BULLS&BEARS

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Grand Re-Opening

A year ago, the U.S. registered its deepest economic contraction since World War II. One year later, the economy is poised to post its strongest year of growth in almost four decades. Economic activity is gaining traction, thanks to expanding vaccine distribution, lowered public health restrictions, and substantial fiscal support. The post-World War II shift to a peacetime economy, which catalyzed a cyclical rebound of growth and inflation, may be the closest historical analog to the upcoming post-COVID era where vaccination and reopening gain steam over the course of 2021 and 2022.

With the passage of the $1.9 trillion American Rescue Plan Act of 2021 on March 11, most expectations for U.S. GDP growth in 2021 now exceed 6%, which would be the best economic growth in the U.S. since 1984. Accompany this with last years more than $3 trillion of fiscal spending and ultra-accommodative monetary policy, it's no wonder that one of the main worries on investors' minds is elevated levels of inflation. In a typical recovery from a recession, consumers, businesses, and state and local governments need time to repair balance sheets before growth in spending returns. In this recovery we currently see balance sheets flush with cash, possibly leading to higher demand levels over the coming months.

Steadfast Fed

U.S. 10-year Treasury yields jumped more than 80 basis points during the first quarter to 1.75%, continuing their recovery from record low levels during the 2020 recession. Rising inflation expectations and real yields drove the increase in nominal yields, representing expectations for a recovery in both real economic growth and higher inflation. Inflation expectations rose to their highest level since 2013.

The Federal Open Market Committee continues to reaffirm their accommodative policy stance, despite higher projections for economic growth. The Fed has also ruled out the need to contain long-term rates, noting very easy financial conditions overall. Tapering of asset purchases and interest rate increases are a long way off.

Much like Fed decisions in the 1940s, they are likely to accept higher inflation and keep interest rates low as they emphasize full employment as their primary mandate. Investor concern is that this may cause structural (long-term) inflation, rather than cyclical (temporary) inflation. The key data point we are focusing on is wage growth, as large persistent increases here could be the signal of structural inflation going forward.

Exceeding Expectations

Valuations in equity markets are elevated. Most conventional metrics (e.g., Price to Earnings, Price to Free Cash Flow, Enterprise Value to Sales, etc.) suggest global equities are expensive relative to their own history. According to FactSet, for 2021, companies in the S&P 500 are expected to generate earnings growth of nearly 22%, while international developed and emerging market stocks are expected to produce earnings gains of 29.7% and 33.4%, respectively. Since the start of the pandemic quarterly earnings have been largely surprising to the upside, with 76% of companies reporting earnings above analyst expectations over the last four quarters, above the long-term average of 65%. Though this is not our base case, the risk is that much of the good news from the economic recovery and the earnings rebound is largely priced into current equity market valuations. If this is true and earnings begin to underwhelm expectations, high volatility and a market pullback could very well be possible.

Please contact us at 1-855-829-7192 if we may be of assistance.

Market Indicators

3/31/21 Year-to-Date Change	
S&P 500	6.17%
NASDAQ	2.95%
Russell 2000	12.70%

Interest Rates	9/30/20	3/31/21
10-Year Treasury Note	0.68%	1.75%
3-Month Treasury Bill	0.107%	0.015%

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