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1st Quarter 2021 Newsletter

It has been just over a year now that we marked the "new normal" standard of living thanks to the COVID-19 pandemic. Thinking back, it was a time of great fear and confusion with so many unknowns about this strange new virus. Now, only one year later, we are witnessing incredible progress both domestically and internationally with the implementation of new vaccines and hopeful for a light at the end of the COVID-19 tunnel.

The 1st quarter of 2021 has seen a noticeable uptick in volatility as money has continued rotating away from the more expensive growth related technology stocks and into the less expensive value oriented stocks. We have also seen phenomenal returns in both mid and small caps, which tend to indicate there is the potential for good economic Gross Domestic Product numbers in the near future. Bonds on the other hand have lagged as investors grapple with how the Fed will handle interest rate policy and inflation as we move forward. We will dive into these in greater detail throughout this letter, but first please take a look at how the 1st quarter of 2021 compares to 2020.

	2020 Year-to-Date	2021 1st Quarter
Dow Jones Industrial Average	9.72%	8.29%
Russell 1000 Growth Index	38.49%	0.94%
Russell 1000 Value Index	2.80%	11.26%
NASDAQ Composite Index	44.92%	2.95%
S&P Mid Cap 400 Index	13.66%	13.47%
S&P Small Cap 600 Index	11.29%	18.24%
MSCI EAFE – International Index	7.82%	3.48%
Bloomberg Barclays US AGG Bond	7.51%	-3.37%

*Wells Fargo Advisors Monthly Major Index Returns

The last twelve months have been very challenging as we have had to adapt to new health measures surrounding how we operate not only within our own daily lives, but also throughout the global economic landscape. As a result of the pandemic, we have seen an enormous uptick in government stimulus spending and liquidity programs provided by the Federal Reserve. The FED and US Treasury have provided approximately $5.2 Trillion in stimulus through the end of the 1st quarter and there is talk of Trillions more to come in the form of infrastructure spending and unemployment benefit extensions.

The result of all of this stimulus injection into the economy and the anticipation of even more stimulus has obviously impacted the financial markets. For instance, during the 4th quarter of 2020 we began to see stocks start shifting away from growth and into more economically sensitive cyclical companies in anticipation of the post-pandemic economic recovery. We expect this rotation to continue within stocks as money shifts to the more traditional pre-pandemic stocks which we believe are undervalued by comparison.

Bond yields have also been noticeably moving higher over the past few months across the entire yield curve in an effort to account for more optimistic US economic growth expectations. This can be tricky for investors as a steepening yield curve can be both a positive and a negative for the stock market. If the yield curve rises too much or too fast, then the cost of financing everything can increase very quickly. The recent rise in bond yields have been the main driver of increased stock market volatility, so we are paying very close attention as the bond market tends to be an extremely good indicator of both future economic growth and inflation. The million dollar question is, "Are bond yields rising in anticipation of economic growth or in anticipation of higher inflation from the Trillions of dollars of government stimulus or both?" As the old saying goes, Time will tell!

Our personal feeling is that the steepening of the bond yield curve is likely to be the biggest risk to the financial markets as we move forward. We anticipate that as the pandemic lockdowns are lifted, there will be a significant amount of pent-up demand to spend money. Therefore, we expect that the bond market is going to be keenly focused on potential inflation risk from the rapidly increasing money supply and statements from the Federal Reserve indicating their willingness to let inflation run hot before raising short-term interest rates. We believe that the financial markets will have a difficult time trying to determine whether increases in inflation are transitory during the post-pandemic reopening excitement or more permanent. The uncertainty around inflation is what we are most cautious about.

Additional factors that we see aside from inflation is the uncertainty for potential changes in tax and regulatory policies. Currently there are debates in Washington D.C. about raising corporate taxes. If passed, higher taxes will likely have a negative impact on corporate earnings in 2022. There are also likely to be more restrictive regulatory policies from the Biden administration. We have already seen that the decision to cancel oil and natural gas pipeline projects has partially led to a 20% increase in the price of oil during the 1st quarter. Therefore, we are continuing to evaluate how potential tax and regulatory policies may impact financial markets. Our initial thoughts are that the rebound in economic growth and massive fiscal spending will help offset any potential negative impacts from higher tax rates and more restrictive regulations.

It is very important that we don't focus too much on the short-term and take our eye off the long-term goals. If anything, the dramatic fall and recovery of the equity markets over the past year has once again validated the importance of maintaining our investment disciplines of having well diversified portfolios and consistently rebalancing in order to help maintain proper risk alignment. As we move forward, our intention is to continue to maintain strong portfolio diversification, but also evaluate whether or not to increase international and emerging market exposure. Additional international investment should help prepare against the potential for the U.S. dollar to decline as a result of additional government spending. Additionally, because we are cautious towards the emergence of potential inflation, we will continue to overweight short-term bonds to help prepare portfolios from possible interest rate risk.

As we look forward into 2021, we definitely see brighter days ahead when it comes to client socialization and interaction. We have certainly missed being able to meet face-to-face and have in-person client events. As soon as we have a clearer picture of when we are available to hold in-person events, we will absolutely let you know. Until then, we welcome the opportunity to have Zoom meetings and we will continue to reach out to you on a regular basis for portfolio updates.

As we have said many times in the past, we are extremely fortunate to work with so many wonderful families. The trust and confidence that you place in our team means so much to us and we cannot thank you enough for the continued referrals of your friends and family members. We hope that you are having a wonderful Spring and wish you and your family an abundance of good health.

Sincerely,

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Managing Director – Investments

Michael B. Dye, CRPC®
Managing Director – Investments

Oliver A. Cervantes, CFP®, CRPC®
Sr. Vice President – Investments

Dividends are subject to change or elimination and are not guaranteed.

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The Dow Jones Industrial Average is a price-weighted index of 30 "blue-chip" industrial U.S. stocks.

The S&P 500/Barra Growth Index is an unmanaged capitalization-weighted index stocks in the Standard & Poor's 500 index having the highest price to book ratios. The Index consists of approximately half of the S&P 500 on a market capitalization basis.

The S&P 500/Barra Value Index is an unmanaged, market-capitalization-weighted index of the stocks in the Standard & Poor's 500 Index having the lowest price to book ratios. The index consists of approximately half of the S&P 500 on a market capitalization basis.

The NASDAQ Composite Index measures the market value of all domestic and foreign common stocks, representing a wide array of more than 5,000 companies, listed on the NASDAQ Stock Market.

The S&P Midcap 400 Index is a capitalization-weighted index measuring the performance of the mid-range sector of the U.S. stock market, and represents approximately 7% of the total market value of U.S. equities. Companies in the Index fall between the S&P 500 Index and the S&P Small Cap 600 Index in size: between $1-4 billion.

The S&P Small Cap 600 Index consists of 600 domestic stocks chosen for market size, liquidity (bid-asked spread, ownership, share turnover and number of no trade days) and industry group representation. It is a market value-weighted index (stock price times the number of shares outstanding), with each stock's weight in the index proportionate to its market value.

The MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.

Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

Since no one investment program is suitable for all types of investors, this information is provided for informational purposes only. We need to review your investment objectives, risk tolerance and liquidity needs before we introduce suitable investment programs to you

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