HIGHTOWER
Westchester

Market Commentary Q1 2021

It's hard to fathom that a year has passed since the pandemic began with March 23rd marking the one-year anniversary of the market bottom. Despite the appearance of being on the path toward recovery, we have to remember that an inordinate amount of damage has been inflicted on the global economy. Given the latest projections, the U.S. is on track for herd immunity possibly as early as this summer. We are witnessing the rise of COVID variants that have the potential to delay the re-opening, but only time will tell. As the economy continues to heal, the Biden administration has moved quickly to propose additional stimulus just weeks after the American Rescue Plan became law.

As we closed out 2020, the overwhelming feeling was that things couldn't get much worse. Unfortunately, January did not start out on a high note as we saw the emergence of virus mutations, the uneven distribution of COVID-19 vaccines, and the gradual relaxation of pandemic-related restrictions. We also, witnessed a new phenomenon in market engineering involving several companies, including a video-game company!

Then February hit and the major equity indexes reached record highs, only to pull back by month-end. Afraid that inflationary pressures would escalate, investors favored Value stocks over Growth stocks, pushing small-cap and mid-cap stocks higher in the process. Investors seemed to be encouraged by President Biden's $1.9 trillion stimulus proposal, accelerated vaccine distribution, and better-than-expected fourth-quarter corporate earnings. Meanwhile, the yield on 10-year Treasuries continued to increase, crude oil prices pushed past $61 per barrel, and the dollar rose.[1]

The optimism seemed to continue as the quarter wrapped up in March with stocks pushing even higher. Several of the main benchmark indexes posted significant gains including the Dow +7%, and the S&P 500 +4%, while Russell 2000 +1% and the Nasdaq +0.4% advanced moderately.[1] Looking under the hood, industrials +8%, utilities +7%, consumer staples +7%, and materials +6% finished the quarter strongly.[1] Treasury yields and the dollar advanced, while crude oil prices and gold fell.[1]

The first quarter was undoubtedly eventful as has been much of the last 12-18 months. Additional federal stimulus payments made their way into a lot of consumer bank accounts, through social media, a group of amateur traders banded together to drive shares of a struggling video gaming company to astronomical heights, interest rates jumped at a pace not seen in years, stoking fears that inflation could rear its ugly head, all culminating in equities ultimately enjoying robust returns. Technology shares, which had driven the market for much of 2020, had a pedestrian quarter, but still gained enough ground to push the Nasdaq up by almost +3%.[1] Energy shares posted some of the largest gains in the quarter, surging over +30%.[1] Financials jumped +18%, followed by industrials +12%, materials +11%, and real estate +10%.[1] Most of which comprise what we call the value sector of the market.

Despite a strong jobs report in March that added 916,000 people to payrolls, the total number of people employed in the U.S. remains about 8 million lower than before the pandemic began.[2] That equates roughly to five years of job gains still lost! On a more positive note, the rapid acceleration of vaccine distributions should aid new job creation through the rest of the year, especially in industries such as leisure and hospitality who were most affected by the pandemic.

We continue to see reasons for optimism across the economic landscape starting with the ISM manufacturing index which rose to 64.7 in March, its highest reading in over 37 years![2] This index surveys purchasing managers to gain an understanding of the current and expected business conditions, with any number over 50 representing an expanding economy. Both the production and new orders components of the index saw their highest levels since January 2004.[2] Also, the ISM non-manufacturing index, which represents service industries, posted a record high in March. Respondents of the survey-based index noted that lifting COVID restrictions has unleashed pent-up demand; however, capacity constraints remain a challenge.

Looking back over the last year or so, it is hard to ignore the impact of the November Presidential election and the January Georgia runoff election, both of which are seen as pivotal dates signaling an expansion of the ultra-accommodative fiscal policies that have been an enormous tailwind for stocks. Up until the fall of 2020, momentum stocks continued to significantly outperform other factors. Intuitively, stocks of higher quality also outperformed, as they held up better during the downturn and were more stable during periods of greater uncertainty. On the other hand, Value stocks struggled mightily, as has been the case for almost a decade. That has since changed as Value has undergone a 180-degree pivot once the vaccines signaled the onset of the economic recovery. Something we are mindful of in client portfolios.

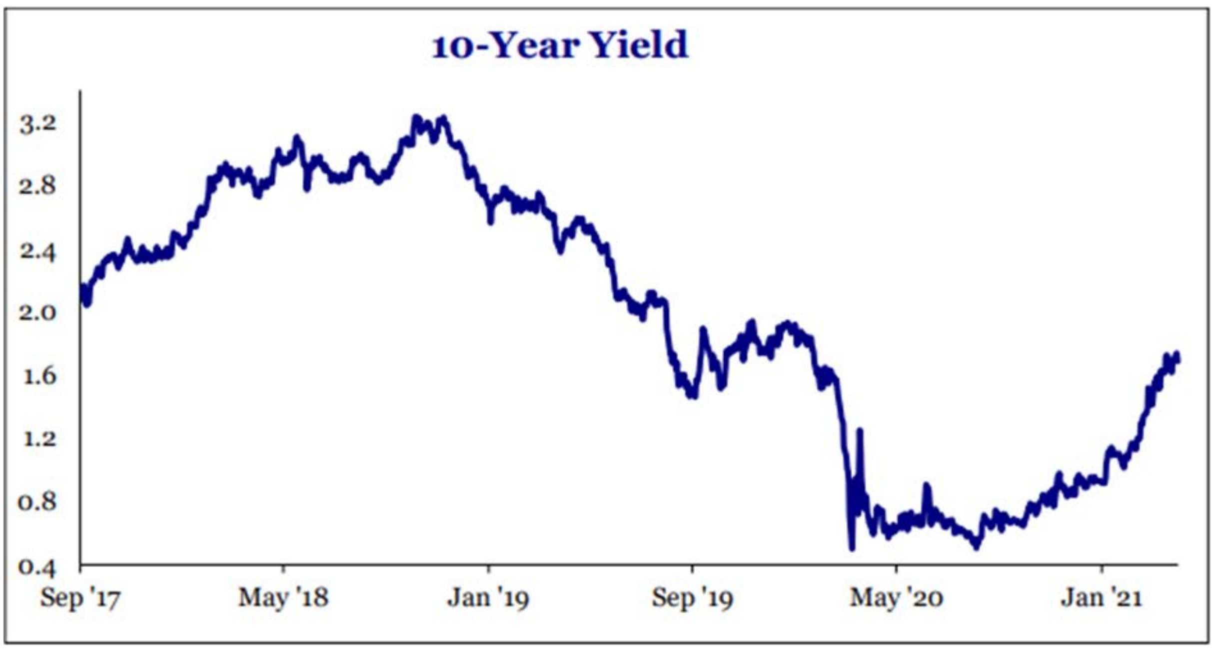
Leading US Indices (Total Return)	2019	1Q'20	2Q'20	3Q'20	4Q'20	2020	1Q'21 (sorted)	YTD
S&P 600 Small-Cap	22.8%	-32.6%	21.9%	3.2%	31.3%	11.3%	18.2%	18.2%
S&P 400 Mid-Cap	26.2%	-29.7%	24.1%	4.8%	24.4%	13.7%	13.5%	13.5%
Russell 2000	25.5%	-30.6%	25.4%	4.9%	31.4%	20.0%	12.7%	12.7%
S&P/Citigroup Value	31.9%	-25.3%	13.1%	4.8%	14.5%	1.4%	10.8%	10.8%
S&P 500 Total Return	**31.5%**	**-19.6%**	**20.5%**	**8.9%**	**12.1%**	**18.4%**	**6.2%**	**6.2%**
Dow Jones Wilshire 5000	27.7%	-21.2%	22.1%	9.0%	14.4%	20.0%	5.8%	5.8%
S&P 100 Mega-Cap	32.2%	-17.2%	20.8%	9.8%	10.7%	21.5%	5.1%	5.1%
Nasdaq	36.7%	-14.0%	30.9%	11.2%	15.6%	44.9%	3.0%	3.0%
S&P/Citigroup Growth	31.1%	-14.5%	26.2%	11.8%	10.7%	33.5%	2.1%	2.1%

S&P 500 Sectors (Total Return)	2019	1Q'20	2Q'20	3Q'20	4Q'20	2020	1Q'21 (sorted)	YTD
Energy	11.8%	-50.5%	30.5%	-19.7%	27.8%	-33.7%	30.9%	30.9%
Financials	32.1%	-31.9%	12.2%	4.4%	23.2%	-1.7%	16.0%	16.0%
Industrials	29.4%	-27.0%	17.0%	12.5%	15.7%	11.1%	11.4%	11.4%
Materials	24.6%	-26.1%	26.0%	13.3%	14.5%	20.7%	9.1%	9.1%
Real Estate	29.0%	-19.2%	13.2%	1.9%	4.9%	-2.2%	9.0%	9.0%
Communication Services	32.7%	-17.0%	20.0%	8.9%	13.8%	23.6%	8.1%	8.1%
S&P 500 Total Return	**31.5%**	**-19.6%**	**20.5%**	**8.9%**	**12.1%**	**18.4%**	**6.2%**	**6.2%**
Health Care	20.8%	-12.7%	13.6%	5.9%	8.0%	13.4%	3.2%	3.2%
Discretionary	27.9%	-19.3%	32.9%	15.1%	8.0%	33.3%	3.1%	3.1%
Utilities	26.3%	-13.5%	2.7%	6.1%	6.5%	0.5%	2.8%	2.8%
Technology	50.3%	-11.9%	30.5%	12.0%	11.8%	43.9%	2.0%	2.0%
Staples	27.6%	-12.7%	8.1%	10.4%	6.4%	10.7%	1.1%	1.1%

US Yields	4Q'19	1Q'20	2Q'20	3Q'20	4Q'20	1Q'21	Q/Q Chg (bps)	Y/Y Chg (bps)
Fed Funds Target Rate	1.75	0.25	0.25	0.25	0.25	0.25	0	0
3-Month T-Bill	1.50	0.07	0.14	0.09	0.08	0.01	-7	-6
2-Year Note	1.56	0.23	0.16	0.13	0.11	0.11	0	-12
5-Year Note	1.68	0.38	0.29	0.26	0.31	0.74	44	37
10-Year Bond	1.91	0.70	0.65	0.66	0.87	1.70	83	101
30-Year Bond	2.38	1.35	1.41	1.45	1.64	2.42	78	107

Source: Strategas

Shifting gears to fixed income, yields continued their historic surge as the Bloomberg Barclays U.S. Aggregate Bond Index finished the first quarter lower by -3.4%, its worst quarterly performance since 1981.[1] As previously noted, the yield on the 10-year Treasury climbed another 0.30% in March and for the quarter went from 0.92% to 1.74%, the highest level since the pandemic began.[1] To put in historical perspective, the 0.82% yield swing was the largest since the fourth quarter of 2016 and the fifth largest on record over the last 30 years.[1] We have kept portfolios shorter in duration in anticipation of these rock bottom rates grinding higher. Simultaneously, spreads for investment-grade corporate bonds continued to tighten, leading to modest outperformance for credit. The high-yield index edged higher in March and finished the first quarter +0.85%, one of the few bright spots across the fixed income landscape.[1] The spread on the below-investment-grade index is now just 3.2% above the risk-free 10-year Treasury, the lowest it's been since 2014.[1] The municipal bond index gained 0.62% in March and is handily outperforming other taxable bond sectors YTD, even before the after-tax benefits are factored in.[1]



Source: Strategas

The Federal Open Market Committee (FOMC) met in March. According to the Committee statement, employment has turned up recently and, despite investor concerns, inflation continues to run well below 2.0% (as I write this, we just printed a noteworthy inflation number). The Committee continues to hold interest rates at their current 0.00%-0.25% target range and expects no change through 2023. Looking back at the "dot plot" over the last decade, we take a lot of this conjecture with a grain of salt.

One of the hottest sectors in the economy over the past year has been housing. Over the past 12 months, existing home sales increased approximately 9%.[2] The median existing-home price was $313,000 in February ($309,900 in January), up 15.8% from February 2020.[2] Year over year, sales of existing single-family homes rose 18.6%.[2]

Overseas, it was a mixed bag for international stocks in March, as the developed markets index MSCI EAFE was higher by 2.3%, while the emerging markets index dropped -1.5%.[1] Developed Europe was the strongest region, with many major economies in the green. Also worth mentioning, the blockage of the Suez Canal by the giant container ship Ever Given for six days caused significant volatility for crude oil and spilled over toward international stocks that trade between Asia and Europe.

International markets were also not immune to inflationary pressures. February saw consumer prices increase in several nations across the globe, including France, Germany, Italy, Canada, China, and Japan. In the markets, the EURO STOXX Europe 600 Index gained about +4% in March; the United Kingdom's FTSE inched up +1%; Japan's Nikkei 225 fell -1%; and China's Shanghai Composite Index plunged nearly -4%.[1]

International Indices (Price Chg)	2019	1Q'20	2Q'20	3Q'20	4Q'20	2020	1Q'21 (sorted)	YTD
OMX Stockholm 30 (Sweden)	25.8%	-16.3%	12.3%	9.9%	2.5%	5.8%	17.0%	17.0%
CAC 40 (France)	26.4%	-26.5%	12.3%	-2.7%	15.6%	-7.1%	9.3%	9.3%
DAX (Germany)	21.5%	-25.3%	21.3%	3.2%	7.4%	0.4%	9.1%	9.1%
S&P/TSX (Canada)	19.1%	-21.6%	16.0%	3.9%	8.1%	2.2%	7.3%	7.3%
Bolsa (Mexico)	4.6%	-20.6%	9.2%	-0.7%	17.6%	1.2%	7.2%	7.2%
Kospi (South Korea)	7.7%	-20.2%	20.2%	10.4%	23.4%	30.8%	6.5%	6.5%
Nikkei 225 (Japan)	18.2%	-20.0%	17.8%	4.0%	18.4%	16.0%	6.3%	6.3%
IBEX 35 (Spain)	11.8%	-28.9%	6.6%	-7.1%	20.2%	-15.5%	6.3%	6.3%
Hang Seng (Hong Kong)	9.1%	-16.3%	3.5%	-4.0%	16.1%	-3.4%	4.2%	4.2%
FTSE 100 (UK)	12.1%	-24.8%	8.8%	-4.9%	10.1%	-14.3%	3.9%	3.9%
Sensex (India)	14.4%	-28.6%	18.5%	9.0%	25.4%	15.8%	3.7%	3.7%
Swiss Market Index	26.0%	-12.3%	7.9%	1.4%	5.1%	0.8%	3.2%	3.2%
All Ordinaries (Australia)	19.1%	-24.9%	17.4%	0.1%	14.0%	0.7%	2.4%	2.4%
Bovespa (Brazil)	31.6%	-36.9%	30.2%	-0.5%	25.8%	2.9%	-2.0%	-2.0%
Shenzhen SE A Shares (China)	36.0%	-3.3%	18.6%	8.8%	8.4%	35.2%	-4.8%	-4.8%

Source: Strategas

Emerging markets equities tracked developed markets higher in the first quarter. Our outlook for emerging markets equities remains positive, although interest rates and the direction of the U.S. dollar remain factors to watch.

China was one of the lone major economies to grow in 2020, as it seemed they were able to combat the virus better than most. Their market performance has since waned as other countries continue to open up. Our relationship with China from a geopolitical perspective will continue to dominate headlines despite the change in administration.

The stimulus at the end of 2020 ($900B) and the relief package signed in early March ($1.9T) equate to nearly 14% of U.S. GDP.[2] Announced on the last day in March, the American Jobs Plan proposes an additional $2.25 trillion in spending geared largely toward improving transportation, communication, and power infrastructure and will undoubtedly push that number higher. The proposed infrastructure plan will be paired with an additional $1 trillion in spending focused on social programs and is expected to be unveiled in April. Only time will tell how much stimulus will be passed by Congress; however, overall fiscal spending is unprecedented and clearly larger than what markets were pricing at the start of 2021. Could this lead to inflation, of course, but how it pairs with the labor market, consumer spending economic growth will determine how hot the economy can and will run.

Not surprisingly, the markets have been on quite the roller coaster since the pandemic began. In under a month the U.S. stock market fell by roughly 34% and has since climbed over 82% in just over one year.[1] Some of the fastest and most drastic market movements in history. It's been an emotional ride to say the least. At the onset of the pandemic fear and despair were palpable, then miraculously came hope and optimism, and now we're witnessing signs of greed and excess (electric vehicles, cryptocurrencies, and that video game company come to mind). So, with anything, we need to acknowledge what positives have come out of this. What wisdom have we gained throughout this cycle? Most importantly, and you've heard us say this time and time again, it underscores just how important it is to not make rash decisions or let our emotions impact our investment choices. None of us are immune to hindsight bias, but what seems obvious today did not feel so feel so obvious at the peak of the crisis. We know that adhering to a disciplined strategy that is aligned with one's goals has never been more important. We are also keenly aware of what overconfidence breeds during these periods of unchecked optimism. Historically, you'd be hard-pressed to find a time when stocks gained over 80% in one year, and usually these trends level off or reverse outright in the following months. Adhering to your plan, staying grounded, not chasing trends, and avoiding speculative bets is likely the best course going forward.

To discuss this commentary further, please contact us at 914-825-8630.

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[1] Morningstar Direct
[2] Strategas Securities, LLC