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Market Commentary

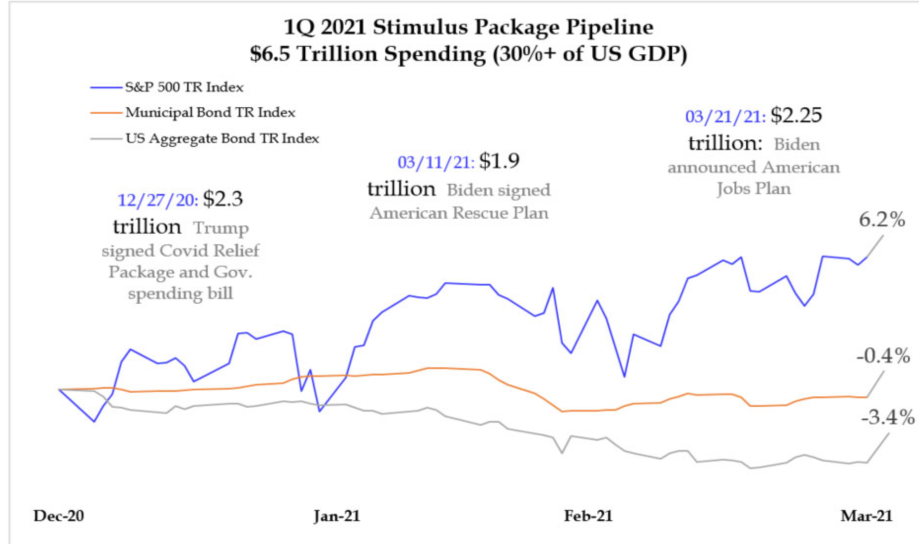
1Q 2021

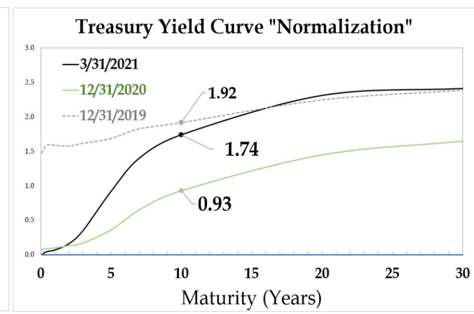
Market Movement Highlights

Looking back on what is now just over a year ago, the broad US equity market, triggered by an expanding natural contagion, collapsed by -34%. On that day (3/23/20) with fear permeating all financial markets, much like a video replay of 2008, would anyone have dared place a bet on so imminent a market recovery or the fact that the stock market would eventually close out the year delivering high double-digit returns?

To what was all of this attributable? Well, as the old saying goes, “never bet against the FED”. Now, that aphorism ought to include… OR the Yellen Treasury, OR a one-party government and a Congress all of whom are hell bent on delivering massive spending bills whose passage rests almost exclusively on the reconciliation process. Now just for a moment, look back on the last decade and you’ll probably remember when Federal Reserve Chairpersons repeatedly implored a reticent Congress to step-up fiscal assistance, knowing monetary policy alone would be insufficient to mend an ailing economy. Well those days are gone… the stimulus is here... and, at least for the present, it’s of great benefit to the consumer, to the economy and to the stock market’s continued surge.

Following the recent passage of the American Rescue Plan Act (ARPA) on 3/11/21, a cumulative $6 trillion plus is either priming or imminently poised to prime the economic pump. These massive spending programs, along with efficacious vaccines and a national rollout second to none world-wide is likely to have COVID cornered here in the US. With that, 1Q2021 saw nothing less than more of the same, as the S&P 500 and the Dow Jones averages posted solid returns of +6.2% and +7.8%, respectively. Meanwhile, after an extraordinary climb in 2020, the tech heavy NASDAQ took a well-deserved breather delivering just +3.0 %.





As is usual, following the close of any quarter, we look under the hood for cash flows and market trends. What we quickly saw in Q1 was a sharp rotation away from the favorite growth names (you know them) in big tech, telecom and communications to the lesser known value driven, economically sensitive names; stocks which underlie the more cyclical sectors like energy, financial and industrials just to name three. Each of these sectors posted outsized returns of +30%, +16% and +11.5%, respectively. This breadth of participation points strongly to an economy on the mend.

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To summarize, large growth stocks delivered a surprisingly meager +0.9% in the quarter, while value stocks surged to over +11.0%. The phenomenon also spilled over to small cap stocks with value returns swelling by some +21% vs small growth's 5%. Speculation as to the reasons behind the shift likely include the size of the pipeline's cash flow and the broad swath of programs to which it ubiquitously will be applied, including health care, education and infrastructure. Despite that a clear shift occurred, it is still too early to know if it has staying power. After all, behind the public rhetoric and the promises lies the politics of execution.

Turning to the fixed income markets, investor expectations for a swift post COVID economic expansion took a modest toll across the bond markets. Clearly, the quarter was marked by continued "risk-on" investor sentiment which left bonds to face more technical winds. For example, municipal bond pricing continued to moderate on natural demand as interest rates rose and primary market inventory remained meager. A couple of other behind-the-scene technical reasons included (a) the time of year where inventory is routinely low and (b) most states further delayed their critical new issuance as they waited to learn how much money the US Treasury would be sending their way.

To exacerbate an already modestly negative bond sentiment, yields on the benchmark 10-year Treasury began increasing sharply early in the quarter. This pressured bond pricing across the board. By quarter's end, the Municipal Bond index registered (0.4%). Taxables, as measured by the Barclays Aggregate shed some (3.4%). Meanwhile, the flood of dollars to Main Street could, sooner than later, ignite a bout of inflation despite the FED's assurances against any significant spikes.

Finally, the US Treasury curve itself continued to steepen over the quarter. This too signals an economy on the road to normalization.

On the international front, developed market stocks delivered only +3.6% for the period, while emerging markets cooled off a bit to generate +2.3%. The difference in performance vs the US was likely the result of insufficient access to vaccines, which has kept the EU and other global economies under economic and social lockdown. For now, it appears the near term engines of global growth will continue to be the world's two largest economies; the US and China.

Crypto Currency

Because it has become such a hot topic in daily financial news, permit us to offer a few thoughts on digital currency. It's fair to say that it's beginning to attract the attention of some of our most venerable banks and investment houses. As usual, institutional attention tends to enhance credibility. We suspect the logic behind the medium is that, theoretically, it is immune to human intervention i.e. manipulation by central banks. And whereas we are now experiencing massive spending initiatives, overlaying what has recently been declared to be a true US debt of >$120 trillion, it should follow that it may only be a matter of time before inflation erupts and the dollar is further devalued. Further the logic points to the possibility, real or imagined, that crypto currency may one day ascend to become the fiat of the future.

As we pen these comments, Fidelity and others like them are feverishly developing liquid crypto currency ETFs, while other companies are emerging to offer fractional trading of the currency itself.

But despite what seems to be a growing enthusiasm for Bitcoin, Ethereum or other digital coin, caution should be the rule. By its nature any fundamental valuation analysis of the medium would be notoriously hard, if not impossible to conduct. (See below the charting of Bitcoin vs the QQQ since its inception.) As well, it appears virtually impossible to determine whether, at any point, the medium is a falling knife or simply taking a breather before its next spike up. As well, if the SEC eventually approves digital ETF products, it'll do so typically with a disclaimer "that no judgement has been made as to the merits of the investment". What we do know is that once approved and introduced to the market, chaos will likely ensue making the timing of optimal buys and sells largely impossible, at least initially and then until technical analysts can begin to develop its public-wide holding/trading history. For now we suspect that an introductory crypto currency ETF is likely to replicate a speculation

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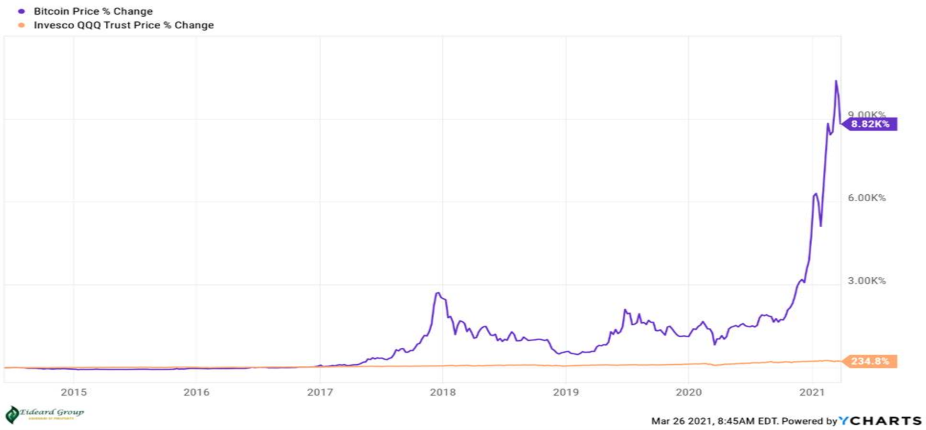
story much like what we all witnessed with GameStop! To summarize… caveat emptor!



Looking Forward

At the risk of being repetitive and "left to itself", government spending combined with pent-up consumer demand should continue to materially benefit the equity markets. As to the bond markets, core to the (ARPA) stimulus bill was the funding of some $195 billion to state governments. This stimulus will be a boon to many states thereby enhancing their creditworthiness across the national spectrum. Meanwhile, if interest rates begin to rise, the next most important question will be "How quickly?" Rates that increase gradually should, in the long run, benefit all bond markets. But the key word here is gradual! We know well that most skilled bond managers are eager to see rates rise after what has been more than a decade of nominal coupons.

In the meantime, we anticipate that Biden's Tax Plan by itself, is likely to dampen private capital formation and economic expansion should it pass in its original form. To wit, the recently floated idea of doubling up on the capital gains tax for the wealthiest of Americans sent shivers through the market and that was only one proposal. Accordingly, we should be ready for more market volatility in the coming months leading up to and following its passage.

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Major Market Indexes Total Returns

Market Indexes	**1Q 2021**	**Past 12 Months**	**Year 2020**
NASDAQ Composite	3.0%	73.4%	44.9%
Dow Jones Industrial Average	7.8%	50.5%	9.7%
S&P 500 (US large cap)	6.2%	56.4%	18.4%
Russell 2000 (US small cap)	12.7%	94.8%	20.0%
MSCI EAFE (Developed Intl.)	3.6%	45.2%	8.3%
MSCI Emerging Markets	2.3%	58.9%	18.7%
Bloomberg National Municipal Bond	-0.4%	5.5%	5.2%
Bloomberg US Treasury Bond	-4.3%	-4.4%	8.0%
Bloomberg US Aggregate Bond	-3.4%	0.7%	7.5%
Bloomberg US Corporate Bond	-4.6%	8.7%	9.9%
Bloomberg US Corporate High Yield	0.9%	23.7%	7.1%
Alerian MLP Index	22.0%	103.1%	-28.7%
WTI Crude Oil	22.4%	188.6%	-20.9%
Gold	-10.4%	5.1%	24.6%

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