GFP *Outlook & Strategy*

April 2021

First Quarter Review

The first quarter of 2021, similar to the preceding twelve months, was among the most eventful quarters in recent memory. During the quarter, events of note included:
• Congress passing the next CARES Act stimulus package
• Massive rotation from growth to value equity investing
• Interest rate and commodity spikes
• The rise and fall of Special Purpose Acquisition Companies (SPACs)
• GameStop retail investor-driven stock volatility.

Overall, the equity markets performed well in the first three months of the year, as normally happens when interest rates first start to rise. Rising interest rates are often a sign of economic strength. However, as rates continue to go higher, related worries about inflation start to grow. In addition to value stocks outperforming growth stocks, international markets outperformed the U.S., as the dollar weakened vs. other currencies. The Global Gross Domestic Product (GDP) outlook brightened with the rollout of the vaccines continuing in most parts of the world. The public markets have assumed the vaccines are effective and that the economy will mostly be back to normal in the back half of 2021. As of this writing, consumer sales data is higher than pre-pandemic levels, an indication of pent-up consumer demand.

Outlook

Typically, speculative situations such as what we saw with GameStop and SPACs, along with any spike in interest rates, would indicate we are nearing the end of an economic cycle. However, unprecedented fiscal stimulus coupled with some of the easiest financial conditions ever witnessed (meaning low rates and supportive Fed policy), shapes our view that the market is unlikely to see a correction of any consequence in the immediate future. It is hard to overstate the impact of the trillions of dollars that the government has issued and how that has stimulated consumer demand, leading to stock market gains.

For now, we expect the markets to consolidate the recent gains and trade in a narrower range than in recent quarters. The biggest risks to our forecast are tax policy that may be more severe than expected and the possibility of inflation rising above the Federal Reserve's targeted levels. We are monitoring both of these factors carefully as they are real risks and would mandate a repositioning of client portfolios. Related to inflation, rising interest rates (even up to levels of a few years ago) would be enough to derail the market as valuations are high and predicated upon a consistent, low interest rate environment. On a more positive note, we expect economic growth and earnings to be extremely strong this year. In fact, second quarter 2021 GDP could be more than +10%.

Equities

Equities have become more expensive with the S&P 500 Index up around 6% to start the year. As mentioned previously, value significantly outperformed growth in Q1, with the S&P 500 Value +10.8% versus the S&P 500 Growth +2.1%, representing a long-awaited shift in market leadership. In addition, with interest rates rising some 70 basis points, equities are more expensive on a risk-premium basis and very close to fair value. As noted last quarter, we are of the view that market prices can go higher from here, but if that happens, we believe it will be driven by new leaders such as cyclical financial sector stocks and other sectors that aren't as adversely impacted by an increase in rates. We have become increasingly bullish on Europe due to the value and cyclical nature of the components of most European stock indices. We also think the U.S. Dollar will stabilize for a while due to interest rates going higher, and therefore emerging market equities should take a breather after a tremendous rally off of the March 2020 bottom.

Fixed Income

Last quarter we wrote, "Traditional interest rate exposure is dangerous right now. If the yield on the 10-Year Treasury were to go up by 100 basis points, which is entirely possible, the average bond fund could lose close to 8 percent or more." Our prediction proved to be somewhat accurate. From here, we think rates will stay within a range near current levels. Importantly, as it relates to the future direction of rates, our view is that because the increase is largely due to the massive amounts of stimulus and should prove transitory, the markets will look past it in evaluating the future. We are still favorable on taking some degree of contained credit risk in bond investments due to the resilience and growth potential of the economy. However, it seems that returns on taking fixed income credit risk going forward will be much more muted as spreads (the premium for taking on credit exposure) have become historically tight. As prices have moved higher, it has become increasingly challenging to find good risk-reward opportunities in public debt, hence our continued focus on finding more non-traditional risk-return to generate yield in a responsible manner for client portfolios.

Alternatives

We are growing increasingly positive on the use of alternatives in client portfolios at this point in the cycle. Certain specialty areas such as multi-family apartment investment strategies and select industrial assets can provide attractive returns, measurable and contained risk, with low correlations to other assets in our portfolios. We are also very positive on private credit investments as the economy is improving and the yields are compelling with well-understood risk parameters. Our research and due diligence procedures are uncovering numerous options in this space.

Conclusion

There are a wide range of variables at play in the markets right now. Among the most impactful near term is what type of tax changes will be implemented and when. Our view is that compromise, to some degree, will be reached on both tax and infrastructure. Inflation is a worry we will watch closely as well. Broadly speaking in the markets, the "easy money" has been made for the near-term but with the economy in full swing and profit growth accelerating, we feel positive returns can be maintained. Our multi-year strategic outlook remains intact and we suggest investors stay fully invested in a thoroughly and thoughtfully diversified portfolio.

As always please call your client advisor or the investment team with questions or comments. We appreciate the opportunity to serve you.

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Registered Investment Advisor
1801 East Ninth Street, Suite 1600 / Cleveland, OH 44114 / Phone 216-861-1148 / Fax 216-861-0106
9380 Montgomery Road, Suite 209 / Cincinnati, OH 45242 / Phone 513-861-2000