MARKET REVIEW & OUTLOOK

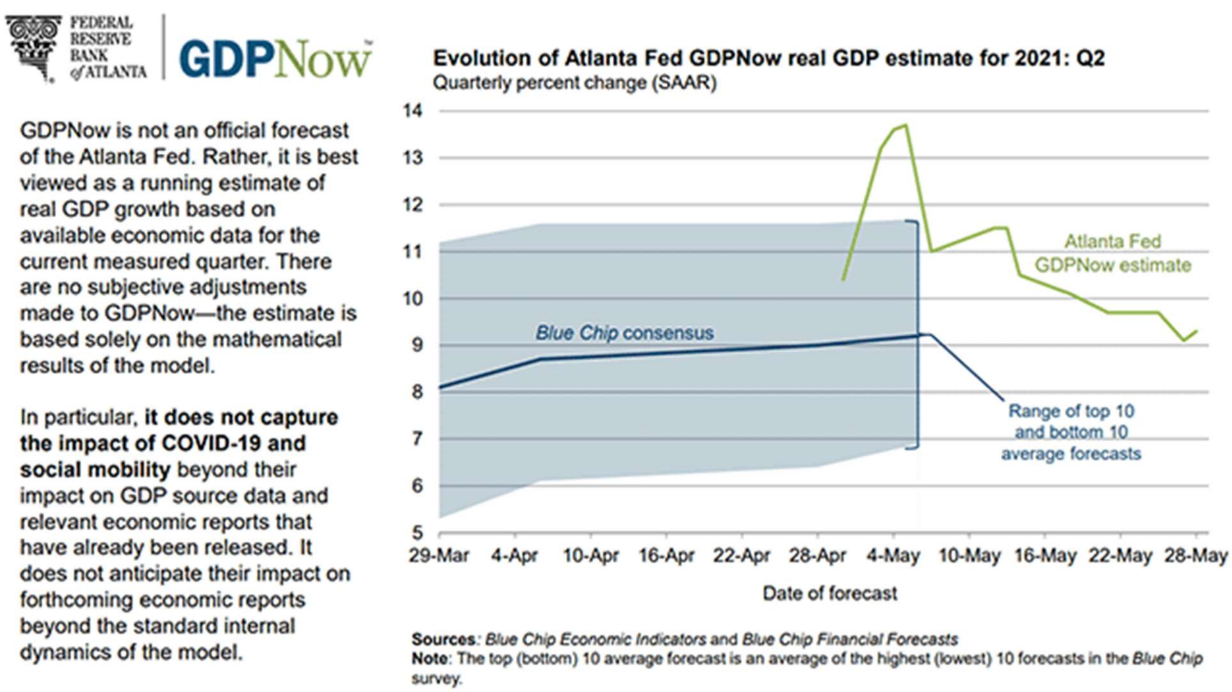
May 2021

KEY TAKEAWAYS

- Large Cap Global Equities hit additional all-time highs during the month, though market gains were tepid.
- Interest rates were also tepid and traded in a relatively narrow directionless range.
- At least "temporary" inflationary pressures are showing themselves, which likely led to the above as markets' weigh whether inflation is a longer-term threat or transitory. Of course, this is the multi-trillion-dollar guess for the Fed as well as markets.

The U.S. Economy

The revised 1st quarter GDP was reported and remained the same at 6.4%. The outlook, as shown below, continues to forecast expectations for stronger GDP growth in the 2nd quarter, maybe even hitting double digits. If those results come to be, then we are on solid footing to have some of the strongest annual GDP growth in history by the end of 2021.



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

Stocks and Bonds

The fixed income markets were fairly muted this month as the yield on the 10-year Treasury, traded within about plus or minus 8 basis points (0.08%) of last month's closing yield of 1.63%. The sideways shuffle in the base Treasury rates resulted in muted 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 +0.30%. The U.S. 10-year treasury bond yield ended the month near the middle of the range at 1.58%, down from April's close of 1.63%.

The Dow Jones Industrial Average rose +1.93%, the S&P 500 gained +0.55%, and the small cap Russell 2000 eked out a positive +0.11%. The international markets took the lead from the U.S. markets. The MSCI EAFE iShares Core International Developed Markets ETF Index rallied +3.32% and the MSCI Emerging Markets iShares Core ETF Index climbed +1.20%.

In May, we saw wide performance divergence in a couple of large sectors. As the chart below shows, the lower valuation Value sectors outperformed the large Growth sectors during the month.

The best performers were…

- Financials: +5.70%
- Materials: +4.62%
- Energy: +4.19%

The worst relative performers were…

- Consumer Discretionary: -3.00%
- Technology: -2.36%
- Utilities: -0.67%%

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

Oil Report

In May, crude oil started the month holding the strength of April and then saw some choppiness on the prospects of Iran rejoining the oil markets, which would increase supply. However, the clear path to Iran regaining access to global markets hit a snag and crude rallied to finish at the highs of the month. The current NYMEX WTI Crude Oil futures settled at $66.63 and posted a gain of nearly 5% from the prior month close of $63.58 a barrel. The price for RBOB gasoline followed a similar path to crude oil. RBOB finished higher by over 3% for the month of May. The strength in gas prices were supported by the cyber-attack on the Colonial Pipeline that had significant disruptions to supplies on the East Coast, but as the pipeline came back online gas prices eased with the return of supplies. Memorial Day marks the beginning of the driving season and this year marks the highest Memorial Day gas prices since 2014. Given that last year most were locked down, this year's traffic is forecast to be 53% higher than last year.

The Rest of the Data

The economy continues to be firing on all cylinders, though longer term could be hamstrung by challenges to hire staff and the ongoing debate of the sustainability of the currently very robust inflation readings. The former was discussed in last month's newsletter and became a topic of action during the month of May. Several states took action to accelerate the September 6th timeline to end the "pandemic" boost from unemployment benefits. Businesses feel that the generous unemployment benefits are rewarding former employees with higher incomes to stay at home than returning to work. There is a debate on this topic and whether that was a large contributor to the significant disappointment in the April employment report discussed below.

The April ISM Manufacturing Index decreased 4.0 points to 60.7 from March's reading of 64.7, the continued strength of commodity prices is still pointing to rising inflation as prices paid continue to be very strong. Additionally, the ISM Services Index eased to 62.7 from 63.7 in April, easing from an all-time high. Any reading above 50 generally indicates improving conditions. Consumer confidence eased to 117.2 in May, which compares to a downwardly revised figure of 117.5 in April. The unemployment rate increased, coming in at 6.1%, as the economy added a much weaker than the 1+ million expectations, with only 266,000 jobs in April. The Consumer Price Index for All Urban Consumers (CPI-U) was up +0.8% in April on a seasonally adjusted basis. Over the last 12 months, the All-Items Index increased +4.2% on a non-seasonally adjusted basis, which is the highest reading since 2008. Overall, these numbers suggest that the economy has enough momentum to finish the quarter with growth at or near double digits in the 2nd. Given the economic strength, continued strength in inflation readings supported by signs of robust wage inflation, the Fed's "transitory" stance continues to be further pressured and has started Fed discussions that it might be time to start thinking about whether to think about acting. Yes, Fed speak and jawbone "easing" has gotten this complex (circular). 😊 Either way, the above concerns have led to the dreaded "stagflation" word gaining more press. The chart below shows the juxtaposition of strengthening inflationary readings measured against economic data missing expectations, the old "was that as good as it gets" mantra potentially taking hold.

Source: https://www.zerohedge.com/markets/bullion-best-may-tech-wrecks-bitcoins-biggest-bust-decade

Summary

The expected narrative of the last few months has become reality. Economic growth continues to be robust and inflation readings have strengthened significantly. We are now approaching the moment of truth, with June potentially being pivotal. The battle royale, transitory vs. sustained inflation, who will win is hard to determine. The Fed and many other central banks, i.e., Japan, have been desperately seeking out sustained inflation for years if not decades, will they finally get too much of their wish? Or will the longer-term deflationary pressures of a heavily indebted system exert their forces. I think anyone firmly stating one position versus the other is overly simplifying a very complex system. 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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