**First Quarter Market Review and Comment**
April 2021

**Updated Market Performance**

| Returns | 1st Quarter 2021 | One Year | Annualized 3 Year | Annualized 5 Year | Annualized 10 Year |
|---|---|---|---|---|---|
| **S&P 500** | **6.17%** | **56.35%** | **16.78%** | **16.29%** | **13.91%** |
| **DJIA** | **8.29%** | **53.78%** | **13.61%** | **15.99%** | **13.09%** |

**Performance: January began the year down -1.01% following a strong 4th Quarter. February reversed January's decline ending up 2.76%. March added to the gains from February posting a return of 4.38%, marking the first month that COVID has not dominated the market.**

After the 4th quarter posted a gain of 12.15%, the 1st quarter continued the advance but with less momentum rising 6.17%. The Dow Jones Industrial Average (DJIA) outperformed the SP500, posting 8.29% gain over the same period. For the previous twelve months the SP500 has returned 56.35%, handily outpacing the DJIA which returned 53.78% over the same period. The annualized three-year returns are well above average (around 10%) with the SP500 one-year returns posting 16.78% and the DJIA one-year returns increasing 13.61%. Over the last five years the annualized returns are running well above historical norms (around 10%), with the SP500 returning 16.29% and the DJIA posting 15.99%. The ten-year annualized numbers are also running above long-term averages (around 10.00%); the S&P500 posted 13.91% vs the DJIA which turned in 13.09%.

Breaking down the returns for the Q1 2021, we note that there were six outperforming sectors and five underperformers. **The best sectors were Energy (29.27%), Financials (15.35%) and Industrials (11.00%). The losers during the quarter were Utilities (1.94%), Information Technology (1.74%) and Consumer Staples (0.45%).** The clear winners the last twelve months were Materials (74.67%), Consumer Discretionary (69.07%) and Industrials (66.69%). Bringing up the rear were Real Estate (28.22%), Consumer Staples (24.83%) and Utilities (15.43%).

**Economy: Growth in the economy is continuing to accelerate. This will last as long as the economy continues to reopen, we continue to receive massive fiscal spending, and monetary policy remains loose. Once the economy is fully operational, spending slows, and the fed begins to tighten monetary policy the economy will go back to below average growth (Historical growth is ~3.00%). We do not currently see recession risks on the horizon. Normally when the federal reserve begins to tighten monetary policy and raise short term rates, they usually end up thwarting growth and causing the economy to go into recession. Currently, it looks like the Fed does not have plans to raise short term rates for the foreseeable future.**

**The third estimate of 4th quarter Gross Domestic Product (GDP) is 4.3%** according to the report released at the end of March by the Bureau of Economic Analysis (BEA). The latest estimate suggests that overall economic growth in the 4th quarter decreased -29.1% from the 3rd quarter 2020 and was revised upward .2% from the second estimate. GDP for 2020 came in at -3.5% compared to 2.2% in 2019, 2.9% in 2018 and 2.2% in 2017. Currently the New York Fed Staff Nowcast (Forecast of U.S. GDP Growth) has forecasted 2021 Q1 GDP growth at 6.18% and 2021 Q2 GDP growth at 1.58%. By comparison, China says their GDP increased at 2.6% in the 4th quarter of 2020. Rebounding from 1st quarter 2020 contraction of -6.8%. China became the first major economy to report growth following the coronavirus pandemic. China's 2019 GDP was 6.1%, 6.6% in 2018 and 6.8% in 2017. Growth rates for the European Union (EU) and the Euro Area were -.50% and -.70% respectively in the 4th quarter 2020. For 2019, GDP rose 1.5% for the EU and 1.2% for the Euro Area. This is down from the 1.9% growth achieved by the EU and the 1.8% achieved by the Euro Area in 2017. GDP Growth forecasts for the end of the 1st QTR 2021 are -1.00% for the EU and -1.20% for the Euro Area.

**Unemployment is continuing to trend down but is still above historical norms (~5.77%). Once all the restrictions on the economy subside the unemployment rate will decrease back to below historical averages.** According to the Bureau of Labor Statistics, March unemployment decreased to 6.0% from 6.2% in February. Unemployment for 2020 came in at 8.11% and was 3.67% in 2019. The number of unemployed decreased to 9.7 million for March. Although both measures are much lower than their April highs, they are a little less than twice their pre-pandemic levels in February 2020 of 3.5% and 5.7 million, respectively. The labor force participation rate was 61.5% in March little changed from February and 1.8% lower than in February 2020.

**Inflation increased 1.23% in 2020, marking the lowest inflation since 2015. Inflation continues to run below historical averages.** After averaging ~1.27% in the 4th quarter 2020, inflation as measured by the Consumer Price Index (CPI) increased to an average of 1.55% so far through the 1st quarter 2021. The average rate of inflation for 2019 was 1.82% and continues to be subdued by historical standards (~2.31% over last 30 years). The gasoline index rose 6.4% in February and accounted for over half of the seasonally adjusted increase of the index.

**Consumption is an important driver of the economy as it represented 67.6% of 4th quarter 2020 nominal GDP.** The U.S. Census Bureau announced in March that retail sales for February 2021 were down -3.0% from January and were up 6.3% above February 2020. Non-store retailers were up 25.9% from February 2020, while food service and drinking places were down 17.0% from last year.

**Manufacturing economy grew in March.** Economic activity in the **manufacturing sector** expanded for the month of March, with the overall economy notching an 10th consecutive month of growth after contracting for one month (April). The Purchasing Managers Index (PMI®) registered 64.7, an increase of 3.9 from January's reading of 60.8. This is the highest reading since December 1983 (69.9) prior to that, the Manufacturing PMI® registered 66 in November 1983. The Manufacturing PMI® continued to indicate strong sector expansion and U.S. economic growth in March. All five subindices that directly factor into the Manufacturing PMI® were in growth territory and at higher levels compared to February. All six of the biggest manufacturing industries expanded, in the following order: Computer & Electronic Products; Fabricated Metal Products; Food, Beverage & Tobacco Products; Transportation Equipment; Chemical Products; and Petroleum & Coal Products. The New Orders and Production indices continued to expand at strong levels. The Supplier Deliveries Index continued to reflect suppliers' difficulties in maintaining delivery rates, due to factory labor-safety issues, transportation challenges and increased demand. The overall economy grew for the 10th consecutive month, according to the nation's supply executives in the latest Manufacturing ISM® *Report on Business®*. Based on historical relationships between PMI and GDP, a PMI of 64.7 corresponds to a 6.2% increase in real gross domestic profit (GDP) on an annualized basis.

**Home prices continue to show strong price gains in January.** According to the S&P Case-Shiller Home Price Indices home prices rose in January with the S&P CoreLogic Case-Shiller National Home Price Index rising 11.2% over the last 12 months. Phoenix, Seattle, and San Diego had the largest year over year increases with 15.8% for Phoenix followed by 14.3% for Seattle and 14.2% for San Diego. According to the National Association of Realtors, the year over year change in existing home sales was 16.3% in February for Single family homes between $250,000-$500,000 and housing supply continued to remain tight in November with 2.0 months of supply.

**Markets: The markets are being swayed less by the Covid-19 virus, when restrictions will be lifted, and when the economy returns to normal. At this time, the market is being driven by more by fiscal spending, dovish monetary policy, and some actual fundamentals. 2020 was a wild and crazy market with the SP500 entering a bear market (February 19th – March 23rd, down ~33.93%) and exiting and entering a new bull market (March 23rd low – Still going, up 86.31%). Hopefully 2021 resembles little of 2020 other than another year of positive returns.**

- **Covid-19 Virus: The market reacted fast and furious as it priced in a worst-case scenario. We have since rebounded and ended 2020 at all-time highs on the SP500. The SP500 posted 33 new closing highs in 2020. This is only the eighth time since 1928 that the year has ended at an all-time high. 2021 started right where last year left off hitting 2 new all-time highs in the 1st quarter and closing above 4,000 (4,019.87) for the first time on April 1st (This was not an April fools' joke).** The immediate impact was felt quick with the closing of most of the global economy. As we continue to work to get on the other side of the virus and the economy returns to normal capacity equity markets should benefit from ultra-low interest rates and the tail wind of all the economic stimulus and fiscal spending we have and will receive. The old acronym TINA (There is no alternative) will come back to fashion.
- **Earnings growth for the SP500 is expected to increase 23.8% for the 1st quarter 2021. If the actual increase for the quarter is 23.8%, it will mark the highest year-over-year earnings growth rate reported by the index since Q3 2018 (26.1%).** According to FACTSET, of the SP500 companies that have reported earnings as of 1 April (Approximately 16), 87.5% reported earnings above the mean estimate and 81.25% have reported sales above the mean estimate. Looking at future quarters, analysts project double-digit earnings growth for the remaining three quarters of 2021, with earnings growth peaking in Q2 2021 at 52.5%.
- **After the continued rally from the low's stocks look rich.** ***Earnings growth will be above average for the next few quarters due to higher earnings and from weaker earnings in 2020 due to the negative impact of COVID-19 on numerous industries (The bar is set low).*** The current 12-month forward Price Earnings (PE) multiple on stocks is 21.9. The long term (20 Year Average) PE for stocks is 15.4, so we do not see a lot of room for valuations to move higher without growth. Lower interest rates allow for higher multiples, so we could maintain these higher levels of P/E's until interest rates return to meaningful levels.
- **Interest Rates are still near Zero again and the Fed is still waiting in the shadows ready to do whatever it takes, but they might have to tighten policy sooner than anticipated if inflation increases to fast.** The Federal Reserve dropped short term rates 1.50% in March of 2020 and launched multiple quantitative easing programs. Rates have since been left unchanged at a range between 0.0-.25%. The Fed continues to closely monitor developments and is prepared to adjust plans as appropriate. The Fed has said that it expects to keep its benchmark short-term interest rate near zero through at least 2023. The 10-year treasury started the year yielding .93% and ended the quarter at 1.74%. This sharp increase caused volatility in stocks especially those that were sensitive to interest rate increases.

**Forecast:**

**We think the biggest threats to the stock market are the uncertainty presented by the Covid-19 virus, interest rates continuing to increase accompanied by runaway inflation, the Fed beginning to tighten monetary policy, and large tax increases on corporations.** We think the SP500 will end the 2nd Quarter between 3,950 and 4,100. At this juncture, we venture a guess that stocks will end up somewhere between 8% and 10% for the year.

For the next six to twelve months, the Federal Funds rate should remain at its current range of 0%-0.25%. **The 10-year Treasury which is currently priced at ~1.63% should remain in a range between 1.60%-1.80% through the end of the 2nd quarter.**

As always, we appreciate your continuing confidence in our firm. Please let us know if you have questions.

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