

## Market Review and Outlook—April 7, 2021

**The Phoenix Rises From the Ashes**—The stock markets bottomed out in mid-March 2020, and so the past year began near the very bottom of hope, promise, and optimism. Half of the figures in the table below, a year ago, were red, with stock losses during the past quarter ranging from 14% to 35%. This served as a bit of a trampoline, enabling stock prices to soar from their incredibly depressed levels last March.

**Markets, Economy, Jobs**—While these three factors are related and ultimately move in the same direction, their timing differs. Typically, markets move first, then the economy, and eventually jobs. In 2020 we had a sudden dramatic shock to the planet, a global pandemic. The suddenness and the scale abbreviated the timing. Global stock markets began to fall, sharply, last February. The US economy began a near lockdown in March, and unemployment skyrocketed the same month. The unique characteristics of this pandemic has led to the development of a very unique recovery timeline for all three factors.

This month the IMF concluded that the recession would have been up to three times worse were it not for the incredible \$16 trillion government fiscal support provided globally. In the US, the Cares Act could not prevent dramatic unemployment, but weekly checks were often provided during these partial shutdowns and financial support was provided to avoid massive foreclosures and evictions. This flood of money helped families ‘tread water’ while they waited for the pandemic to be solved.

And the pandemic has seemingly been solved, with treatments identified during the Spring, Summer and Fall of 2020, and vaccines approved by December. The US has provided at least one vaccine dose to over 30% of residents, and the pace is increasing. There are worrisome variants, however it appears that we are making progress every day.

With federal spending providing a base of support for US families, and medical science advancing towards solutions, the stock markets looked well beyond 2020, and surged steadily from their mid-March 2020 lows. The economy appears to be following suit, with about a 12 month lag; it is expected to surge for at least the next year, and this doesn’t fully incorporate the further fiscal stimulus from the American Rescue Plan passed into law last month. Over 60% of lost jobs have been recovered, and all lost jobs could come back by the end of next year.

### What should investors do now, after the markets are already back?

Category	3 Months	12 Months	3-Yr Avg	5-Yr Avg	10-Yr Avg
<b>Fidelity Cash Reserves</b>	+0.00%	+0.01%	+1.14%	+0.87%	+0.44%
<b>Intermediate Core Bond</b>	-2.96%	+2.79%	+4.57%	+3.11%	+3.34%
<b>Intermediate Muni Bond</b>	-0.20%	+5.77%	+4.27%	+2.89%	+3.82%
<b>Large-Cap Stock</b>	+6.74%	+56.80%	+14.87%	+14.80%	+12.40%
<b>Mid-Cap Stock</b>	+10.93%	+74.76%	+12.39%	+13.04%	+10.72%
<b>Small-Cap Stock</b>	+15.14%	+89.31%	+11.96%	+13.48%	+10.55%
<b>Foreign Large-Cap Stock</b>	+3.71%	+48.07%	+5.94%	+8.81%	+5.40%
<b>Health</b>	+0.72%	+50.10%	+15.75%	+15.28%	+15.29%
<b>Real Estate</b>	+8.21%	+39.76%	+9.47%	+5.92%	+8.25%
<b>Technology</b>	+3.65%	+90.09%	+26.19%	+26.85%	+17.46%
<b>Moderate Allocation (60% stocks)</b>	+4.21%	+36.90%	+9.72%	+9.70%	+7.99%

*The data in this table comes from Morningstar and is as of March 31, 2021.*

*Information herein should not be construed by any consumer and/or prospective client as a solicitation to effect, or attempt to effect, transactions in securities, or the rendering of personalized investment advice for compensation.*

**Grand Canyon Investing**—We have never witnessed such a quick deep recession or such a quick, steep recovery. This requires some discipline. The first rule is to resist the temptation to consider figures which begin before the canyon and end within the canyon, or begin within the canyon and end after the canyon. Specifically, you should largely disregard the first two columns in the performance table on the prior page, with figures for the past calendar quarter and the past year's results. The 3-, 5-, and 10-year figures, however, are much more meaningful. Similarly, whether stocks are cheap or expensive is often determined by looking at PE ratios (share price divided by earnings per share). At this time, however, earnings are still deep in the canyon and thus fail to provide their traditional insight, as earnings are expected to surge over 30% this year and 15% next year.

**Bonds First**—Let's begin by looking at bonds, and specifically at what we call quality bonds, those which trade based on their interest rates. The short-term Fed rate has been essentially zero for most of the past decade. When it was higher, it never even reached 2½%. Ten-year Treasuries, currently at 1¾, have been below 4% for the past decade. With quality bond yields so very low, it is simply impossible for them to provide attractive ongoing returns. The best that you can expect is to annually earn their low current interest rate, and to not worry much about their price see-sawing.

This leads bond investors to look beyond quality bonds, into what we call opportunity bonds. These bonds trade more based on their credit quality, and the direction of the economy. These include a range of types of bonds, including high-yield bonds, bonds with floating interest rates, convertible bonds, foreign government and corporate bonds, and bonds from emerging markets. As a class, these have two notable characteristics: they currently yield more than quality US bonds, and, should the US and global economy strengthen, their prices should rise, boosting returns.

Quality bonds are all-weather assets, while opportunity bonds are fair-weather assets. At this time, we see very strong economic growth for at least the next year, and as such, we are 'leaning into' opportunity bonds.

**Taking Stock**—As noted on the prior page, today's stock prices appear to fully incorporate all of 2021's good news, the path to COVID-19 herd immunity, lifting of the range of activity restrictions, the unleashing of the US consumer after being restrained for over a year (watch out, Disney World!), and even the American Recovery Plan's multi-trillion dollar stimulus. Thus the critical question is, what will the US and global economies look like in 2022 and 2023?

While there is great support for a very strong US economy in 2021 and early 2022, there are several worrisome factors. The first is inflation. Historically inflation has risen in the face of significant government debt and monetary stimulus. The past 13 years has shown us that this is not a guarantee, for government deficits have ballooned and the Fed's stimulus has been massive, and yet inflation has largely remained under 2% for years, and under 3% for almost 30 years. The reason that I raise it now, is that the planets are aligning for inflation by next year, with a lot of money in US consumers' hands and limited supply of goods and services. The second worrisome factor is that there aren't clear catalysts for US real economic growth past 2022 to exceed the 2% ceiling we have faced for the past twenty years.

**Curbing Our Enthusiasm**—The chart on the previous page shows double digit annual returns from US stocks for the past 5- and 10-years. This has been wonderful, and has led to very generous current portfolio values. However, it describes a market in which future returns will be lower, a 'reversion to the mean.' Now lower returns aren't as bad as they sound, given 1) past higher returns have boosted portfolio values, and 2) inflation remains much lower than its historic average level of almost 4%.

**Looking for Gems**—There are some areas of optimism, in addition to opportunity bonds as mentioned earlier. There are areas with more modest returns over the past ten years, notably value stocks and foreign stocks. Both have been outperforming in recent months, and this could persist for years. We are always looking for unappreciated values. This is a bit harder to accomplish now, but even more important.