May 2021

Market Update

The moment the market has been waiting for has arrived. For the last year stock prices have steadily risen in anticipation of a surge of economic activity driven by record savings and stimulus, deferred consumption, low interest rates, and vaccinations. Investors have assumed this activity would lead to 2021 earnings so strong that they would make 2020's terrible numbers irrelevant to company valuations. We are now seeing the first quarter earnings numbers roll in, and for the most part they are indeed the impressive numbers the market was hoping to see. As of April 26th about a quarter of the S&P 500 companies had reported Q1 earnings, and 84% of these reported numbers that beat estimates. In aggregate, Q1 earnings are 24% above estimates which were already elevated. If these percentages hold for the whole quarter they would be the largest positive surprises since FactSet began tracking these measures in 2008.

Gross Domestic Product estimates for 2021 started in the 3-4% range, moved into the 5-7% range a few months ago and are currently in the 6% to 9% range. Earnings estimates for all four quarters rose in April as well. This has certainly helped markets and virtually every major asset class showed gains for the month. Interestingly, interest rates which had been moving higher for months as growth accelerated suddenly peaked and moved lower in April. While falling rates are often seen as a sign of a cooling economy, it would be one of very few signs potentially indicating this and it is more likely that the lower rates were caused by foreign investor bond buying (US rates are more attractive) and bank treasury buying (banks having so much in deposits from the recent stimulus checks).

So while most news will probably be very positive over the next several months we should remember that there are always risks to investors. New strains of the coronavirus are making their way across the globe and may disrupt a global recovery. Supply chains have not recovered from last year's shutdowns and won't fully recover for some time. Shortages of materials like lumber and semiconductors/chips and of inputs such as labor have caused prices to move meaningfully higher. This will affect companies differently, so there remains a level of uncertainty we can't avoid.

New tax policy is also creating uncertainty. Stimulus spending, an infrastructure package, and an American Families Plan will be accompanied by a need to increase tax revenues. The proposed spending, which could eventually be moderated, will require meaningfully higher taxes. While most discussions have centered around corporations and the highest income households doing the heavy lifting a broadening of the tax base, involving more middle to upper income tax filers, may be necessary. We have yet to make any investment portfolio adjustments based on potential tax law changes but we will continue to monitor these developments and will have an update once details are more clear.

We also have not changed our base case which is that the recovery will continue through 2021 into 2022 with longer-term interest rates and inflation slowly rising as the economy moves towards some level of normalizing. We are not forecasting a market correction but we should acknowledge that a market pullback would be completely normal. This is especially true given the last twelve month's rise in prices, high amounts of leverage/borrowing on margin, and the speculation we have seen in certain corners of the market. We still believe that productive companies across broad economic sectors are attractive under current conditions and we continue to analyze company and asset class valuations in light of prices and interest rates.

Performance Summary

The S&P 500 index moved 5.3% higher in April and is now up 11.8% YTD. Other markets across the globe were also higher (developed markets +3.0% and emerging markets +2.5%). Small companies were up less but still positive at 2.1%. Concerns about supply chains and shortages helped real assets with real estate up big and commodities up 9.5%.

Bonds were higher in April (+0.8%) as interest rates fell. As noted above falling rates sometimes indicate market weakness but fear gauges were not rising. The US dollar fell 2.0% and the VIX volatility index was flat. Gold was up 3.0% but for the year is still -7.1% and it has not moved over the last year.

There is a risk of loss from an investment in securities, including the risk of total loss of principal, which an investor will need to be prepared to bear. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable or suitable for a particular investor's financial situation or risk tolerance.

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The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities. There is over USD 9.9 trillion indexed or benchmarked to the index, with indexed assets comprising approximately USD 3.4 trillion of this total. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

The CBOE Volatility Index, or VIX, is a real-time market index that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of the S&P 500 index options, it provides a measure of market risk and investors' sentiments. It is also known by other names like "Fear Gauge" or "Fear Index."

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