Shearwater Creek Investment Matters

2nd Quarter 2021 Market Update

Post-Covid Recovery Continues…

<u>2nd Quarter 2021 Review</u>:
Investor appetite for risk assets remained strong in 2nd Quarter 2021 with continued optimism of a post-pandemic recovery driven by both fiscal stimulus and an accelerated coronavirus vaccine rollout. U.S. equity indexes posted a 5th consecutive quarter of positive returns with tech and growth stocks reasserting their market leadership. The Nasdaq led major averages up +9.49% for the quarter while the S&P 500 Index trailed slightly behind up +8.55%. The Dow Jones Industrial Average gained +5.08%. Meanwhile, small-cap stocks which led all sectors in Q1 2021 lagged behind, gaining only +4.29%. So-called "meme" or "chatroom" stocks (smaller-cap, mainly consumer-oriented shares) continued to see sharp trading swings.

Europe led international markets gaining +7.74% as hopes for an economic recovery outweighed worries about early tightening in monetary policy and uncertainty triggered by rising coronavirus infections caused by a new variant of the virus. Worth noting, sixteen European Union (EU) states began using the EU Digital COVID Certificate which became available on July 1st. Meanwhile, France ended a nightly curfew that had been in place since October and began phasing out mask requirements in most public places as did Denmark. Germany said it was planning to do so as well. MSCI Emerging Markets equities posted a +5.12% gain for the quarter. MSCI China Index stocks gained +2.32 while Nikkei 225 stocks lost -0.25%.

Thanks to strong demand from overseas investors and reassuring comments from Fed Chair Jerome Powell and other officials that inflationary pressures were likely "transitory" and due mostly to pandemic-related supply constraints, U.S. bonds as measured by the Bloomberg Barclays U.S. Aggregate index managed a +1.83% return in Q2 2021. In mid-June, the yield on the 10-year Treasury note reached its lowest level since the start of March, Lumber prices tumbled from record highs as sawmills stepped up production and metals prices fell as China released stockpiles to cool the market. Municipal bonds benefited from new federal support for state and local budgets, but mortgage-backed securities lagged amid fears that the Fed might reduce its purchases through a program designed to keep downward pressure on long-term interest rates.

In early April, the Labor Department reported that 916,000 jobs were added in March, well above expectations. The gain was later revised down to 785,000—and increases in April (278,000) and May (559,000) were smaller—but a shortage of available workers rather than a slowdown in labor demand appeared to be at work. The Labor Department's tally of job openings reached its highest level in records dating back to 2000 and weekly jobless claims declined almost steadily throughout the quarter to pandemic-era lows. Service and manufacturing activity also indicated healthy expansion. The better labor market was reflected in consumer spending, which also got a boost from renewed stimulus payments. March retail sales grew by 9.8%, the most since May 2020, and measures of consumer sentiment reached their highest levels since the onset of the pandemic.

<u>2021 Market Outlook:</u>
While the global economic recovery was faster and stronger in the first half of 2021 than markets expected at the start of the year, there also are potential risks to growth that we will be monitoring in the months ahead. These include:

■ Coronavirus. While vaccine campaigns have gathered speed in many developed countries, progress remains slower elsewhere. Meanwhile, new variants remain a potential threat.

■ U.S. fiscal policy. Although the Biden administration is seeking to raise the U.S. corporate tax rate, any increase is likely to be moderate and neutral for U.S. equities. However, proposed increases in capital gains and dividend taxes, if enacted, would be negative for after-tax returns on most asset classes.

■ Valuations. Price/earnings multiples in some sectors and stocks reflect lofty earnings expectations. Even strong second-half results might fail to meet those expectations, generating market volatility.

■ Political instability. Latin America, Eastern Europe, and the Middle East all contain potential flash points that could disrupt the global recovery. That said, a transformed global economic landscape is generating potential opportunities as well as risks.

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As we noted last quarter, this is a time to be careful, as there are clear signs of market speculation. Here's a performance recap of major market indexes for Q2 2021:

Equity Indexes:	Q2 2021	2021 YTD
S&P 500	8.55%	15.25%
Dow Jones Industrial Average	5.08%	13.79%
Nasdaq Composite (Principal Return)	9.49%	12.54%
Russell Midcap	7.50%	16.25%
Russell 2000	4.29%	17.54%
MSCI All Country World	7.53%	12.56%
MSCI Europe	7.74%	12.28%
MSCI Emerging Markets	5.12%	7.58%

Bond Indexes:		
Bloomberg Barclays U.S. Aggregate	1.83%	-1.60%
Bloomberg Barclays Global Aggregate Ex-USD	0.92%	-4.42%
Credit Suisse High Yield	2.51%	3.89%
J.P. Morgan Emerging Markets Bond Global	3.93%	-1.00%

Note: Returns are for the periods ended June 30, 2021. The returns include dividends and interest income based on data supplied by third-party provider RIMES and compiled by T. Rowe Price, except for the Nasdaq Composite Index, whose return is principal only. Sources: Standard & Poor's, LSE Group, Bloomberg Barclays, MSCI, Credit Suisse, Dow Jones, and J.P. Morgan (see Additional Disclosures).

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Sources: [1]Thomson Reuters. Past performance is no guarantee of future results. Yields may be lower or higher than quoted above. Yields fluctuate as market conditions change. An index is unmanaged and not available for direct investment. The indices are presented to provide you with an understanding of their historic long-term performance and are not presented to illustrate the performance of any security. Large Cap = S&P 500 Index (The S&P 500 index is weighted by market value, and its performance is thought to be representative of the stock market as a whole.), Mid-cap = Russell Midcap Index (The Russell Midcap Index measures performance of the 800 smallest companies (31% of total capitalization) in the Russell 1000 Index, with weighted average mark et capitalization of approximately $6.7 billion, median capitalization of $3.6 billion, and market capitalization of the largest company $13.7 billion.), Small-cap = Russell 2000 Index (The Russell 2000 Index is a small-cap stock market index of the bottom 2,000 stocks in the Russell 3000 Index.), DM Ex-U.S. = MSCI EAFE Index (The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. & Canada.), Emerging Markets = MSCI EM Index (The MSCI Emerging Markets Index is an index created by Morgan Stanley Capital International (MSCI) designed to measure equity market performance in global emerging markets.), Bloomberg Barclays U.S. Aggregate Bond Index (The Bloomberg Barclays US Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type.), ICE U.S. Treasury 20+ Year Bond (The ICE U.S. Treasury 20+ Year Bond Index measures the performance of Treasury securities and is selected by a Market Value process.), Markit iBoxx USD Liquid High-Yield Bond Index (Consists of liquid USD high yield bonds, selected to provide a balanced representation of the broad USD high yield corporate bond universe. The index is used as a basis for tradable products, including ETFs.)