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2021 Second Quarter Review
"The Grand Re-Opening"

After almost a year and a half of covid-related restrictions, the economy has begun to re-open and investors like it. As of the end of the second quarter, the S&P 500 has advanced 14.4%, the DJIA 12.7% and the more tech-related Nasdaq Composite 12.5%. Long term bonds have recovered a portion of the drubbing they suffered since their peak values of last August, but the iShares 20+ Year Treasury Bond ETF is still down over 8% in price since the beginning of this year.

The big story is the reopening of the economy and the stellar profit comparisons that many companies are reporting versus the pandemic-depressed levels of a year ago. Yardeni Research calculates that the earnings growth rate for the S&P 500 for the first quarter was almost 50% compared to the previous quarter and up an astonishing 287% year over year. Those profits were above consensus expectations as rebounding demand for goods and services met with the slimmed-down cost structures of many corporations following the pandemic slump in business. In addition, the jump in demand coincided with disruptions in the supply chain of many businesses and set off expectations for increasing inflation. The Federal Reserve is taking the position that the inflationary surge will be temporary and will subside once the recovery is further along. The Fed has been wrong about so many things in the last several decades that seasoned investors remain skeptical.

As mentioned last quarter, the overwhelming factor behind the recent market advance appears to be the tidal wave of fiscal and monetary stimulus that has poured into the economy. Bank of America reports that over $580 billion flowed into equity funds in the first half of this year. A repeat of that inflow in the second half would result in more inflows in 2021 than in the 20 previous years combined. It is this historic influx of money that has inflated prices across asset classes: equities, real estate, commodities, and collectibles. Excess money creation often gives rise to speculation as bubbles form and lure investors in. Signs of speculative excess continue with the volatility of heavily-shorted "meme" stocks, but the crypto-currency fever appears to have broken recently with a 50% fall in the value of bitcoin since the frenzied buying of mid-April. Heartier investors say that those kinds of moves are to be expected as part of the wild frontier of playing crypto-currencies. However, this may also be a precursor of a climax in speculation in other asset classes as well.

The economy (as measured by GDP – gross domestic product) is projected to grow at a pace north of 6% as people and corporations ramp up spending on products and services again. As might be expected after such a traumatic halt in economic activity, there have been some glitches in getting things going again. As demand picks up faster than production, shortages have developed in such diverse items as computer chips, lumber, rental cars, and Starbucks chai tea bags. Labor is also in short supply and has added to the problems facing the reopening economy. Some of these are short-term phenomena while others represent a longer-term shift in the nature of the economy.

One of the effects of the pandemic has been to accelerate changes that had already begun taking hold in the economy. Some the obvious trends are e-commerce, home office technology, and digital security that were boosted by the shut-down. However, the decades-long shift toward globalization is being at least partially reversed. Recent shortages of goods have highlighted the vulnerability of having critical supplies brought in from overseas. The trend toward more domestic production of semiconductors, pharmaceuticals, and equipment for food production may boost economic activity in areas of the country that have heretofore been hurt by loss of jobs to globalization. The shift toward clean energy and electric vehicles will likely accelerate. Cyber security has become a major concern with recent ransomware attacks. An agreement on an infrastructure spending bill may give a boost to engineering and construction stocks as well as those involved in digital infrastructure. Demographic trends point to a wave of retirements in the next few years as baby boomers age, which bodes well for healthcare stocks. Developments like these represent areas of opportunity… IF investments can be made at a reasonable enough price.

Interest rates had appeared poised to rise with inflation but have recently fallen to levels that provide a negative “real yield” (interest rate minus inflation) for practically all Treasury bond maturities. Consequently, we are not big fans of increasing investments in those bonds. If interest rates remain low and inflation rises, precious metals would likely benefit while also providing a potential hedge against disruptions caused by increases in geo-political tensions.

With speculative activity rising, the number of specific investments that can be made with a satisfactory risk/reward balance is reduced. However, we still see opportunities in individual investments that appear to be overlooked and/or undervalued and will continue to weigh those risks against the expected returns.

We are providing your quarterly reports in a new format and would welcome your comments and suggestions as to how you like them. Please review these at your convenience and give us a call with any comments or suggestions you might have.

Best regards,

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