STRAIGHT TALK

2nd Quarter 2021

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2021
Market Returns

Domestic Large
S&P 500
15.25%

Domestic Small
Russell 2000
17.54%

Intl Developed
MSCI EAFE
8.83%

Emerging Markets
MSCI EM
7.45%

Fixed Income
BBgBarc US
Aggregate Bond
-1.60%

**Returns are from Morningstar, with dividends reinvested, and are through 6/30/21*

The good times continued for equity markets in Q2, as the economic rebound remained in full swing, and stocks posted another quarter of solid gains. Meanwhile, bond markets even managed to claw back some of the losses suffered in the first quarter, though many "core" bond funds remain in negative territory for the year. All in all the first half of this year has been largely as expected, and the level of worry about markets and the economy is a fraction of what it was at this time last year.

Under the hood there were some subtle differences in market returns in the second quarter. Perhaps most notable was the rebound in the performance of growth stocks. After underperforming in Q1, growth took the lead in Q2. As seen below, the difference in quarterly returns in the broad-based Russell 3000 indices was pronounced. Value continues to lead on a year-to-date basis though, something we expect will continue as the year progresses.

	Q1 2021	Q2 2021	First half
Russell 3000 Growth TR	1.19%	11.38%	12.71%
Russell 3000 Value TR	11.89%	5.16%	17.66%

The difference in market performance between the two styles can be explained by changes across bond markets. In the first quarter expectations of rising growth and inflation caused a steepening of the yield curve (difference between short and long-term rates). In the second quarter we saw a notable flattening of the curve as the Fed updated their policy views, for the first time indicating rate hikes before 2024. This caused long-term rates to fall as a lower growth and inflation outlook was baked into markets. In our view, the dip in rates in Q2 will prove to be temporary. Above-trend growth and inflation are here now and for the next little while, and this should ultimately manifest in rising longer-term interest rates later this year.

Stocks will likely continue to move relative to changes in rates, with higher rates and a steeper yield curve generally better for cyclical value stocks, while the opposite should benefit growth stocks. Bond markets, meanwhile, will continue to take their cues from the Fed, watching for any changes in policy or tone. Thus we may be back in a period where investors are going to be hanging on their every word, so expect silliness and short-term market gyrations around Fed meetings. For all their wisdom and good intentions, the Fed is typically no better at predicting the future than any of us.

One of the more important things to remember is that we are still dealing with the fallout from the pandemic. It will take some time before we really know what normal is, at least in an economic sense. If the pre-pandemic period was the "New Normal" of low rates, low growth, and long stretches of low volatility, we are now in the period of "No Normal" where inflation and growth rates are higher than before, but maybe only temporarily so, and volatility is likely to be higher as we adjust to the rapid economic changes brought on by the pandemic. This does not mean that markets will do poorly, just take a look at recent returns. We should, however, expect the occasional surprise and remain open in our thinking and nimble in our investment decisions, while still maintaining a long-term view to avoid getting whipsawed.

Thanks to modern science, it has been a good year on many fronts and we are all hopefully getting back to living life without the fear of COVID. If the Fed and monetary policy is our biggest worry in the coming months it likely means that things are going fairly well. There will always be some concern, some reason to be cautious, something to be that wall of worry, but as long as economic fundamentals remain strong, we see no reason to be overly concerned about markets. Enjoy the summer and as always do not hesitate to reach out if you have any questions or concerns.

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