Market Commentary

Greetings!

We hope that this letter finds you and your loved ones in good health.

MARKET COMMENTARY

Since our prior monthly market commentary, we have witnessed further economic and political developments in terms of fiscal and monetary policy, vaccine progression, and U.S. manufacturing/service data which has caused price gyrations throughout the equity and fixed-income markets.

POLICY

In terms of fiscal policy, the Biden Administration recently announced a $2.25T spending package slated for the next 8 years aimed at rebuilding U.S. infrastructure such as bridges, roads, airports as well as funding initiatives for elderly and disabled care, affordable housing, and manufacturing job training. While substantial in both dollar and percent of GDP terms, the total value of the proposed bill was generally in line with political and Wall Street analyst expectations. The bill has a long road to become law as the Democrats will still need to get several GOP members on board to avoid budget reconciliation where the chamber is in a dead split by party.[1] This plan comes just weeks after the administration extended the American Rescue Plan Act of 2021 on March 11th, which extended citizens a $1,400 stimulus payment ($2,800 joint return), plus $1,400 for each dependent for married couples earning less than $150,000 and individuals less than $75,000[2].

In our view, these initiatives are intended to support near and medium-term GDP growth through higher consumption and government spending, which likely pushes inflation higher as well in the near term. The dollar value of the enacted plus proposed legislative actions will bring U.S. federal debt to GDP well above 118% which represents the highest point in the country's history after WWII. [3] While concerning levels of federal debt has been a popular and reasonable discussion point since 2008 and TARP, equity and bond prices have shrugged it off, nevertheless. Will this continue?

The Chair of the Federal Reserve, Jay Powell, spoke on March 17th after the weeklong meeting with Federal Open Market Committee. Despite inflationary trends across many sectors of the U.S. economy accelerating over the last six months, the Fed indicated that inflation is persistently running below its goal of "inflation moderately above 2% for some time." As a result, the Fed indicated it will keep short-term interest rates at 0% to 0.25% until labor market conditions improve and continue its current pace of asset purchases ($120B/mo) for the foreseeable future. Heading into the meeting, bond yields had skyrocketed (dragging down prices) due to improving growth and inflation. The evolving market narrative centered around the Federal Reserve announcing it would consider trimming the pace of asset purchases to stave off rising inflation. This did not come to fruition. While four Fed members now see at least one rate hike in 2022, up from 1 from the December meeting, a majority of the membership see no rate hike even in 2023. [4]

FUNDAMENTALS

Economic data for both the quarter and month of March in terms of the manufacturing and service economies were robust as the U.S. recovers from COVID-19 shutdowns aided by the aforementioned fiscal stimulus and vaccine rollouts. The U.S. manufacturing purchasing manager's index (PMI) of 59.0 in March (vs. 58.6 in February) reflects a solid economic upcycle; however, continued supply outages did hamper growth in March, which will be exacerbated by the cargo shipping delays in the Suez Canal. As a result, input cost inflation reached its highest reading going back to 2007. The Service PMI of 60.0 reached an 80-month high due to lighter COVID-19 restrictions. Business confidence also increased in March reaching a near 7 year high. [5]

Investors typically seek securities where the changes in fundamentals are most appealing. As a result, the sectors most impacted by COVID-19 shutdowns, which recognized the deepest earnings declines such as Energy, Industrials, and Materials are seeing their earnings improve the most, thus the outperformance relative to classically defensive sectors and/or those not impacted significant by COVID-19 such as Technology.

Furthermore, abundant growth has driven investors to seek the typically riskiest sectors and accelerating inflation has concerned bond holders which receive fixed coupon payments. As a result, prices declined in relatively safer fixed-income securities in 1Q; however, the Financials sectors performed well as banks benefit from higher long-term interest rates.

VACCINATION ROLLOUT

As of March 30th, 148M doses of the different vaccines have been administered in the U.S. (96M one dose, 53M both doses) which equates to 22.7% of the population and compares to 11.6% of the population at the beginning of the month, and 0.5% to start 2021. The current vaccine run rate is ~2.8M does per day with Johnson & Johnson's single-shot vaccine receiving emergency approval in late-February contributing to the recent increase in dosage rate. At the current rate of vaccination, 75% of the U.S. population could be vaccinated by the end of July. [6] With 15-20% of the population naturally immune to the virus[7], by the end of the summer, the U.S. should near herd immunity, and public activities may indeed return to pre-COVID levels. Of course, this is a generalization, and will vary significantly state-by-state.

A PREVIEW AHEAD

The primary question many are asking is how much longer the current regime of Reflation (higher growth & inflation) lasts? While the current data is robust, there are concerns around 1) the longevity of the current upcycle given permanent unemployment trends and 2) the market's reaction to data releases in the summer and fall likely showing growth and inflation slowing concurrently. Will market participants look favorably on equities as real GDP growth inevitably declines from its double-digit 2QCY21 level? Will inflation go back to its sub-2% trend as manufacturing capacity is right-sized after pandemic shutdowns and temporary supply-chain disruptions are cleared?

There will constantly be cyclical dynamics at play over the short run causing price deviations from prior regimes or trend, whereas client portfolios are designed to prosper over the long-term by factoring in risk tolerance, time horizon, and goals. A diversified portfolio typically provides a balance amongst market capitalization, fixed income, equity, growth and value securities, which we believe provides the highest probability of achieving one's goals.

As always, if you have any questions or would like to discuss your accounts or financial situation further, please call your advisor directly or email us at clientservices@benchmarkfinancial.info. Please visit our website at www.benchmarkfinancial.info for more information on our planning services.

Sincerely,
Benchmark Financial

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[1] https://www.cnbc.com/2021/03/31/biden-infrastructure-plan-includes-corporate-tax-hike-transportation-spending.html
[2] https://www.irs.gov/newsroom/questions-and-answers-about-the-third-economic-impact-payments-topic-b-eligibility-and-calculation-of-the-third-payment
[3] https://app.koyfin.com/charts/g/ec-wfuv2d?i=g
[4] https://www.federalreserve.gov/monetarypolicy/files/monetary20210317a1.pdf
[5] https://www.markiteconomics.com/Public/Home/PressRelease/565cc8b204be4b789af68dbfabf9746b
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