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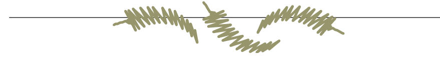


MARKET COMMENTARY **April, 2021**

The S&P 500 rose 6% in the 1Q2021 to finish at a record close. Equities were the only major asset class to gain ground in the quarter, as bonds declined with the spike in longer term interest rates. The 10-year Treasury yield increased 83 bps to close out the quarter at 1.74%. Value and cyclical stocks outperformed growth as funds rotated into areas thought to benefit from reopening and a sharp rebound in economic activity. In recent weeks, performance has broadened to include large cap high quality growth stocks and longer-term interest rates have also taken a breather. Stepping back, the S&P Index is up roughly 80% from the March 2020 low but a more comprehensible 21% from its prior high in February of last year before the pandemic and tumult of 2020 unfolded.

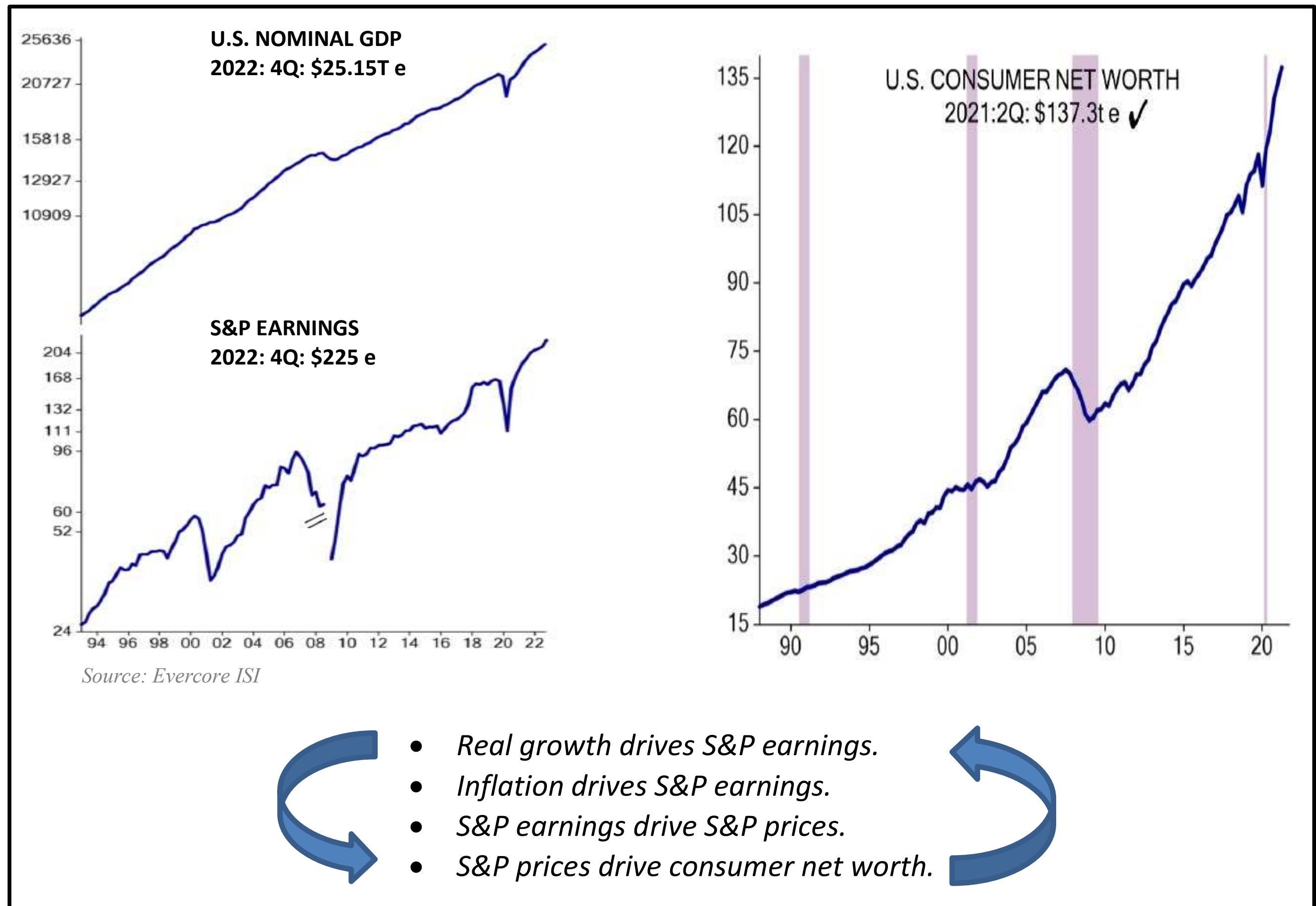
A Time Like No Other

No less an authority than legendary investor Stanley Druckenmiller has called the current environment the "wildest cocktail of market forces" he has ever seen in more than 40 years as a hedge fund and investment manager. GDP is poised to grow at its fastest rate since WWII at 7% or more, with housing, retail sales, manufacturing, corporate profits, and consumer net worth (aided by fiscal stimulus in the form of pandemic relief payments directly to taxpayers, rising home values and stock prices) all booming. Money is booming too as monetary and fiscal policy remain the most accommodative in modern history. The market is awash in cash and this is powering assets higher across the board. Plentiful money has also created bubble pockets, even manias, from the Robin Hood Game Stop retail investors to cryptocurrencies to electric vehicles and fuel cells to a relentless IPO market of alluring disruptive but unproven businesses.

The breadth of the recovery and acceleration in activity is also extraordinary:

1. Vaccines are working at "warp speed" with 130 million Americans (40% of the population and almost 45% of adults) already partially vaccinated and 81 million fully vaccinated.
2. Inflation is picking up, particularly in the commodity space, but the Fed believes it will prove transitory and is willing to tolerate inflation above the 2% target level for a time.
3. The National Manufacturing Survey registered its highest reading in March 2021 in 37 years. Housing, auto, and inventory rebuilding are all leading the way.
4. Employment growth was stronger than forecast in the last two monthly reports and we could see a 4% unemployment rate by year end.
5. China's economy is also booming but much of the rest of the world remains in the grip of the pandemic. Vaccination progress is slow and reopening has barely begun in Europe and parts of Asia and Latin America. When this finally happens, it will boost global growth significantly in the second half of the year. It will also boost inflation and yields could surge again as we saw in March. The Fed will likely wait until the pandemic seems well in hand in Europe and globally before announcing its plans for tapering bond purchases – but this could come as early as the Fall.

6. Consumer net worth is up over 20% in past year and the Wealth Effect is benefiting the economy and stocks. An elevated savings rate provides further fuel for a boom in consumer spending and a pick up in the "velocity" of money as we discussed in our last letter.
7. The economy drives the market and vice versa. Corporate profits are surging and are projected to set new highs in 2021 by a goodly margin and then increase another 5%-10% in 2022. Peaks in the S&P 500 Index typically coincide with a peak in earnings.



Conclusion

Given its rapid vaccination rate, and progress towards herd immunity, the United States is poised to be among the first of the larger industrial nations to return to full production and employment. Despite the tragic loss of life, the effort to regain pre-corona virus levels of economic growth and production is unfolding rapidly—in contrast for a while at least to the more stagnant European Union that will take months to catch up to U.S. vaccination rates.

It has become popular to draw parallels between the current environment and the *Roaring Twenties* when America also emerged from a global pandemic. But some economists have compared the likely trajectory of 2021 post-viral America to the second half of 1945 and 1946 when an intact America—in contrast to devastated Europe, the Soviet Union, and Japan—experienced an economic surge. In the words of historian Victor Davis Hanson: "Civilians and soldiers reemerged from wartime conditions in a country

untouched by war, but awash in vast deficit spending, pent up demand, and new factories and services ready to be recalibrated to serve consumer demand and population growth."

All sorts of known unknowns follow. When will tax hikes, new regulations, green energy subsidies, curtailment of traditional oil and gas, and massive accumulating debt begin to slow things down? Will a near $30 trillion national debt growing at $2 trillion a year finally lead to inflation, or stagflation, or permanent zero interest rates - or an abrupt recession, or worse? No one knows. But the potent cocktail of forces unleashed favors a robust economy well into 2022. We have positioned our portfolios accordingly, adding stocks over the past few months that should benefit from global reopening and a stronger economic environment.