategies which are designed for your specific financial situation. When we test these portfolios, we regularly test for the impact of these type of short-term corrections. This means that you are prepared for a variety of market scenarios, and corrections do not need to be something which cause alarm. We expect them and prepare for them, just as we also prepare for the subsequent market surge which will inevitably follow.

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