Second Quarter 2021

Fig. 1 – S&P 500

Fig. 2 – U.S. 10-Year Treasury Yield

Market Recap

Stocks continued to rise in the second quarter of 2021, building on the first quarter's gains. The large cap S&P 500 index (**Figure 1**) posted a total return of +8.6%, +15.3% year-to-date. In a reversal of the first quarter's action, growth stocks, especially technology, (+11.9%) topped value issues (financials, industrials) (+5.0%). Mid-cap and small US stocks again moved higher, with the S&P Mid Cap 400 index +3.6%, and the Russell 2000 Small Cap index +4.3%. Foreign stocks generally logged strong quarters but continued to lag U.S. markets for the year. Developed markets outside the U.S. rose +5.2% and emerging markets were up +5.1%.

Earnings of S&P 500 stocks leaped a remarkable 49.3% in the first quarter trouncing analyst expectations of +19.9%. Revenue growth (+10.3%) was also much better than expected (+3.0%). Earnings topped estimates for the fourth straight quarter. The earnings growth comes a year after the lockdown that began in March 2020, making comparisons easy. However, aggregate earnings for the S&P 500 were $434.9 billion, an all-time high. Most sectors of the economy are enjoying strong demand. According to research service Zacks, second quarter earnings are now expected to grow 61.6% over last year, the low point of the recession. Based on the results of the last several quarters, that estimate may be too low. Stocks have probably priced in great earnings reports. Investors will be looking at company guidance for the rest of the year and 2022 to justify further gains in the second half of the year.

Economic Perspective

Gross domestic product (GDP) grew at a robust annualized rate of 6.4% in the first quarter, the third consecutive quarter of solid growth. Durable goods manufacturing, professional and technical services and hospitality were among the leading sectors, as both businesses and consumers resumed pre-pandemic levels of activity. Looking ahead, purchasing manager surveys continued to run at very high levels. Both manufacturing and service readings showed strong order flow and expected employment. Businesses have also reported cost inflation, some of which have been experienced by consumers. Construction throughout the U.S. boomed. Existing home sales, on the other hand, showed some signs of slowing, as potential buyers may be digesting record high prices.

The U.S. vaccination effort continued has enabled this reopening activity. As of June 30th, about 66.8% of U.S. adults have had at least one shot, and 57.9% are fully vaccinated. While the pace of vaccination has slowed, more than one million people are receiving shots daily. The vaccines have thus far been effective against new COVID-19 variants, another source of optimism.

U.S. employment continued to rise in the quarter. Job growth was tepid in April and March, but jumped in June, as employers added 850,00 new hires. The unemployment rate ticked down to 5.9% from 6.7% at the beginning of the year, as more people began to look for work. Many employers have struggled to fill positions. Childcare, fear of COVID and extended unemployment benefits have all been factors slowing reentry into the workforce. As those unemployment benefits run off, and vaccination rates increase, we'll likely see more job seekers and more positions filled. Across the U.S.

Index returns taken from Morningstar.com

economy, job openings reached a record high of 9.3 million. Employers have begun offering signing bonuses and higher wages in hopes of luring workers. Wages grew 3.6% in June, another modest sign of post-pandemic inflation.

Interest rates dropped during the second quarter, as bond investors appeared to shrug off signs of inflation. The 10-year U.S. Treasury bond yield fell from 1.7% to 1.45%. This surprised many market watchers, who expected rates to rise further this year, but some leveling off was probably inevitable. Higher interest rates bring in more bond buyers, as cash yields are still close to zero. The decrease in rates coincided with the growth stock surge and slowing of the value stock rally. Many commodity prices peaked during the quarter (**see Figure 3 – Lumber)** after a speculative run-up, easing inflation fears.

Fig. 3 – Lumber Futures

Looking Ahead

Last quarter we wrote that equity markets were likely to rise further during the year. As of this writing, stocks are still supported by the vaccine rollout, a patient Federal Reserve holding steady on rates, and the potential of an infrastructure package from Washington. There is legitimate concern about stock valuations, but those may be supported, at least in part, by accelerating corporate earnings and low interest rates. Consumer finances remain historically strong by some measures. Household savings as a percentage of personal income (**Figure 4**) are historically high. At the same time, household debt payments as a percentage of personal income (**Figure 5**) remain well below financial crisis levels. These factors should continue to support strong activity in our economy, which is dominated by consumer spending.

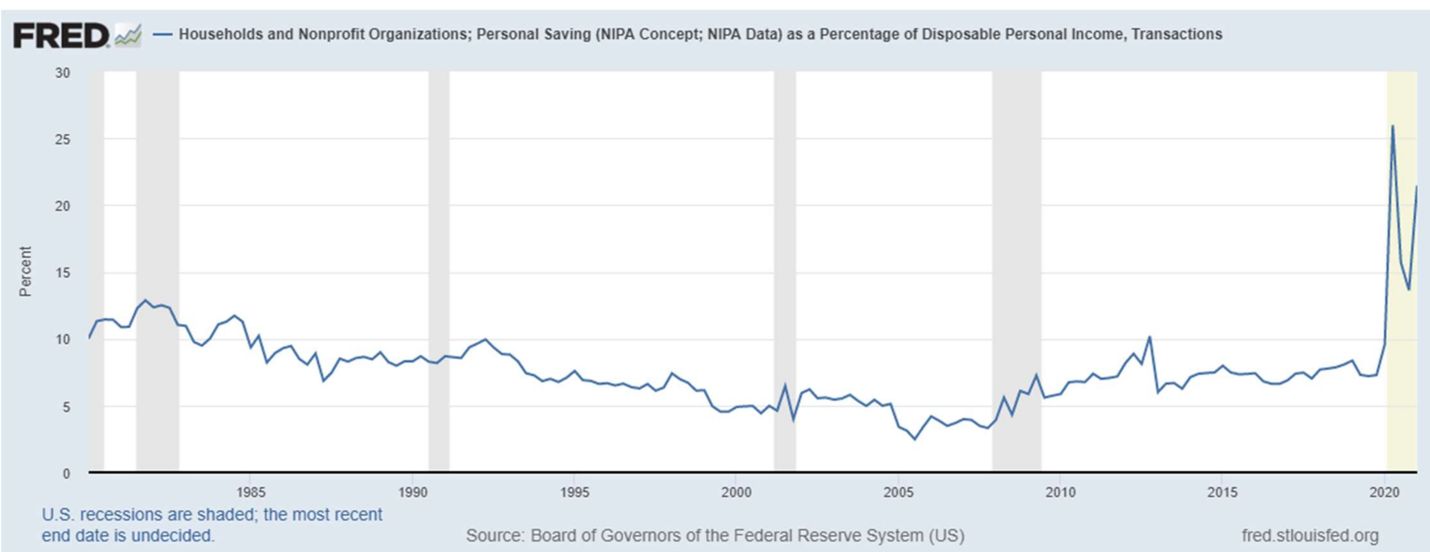

Figure 4 – Personal Savings as a Percentage of Disposal Income

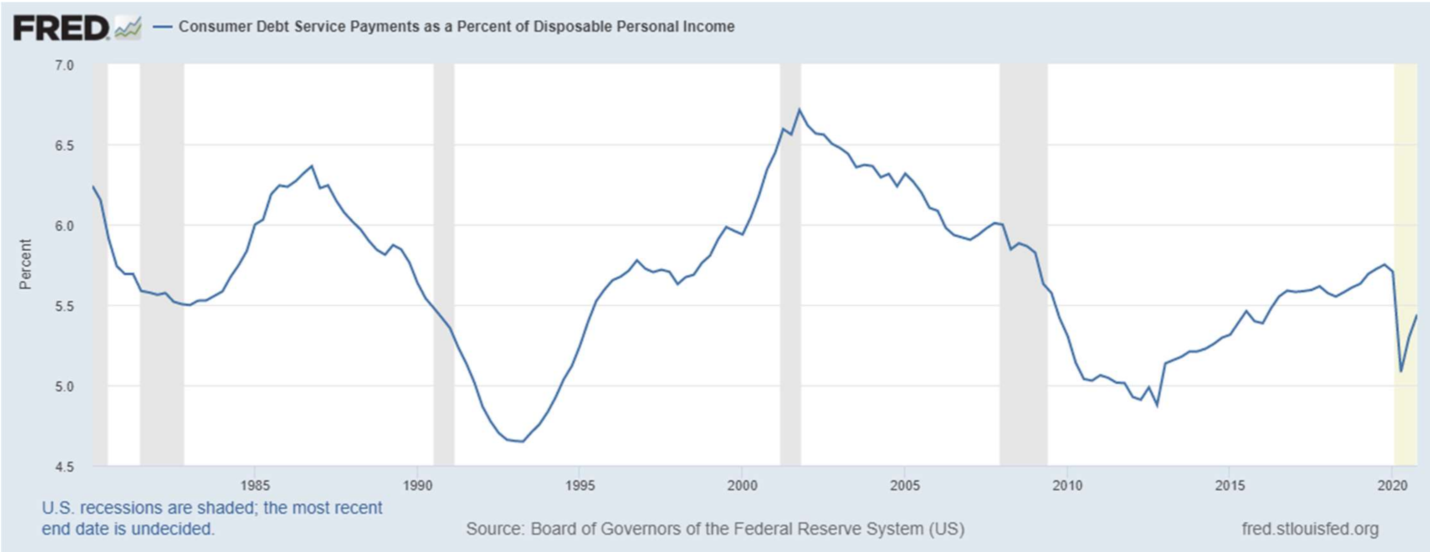

Figure 5 – Consumer Debt Service as a Percent of Disposal Personal Income

The past 16 months have been challenging in many ways and devastating for some. Looking ahead, there is reason for hope in the U.S. and world economies. We hope that you and yours are enjoying the summer and encourage you to contact us anytime.

Best regards,

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