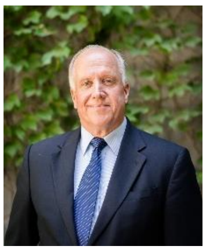
2021 – 1st Quarter Review & Outlook

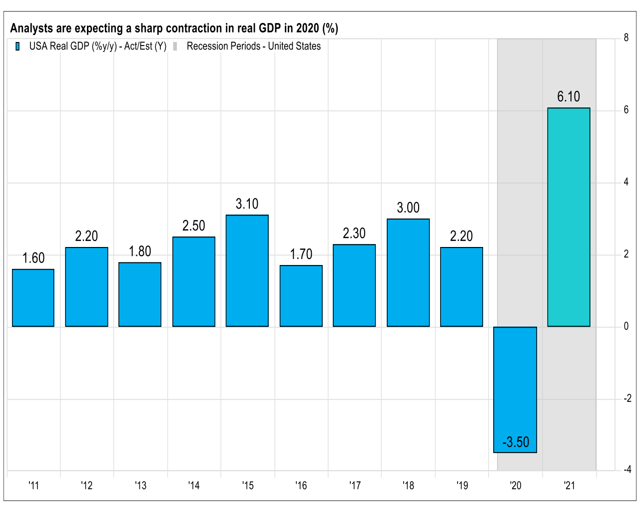
Economic and Investment Review



Mark Anderson

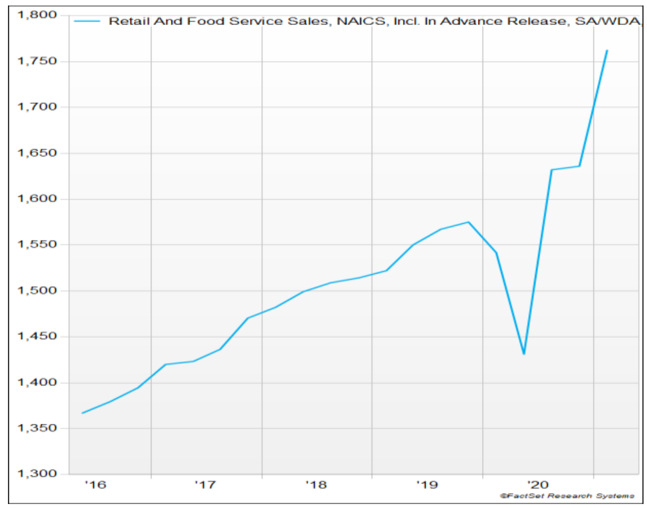
Chief Investment Officer

Economic Growth: The U.S. economy is rebounding quickly from the damage caused by COVID-19. The consensus estimate for Q1 2021 GDP (annualized) is 5.6% and 8.3% for Q2. The estimate for the full year is currently 6.1%. The estimate has been revised upward significantly from year end 2020 when it stood at 4.0%. Notably, Goldman Sachs forecasts the growth rate to be 7.2% for the year based on continued recovery in economic activity due to post-vaccination reopening, accommodative monetary and fiscal policy, pent-up savings and limited scarring effects.



Source: FactSet

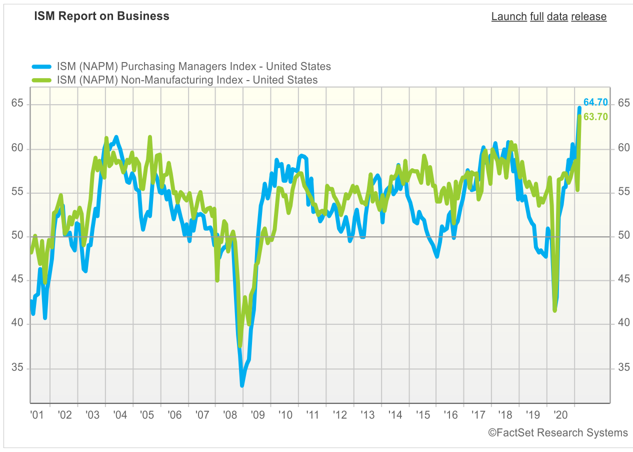
The four major components of GDP are personal consumption expenditures, business investment, government spending, and net exports. Personal consumption or consumer spending accounts for about 68% of GDP. Consumer spending has surged as more people are vaccinated, businesses reopen or open more fully, employment improves and stimulus checks are used for goods and services. March retail sales jumped up by 9.8% from the previous month. The strongest growth was seen in Sporting Goods, Hobby, Book & Music Stores, followed by Clothing & Clothing Accessory Stores, Motor Vehicle & Parts Dealers and Food Service & Drinking Places. Food & Beverage Stores saw the slowest growth.



Source: FactSet

Industrial production rose 1.4% in March (+1.0% y/y). March was the first positive month since August of 2019.

The ISM (Institute for Supply Management) Manufacturing and Services indices are both at their highest levels in over twenty years. The Manufacturing PMI (Purchasing Managers Index) was reported at 64.7 and the Services PMI was reported at an all time high of 63.7. (Any reading over 50.0 indicates expansion and any reading under 50.0 indicates contraction.) The indices are more of an indication of direction or trend rather than absolute levels as they gauge month-to-month changes but the upward trend is clear.

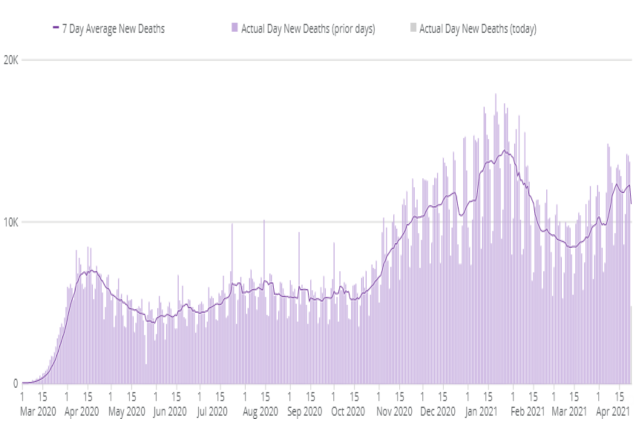


Source: FactSet

Supply chain issues largely caused by the pandemic continue to linger and drag on manufacturing output.

Expectations for global growth have also increased. The IMF (International Monetary Fund) forecasts global growth of 6.0% for 2021 compared with 4.2% at the end of last year. However, the IMF states that "high uncertainty surrounds the global outlook. Future developments will depend on the path of the health crisis, including whether the new COVID-19 strains prove susceptible to vaccines or they prolong the pandemic." COVID deaths and cases have trended up over the past two months.

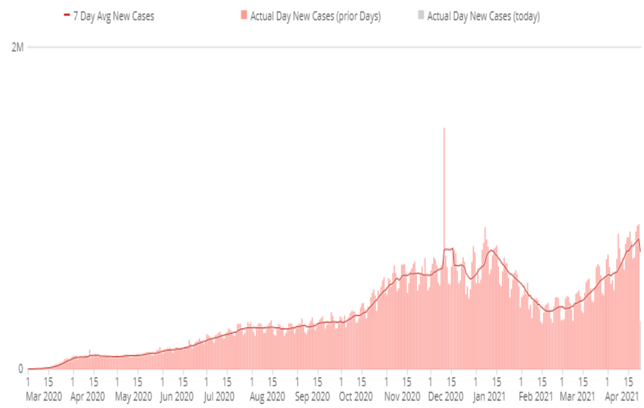
Global New Deaths



Source: Domo

It should be noted that India is a current hot spot and accounts for a significant portion of new cases

Global New Cases



Source: Domo

and deaths. The numbers are much smaller in other global areas.

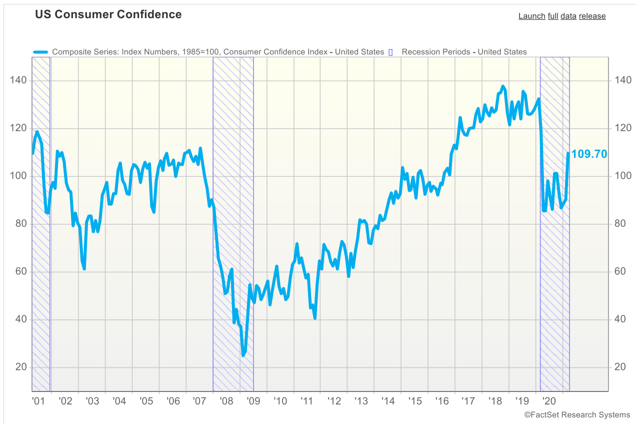
There is some indication that cases likely decline after 25% of a population has been vaccinated. About 27% of the U.S. population is fully vaccinated and it is expected that 70% will be fully vaccinated by July. However, only about 6% of the rest-of-the-world population has been vaccinated and it may be 2023 before the 70% level has been reached.

COVID related unemployment peaked in April 2020 at 14.7%. Since then, the unemployment rate has fallen steadily to 6.0% in March. Based on the consensus estimate, unemployment is expected to fall to 5.4% by the end of the year. However, the unemployment rate does not tell the whole story as labor force participation remains below pre-pandemic levels and the number of people desiring full-time jobs but working part-time jobs remains elevated. Also, there are still 8.4 million fewer jobs than there were prior to the pandemic. However, economists expect employers to add 7.1 million jobs in 2021 largely offsetting that number.

The Fed's Beige Book indicates that the pace of job growth "varied by industry but was generally strongest in manufacturing, construction, and leisure and hospitality. Hiring remained a widespread challenge, particularly for low-wage or hourly workers, restraining job growth in some cases."

The Beige Book also indicated that wage growth has accelerated slightly, particularly in manufacturing and construction where finding and retaining workers has been difficult.

U.S. consumer confidence has rebounded to its highest levels since before the pandemic shut things down. Consumers are regaining their optimism due to COVID-19 coming under better control, a recovering economy and an improving employment picture.



Source: FactSet

The risk of inflation picking up appears higher than it has in some time. Massive government spending, business reopening, pent-up savings and pent-up demand impact the demand side of the economy at the same time as supply of goods and services may be constrained. Constraints may be due to employment and hiring limitations as well as supply chain disruptions. Wage growth will also likely add to inflationary pressures in the near-term. The Fed anticipates a transitory increase in inflation for a period until demand and supply approach equilibrium. Over the longer term, Goldman Sachs expects core PCE inflation to rise to 2.1-2.2% by 2023-2024. This would be higher than recent levels but within their new guidelines.

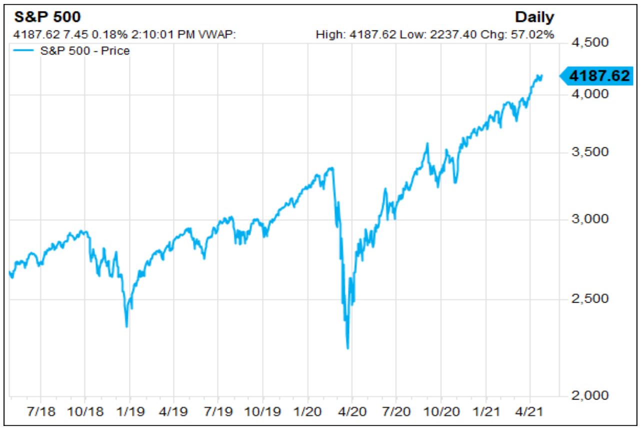
President Biden released the American Jobs Plan on March 31, 2021. The plan includes $2.3 trillion in additional federal spending on various forms of public infrastructure, research and development, workforce training and affordable housing. An additional $400 billion has been tagged for clean energy tax credits. The spending would take place over the next eight years beginning in 2022. The plan would be funded by:

- Increasing the corporate tax rate from 21% to 28%.
- Establishing a minimum tax on corporate book income.
- Raising the tax on foreign profits.
- Eliminating the deduction for Foreign Derived Intangible Income.
- Eliminating tax preferences for fossil fuels.

Raising corporate taxes to 28% would put the U.S. at a disadvantage relative to many other areas of the world. The world average tax rate is 23.3% and the average for the European Union is 22.2% as reported by OCED (Organization for Economic Co-operation and Development). Goldman Sachs holds the position that Congress will raise taxes but not to the level proposed by President Biden. They expect the corporate tax rate to increase to the 25% range with changes in international taxation.

Equity Markets

The S&P 500 closed above 4000 for the first time on April 1, 2021. The index finished 2020 at 3756. The U.S. large cap equity market had a few fairly minor downturns following the result of the Georgia elections, COVID-19 issues and interest rate movement, but generally powered higher. The S&P 500 returned 6.2% in Q1 and 56.4% for one year ending March 31, 2021. One year equity returns look particularly strong due to the low base created by the COVID-19 correction/recession.

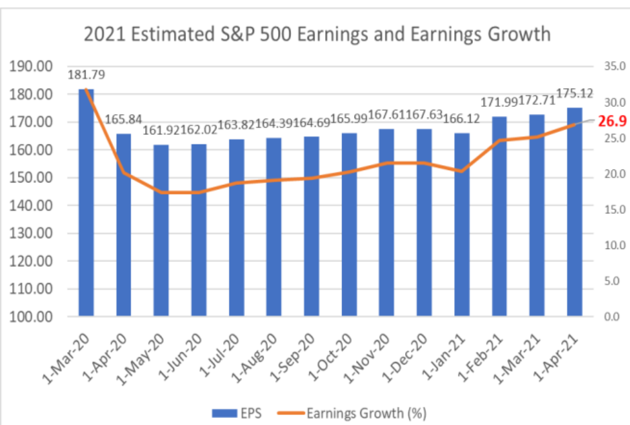


Source: FactSet

Larry Adam, Chief Investment Officer-Private Client Group-Raymond James, points out that the second year of a bull market is typically more muted and more volatile but still tends to be positive. Higher levels of volatility are often the result of higher levels of optimism. He lists the following as reasons for optimism:

- Economic growth
- Fed – balance sheet expansion
- COVID-19 containment
- Dividend growth
- Earnings growth

Earnings declined 14.4% in 2020 but are expected to rebound strongly in 2021 and beyond. The consensus estimate for 2021 S&P 500 earnings is 175.12, up 26.9% from the previous year.

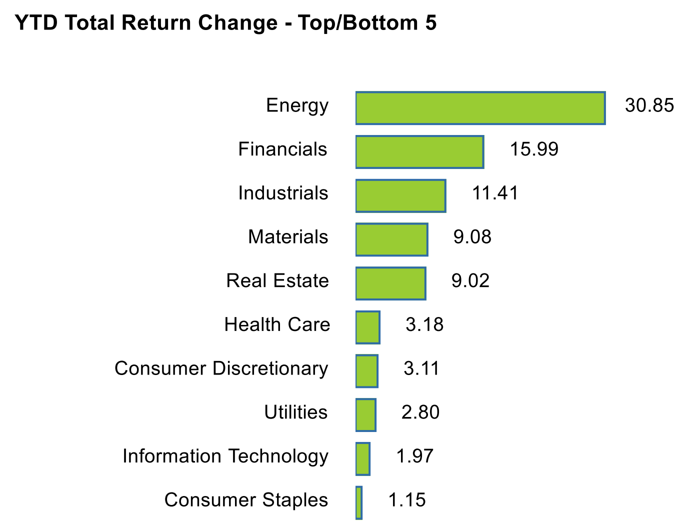


Source: FactSet, Fortress Asset Management

Earnings are expected to be up and additional 14.9% in 2022.

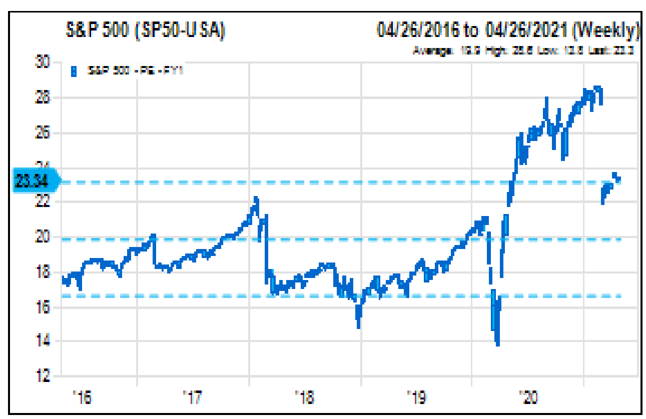
FactSet reports that approximately 25% of the companies in the S&P 500 have reported Q1 revenue and earnings to date. A positive revenue surprise was reported by 77% of those companies and 84% reported a positive earnings surprise. If the remainder of companies maintain an 84% earnings surprise average it will tie for the highest mark since FactSet began tracking the metric in 2008.

The Energy sector produced the largest **earnings surprise** of the S&P 500 economic sectors in Q1, followed distantly by Consumer Discretionary and Financials. Consumer Discretionary was the leading sector in **earnings growth** at 103.4% followed by Financials at 72.5%. Industrials and Energy were the bottom sectors at -16.2% and -10.4% respectively. Information Technology lead all sectors in **revenue growth** at 15.5%, followed by Communication Services at 12.0%. Energy lead for the quarter in **total return** at 30.85% followed by Financials at 15.99%.



Source: FactSet

The S&P 500 continues to trade at all-time highs. The 2021 price earnings multiple for the S&P 500 is 23.3X.



Source: FactSet

The PE multiple is at one standard deviation above a lofty 5-year average if 20X.

The 12-month consensus target price for the S&P 500 is 4,574. This target price indicates an 8.3% upside from current levels and 8.8% for the year.

Goldman Sachs is forecasting that the S&P 500 reaches 4300 over the next twelve months based on 31% earnings growth. Our forecast at Fortress Asset Management is also 4300 based on consensus earnings growth numbers and a PE multiple of 23.5X trending down to 21.5X in 2022 and 19.5X in 2023. The downward trending multiples are based on reversion to the mean and upwardly trending interest rates.

The S&P 500 was up 6.17% in Q1, 56.40% for 1 year through March 31. Large cap value stocks roared ahead 10.14% in Q1 compared with 1.91% for large cap growth stocks. Large cap growth stocks continue to lead for one and three years. Mid cap and small cap stocks continued to benefit from the reopening trade and overtook large cap stocks in Q1 and for one year.

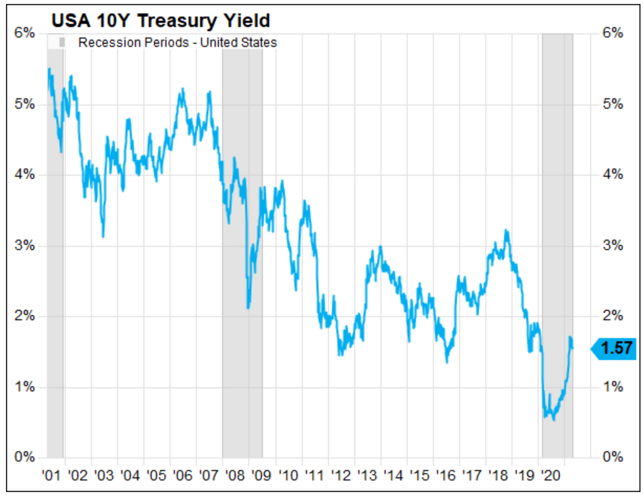
2021 Q1 Returns				
EQUITY	Q1 2021	YTD 3.31.21	1 Year 3.31.21	3 Years Annualized
S&P 500	6.17	6.17	56.40	16.74
S&P 500 Value	10.14	10.14	46.47	8.90
S&P 500 Growth	1.91	1.91	57.89	18.98
Dow Jones Ind Avg	7.76	7.76	50.52	11.00
S&P Mid Cap 400	13.47	13.47	83.53	13.38
S&P Small Cap 600	18.24	18.24	95.42	13.68
MSCI EAFE	3.48	3.48	44.57	6.08
MSCI Emerging Mkts	2.29	2.29	58.39	6.53

Source: FactSet

Developed international stocks (MSCI EAFE) were up 3.48% for the quarter and 44.57% for one year. Emerging Market stocks were up 2.29% for the quarter and 58.39% for one year. Developing and Emerging Markets may lag the U.S. until greater distribution and administration of vaccines are made later in the year.

Fixed Income Markets

The 10-year U.S. Treasury began the year at 0.92%, rose quickly to 1.66% in early April and has since taken a breather, moving down slightly to 1.57%. Bond holders benefited from the general decline in interest rates over the past twenty years but have suffered from the move up so far this year.



Source: FactSet

The consensus estimate for the yield on the 10-year US Treasury is 1.85% for the end of 2021. Factors supporting higher rates continue to be improving economic growth due to vaccine distribution, near record fiscal deficits, the related increase in issuance and added inflationary pressures.

Investment grade bonds, as represented by the Bloomberg Barclays U.S. Aggregate Index, declined -3.37% for the first quarter and were up 0.71% for twelve months through March 31. If interest rates move up as indicated by the consensus estimate, total return for the index for the year will likely drop an additional 0.75 – 1.00%.

2021 Q1 Returns				
FIXED INCOME	Q1 2021	YTD 3.31.21	1 Year 3.31.21	3 Years Annualized
B B US Agg Bond	-3.37	-3.37	0.71	4.65
S&P National Muni	-0.41	-0.41	4.98	4.69
B B High Yield	0.60	0.60	20.68	5.93

Source: FactSet

Bonds are used as a source of income; however, in the current low interest rate environment they may be looked at as more of a tool to help manage portfolio volatility. Based on the expectation for interest rates to trend upward, we recommend modestly shortening duration (reducing the sensitivity to changes in interest rates) of bond portfolios and bond funds held.

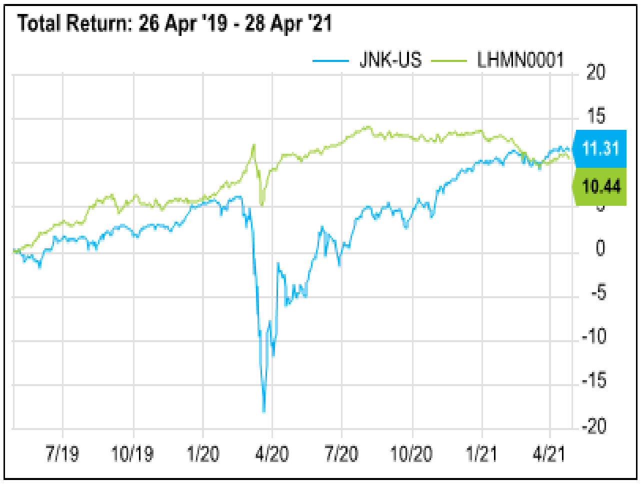
Municipal bonds, as represented by the S&P Municipal Index, were down -0.41% for the quarter and up 4.98% for one year through March 31.

Municipal bonds are typically compared with similar maturity Treasuries and high-grade corporate bonds when looking for investment opportunities. Also, in order to have a more apples to apples comparison, municipal bond yields are converted to taxable equivalent yields. Typically, the top Federal bracket (37%) is used to make comparison.

There is currently no advantage to owning < 10-year maturity AAA municipal bonds. Either longer maturities or lower credit quality have to be selected in order to gain any advantage. AA bonds begin to have an advantage beyond 7 years and increase their advantage in longer maturities. A rated bonds have an advantage across all maturities on the yield curve and also increase their advantage as maturities increase. If the Biden administration is successful in moving tax rates higher, demand for municipal bonds will increase.

High yield bond spreads relative to comparative US Treasuries widened to extreme levels during early days of the pandemic and related lock downs. Default rates increased due to the impact of the pandemic on business operations and cash flow. However, default rates are trending down and spreads relative to comparable Treasury bonds have tightened significantly since that time.

The following chart displays the high yield market represented by the SPDR Bloomberg Barclays Bond ETF (JNK) compared with the investment grade Bloomberg Barclays Aggregate Bond Index (LHMN0001). The high yield market has made up significant ground on the investment grade index since March 2020.



Source: FactSet

High yield bond funds can be an important part of a well-diversified portfolio strategy.

Disclosures

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