

Outlook for April 2021

First Quarter Recap

On the Rise—Stocks, Bond Yields and Inflation Concerns

It appears fiscal policy has effectively bridged the income gap between massive job loss in the services sectors and the broad vaccine distribution that has hastened the reopening of the economy. First-quarter GDP should be strong despite February's weakness caused by inclement weather across the country. Since lost production due to weather events is typically recovered in subsequent months, the markets generally ignored the slowdown, focusing instead on infection, hospitalization and vaccination rates.

Within the equity markets, cyclical sectors continued their end-of-year momentum, notably outperforming the more stable growth sectors. Excitement around impending economic reopenings is driving earnings-growth expectations and pricing for the more economically-sensitive areas of the market. In addition to value stocks outpacing growth, small and mid-cap stocks beat the large-cap indices. Overseas, the European economy contracted once again as rising infection rates led to renewed lockdowns. Despite the weaker economy, European equity markets performed well, with investors looking beyond these near-term issues to a broader reopening over the summer.

During the quarter, some large hedge funds' high-profile struggles garnered much attention. Melvin Capital was caught in a classic short squeeze. It appears predominantly retail investors using social media bid up prices of companies with relatively weak business fundamentals, which caused steep losses in the hedge fund. Another incident occurred at the end of the quarter when Archegos Capital was forced to unwind highly-levered positions, creating significant losses for some of its lending banks. Investors are currently viewing these as isolated incidents, providing no systemic risk to markets and the economy.

A bigger risk to equity markets may be the sharp rise in bond yields and the steepening of the yield curve seen throughout the quarter. The yield on the 10-year Treasury note nearly doubled on heightened fears that strong economic growth would provoke inflation. The Fed viewed this spike as a sign of economic recovery and reiterated it would maintain its current policy until inflation rises more consistently above the 2% target.

Key Market Drivers

The \$1.9 trillion fiscal package passed in March on top of the relief provided at the end of 2020 should help drive strong economic growth for at least the next two quarters, with an expected 8% U.S. GDP growth rate for full-year 2021. We believe any inflation will be more cyclical than longer-lasting. Sufficient slack exists in the labor force, and employee productivity should improve thanks to capital spending on technology. Strained supply chains as reflected in a severe semiconductor chip shortage and worsened by the blockage of the Suez Canal should ease as production ramps up over the spring and summer.

Outside the U. S., Europe should emerge from its double-dip recession in the second quarter as its admittedly disjointed vaccination effort gains traction. Additionally, Japan appears poised to return to growth and full employment, fueled by the global economic recovery. The Chinese economy should settle back into its previous 5-6% growth path after having fully rebounded at the end of last year.

Our Perspective

Equity Markets



- Earnings growth should overtake valuation multiple expansion as the primary driver of U.S. equity returns. Earnings per share on the S&P 500 index is expected to be around 25%, which should offset any contraction in multiples caused by rising bond yields. That said, investors may begin to discount 2022 earnings in light of the proposed corporate tax increases.
- Less exposure to health care and technology and a higher weighting in economically-sensitive sectors may lead to relative outperformance of European equities compared to U.S. stocks. Although, this forecast is dependent upon the region lifting its mobility restrictions.
- Japan’s export-dominated equity markets should benefit from the significantly higher growth expected in the U.S. and China, offsetting slower growth in domestic consumption from hesitant consumers.
- Chinese equities may be the only major market to suffer from central bank tightening headwinds and their potential impact on the stock prices of rapidly growing technology and communication services companies.

Bond Markets



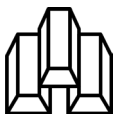
- U.S. bond yields should continue to climb due to strong economic growth and rising inflation expectations. The Fed could step in if yields begin to affect the recovery, although it’s not clear what rate level would spur a response.
- High-yield bonds may be a better alternative, given the low default rate. However, credit spreads have already declined to their pre-pandemic lows.
- While a rising dollar is usually not good for emerging market debt, attractive yields and rebounding economies could present buying opportunities in this asset class.

Monetary Policies/ Currencies



- U.S. monetary policy should hold steady through 2022. However, investors should watch for signs that the Fed may begin tightening sooner. The Fed will likely not react to any inflation caused by pent-up demand or supply chain issues, viewing these price pressures as transitory.
- The Bank of England is also expected to maintain its current policy, given vaccination rates and the economy’s anticipated reopening. While the European Central Bank has promised to ease even more due to the lack of fiscal relief, the pending recovery should enable the bank to stay the course.
- Japan’s rebounding economic growth should help the Bank of Japan maintain its current stance. It would prefer not to take any further action since negative rates and quantitative easing have had minimal effect. The Peoples Bank of China may tighten rates to combat the growing debt burden and speculative investing.
- Higher currency-hedged interest rates and a faster, deeper economic recovery should continue to push the U.S. dollar higher over the coming months. That said, exploding fiscal deficits may hinder flows into the currency.

Commodities



- Commodity prices should trend higher as the global economy continues to recover, but supply issues warrant monitoring.
- The \$60+ price for WTI crude may spur the dormant U.S. shale industry to increase production. OPEC+ Russia’s production discipline could break down if those economies need to generate more growth.
- Higher real interest rates are usually a headwind for gold prices. However, continued aggressive global monetary easing should prevent a significant price decline.

What This Means for Investors

Record fiscal policies combined with the reopening of most service industries may fuel the greatest U.S. economic growth rate in years. While Fed policy should remain steady, the spike in longer-term bond rates could potentially impede equity returns, particularly in the high-multiple growth sectors. Markets will continue to focus on the economic recovery, with cyclical companies primarily experiencing a “V”-rebound in corporate profits. Consumer spending may slow in the near term due to higher oil and gas prices. Even so, higher personal income and savings rates should provide ample fuel for notable consumption over the rest of the year.

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Index Performance Data							
	1Q 2021	1-Year	3-Year Annualized		1Q 2021	1-Year	3-Year Annualized
Equity Index Returns				Fixed Income Returns			
Dow Jones	8.29%	53.78%	13.61%	Barclays Aggregate Bond Index	-3.37%	0.71%	4.65%
S&P 500	6.17%	56.35%	16.78%	Barclays 1-10 Year Municipal Bond	-0.26%	4.54%	3.97%
Russell 2500	10.93%	89.40%	15.34%	Merrill Lynch High Yield Master II	0.90%	23.31%	6.53%
MSCI ACWI	4.57%	54.60%	12.07%	Citi World Government Bond Index	-3.05%	-1.05%	4.13%
MSCI EAFE	3.48%	44.57%	6.02%	JPM Emerging Markets Bond Index Global	-4.74%	14.29%	3.87%
MSCI Emerging Markets	2.29%	58.39%	6.48%	Barclays TIPS	-1.47%	7.54%	5.68%
				Citi U.S. 3-Month T-Bill	0.02%	0.21%	1.45%
Other Index Returns							
MSCI U.S. REIT	8.76%	37.69%	9.51%	Source: FactSet, Morningstar Direct **Citi World Government Bond Index is the hedged index			
Bloomberg Commodity Index	6.92%	35.04%	-0.20%				



First Quarter Market Summary

	Price	2Q20	3Q20	4Q20	1Q21	YTD	1-Year	Annualized		
								3-Year	5-Year	10-Year
U.S. Equity Benchmarks										
Dow Jones Industrial	32,982	18.51	8.22	10.73	8.29	8.29	53.78	13.61	15.99	13.09
NASDAQ Index Composite	13,247	30.95	11.24	15.63	2.95	2.95	73.40	24.54	23.44	18.22
S&P 500	3,973	20.54	8.93	12.15	6.17	6.17	56.35	16.78	16.29	13.91
Russell 1000 (Large Cap)	2,238	21.82	9.47	13.69	5.91	5.91	60.59	17.31	16.66	13.97
Russell 1000 Growth	2,446	27.84	13.22	11.39	0.94	0.94	62.74	22.80	21.05	16.63
Russell 1000 Value	1,494	14.29	5.59	16.25	11.26	11.26	56.09	10.96	11.74	10.99
Russell Mid Cap	2,957	24.61	7.46	19.91	8.14	8.14	73.64	14.73	14.67	12.47
Russell Mid Cap Growth	1,645	30.26	9.37	19.02	(0.57)	(0.57)	68.61	19.41	18.39	14.11
Russell Mid Cap Value	2,521	19.95	6.40	20.43	13.05	13.05	73.76	10.70	11.60	11.05
Russell 2000 (Small Cap)	2,221	25.42	4.93	31.37	12.70	12.70	94.85	14.76	16.35	11.68
Russell 2000 Growth	1,525	30.58	7.16	29.61	4.88	4.88	90.20	17.16	18.61	13.02
Russell 2000 Value	2,381	18.91	2.56	33.36	21.17	21.17	97.05	11.57	13.56	10.06
S&P GICS Sectors										
	Weight									
Consumer Discretionary	12.4%	32.86	15.06	8.04	3.11	3.11	70.29	19.81	17.87	17.50
Consumer Staples	6.1%	8.12	10.38	6.35	1.15	1.15	28.38	12.14	8.21	11.64
Energy Sector	2.8%	30.51	(19.72)	27.77	30.85	30.85	75.16	(5.48)	(0.75)	(1.55)
Financials	11.3%	12.20	4.45	23.22	15.99	15.99	67.50	9.78	15.67	12.11
Health Care	13.0%	13.59	5.87	8.03	3.18	3.18	34.04	15.09	13.61	15.61
Industrials	8.9%	17.01	12.48	15.68	11.41	11.41	69.61	12.13	13.72	12.23
Information Technology	26.7%	30.53	11.95	11.81	1.97	1.97	66.61	28.54	27.64	20.50
Materials	2.7%	26.01	13.31	14.47	9.08	9.08	78.29	13.99	14.31	9.46
Communication Services	10.9%	20.04	8.94	13.82	8.08	8.08	60.88	18.79	10.15	10.41
Utilities	2.7%	2.73	6.14	6.54	2.80	2.80	19.42	12.01	8.92	11.27
Real Estate	2.5%	13.22	1.92	4.94	9.02	9.02	32.03	12.31	8.10	10.02

		2Q20	3Q20	4Q20	1Q21	YTD	Annualized			
							1-Year	3-Year	5-Year	10-Year
Global Equity Benchmarks		Price								
MSCI ACWI	2,812	19.22	8.13	14.68	4.57	4.57	54.60	12.07	13.21	9.14
MSCI AC World x-USA	336	16.12	6.25	17.01	3.49	3.49	49.41	6.51	9.76	4.93
MSCI EAFE	2,208	14.88	4.80	16.05	3.48	3.48	44.57	6.02	8.85	5.52
MSCI EAFE Growth	2,071	16.95	8.43	13.09	(0.57)	(0.57)	42.59	9.84	10.84	7.21
MSCI EAFE Value	2,826	12.43	1.19	19.20	7.44	7.44	45.71	1.85	6.57	3.65
MSCI Emerging Markets	1,316	18.08	9.56	19.70	2.29	2.29	58.39	6.48	12.07	3.65
MSCI BRIC	392	16.91	10.41	15.26	(0.10)	(0.10)	48.64	6.93	14.41	3.27
MSCI Japan	3,886	11.61	6.94	15.26	1.57	1.57	39.73	6.32	10.47	7.20
Interest Rates		Yield								
3m Treasury Bill	0.03	0.04	0.03	0.02	0.01	0.01	0.10	1.34	1.12	0.59
U.S. LIBOR 3m	0.19	0.15	0.06	0.06	0.05	0.05	0.32	1.62	1.44	0.88
U.S. Treasury 3m	0.34	0.06	0.04	0.05	0.06	0.06	0.21	1.49	1.47	1.09
U.S. Treasury 10yr	1.74	0.17	0.16	0.21	0.32	0.32	0.87	1.86	1.99	2.11
U.S. Treasury 30yr	2.42	0.34	0.34	0.40	0.51	0.51	1.60	2.34	2.51	2.86
Fixed Income		Price								
Citi 3-month T-bill	660	0.14	0.03	0.02	0.02	0.02	0.21	1.45	1.15	0.60
BC U.S. Gov't & Related 5-7	105	3.63	1.33	0.80	(2.65)	(2.65)	3.04	5.28	3.59	3.85
BC Municipal Bond 1-10 Year	114	2.69	1.07	0.98	(0.26)	(0.26)	4.54	3.97	2.65	3.16
BC TIPS	112	4.24	3.03	1.62	(1.47)	(1.47)	7.54	5.68	3.86	3.44
BC Aggregate	105	2.90	0.62	0.67	(3.37)	(3.37)	0.71	4.65	3.10	3.44
ML High Yield Master II	104	9.61	4.71	6.48	0.90	0.90	23.31	6.53	7.94	6.31
Citi World Gov't Bond Index	950	1.07	0.72	0.26	(3.05)	(3.05)	(1.05)	4.13	3.00	3.93
JPMorgan EMBI Global	889	11.21	2.28	5.49	(4.74)	(4.74)	14.29	3.87	4.74	5.35



		2Q20	3Q20	4Q20	1Q21	YTD	1-Year	Annualized		10-Year
								3-Year	5-Year	
Real Estate	Price									
MSCI U.S. REIT	1,226	11.70	1.63	11.52	8.76	8.76	37.69	9.51	5.32	8.53
FTSE EPRA/NAREIT Europe	1,769	9.14	6.15	16.96	(4.32)	(4.32)	29.65	1.89	4.16	5.74
Commodities										
Bloomberg Commodity Index	83	5.08	9.07	10.19	6.92	6.92	35.04	(0.20)	2.31	(6.28)
Energy	24	9.84	4.34	2.21	17.32	17.32	37.44	(13.62)	(4.26)	(14.75)
Agriculturals	51	(4.85)	11.90	21.36	6.81	6.81	38.02	3.05	0.36	(5.26)
Livestock	23	(8.62)	13.83	2.45	10.44	10.44	17.69	(4.58)	(4.96)	(4.94)
Softs	33	0.59	7.67	14.26	(1.49)	(1.49)	21.91	(2.95)	(4.36)	(10.55)
Industrial Metals	143	12.32	11.18	14.25	7.49	7.49	53.35	4.73	10.31	(2.86)
Precious Metals	212	15.04	7.80	2.41	(9.26)	(9.26)	15.25	8.56	6.05	(0.76)
Currencies	Price									
ICE Dollar Index	93	(1.67)	(3.60)	(4.21)	3.66	3.66	(5.87)	1.13	(0.30)	2.08
Euro / U.S. Dollar	1	2.36	4.41	4.34	(3.94)	(3.94)	7.11	(1.50)	0.62	(1.87)
Pound / U.S. Dollar	1	(0.35)	4.63	5.74	0.93	0.93	11.27	(0.55)	(0.81)	(1.49)
U.S. Dollar / Yen	111	(0.06)	(2.18)	(2.17)	7.03	7.03	2.36	1.28	(0.34)	2.92

Source: Factset, Morningstar Direct, iShares website

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