Quarter 2 - 2021 Market Update
This is what recovery looks like

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We hope you are doing well as you read this Market Update Letter. This is our quarterly newsletter where we review the past quarter, share our perspective on the current situation and what we expect going forward.

Lifting off…how far we have come

The last twelve months have been something none of us could have imagined back in 2019. Just over a year ago business closures and lockdowns were taking hold. We found ourselves in the midst of a pandemic and everyone was absorbing the reality and implications of restrictive government health mandates. Economists and financial experts quickly began trying to determine what kind of recovery we would experience coming off a man-made recession. This was to be a recession like no other experienced before and was new territory for all of us.

Many initially argued for a V-shaped recovery, expecting all economic activity to slow dramatically, but then ramp back up as we recovered from the pandemic. As time progressed, the economy realized more of a K-shaped recovery. This type of recovery happens when different parts of the economy recover at varying rates or times, versus a more even recovery across industries, sectors and workers. As an example, companies that sold goods online recovered faster as people sat home and shopped (some using stimulus money) online, while many service, entertainment and leisure businesses that endured the most restrictive closures are more recently seeing business increase.

The stock market's recovery has been more V-shaped, as investors began looking forward to an eventual recovery, starting as early as late spring/early summer 2020. Currently, economic activity is quickly accelerating as vaccinations occur, restrictions on business are lifted, and large financial stimulus are all benefitting the economy. Gross Domestic Product (GDP) growth is expected to be quite strong over the next quarter or two as the economy rebounds. After that we expect economic growth to likely slow back to a more average, yet still positive pace.

Primary contributors to our recovery from COVID-19

Vaccines

The U.S. invested in vaccines from multiple pharmaceutical companies and has distributed those vaccines faster to the population than many other developed nations. This success is allowing us to resumie a more normal lifestyle. As noted by Larry Adam, Raymond James Chief Investment Officer, in his April 12th webinar titled "Resilience is in our DNA", Israel, who has led the world in vaccinations, has found that when you have 25% of the population vaccinated, you begin to experience a systematic and more permanent decline in the number of COVID-19 cases. According to the CDC, as of April 18th 30% of the United States' population has been fully vaccinated, and 50% of U.S. adults have received at least one Covid-19 vaccination, so we are already above this metric.

Government spending

Government spending to help support the economy during the pandemic, including the recent 1.9 trillion dollar stimulus package, has totaled 5.5 trillion dollars. That is 2.5 times more than what was spent during the

Great Recession in 2008 and more than 10 times (in today's dollars) what the government spent during the Great Depression. This unprecedented level of monetary support has put dollars into the pockets of many Americans, some of which has found its way to the markets.

Federal Reserve support

Additionally, the Federal Reserve increased their balance sheet by 3.5 trillion dollars, buying bonds and mortgage-backed securities.

The combined support of government spending and the Federal Reserve's balance sheet increase totals 9 trillion dollars. That amount, according to Adam, is enough to be the third largest economy in the world. It is also more than the combined economies of Japan and Germany.

All of this is allowing the economy to not only re-open, but do so with expectations for strong consumer spending and economic growth. There is a lot of pent-up demand for spending. Consumers with stimulus checks in hand and who have enjoyed increases in the value of real estate and investments are ready to get out and spend money. Adam noted in the webinar that the Federal Reserve recently raised their expectations for GDP growth by 2.3%, saying they now believe the U.S. economy will grow by 6.5% during 2021. That is the single largest growth-revision increase ever.

First Quarter Index performance and Market Update

Before we go on to discuss the broader picture as we see it currently, please take a few moments to review first quarter-2021 returns. The eye-popping returns for the past twelve months are likely to stand out. These are the returns from the bottom of the COVID-19 induced sell-off. It is yet another example of why it almost always pays to remain invested, rather than panic and abandon the market during tumultuous times. As nerve-wracking as it was, 2020 turned out to provide a great opportunity for those able to add to investments.

Dow Jones Target Risk Indexes	QTD	YTD	Past 12 months
Dow Jones Aggressive Index	6.62%	6.62%	63.39%
Dow Jones Moderate Aggressive Index	4.67%	4.67%	48.91%
Dow Jones Moderate Index	2.53%	2.53%	35.47%
Dow Jones Moderately Conservative Index	0.34%	0.34%	22.70%
Dow Jones Conservative Index	(2.00%)	(2.00%)	9.58%
U.S. Equity Indexes			
S&P 500 (Total Return)	6.17%	6.17%	56.35%
RUSSELL 2000 (Total Return)	12.70%	12.70%	94.85%
International Equity Indexes			
MSCI EAFE DEVELOPED MARKETS	3.48%	3.48%	44.57%
MSCI EMERGING MARKETS	2.29%	2.29%	58.39%
Fixed Income Indexes			
BLOOMBERG BARCLAYS US AGGREGATE BOND	(3.37%)	(3.37%)	0.71%
BLOOMBERG BARCLAYS US CORPORATE HIGH YIELD BOND	0.84%	0.84%	23.72%

Returns provided by Morningstar as of 3/31/2021

Turn, turn, turn, to everything there is a season

This song that has been covered by multiple artists, but was originally sung by The Byrds comes to mind as we write this. The past several years, and especially last year was the season of growth-style investing. If you

never re-balanced your portfolio the past few years, you would likely be way over-weighted in growth-style investments. This year value investing has come roaring back. Let us explain how and why this is occurring.

We noted on our First quarter Market Update in early January that the strong gains made during November and December represented the strongest November/December combo ever. As a result, we stated in the short-term markets were over-extended we anticipated a consolidation period or pull-back.

What ended up happening is that instead of a full-fledged correction the market instead began rotating. Some areas of the market, such as technology and stay-at-home stocks that did quite well through the pandemic were sold off so that buying could occur in other areas of the market that now look poised to benefit from the economic improvement:

- **Financial** companies benefit from an increase in economic activity and higher interest rates.
- **Energy** is enjoying tailwinds from an increase in oil prices and improvement in the economy. After a long period of underperformance, during which many energy companies found ways to cut cost and run more efficiently, these companies are attracting investors.
- **Consumer discretionary** businesses, such as retailers, restaurants, entertainment and travel have all been coming back to life. Investors started investing in these areas in anticipation of restrictions being lifted, life getting more back to normal and a pent-up demand for these types of activities. They also are beneficiaries of stimulus checks.
- **Industrials** businesses also benefit from the re-opening. Additionally, the Federal Government is working on an infrastructure package that would benefit many companies in this sector.

The result of all this rotation was a correction within areas such as technology, some online retailers, grocers and staples that made strong gains in 2020. However, with investments going into formerly unloved areas there was an overall broadening out of investments, so the S&P 500 and Dow Jones Industrial Average indices were able to continue a slow march higher, making new all-time highs. More recently money is flowing back into some of the stocks that corrected and market breadth is very strong, an indication of an overall healthy economy and market.

At any time a correction may still occur, and likely there will be at least one during 2021, but with low (although rising) inflation, continued low (although slightly rising) interest rates and a very accommodative Federal Reserve that has told us repeatedly they don't expect to raise rates any time soon, we expect continued gains across many areas of the market to occur.

What could be cause for concern

Massive government spending - The amount of government spending that has occurred this past year is unprecedented. The Biden administration is planning tax increases to offset some of the spending, but they really can't tax their way out of this much debt and additional spending they want to take incur through a yet-to-be-passed infrastructure package.

Inflation - Inflation is picking up, coming off very low levels. As everyone gets out and increases spending a short-term surge in inflation is expected, but Federal Reserve Chairman, Jerome Powell continues to express his opinion this will be temporary. Currently most experts believe sustained inflation will not rise much above 2%. The economy can continue doing quite well around that level.

Rising bond rates – Rising rates were partly to blame for the recent correction in technology stocks. When interest rates rise the cost of borrowing increases and many growth companies borrow money to help fund their growth. Adam believes that the 10-year treasury yield will top out about 2% at year-end. While it has been rising as the U.S. economy recovers from the pandemic, a few things will help keep the 10-year from rising much about 2% in the near future.

1. Many countries outside the U.S. are behind us in the pandemic recovery. Most countries have extremely low interest rates, so the current 2-year rate around 1.6% in the U.S. (as we write) is more attractive to investors. Healthy demand for U.S. government bonds helps keep rates low.

2. It is in the best interest of the U.S. government for interest rates to remain low. According to Adam, combining all government and personally held debt in the U.S. totals 46.1 trillion dollars. Higher rates means it will cost more to pay off that debt. That would slow the economic recovery. The high amount of debt is a concern and one that will have to be dealt with, but for now as long as interest rates remain low and economic growth is strong that will help.

If experts are wrong about inflation expectations or if treasury bond rates rose much higher than expected or too quickly those things would create headwinds for the market, so we are paying close attention to these things.

Finally, at some point the Federal Reserve will need to begin raising interest rates. That could certainly cause a market pullback. Overall though, things are supportive of the bull market continuing for the foreseeable future.

We will continue e-mailing you invitations to informative conference calls when they occur. Please also check our website and social media pages regularly for timely updates on all these topics.

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As always, please let us know of any significant changes in your life or situation that could impact your financial plan. In the meantime, we continue to follow the processes we have developed over the years that enable us to provide you our very best.

Thank you for your trust in me and in our practice.

Sincerely,

Eric W. Hilliard

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