STRAIGHT TALK

1st Quarter 2021

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Q1 2021
Market Returns

Domestic Large
S&P 500
6.17%

Domestic Small
Russell 2000
12.70%

Intl Developed
MSCI EAFE
3.48%

Emerging Markets
MSCI EM
2.29%

Fixed Income
BBgBarc US
Aggregate Bond
-3.37%

**Returns are from Morningstar, with dividends reinvested, and are through 3/31/21*

Notwithstanding some fickleness on the part of investors and the lingering uncertainty of the COVID-19 virus, the narrative of economic reopening remains intact for this year. Stocks have fared well to start 2021, with the expectation that earnings will rise 20-30% this year as the US and eventually the rest of the world moves past the pandemic. With this we have expectations of higher growth, some inflation and slowly-rising interest rates. This has contributed to a jump in bond yields and small losses in most bond portfolios, though we may have already seen the worst of that move. Disruption continues to be a common theme - not just in the economy, but also in economic indicators - as economists attempt to make sense of the swings in data caused by the shutdowns and reopenings.

From week to week we have seen different segments of the market move up or down, whether it has been growth-heavy stocks like technology or areas more associated with the cyclical rebound (small caps, emerging markets, energy, financials, etc.). Overall we see stocks broadly rising as robust earnings growth, stimulus, and low rates are all supportive of further gains in equities.

Much has been made of the potential that the high levels of government spending, coupled with extremely low short-term rates and a strengthening economy, might lead to runaway inflation. While some level of caution is warranted, we believe that the inflation outlook needs to be separated by time. In the short-term, inflation is likely to trend higher as annual numbers are compared to those of 2020's largely locked-down spring and summer months. We believe however, that long-term inflation is far from a given.

There is a common assumption that increased Government borrowing/spending inevitably leads to inflation. History has shown, however, that the relationship between these factors is actually rather weak. We do not have to look back very far to see a drastic example of this. Ever since the "Great Recession" of 2008, we have seen an increase in Government borrowing and spending that previously would have been unimaginable, yet broad-based inflation has been essentially nonexistent. Why is this? And if increasing Government debt is not a great indicator of inflation, what is? The answer lies in the labor market - particularly the size of the labor force itself and the growth in overall wages.

The last truly extended inflationary period that existed in the United States took place in the late 1960s and the 1970s. There was certainly more than one reason for this, but that timeframe coincided with a significant expansion of the US labor force. Conversely, the labor force, as well as the rate of wage growth, have been shrinking since the 1980s - along with the rate of GDP growth, interest rates and inflation. Today, the outlook for wage growth is still quite murky. Millions of people are still unemployed (or underemployed) due to the pandemic. It will take time before this level of slack in the economy is rectified and before we see levels of wage growth that could help drive sustained inflation.

It has been a challenging time and many people have faced terrible hardships. We are not out of the woods just yet, but we continue to see many reasons to be positive. There are always risks, but now more than ever we are thankful for what we have and the science (and people) that have given us hope for some return to normal. We hope that as we move into the spring and summer months, many of us will be focused on enjoying the simple things we largely took for granted not long ago. As always, we will be here for all your investing needs. Thank you for your continued trust and please contact us with any questions or concerns.

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