Market Commentary

June 30, 2021

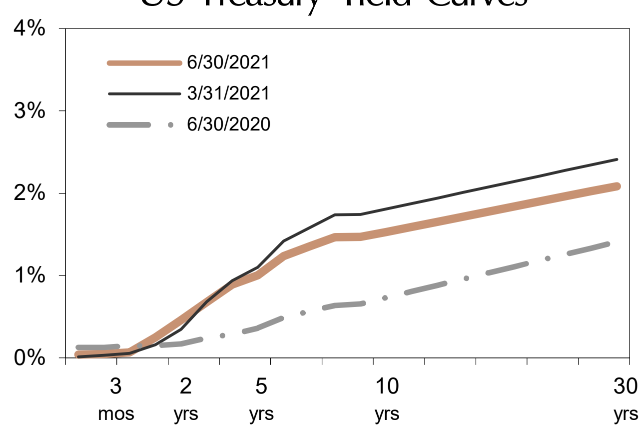
THE GREAT REOPENING!

As we entered the just concluded second quarter, an abundance of HOPE and OPTIMISM filled the air as investors had been reinvigorated with THE vaccine(s) and the belief that the pandemic was fading, additional monetary stimulus and enough pent-up demand to propel economic growth for a while, leading to what many predicted for Q2 and possibly beyond – The Great Reopening! A Roaring-20's of the 21st Century. Dancing in the streets! Okay, maybe that is a bit of a stretch but, when you see reports of morning, rooftop dance parties, 100 stories up in New York, that are reportedly free of drugs and alcohol, maybe not? Anyways, the reopening story has been months in the making and should lead to expanding global growth in the second half of the year, which should be good for stocks. The issue at hand is whether inflation, which is currently, above target in terms of the parameters set by the FED, is transitory, meaning temporary, or more of a long-term issue that will need to be addressed? We'll, see.

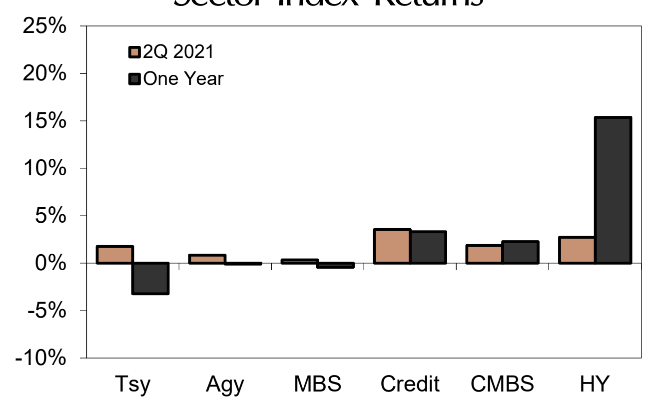
For the quarter, the broad-based "reopening trade" and rally continued as US equity markets posted positive returns, thus outperforming international and emerging markets, as the S&P 500 was up 8.55% vs. 5.48% for International (MSCI EAFE All Country World ex-US Index) and 5.05% for Emerging Markets. Large cap stocks outperformed small cap, both domestically and abroad. However, large cap growth outperformed large cap value, while small cap value outperformed small cap growth. REIT's, with housing prices soaring, was the top-performer outperforming all asset classes with the Dow Jones REIT Index up 11.76% in Q2. For the quarter, the Barclays US Aggregate Index was up 1.83%, yet is still negative year-to-date –1.60%.

Speaking of fixed income, bonds recovered some during the quarter as the FED signaled it was on watch for all inflationary pressures. Yields on the 10-year US Treasury slid during the quarter from 1.74% to 1.45% (29 bps). The 30-year US Treasury declined from 2.41% to 2.09% (32 bps). High-yield bonds continue to outpace government and corporate bonds, as the Morningstar High Yield Bond Index rose 2.7% in the second quarter and 15.4% over the past year. This is consistent with the belief of a stronger economy.

US Treasury Yield Curves



Sector Index Returns



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From the onset of the quarter our portfolio durations were slightly below their benchmarks as we continued to expect the yield curve to gradually steepen, despite the slight flattening we witnessed during the first quarter. Credit spreads narrowed during the quarter fueled by massive central bank liquidity and now only look like fair value versus treasuries. Although we continue to maintain an overweight in credit exposure, our portfolios credit spread duration is slightly less than that of their benchmarks. We have maintained an underweight in MBS versus the index, given the uncertainty over potential defaults due to temporary layoffs and the expectation of the FED tapering their purchases of mortgage securities (MBS) in Q4.

Economically, the U.S. continues to re-open and recover, which should continue to be good for stocks. As of this writing, nearly all signs are positive, minus the concern surrounding inflation (CPI). Growth in terms of GDP continues to expand with the most recent GDPNow Q2 forecast to be 7.8%. The June labor report surprised to the upside adding 850,000 jobs, yet despite this the unemployment rate did tick upward to 5.9%. Additionally, May's initial report was revised upward to 583,000 from 549,000 workers. Another positive is that the demand for labor is showing in wage growth as wages grew by 6% in June and are up 4% over the last two-years. Inflation (CPI) though, as mentioned above, is somewhat the one negative at this time. May Core CPI rose 3.8% YOY (year-over-year), the biggest increase since June 1992, yet is believed by most to be transitory, or temporary, as it includes the historically low numbers from the shut-down a year ago. In other words; as things get back to "normal" over coming months, the inflation numbers should revert back to more "normal-like" figures that we are used to seeing. It bears repeating that the FED's, recently revised/updated inflation target, for when they would be expected to take initial action on curbing inflation is "an average of 2%". As fixed income managers, we are cognizant and wary of the potential for the economy to begin "running hot", leading to higher inflation and interest rates, thus eroding portfolios of their principal value, which is what we look to guard against. Stay tuned!

In equities, the disparity in sector performance witnessed in the first quarter narrowed in the second, with all but the utilities sector posting gains. Real Estate stocks led the way, gaining 12.3%, with Technology (+11.3%), Communications (+10.5%) and Energy (+10.1%) not far behind. Technology shares seemed to benefit from stronger-than-expected earnings and expectations for a slower rebound where investors are betting on their growth potential. In late June President Joe Biden seemed to secure a deal on an infrastructure package worth about $1 trillion to upgrade roads, bridges and broadband networks over the next eight years. The agreement fell short of the $2.3 trillion infrastructure spending plan announced in March, and as of this writing has not been passed but could be an additional positive for stocks, particularly industrial and material companies.

While the reopening is alive and well when considering many areas and pockets of the economy, it seems to be in fits and starts, thanks in large part to supply issues, if not outright shortages. Home sales have probably never been better. Many homes are being bought sight-unseen and almost all at premium prices above the original asking price. Auto sales, particularly used vehicles, are also fetching premiums, which is mostly due to the computer micro-chip shortage that was due to the COVID shutdown, as well as global trade and tariff issues. For those interested in installing a pool, there is a 2-year wait in many parts of the country. And forget about buying appliances or furniture unless it is on the store-room floor! All are supply issues and thus driving up prices (inflation) – at least temporarily. Some data though is starting to confirm the transitory nature of the current environment. For example, recent consumer survey data points to a decline in the intentions of consumers to buy homes, autos and other large durable goods. We'll, see.

As always, we will remain diligent and disciplined in our approach, realizing that it is these principles that steer us to the VALUE capital markets have to offer long-term investors. Stay safe and be well!