NorthLanding
Financial Partners, LLC

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U.S. Economy & Financial Market Observations

During the second quarter, equity markets continued to cruise to new records powered by an economic recovery that appears to be still accelerating. U.S. stocks have now notched five straight quarters of gains, their longest such streak since 2017. The S&P 500 Index, which tracks the largest U.S. public traded companies, climbed **15.3%** through mid-year, tacking on **8.6%** during Q2. Meanwhile, the smaller publicly traded companies that make up the Russel 2000 Index gained just **4.3%** in the quarter, but still lead most equity asset classes with a **+17.6%** YTD gain. International equity has also been positive, but lagged U.S. returns with the MSCI ex-U.S. Index standing **+9.1%** at mid-year. Bonds have rallied recently on concerns over Covid-19's Delta variant dampening growth and continued expectations of low interest rates. The Barclays Aggregate gained **1.8%** during Q2 though it finishes mid-year with a total return loss of -1.6%. Municipal bonds have continued to be a relative bright spot with the Barclays NY Muni Index, for example, now **+1.5%** for the year[1].

As stocks indexes march upward setting new records, several fundamentally positive drivers have supported markets. For example, June's recently released jobs report showed employers adding 850,000 jobs, the biggest gain in 10 months. Generally, obstacles to hiring are tumbling down. Rising vaccination rates, easing restrictions on businesses, and expiring unemployment benefits all continue to stoke jobs. In addition to strong job growth, markets have also continued to be bolstered by reports of rising earnings – according to FactSet, a record number of companies have revised Q2 sales and earnings estimates upward. While higher corporate earnings are one of the strongest drivers of higher stock prices, it is unclear how much of this good news is already baked into prices with markets sitting very near record highs. The S&P 500, in fact, notched its 38th record-high close of the year, as recently as Monday, July 12th.

An additional factor that has continued to support markets – for now at least - has been the participation of retail investors. Some speculative pockets of retail investment have collapsed, for example Bitcoin has fallen about 48% since its late April peak. Yet individual investors still poured $27.9 billion into stocks in June, according to Vanda Research. This is the highest monthly level on record since at least 2014. Individual retail investors have a reputation for being late to the party, so these large inflows tend to warrant a more cautious view heading into the summer months. We also note that markets at large have not had a correction of at least 5% since October of 2020.

One trigger for such a correction may prove to come from persistently high inflation data. A rapidly reopening economy juiced with cash stimulus from the Federal Reserve has continued to fuel pent-up spending for goods and services, driving prices higher. Over the prior three months through June 30, consumer prices measured by the so-called core price index (the Fed's preferred measure of inflation that excludes volatile food and energy prices) has now risen **2.3%.** This 90-day rate of change translates to a startlingly high annualized rate of **9.2%.** Over the last year, the core price index has now increased **4.5%** from June 2020 – the largest 1-year increase for that reading since 1992. The only silver lining we can see here is that if such inflation persists through the fall, Social Security recipients would stand to see their largest COLA increase since the early 1980's.

Index Total Returns	Q2 2021	2021 YTD
Russell 1000 Growth	11.93	12.99
Russell 1000 Value	5.21	17.05
S&P 500 Composite	8.55	15.25
DJ Industrial Average	5.08	13.79
NASDAQ Composite	9.68	12.92
S&P MidCap 400	3.64	17.59
Russell 2000	4.29	17.54
MSCI All Country Ex USA	5.48	9.16
FTSE Emerging Markets	5.16	8.10
MSCI U.S. REIT	11.74	21.24
Barclays US Aggregate Bond	1.83	-1.60
Barclays US High Yield Bond	2.74	3.62
Barclays Municipal New York	1.88	1.48
Bloomberg Commodity Index	13.30	21.12

Meanwhile, the Fed has downplayed inflation risk, repeating their drumbeat that inflation readings are merely "transitory" and assuring markets that inflation will recede next year. We are skeptical, tending to agree with economist Milton Friedman, who once quipped that the only time to be *really concerned* about inflation is when the Fed says *not* to be. The reality is that the U.S. money supply has increased by about 30% over the last year. While supply chain issues and reopening issues are indeed transitory, money supply is simply not. If this dynamic causes inflation to be higher than expected or linger longer than expected, interest rates would likely need to be lifted sooner, or more aggressively, causing returns on most major asset classes to suffer.

With Covid variants spreading, inflation data strengthening and retail investors with government-stimulus cash continuing to pour money into financial assets, the market may be overdue for a more robust correction than we have seen this year. We would advise clients to anticipate more downside volatility while understanding that the strong YTD returns we have enjoyed might mean further gains may be harder to win in the second half of 2021.

Current Portfolio Stance & Outlook

NLFP Core Model Portfolios ended mid-year with results ranging from **+4.70%** to **+13.90**, producing consistently solid and stable performance relative to benchmarks and index returns. In this environment where we have seen rampant thematic bubbles ranging from cryptocurrencies to meme stocks, our core index approach will not provide flashy returns. It has continued to provide our clients with reliable returns and greatly reduced risk compared to active, performance chasing investment strategies that are currently holding sway.

Among your holdings most accretive to performance in the first half were **Vanguard Small Cap Value** (VBR, +23.1%) and **Vanguard Value Index** (VTV, +16.8%). Lagging components included **iShares Aggregate Bond Index** (AGG, -1.6%) and **FirstTrust TCW Fixed Income** (FIXD, -1.14%). Bonds performed better in Q2 but higher quality, intermediate duration funds remain negative for the year. On the equity side of the ledger, international stocks after a strong start to the year, waned in Q2 and produced the lowest equity asset class returns in our portfolio. Our largest international holding **iShares Core MSCI EAFE Index** (IEFA) was up just **9.14%** during the first 6-months of 2021.

Our current portfolio positioning (after modest tweaks to our strategic allocations in April) continue to favor value-style stocks and maintain our weightings in both international index holdings and smaller companies. We currently observe a generally pervasive laisse faire attitude towards inflation risk. In fact, we feel this remains the largest risk to financial stability as aggressive inflation would, in-turn cause more aggressive interest rate increases. Besides adding weight to our **Fidelity Inflation Protected Bond Fund** position (FIPDX, +1.72% YTD) twice in the last 9 months, our April rebalancing added to short duration bonds less sensitive to the risk of rising rates. Growth and technology stocks which were also recently trimmed in our models, would likely be hit the hardest in an adverse inflationary scenario, while value stocks would likely show more resiliency. In addition, because the U.S. stock market is relatively more skewed towards growth stocks, international equites, with inherent value stock orientation, should be less affected.

On the heels of post-Covid and post-election relief, the first half of the year provided a remarkably smooth performance ride. We must expect some tests to investor fortitude and heightened volatility in the second half of the year. With our Spring rebalancing completed, a bias towards holding quality assets and no exposure to investment fads, we would recommend our clients enjoy the summer with the expectation of riding through any volatility that should occur. Especially this summer, with so many opportunities to enjoy travel, family and friends that 2020 did not afford, we encourage you to indulge knowing that your portfolio will continue to participate in market gains, with a thoughtful and careful approach to managing inflation and other risks for the balance of 2021.

NorthLanding Financial Partners, Investment Direction Committee

1. Investment index and NLFP portfolio performance data through 6/30/2021 is provided by Morningstar and believed to be accurate as of the date of this publication, gross of any advisory fees. Other sources include the Wall St. Journal, Bloomberg, Federal Reserve Economic Data (FRED) and the Vanguard Group. All investment strategies including diversified asset allocation have risk. Past performance of our investment approach, and component holdings does not guarantee future results. Advisory services are offered through NorthLanding Financial Partners, LLC, ("NLFP") Registered Investment Advisor. While all data is believed to be from reliable sources, accuracy and completeness are not guaranteed.