ECONOMIC & FINANCIAL MARKET UPDATE – JUNE 2021
What A Difference A Year Makes!

Reflections

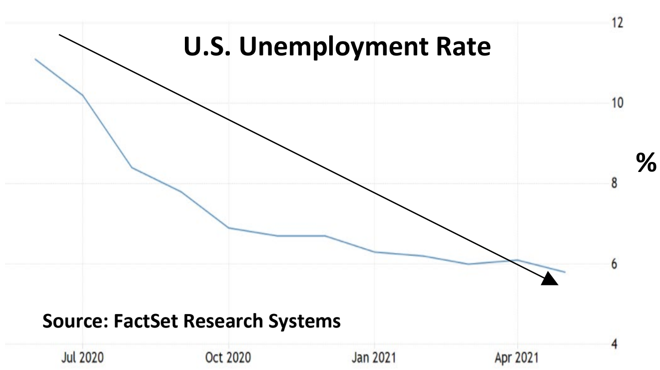
By June last year, actions and policies were clearly in place to help end the public health and resulting economic crisis that had so negatively impacted the health and wellbeing of Americans (and the globe). However, at that time (6/11/20), the U.S. economy was in the midst of two consecutive quarters of negative GDP growth[i], an Unemployment Rate of 11.1%, 1.5 million Initial Unemployment Claims[ii], declining consumer confidence, industrial production and corporate profits. Covid-19 cases and deaths were twice today's 7-day average rates[iii].

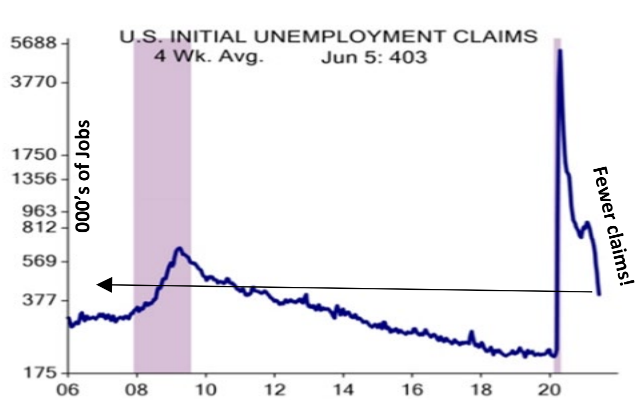
As we described in our last update though, the success of Covid-19 vaccines, along with rapid inoculation procedures (53% of Americans over 12 have had a least one vaccine shot[iv]), critical decisions by The Federal Reserve and massive economic stimulus packages e.g., ***The Cares Act***[v] and ***The American Rescue Plan***[vi], were quickly setting the stage for recovery. And quite a recovery it has been.

Moving Ahead

As a result of actions described above, the U.S. economy began to accelerate in the third quarter of 2020 led by consumers' pent-up desire to spend dollars provided by the government. The demand and strong consumer spending set the stage for what has been the sharpest economic "V" in history and is expected to be the strongest period of U.S. economic growth in more than forty years[vii]. GDP increased at a +4.3% annual rate in the final quarter of 2020, followed by a +6.4% rate in the first quarter this year, and is likely to be an even stronger annualized rate (+9.0% est.) this quarter.

With the recovery, has come sharp declines in the U.S. Unemployment rate (5.8%), and Initial Unemployment Claims (375K – a post-pandemic low)[viii]. At the same time S&P 500 profits (est. $210+/sh. vs. 2020 $139.76/sh.)[ix] and stock prices have risen significantly, Consumer Confidence has improved, and U.S. Household Net Worth has reached record levels[x]. The charts below, describe just how significant some aspects of the recovery have been.





Source: Evercore ISI, Inc. for all charts ex. U.S. Unemployment Rate

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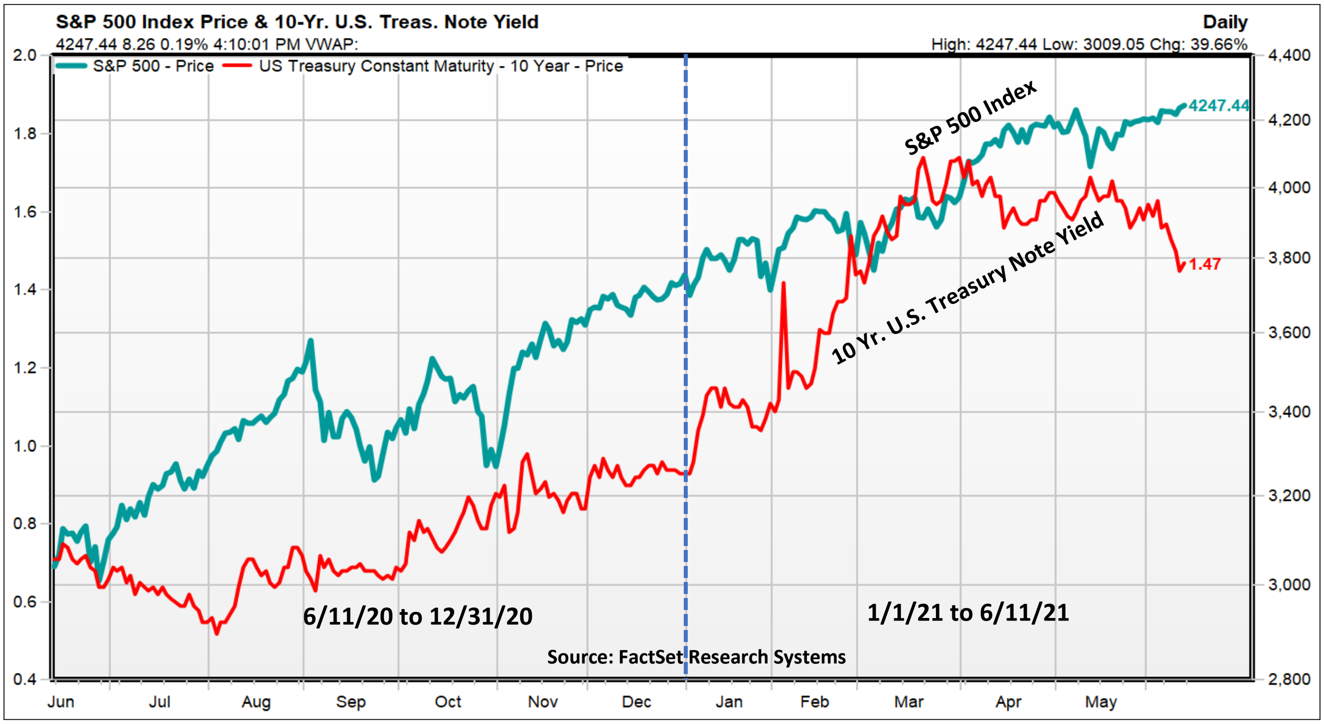
Confidence

The U.S. economy is likely still several years away from the pre-pandemic levels of employment, but the powerful economic snap-back that has coincided with monetary stimulus, successful vaccine launches, rising corporate earnings, and eased restrictions has renewed the faith of investors and is currently reflected in the strength of the equity (S&P 500) market.



During the past twelve months, the S&P 500 has risen +39.6% (+13.0% from 12/31/20)[xi] reflecting confidence in the trends just described. At the same time, although interest rates remain historically low, they too have risen, further indicating improved economic strength. As a proxy for interest rates in general, the red line on the chart displays the yield on the 10-year U.S. Treasury note. During the past twelve months, the yield increased from 0.71% to 1.47%[xii].

Despite the rise in the S&P 500 index during this period, the valuation (P/E) of "the market" has declined. On June 12th last year, the S&P 500 ended the day at a price of 3041.31 while year-end 2020 S&P 500 earnings were ***anticipated*** to be $125/share creating a P/E (3041.31/125) of 24X 2020 earnings.

Although the S&P 500 ended June 11th of this year, 39% higher (4238.44) than on the same date last year, the valuation (P/E) of the S&P is lower because ***expected*** 2021 S&P 500 earnings have increased considerably to $210/share. Using the same formula to find the P/E (4238.44/210) results in a current valuation of 20X 2021 S&P 500 earnings.

Though not "inexpensive" by historical measures, the tailwinds of increasing corporate profits (the "engine that drives stock prices"), pent-up demand, historically low interest rates, and continued domestic and global monetary stimulus should support and lead stock prices higher during the next 18-24 months, but probably not without periods of volatility.

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Looking & Thinking Ahead

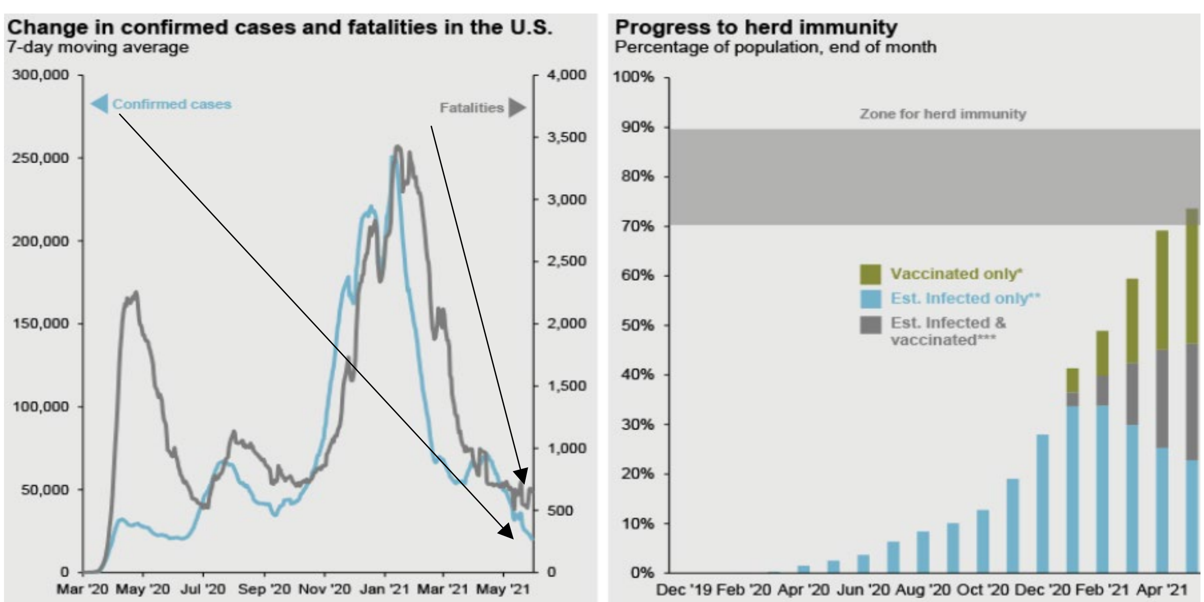
We are confident in our outlook that the simultaneous global economic recovery will continue, and the positive impact that should have on jobs, incomes, confidence, and equity values. However, we are also aware that we need to be observant of potential obstacles to that outlook. Inflation, interest rates, taxes, geopolitical risks, and any indications of a resurgent Covid-19 are on the “front burner” of our attention.

Inflation is rising as economies return to strong growth. Some inflation reflects price changes from a very low, (no inflation) pandemic base, some from supply chain bottlenecks, component shortages, raw material demand, and a now tight labor market. While concerning, we believe the recent uptick in inflation may be transitory and pressures will lessen as logistics “settle down”, elevated unemployment benefits decline and the recent “explosion” in demand moderates. We monitor this critical factor closely for trends that may change our decisions.

With respect to interest rates, The Federal Reserve will likely keep financial conditions easy until it achieves the goals of “maximum sustainable employment, and a rate of price increases moderately above 2.0%”[xiii]. While the U.S. is not close to pre-covid levels of employment, inflation has been rising at a rate above the 2.0% objective. As mentioned above, we believe that inflation pressures will lessen as the rate of expansion lessens.

A pandemic resurgence is possible, particularly in other parts of the globe, but with a growing percentage of people vaccinated, and greater vaccine availability around the globe, the probability and severity of a resurgence has declined.

Covid-19 Data – Dramatic Changes



Source: JP Morgan & John Hopkins Hospital

The Biden administration raised the likelihood of increased individual tax rates and a roll back of the recent corporate tax cut when it announced the ***Made in America*** plan[xiv]. Tax increases are likely, but not before a good deal of debate and compromise. The magnitude of any increase is not likely to negatively impact most individuals or slow the recovery. Lastly, geopolitical risk, including U.S. relations with China, North Korea and/or other regions can always create economic and financial market headwinds and deserve intense ongoing evaluation.

What A Difference A Year Makes!

Strategy

At this stage of the recovery with the positive trends of increased employment, incomes, corporate profits, low interest rates (likely to rise somewhat), strong housing, and record high household net-worth, our outlook remains cautiously optimistic. However, as we have indicated previously and as we have done, when markets or market sectors get "frothy", or as client equity allocations reach the top of their range, as they have during the past year, we have not hesitated to opportunistically reduce equity positions to maintain the well-diversified and balanced posture that we believe is critical for long-term consistent growth of principal and income. Proceeds from sales were used to further diversify the equity portfolio as well as to purchase additional bonds as interest rates have risen. Fixed income (bonds) activity has focused on the purchase of TIPS e.g., Treasury Inflation Protected Securities so that if/as inflation rises, so will the interest rate on these bonds.

Our primary focus is always on maintaining a long-term investment perspective, adhering to the philosophy and disciplines we have discussed with you, avoid reacting to "headline noise", and to maintaining high quality, well diversified portfolios. In doing so we anticipate achieving your expectations and desire for cash flow, liquidity, and growth of capital without undue volatility.

We appreciate your confidence, and we highly value our relationship and friendship. We look forward to any comments, questions, or critique you may have, and importantly, we look forward to seeing you, in person, on a more regular basis in the future.

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[i] United States Bureau of Economic Analysis; 1st & 2nd calendar quarters 2020
[ii] Trading Economics, June 10, 2021
[iii] The New York Times; John Hopkins University Hospital website, June 15, 2021
[iv] Our World In Data, June 15, 2021
[v] The Cares Act of 2020, United States Congress, March 27, 2020
[vi] The American Rescue Plan, United States Congress, March 11, 2021
[vii] FactSet Research Systems, 2nd calendar quarter 1983 to 2nd calendar quarter 1984
[viii] Bureau of Labor Statistics, May 2021
[ix] Evercore ISI & Yardeni Research, June 11, 2021
[x] Evercore ISI, June 11, 2021
[xi] FactSet Research Systems, June 11, 2021
[xii] United States Treasury, June 11, 2021
[xiii] United States Federal Reserve Open Market Committee, April 27 -28, 2021
[xiv] Made in America Plan, The White House, March 31, 2021