Second Quarter 2021 Commentary

Investments and the Economy

The economic recovery forged ahead in the second quarter and stocks expanded on the first quarter rally. . For the quarter ending 6/30/2021, the S&P 500 was up +8.55% bringing its total performance for the year up to +15.25%. It was the fifth straight quarter in which the S&P 500 experienced returns greater than 5%. This current rally is remarkable for its consistency and lack of volatility, notwithstanding the wild ride of “meme-stocks” and crypto-currency.

Fixed income also exhibited positive performance for the quarter and was up +1.83%, bringing the YTD performance to -1.60%. The strong quarterly performance was driven in large part by the decline in treasury yields from a 52 week high of 1.74% down to +1.45% as of June 30. Much of the move came after the June Federal Reserve meeting when Chairman Powell reiterated that while they acknowledge inflationary pressures building in the economy, they mainly attribute these to “transitory factors”. We tend to agree with this notion and shared our thoughts several weeks ago in our piece, “Should Investors be Worried about Inflation”.

The performance of International equities continued to lag the U.S. after several challenging months, which saw the emergence of the new COVID-19 Delta variant and slower rollouts of vaccines (more on this below). However in spite of these challenges, the MSCI EAFE closed the quarter up +4.37% bringing the total performance for the year to +7.33%.

From the perspective of the U.S. economy, consumer behavior and economic metrics suggests that many believe the Covid-19 pandemic is a thing of the past. Consumers, flush with cash, are spending again as cities and states re-open. GDP growth was a strong 6.4% in the 1st quarter and in fact the International Monetary Fund (IMF) now expects the U.S. to achieve 6.4% annualized growth for the entire year. A level not seen since the 1980's.

3Q Outlook

While we continue to view the current backdrop as supportive for risk assets such as equities, we remain cautious about the velocity of the economic recovery. The June FOMC meeting reinforced our belief that the central bank will keep conditions accommodative for as long as the unemployment rate remains elevated. Though some analysts have argued that equity valuations are above their historical norms, we believe it is warranted given the low interest rate environment and the lack of financial assets that produce positive, inflation-adjusted returns. History has also shown us that equity valuations are typically elevated coming out of a recession

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but that companies will often grow into those multiples in the year following. We are seeing this dynamic play out today. Below is a chart of the S&P 500 earnings per share estimates for the full year of 2021. At the start of the year the consensus estimates were for$160.33 per share and that number has increased approximately 15% from January and estimated earnings on the S&P 500 now stand at $183.68.

Additionally, we are tracking and watching the money supply levels or what is known as "M2" to economists. A recent report from Bloomberg suggested there could be as much as $20 trillion in total cash deposits, savings deposits, and other short term, "near

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cash" investments. While there has been concern about goods inflation, it is reasonable to believe that at least some of this cash will flow into equities.

Conclusion:

We believe that concerns about inflation and subsequent rising rates are overblown. Yes, we are experiencing a short term inflation spike but we do not view this as a secular trend. In our opinion, the FED does not appear to be in a hurry to increase interest rates. With the Delta variant taking hold around the world, and yes, also here in the United States, the pandemic is, unfortunately, far from over. "Breakthrough" cases, those testing positive for Covid-19 who are fully vaccinated, are on the rise, although thankfully most are experiencing mild cases or are totally asymptomatic (although that adds to the challenge of controlling the spread). This new phase of the pandemic is likely to lead to a delay in offices reopening and may force politicians to again implement mask wearing mandates and could cause disruptions with the back-to-school in season in the Fall. We believe it has never been more important for investors to allocate capital to a well-diversified portfolio with a focus on high quality, actively managed equity strategies and not shun risk assets solely based on their strong performance of the last year.

As always, we welcome any questions or thoughts and wish you a wonderful summer.

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