Asset Strategy Consultants

# MARKET REVIEW

First Quarter 2021

We are pleased to present *Market Review,* featuring a discussion of the Capital Markets during the First Quarter 2021 and a summary of historical performance for the major asset style passive indices for the period ending March 31, 2021. We hope you find the information useful and helpful in your investment considerations.

We welcome your comments.

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Founded in 1991, Asset Strategy Consultants provides investment consulting services to institutional clients representing $12.7 billion under advisement. Headquartered in Baltimore, Asset Strategy Consultants has offices throughout the East Coast.

## THE MACROECONOMIC ENVIRONMENT

### 2021—Off with Gusto!

**The roll-out of vaccines and ongoing central bank stimulus fueled optimism and drove equity prices higher during the quarter but also spurred concerns over inflation, pushing U.S. Treasury yields higher during the first three months of the year. A $1.9 trillion stimulus package was signed into law, and an additional $2-plus trillion infrastructure proposal lies in the wings.**

The S&P 500 Index hit an intra-day record high going into quarter-end and is in "overvalued" territory by a number of valuation metrics, reflecting robust earnings expectations. Overseas markets generally outperformed the U.S. in local terms, but a strengthening U.S. dollar eroded much of the relative gains. The U.S. Treasury 10-year yield closed the quarter at 1.74%, above the S&P 500 dividend yield (+1.5%) for the first time since mid-2019.

Employment gains, consumer spending and confidence, and housing were among the bright spots during the quarter. And on April 1 the ISM manufacturing print (64.7) was the highest since 1983 (a reading over 55 signals "exceptional growth"). Fourth quarter real GDP was revised up to 4.3%, bringing the 2020 figure to -3.5%. A survey of economists by The Wall Street Journal revealed that the average 2021 forecast was boosted to 6%, which would be the fastest pace since 1983. In further good news, the Conference Board's U.S. consumer confidence index hit a one-year high in March and posted the largest one-month gain in 18 years. As for housing, the S&P CoreLogic Case-Shiller National Home Price Index, which measures average home prices in major cities, gained just over 11% y-o-y as of Jan. 31, its highest annual rate since 2006. The surge in housing prices has been fueled by low mortgage rates and record low inventory.

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The recently passed stimulus package represents roughly 10% of U.S. GDP; with last year's stimulus, the total is about $5 trillion or 25% of U.S. GDP. The recent package included $1,400 checks to qualified individuals, an extension of unemployment insurance, and aid to state and local governments. The Congressional Budget Office projects that the federal budget deficit will reach $2.3 trillion in 2021, just over 10% of GDP and the second highest level since 1945, exceeded only by last year's figure. In the 2020 fiscal year, which ended Sept. 30, the deficit hit a record $3 trillion. Note also that the CBO's 2021 projection does not include the recent $2 trillion stimulus package.

At its March meeting, the FOMC increased its GDP projection for 2021 from 4.2% to 6.5% (falling to 2.2% in 2023), and its median projection for year-end unemployment fell to 4.5%. However, expectations for PCE core inflation remain muted (2.2% in 2021; 2.0% in 2022). The Fed funds rate was kept on hold at close to 0%, and asset purchases are slated to continue. And, importantly, expectations for rate hikes remain on the distant horizon. The Fed's statement that "the ongoing public health crisis continues to weigh

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on economic activity, employment, and inflation and poses considerable risks to the economic outlook" indicated that it is in no rush to raise rates or taper its asset purchases and re-confirmed the view that is willing to let inflation run above its long-term target of 2%. It also acknowledges that full employment will take time to achieve. While market participants worry that rapid economic growth combined with prospects for increased Treasury supply to fund a growing deficit will lead to additional inflation, the numbers have yet to reflect that concern. As of February, headline CPI was 1.7% y-o-y and core CPI was 1.3% y-o-y in spite of higher energy and food prices. Some expect that any rise in inflation will be short-lived. The recent stimulus package is a one-time injection that is not expected to fuel long-term inflation; likewise, pent-up demand will likely have a short-term effect on price gains but not necessarily a protracted impact. Finally, secular changes including technology innovation and shifting demographics continue to temper inflationary pressures. As the Fed has repeatedly made clear, it is willing to accept inflation that runs above 2% in order to reach a longer-term average of its 2% target. ■

## EQUITY MARKETS

U.S. equity indices delivered mostly positive results (Russell MidCap Growth was the lone exception with a 0.6% loss). The S&P 500 Index (+6.2%) was led by Energy (+30.9%) and Financials (+16.0%), while Information Technology (+2.0%) and Consumer Staples (+1.1%) lagged. Value sharply outperformed growth; R1000V: +11.3%; R1000G: +0.9%. Value stocks have underperformed growth since the market peak in February 2020, but the gap has narrowed significantly over the last two quarters. Small cap stocks sharply outperformed large cap during the quarter (R2000: +12.7%; R1000: +5.9%), benefiting from less exposure to the Technology sector as well as strong performance from Retail. Certain sectors have experienced sharp double-digit increases in recent months as vaccine-induced optimism has fueled a rebound. Data from JP Morgan shows that from Nov. 6, 2020 (reflecting the last business day before it was announced that a vaccine candidate had better than 90% efficacy against COVID-19), airlines, energy, retail REITs, and cruise lines/hotels/resorts have soared more than 50%.

Global ex-U.S. indices posted positive results but generally lagged the U.S., due largely to U.S. dollar strength. The MSCI ACWI ex-USA Index gained 3.5% but was up 6.5% in local currency terms. The greenback gained 6.6% vs. the yen and nearly 4% vs. the euro over the quarter on bright prospects for economic growth in the U.S. and rising interest rates. The U.K. (+6.2%) delivered relatively strong results while Europe (+3.5%) and Japan (+1.6%) lagged. As in the U.S., small cap stocks outperformed large; value outperformed growth; and Financials did especially well. Emerging markets lagged developed markets; the MSCI Emerging Markets

Index gained 2.3% and 4.0% in local terms. China (-0.4%) and Brazil (-10.0%) were laggards as President Xi intensified regulation of China's tech sector, pressuring share prices, and Brazil struggled to contain COVID-19. Taiwan (+10.9%) was a top performer, and the country is up more than 90% over the last 12 months, boosted by its heavy weighting in and strong performance from Technology stocks. In contrast, South Korea posted a muted 1.6% gain. ■

## FIXED INCOME MARKETS

Concerns over future inflation drove the 10-year U.S. Treasury yield to an intraday high of 1.77% in March, a 15-month high, before closing the quarter at 1.74%, up from 0.93% at year-end. The Bloomberg Barclays US Treasury Index fell 4.3%, and the long-term US Treasury Index (-13.5%) suffered its harshest decline since 1980. TIPS (-1.5%), outperformed nominal Treasuries as 10-year breakeven spreads widened from 1.99% at year-end to 2.37% as of March 31. The Bloomberg Barclays US Aggregate Bond Index fell 3.4%, with spread sectors outperforming Treasuries and lower quality faring the best. High yield corporates posted a 0.8% gain, as measured by Bloomberg Barclays, amid a record-making spate of issuance. The CCC-rated sector gained 3.6%, benefiting from risk-on sentiment, rising stock markets, and the recovery of some COVID-19 victims (airlines, retail, energy). Bank loans, which have floating rate coupons and a relatively short duration, gained 1.8% (S&P LSTA). Municipals outperformed U.S. Treasuries against a favorable supply/demand backdrop (Bloomberg Barclays Municipal Bond: -0.4%). In addition, the market was supported by the $350 billion allocated to support state and local governments in the recent stimulus package.

Rates also rose overseas and a strengthening U.S. dollar further eroded foreign bond returns for U.S. investors. The Bloomberg Barclays Global Aggregate ex-US Bond Index fell 5.3% (-1.9% hedged). The dollar gained nearly 4% versus a basket of currencies. Emerging market debt returns were also negative. The JP Morgan EMBI Global Diversified fell 4.5% and the local currency JP Morgan GBI-EM Global Diversified sank 6.7%. ■

## REAL ASSETS

Real assets posted strong returns in 1Q on prospects for a robust recovery as well as a potential hedge against coming inflation. Oil prices continue to climb with Brent Crude oil closing at over $60/barrel. The Alerian MLP Index was up 22% for the quarter. The S&P GSCI Index soared 13.5% although gold (spot price: -9.5%) declined. REITs, as measured by the MSCI U.S. REIT Index, rose 8.8%. The Bloomberg Barclays 1-10 Yr. US TIPS Index posted a muted 0.6% result, but outperformed nominal U.S. Treasuries as inflation expectations rose. ■

## CLOSING THOUGHTS

What a difference a vaccine makes! Pent-up demand for restaurants, movies, travel, and shopping are expected to unleash consumer spending and support a robust economic recovery in 2021. Stock markets appear to be priced for this scenario. With that, rising rates and simmering concerns over inflation are clouds on the horizon. So far, the Fed is unwavering in its commitment to remain accommodative until it meets its full employment and inflation objectives. The 2021 path of the economy, the pandemic, and the markets is likely to provide some twists and turns, and while the start has been bright, ASC continues to advise adherence to a disciplined investment process that includes a well-defined long-term asset allocation policy and, if applicable, to understand the risks undertaken to improve expected investment returns. ■

*Source: Asset Strategy Consultants and Callan Associates*

**Important Disclosure Information**

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# PRELIMINARY RETURNS FOR VARIOUS PERIODS: 1Q21

| | | January | February | March | Last Quarter | Year to Date | Last Year | Last 3 Years | Last 5 Years | Last 10 Years | Last 15 Years |
|---|---|---|---|---|---|---|---|---|---|---|---|
| EQUITY | 1 Russell:3000 Index | (0.44) | 3.13 | 3.58 | 6.35 | 6.35 | 62.53 | 17.12 | 16.64 | 13.79 | 10.05 |
| | 2 Russell:1000 Index | (0.82) | 2.90 | 3.78 | 5.91 | 5.91 | 60.59 | 17.31 | 16.66 | 13.97 | 10.17 |
| | 3 Russell:1000 Growth | (0.74) | (0.02) | 1.72 | 0.94 | 0.94 | 62.74 | 22.80 | 21.05 | 16.63 | 12.38 |
| | 4 Russell:1000 Value | (0.92) | 6.04 | Z | 11.26 | 11.26 | 56.09 | 10.96 | 11.74 | 10.99 | 7.69 |
| | 5 Russell:Midcap Index | (0.26) | 5.57 | 2.71 | 8.14 | 8.14 | 73.64 | 14.73 | 14.67 | 12.47 | 9.80 |
| | 6 Russell:Midcap Growth | (0.33) | 1.71 | (1.91) | (0.57) | (0.57) | 68.61 | 19.41 | 18.39 | 14.11 | 10.97 |
| | 7 Russell:Midcap Value | (0.23) | 7.75 | 5.16 | 13.05 | 13.05 | 73.76 | 10.70 | 11.60 | 11.05 | 8.67 |
| | 8 Russell:2500 Index | 2.45 | 6.52 | 1.64 | 10.93 | 10.93 | 89.40 | 15.34 | 15.93 | 12.20 | 9.53 |
| | 9 Russell:2500 Growth | 2.80 | 3.14 | (3.34) | 2.49 | 2.49 | 87.50 | 19.96 | 19.91 | 14.21 | 11.14 |
| | 10 Russell:2500 Value | 2.21 | 8.90 | 4.96 | 16.83 | 16.83 | 87.47 | 10.88 | 12.15 | 10.23 | 7.87 |
| | 11 Russell:2000 Index | 5.03 | 6.23 | 1.00 | 12.70 | 12.70 | 94.85 | 14.76 | 16.35 | 11.68 | 8.83 |
| | 12 Russell:2000 Growth | 4.82 | 3.30 | (3.15) | 4.88 | 4.88 | 90.20 | 17.16 | 18.61 | 13.02 | 10.05 |
| | 13 Russell:2000 Value | 5.26 | 9.39 | 5.23 | 21.17 | 21.17 | 97.05 | 11.57 | 13.56 | 10.06 | 7.38 |
| | 14 S&P:500 | (1.01) | 2.76 | 4.38 | 6.17 | 6.17 | 56.35 | 16.78 | 16.29 | 13.91 | 10.02 |
| | 15 S&P:400 Mid Cap | 1.50 | 6.80 | 4.67 | 13.47 | 13.47 | 83.46 | 13.40 | 14.37 | 11.92 | 9.94 |
| | 16 S&P:600 Small Cap | 6.29 | 7.65 | 3.33 | 18.24 | 18.24 | 95.33 | 13.71 | 15.60 | 12.97 | 9.78 |
| | 17 MSCI:ACWI ex US | 0.22 | 1.98 | 1.26 | 3.49 | 3.49 | 49.41 | 6.51 | 9.76 | 4.93 | 4.48 |
| | 18 MSCI:EAFE | (1.07) | 2.24 | 2.30 | 3.48 | 3.48 | 44.57 | 6.02 | 8.85 | 5.52 | 4.10 |
| | 19 MSCI:EM | 3.07 | 0.76 | (1.51) | 2.29 | 2.29 | 58.39 | 6.48 | 12.07 | 3.65 | 5.95 |
| | 20 MSCI:ACWI | (0.45) | 2.32 | 2.67 | 4.57 | 4.57 | 54.60 | 12.07 | 13.21 | 9.15 | 7.04 |
| FIXED INCOME | 21 Blmbg:Aggregate | (0.72) | (1.44) | (1.25) | (3.37) | (3.37) | 0.71 | 4.65 | 3.10 | 3.44 | 4.29 |
| | 22 Blmbg:Gov/Credit | (1.04) | (1.76) | (1.54) | (4.28) | (4.28) | 0.86 | 4.99 | 3.36 | 3.70 | 4.41 |
| | 23 Blmbg:Credit | (1.19) | (1.74) | (1.59) | (4.45) | (4.45) | 7.88 | 5.95 | 4.67 | 4.83 | 5.36 |
| | 24 Blmbg:Corporate High Yld | 0.33 | 0.37 | 0.15 | 0.85 | 0.85 | 23.72 | 6.84 | 8.06 | 6.48 | 7.36 |
| | 25 Blmbg:Municipal Bond | 0.64 | (1.59) | 0.62 | (0.35) | (0.35) | 5.51 | 4.91 | 3.49 | 4.54 | 4.40 |
| | 26 Blmbg:US TIPS | 0.33 | (1.61) | (0.19) | (1.47) | (1.47) | 7.54 | 5.68 | 3.86 | 3.44 | 4.37 |
| | 27 Blmbg:Glob Agg ex USD | (1.03) | (1.94) | (2.42) | (5.29) | (5.29) | 7.15 | 1.15 | 2.13 | 1.26 | 3.30 |
| | 28 S&P:LSTA Levg Loan | 1.19 | 0.59 | 0.00 | 1.78 | 1.78 | 20.71 | 4.13 | 5.28 | 4.25 | 4.60 |
| | 29 ML:US Treasuries 1-3 Yrs | 0.02 | (0.08) | 0.02 | (0.05) | (0.05) | 0.24 | 2.77 | 1.71 | 1.29 | 2.22 |
| | 30 LIBOR - 3 Month | 0.02 | 0.01 | – | – | – | – | – | – | – | – |
| | 31 3 Month T-Bill | 0.01 | 0.01 | 0.01 | 0.03 | 0.03 | 0.12 | 1.49 | 1.19 | 0.63 | 1.16 |
| REAL ASSETS | 32 Blmbg:Commodity TR Idx | 2.63 | 6.47 | (2.15) | 6.92 | 6.92 | 35.04 | (0.20) | 2.31 | (6.28) | (3.42) |
| | 33 GS Commodity Index | 4.94 | 10.58 | (2.15) | 13.55 | 13.55 | 50.22 | (4.93) | 1.18 | (8.60) | (6.88) |
| | 34 MSCI:US REIT Index | 0.16 | 3.99 | 4.42 | 8.76 | 8.76 | 37.69 | 9.51 | 5.32 | 8.53 | 6.10 |
| | 35 Alerian:MLP Index | 5.84 | 7.77 | 6.91 | 21.95 | 21.95 | 103.13 | (2.98) | (1.30) | (0.93) | 4.59 |

*Source: Callan Associates*