

Thoughts from the Holy City – May 2021

“Successful investments are usually long term because they flow from forces that are significant and likely to be in place for some time – years even or even decades.”

- Gary Shilling

The markets continue their upward trend, supported by accommodative fiscal policy from the Federal Reserve, strong gross domestic product (GDP) numbers and solid earnings reports.

As President Biden celebrated his 100th day in office to close the month, the traditional favorable equity market performance during the so-called “honeymoon” phase continued, with the S&P 500 rallying about 10% over that time frame. The S&P 500 ended April up 5.24%, its third consecutive positive monthly gain. The Dow Jones and NASDAQ reached new highs as well.

Driving the equity market higher is the rapid distribution of over 235 million vaccines, the best economic growth (+6.4% annualized) since 2003, and a dramatic, better-than-expected surge in corporate earnings – the highest (+36%) since 2010, explains Raymond James Chief Investment Officer Larry Adam. As the presidential “honeymoon” period ends, debates over government spending, taxes, inflation and Fed tapering are likely to lead to increased volatility.

The advance estimate of first quarter GDP came in at a 6.4% annual rate, but Raymond James Chief Economist Scott Brown notes that the headline figure understates the economy’s strength. Consumer spending on durable goods rose sharply, fueled by stimulus checks, and spending on services should pick up as the economy reopens.

In Washington, infrastructure and tax proposals remain just that – proposals. Congress is drafting legislation, and Raymond James Washington Policy Analyst Ed Mills expects to see broad compromise in order to secure the necessary votes. Generally speaking, Mills believes we can expect a significant amount of additional federal spending later this year tied to revenue-raising measures. The compromises necessary for passage may create a near-term Goldilocks scenario for the market in terms of further economic stimulus.

Yield, interest rates and inflation

With interest rates remaining low despite positive economic reports, demand for yield is rising across all bond maturities. Investors are keeping a wary eye on inflation, as are the members of the Federal Open Market Committee. Long-term inflation expectations, which have remained close to the Federal Reserve’s 2% long-term goal, are key. Should those long-term inflation expectations rise significantly, then actual inflation would trend higher, Brown notes. However, the Federal Reserve, which wants inflation to be moderately higher in the near term, has the tools to bring inflation back down. Fed Chair Powell has signaled that monetary policy will remain accommodative until employment and inflation are closer to the central bank’s goals.

Overseas

Once again, U.K. and European markets generated modest gains for the month, lifted by positive earnings reports and optimism for economic recovery as more and more vaccines get distributed. However, in Asia, market performance was decidedly mixed. Singapore and Hong Kong made plans to broaden travel opportunities; on the other hand, Japan (host of the Summer Olympics) implemented its first-

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ever lockdowns, and India's COVID-19 cases rose to record levels, prompting large-scale economic disruption.

The bottom line

The vast majority of S&P 500 companies have surprised on the upside, beating their estimates by an average of 23.7%. Even with a relatively bullish outlook for domestic stocks, investors should expect normal pullbacks on occasion. Those ready to put cash to use can plan to use any weakness as an opportunity to strategically add positions at an individual stock and sector level. Lastly, remember to file your taxes before the extended deadline of May 17.

Be Well,

Grier

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The S&P 500 is an unmanaged index of 500 widely held stocks. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The NASDAQ composite is an unmanaged index of securities traded on the NASDAQ system. The MSCI EAFE (Europe, Australia, Far East) index is an unmanaged index that is generally considered representative of the international stock market. These international securities involve additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. An investment cannot be made in these indexes. It is not possible to invest directly in an index. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index. International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets.

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