Market Review and Outlook—July 8, 2021

COVID-19 is Fading from the Headlines—In the past quarter the US has exceeded a 50% level of its total population with at least one dose, and UK, France, and Germany are in the same neighborhood. During the past three months, Japan has jumped from about 2% to 25%, India has reached 20%, and Brazil exceeds 30%. While there remain many hotspots in the US and the rest of the developed world, we appear to have reached the homestretch of the race. With most health metrics improving steadily, investors' attention has shifted from public health to economic health.

The Punchbowl is Spiked—President Biden and Congress in March passed the $3 billion American Rescue Plan, and a $1+ billion infrastructure deal appears to be firming up. New monthly child tax credit checks are arriving this month, pumping new dollars into the US economy.

Jobs are on the Rise—While pandemic-boosted unemployment benefits have ended in several states, and all end in September, job openings are reaching record highs. Industries decimated by the pandemic, such as hospitality, entertainment, and travel, are rebounding. The global supply chain was crippled during the pandemic, and companies are working hard to rebuild their inventories, and ensuring that their supply pipelines are secure. This is driving manufacturing activity, and the related jobs.

Ignoring the Pandemic—The last pandemic on the order of COVID-19 was a century ago. As such, it appears to be irresponsible to view the economics and market activity that includes a portion (the meltdown only, or the recovery only) of the pandemic, and draw any conclusions. I therefore suggest simply ignoring the **12 Month** column, below, and instead spending more time on the **3-, 5–** and **10-Yr Avg** columns.

What Does the Table Tell Us? Over the past twenty calendar years, bonds have returned close to 5% annually, and stocks have returned 5-10%. The table indicates that trailing 10-year figures are lower than normal for bonds, fairly normal for foreign stocks, but greater than normal for US stocks. I will discuss our outlook for bonds on the next page. The data in the 10-year column of the table indicates that US stocks are 'ahead of themselves.' I note that over the past three years investors have arguably earned five years worth of returns.

And So? Any time this table is all blue, caution is warranted. Any time that some lines have figures much greater than others, it is likely time to conduct very deliberate rebalancing. On the next page I will review our expectations for future directions in investments, and how this relates to good rebalancing decisions now.

Category	3 Months	12 Months	3-Yr Avg	5-Yr Avg	10-Yr Avg
Fidelity Cash Reserves	+0.00%	+0.01%	+1.02%	+0.86%	+0.44%
Intermediate Core Bond	+1.77%	+0.77%	+5.26%	+3.02%	+3.31%
Intermediate Muni Bond	+1.53%	+4.61%	+4.51%	+2.72%	+3.64%
Large-Cap Stock	+7.55%	+40.47%	+16.77%	+16.15%	+13.21%
Mid-Cap Stock	+5.47%	+50.44%	+13.15%	+13.75%	+11.35%
Small-Cap Stock	+4.36%	+60.18%	+11.32%	+13.88%	+11.19%
Foreign Large-Cap Stock	+5.12%	+33.76%	+8.50%	+10.08%	+5.80%
Health	+7.18%	+30.16%	+16.10%	+15.71%	+15.27%
Real Estate	+11.34%	+36.79%	+10.81%	+7.03%	+9.08%
Technology	+8.63%	+53.90%	+27.50%	+28.80%	+18.74%
Moderate Allocation (60% stocks)	+5.21%	+27.06%	+11.00%	+10.26%	+8.34%

The data in this table comes from Morningstar and is as of June 30, 2021.
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Eradication, Economy, Earnings, Employment—While it is a receding concern, we must begin by reviewing the global status of COVID-19. Many leading countries have exceeded a 40% vaccination rate by June 30th, and the pace is steady, at times accelerating. Certainly we would love to see a higher rate in the leading countries, and we would love to see a broader list of countries well on the vaccination path. However, it appears that vaccinations will continue to increase in number and breadth across the globe. You could view this as a 'rolling recovery' from COVID-19.

Virtuous Cycle in the US—Substantial vaccination rates in the US have enabled businesses and industries to begin to return toward normal, and this return has been aided by broad fiscal and monetary stimulus/support. Investors correctly foresaw this last year as US stock markets quickly began a steady and strong recovery, and have recently been making new highs. US company earnings for 2021 are expected to exceed not only the depressed 2020 earnings, but also the pre-pandemic 2019 earnings. Further record earnings levels are expected in 2022 and 2023. Jobs have rebounded dramatically, as unemployment fell from a 15% high last April to a below-average level of 6% lately. Job openings are at the highest level in over 20-years as enhanced unemployment benefits are set to expire, setting the stage for further strong economic growth for several more quarters.

Rolling Global Recovery—This same virtuous cycle is likely across the globe, in the coming year or two, as each country/economy reaches a sufficient vaccination level to enable its economy to reach (exceed) its pre-pandemic levels. Rolling recoveries can be very good for investors, as they can help sidestep a coordinated downturn. Furthermore, if every global economy was emerging from the pandemic at the same time, this would introduce a dramatic level of sudden demand, which could lead to an inflationary spiral.

Stock Earnings versus Stock Prices—Given this backdrop, we are very optimistic about stock earnings growth, in the US and overseas. However, investors don't directly buy and sell stock earnings; we directly buy and sell stock shares (often through mutual funds and ETFs). Current stock shares, especially those for US companies, are high, as measured by the P/E ratio. In the first half of 2021, the P/E ratio fell over 5%, however the earnings rose almost 20%. The first half of 2021 provides a prime example of the case in which an overpriced stock market can keep rising as long as earnings are growing strongly. The $64,000 question, therefore, is whether US stock prices will reach less expensive levels through rising earnings, or falling prices, or a bit of each. Phrased another way, how much of the rest of 2021's earnings growth, and 2022's is fully priced into today's US stock market prices?

Stock Strategy—We feel that US stock prices are expensive, but not unreasonably, given the very strong future earnings growth expectations. We do feel that foreign stock prices are more attractive than in the US, and foreign stock markets stand to benefit from the same strong earnings recovery as in the US, just appearing later.

Inflation, Interest Rates, and Bonds—The inflation bogeyman has been predicted since the Great Recession of 2008-2009, tied to the big bank bailout. It didn't show up then. The same threats have been heard since March 2020 with the multiple multi-trillion dollar fiscal recovery packages adopted over the past sixteen months. It hasn't shown up yet this time either. The reason is that fiscal stimulus is inflationary when the economy is strong, but not when the economy is dangerously weak. This reason is why the Fed is focused on unwinding the dramatic monetary stimulus it has overseen since 2008.

The Fed's monetary stimulus over the past 13 years has led bond rates to be fairly flat. The return for intermediate-term core (quality) bonds has been only 3.31% annually over the past decade. The currently yield for 10-year Treasury bonds stands at 1.4%, less than one-quarter the average yield over the past 63 years.

And Therefore?—With all of this background, we expect little from quality bonds. They do provide stability when surprises arise (such as last year's global pandemic, when they did exceptionally well). However, they also include risk of painful losses should rates rise sooner and higher than expected (which, by definition, we don't expect). With such a strong economic growth story underway and apparently ahead of us, we continue to lean heavily into opportunity bonds. Given the headwinds faced by quality bonds, and given the strong economic growth dynamics here and abroad, we are maintaining a modest lean into stocks, and are looking for foreign stock returns to begin to outpace US returns, 'any time now,' and for this to continue for several years.