WaterRock Global Asset Management, LLC

MARKET REVIEW & OUTLOOK

June 2021

BREAKING NEWS

- The June unemployment report was released on Friday with job gains of 850,000, exceeding expectations. The mega cap Tech sector loved the news and soared over 1%, while the Russell 2000 small cap dropped over 1%. Consensus is that this leaves the Fed right where they are at.

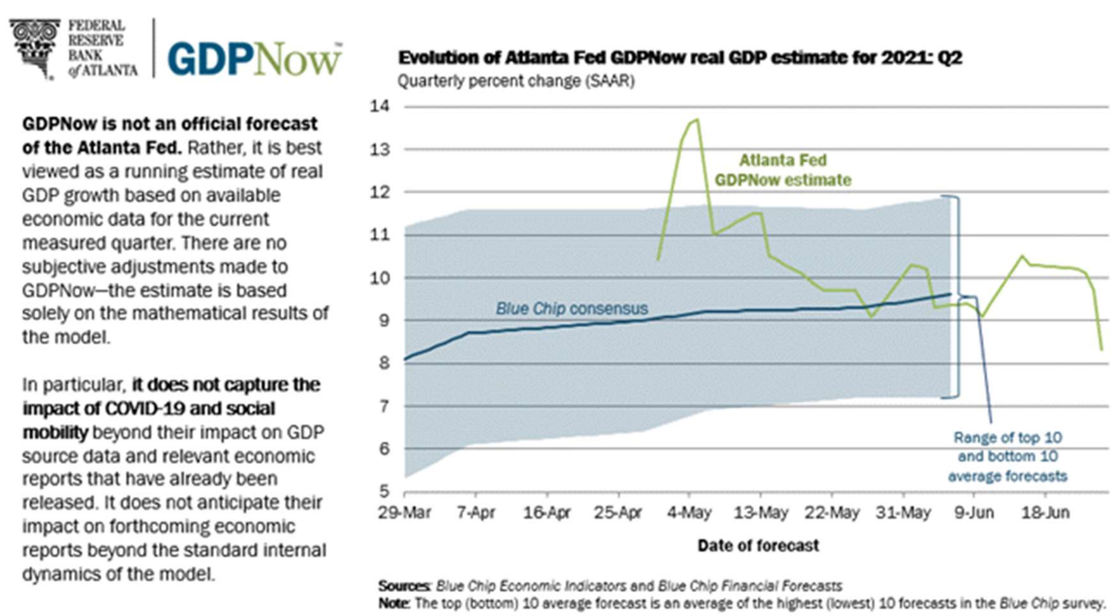
Back to our regularly scheduled programming…

KEY TAKEAWAYS

- Global Equities generally continued marching higher setting additional all-time highs during the month, though market gains were muted.
- Interest rates dropped fairly significantly during the month on longer maturities.
- The staunch “transitory” inflation stance of the Fed took a shot across the bow during the latest Fed meeting in mid-June. Though still looking like a long time before Fed words become actions.

The U.S. Economy

The economy continues to be robust, though the results are now generally not beating lofty expectations. The market is all about expectations and if expectations get too far ahead of results, the markets generally cool off. As can be seen in the chart below, 2nd quarter GDP expectations are for stronger growth than we saw in the 1st quarter. However, the green line shows the trend of expectations, with incoming data, has taken a turn lower.



Source: https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

The fixed income markets saw a pretty sharp drop in yields to start the month on the 10-year Treasury, then saw some volatility in anticipation of the mid-month Fed meeting, which reversed after the meeting concluded. The strength in the base Treasury rates resulted in solid results throughout the fixed income complex, including high quality fixed income. High-quality fixed income, as measured by the iShares US Aggregate Bond ETF, saw positive returns, finishing the month with a gain of +0.72%. The U.S. 10-year Treasury bond yield ended the month near the bottom of the range at 1.44%, down from May's close of 1.58%.

The Dow Jones Industrial Average eased -0.08%, the S&P 500 rallied +2.22%, and the small cap Russell 2000 climbed +1.83%. The international markets where bifurcated, "delta" variant concerns? The MSCI EAFE iShares Core International Developed Markets ETF Index slumped -1.35% and conversely the MSCI Emerging Markets iShares Core ETF Index gained +1.58%.

In June, we again saw wide performance divergence in a couple of large sectors, but in the opposite direction of last month. As the chart below shows, the Inflation is "transitory" large Growth sectors outperformed the Value sectors during the month.

The best performers were…

- Technology: +6.81%
- Consumer Discretionary: +3.30%
- Energy: +3.18%

The worst relative performers were…

- Materials: -5.67%
- Financials: -3.42%
- Utilities: -2.96%%

Source: https://www.sectorspdr.com/sectorspdr/tools/sector-tracker

Oil Report

In June, crude oil had a steady rally on recovery hopes and expectations that OPEC+ would continue to be supportive of higher prices by restraining the rate of supply growth. The recovery continues to look intact and OPEC+ did not disappoint committing to continued restraint of supply through the end of the year. Additionally, the outlook for a renewed agreement with Iran has waned especially considering the newly elected president of Iran has expressed no interest in a deal. The current NYMEX WTI Crude Oil futures settled at $73.47 and posted a gain of over 10% from the prior month close of $66.32 a barrel. The price for RBOB gasoline had a saw-toothed pattern higher. RBOB finished higher by almost 5% for the month of June. Gas prices were supported by the continued strength of the economy and the summer driving season. We had to travel to Los Angeles and did so by car and saw firsthand the increase in gas prices. Arizona is nearing $3, but California was nearly a full dollar more and almost $4, one of the benefits of no longer living in California, 😊 Next up is hurricane season, which is off to a robust start with 3 named storms already. We will have to keep an eye on potential production disruptions.

The Rest of the Data

As mentioned previously, the economic growth continues to be robust, though as the chart below shows, expectations have been higher than reality has been printing.

Source: https://www.zerohedge.com/markets/stocks-bonds-soared-q2-bitcoin-buck-broke-down

The May ISM Manufacturing Index increased 0.5 points to 61.2 from April's reading of 60.7. Additionally, the ISM Services Index increased to 64.0 from 62.7 in May, notching an all-time high. The prices paid component remains very elevated in both surveys and continues to signal strengthening inflation pressures. Any reading above 50 generally indicates improving conditions. Consumer confidence jumped to 127.3 in June, which compares to an upwardly revised figure of 120.0 in May. The unemployment rate fell, coming in at 5.8%, as the economy added more jobs than April's print, but still missed expectations, with only 559,000 jobs in May. The Consumer Price Index for All Urban Consumers (CPI-U) was up +0.6% in May, the first relative monthly decline since at least November, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index increased +5.0% on a non-seasonally adjusted basis, which continues to be the highest reading since 2008. The CPI ex Food and Energy was 3.8% and the largest 12-month increase since June 1992. Overall, these numbers suggest that the economy has enough momentum to finish the quarter with growth at or near double digits in the 2nd quarter. The Fed did soften their stance on whether inflation is "transitory", by now thinking about when to raise rates and the answer was sometime in 2023. Initially the market sold off on fear of Fed easing coming to an end, though the market realized this was more like your parents calling and extending your curfew from Midnight to 2am, so the party still has time to go!

Summary

The story of the last few months continues, the economy is strong, unemployment is reducing, and inflationary pressures are firming. The Fed sort of blinked with a minor acknowledgement that inflation may not be "transitory" but stating action may not occur until 2023 leaves a lot of time for the markets to run wild on continued Fed support. This could lead to the proverbial policy error by the Fed, the market is taking the Fed at their word, but if the current 5% inflation rate lasts much longer the Fed may have to back track and act in 2021. Fed rate hikes this year would be a complete blindside to the market and would likely lead to a significant drop in stocks, especially growth-oriented Tech stocks. The Fed has pushed in all their chips on Black, let's hope it doesn't flip Red. We will continue to monitor developments and evaluate if any position changes are warranted in the coming weeks and months.

Our focus is on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is sustained vs. transitory inflation, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. If the markets continue to march higher, we will capture some of those gains and reallocate to less volatile high-quality bonds. If the equity markets enter a period of negative performance, we have dynamic investment vehicles that utilize rules-based defense mechanisms to reduce the risk of the portfolio. Further, if the market gets too extended on the upside, some of the vehicles will capture partial gains and wait for the extension to correct.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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Institutional Asset Management adapted for Private Wealth™

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