GFP *Outlook & Strategy* July 2021

Investing in 2021: Turbulent waters below a calmer surface

Second Quarter Review

The second quarter of 2021 saw a significant amount of activity on a variety of fronts. Perhaps the biggest surprise in Q2 was the rapid decline in the 10-year Treasury bond yield. This caught investors off guard and caused stock market rotation back from value to growth investments, but without much overall change in the broader markets.

Second quarter events of note included:

• The resurfacing of COVID worries due to the emergence of the Delta variant
• Significant oil price increases due to potential supply constraints
• Labor shortages and supply chain disruptions impacting segments of the economy
• Stock market rotation in terms of value vs. growth performance leadership
• The decrease of interest rates and commodity prices, including a 40% drop in lumber prices after a massive increase
xearlier in the year
• Political drama over tax increases and infrastructure spending
• A decline in retail investor-driven stock volatility

Overall, the equity markets continued to perform well in the second three months of the year. Interest rates went down significantly due to technical investment positioning as well as economic fears around COVID and potentially diminished 2022 growth. The big technology stocks realized strong performance towards the end of the quarter, and thus the overall market held up well. Many commodities were down significantly. In general, the market remained steady with an upward bias.

Outlook

As we noted last quarter, unprecedented fiscal stimulus coupled with some of the easiest financial conditions ever witnessed (meaning low interest rates and dovish Fed policy), shape our view that the market is unlikely to see a major correction in the immediate future. As we get deeper into the summer and future tax and monetary policies unfold, less favorable scenarios could arise. However, with this much liquidity from government stimulus and the favorable conditions described above, the market is going to wait and react later rather than anticipate future policy outcomes. Concerns about inflation were another potential big issue for the market, but that has become less of a risk for now as forward-looking inflation expectations have somewhat diminished.

Given year over year comparisons with pandemic-impacted 2020, GDP growth should lessen after Q2, but still remain quite strong. The big question is what will happen to growth in 2022 and beyond.

Equities

Our view is that the equity markets will be relatively uneventful in the near term. We believe that rates will increase a bit through the end of the year and that value stocks will continue to outperform for the year. However, as we have stated in the past, we have both value and growth style exposure in our portfolios as a diversified approach. We will not abandon the growth investing factor to any great extent because select growth stocks have strong financials and outstanding long-term prospects. At the same time, certain sectors are inexpensive relative to their intermediate term earnings outlook and provide compelling value-based opportunities. We continue to be bullish on Europe due to the value and cyclical nature of the components of most European stock indices. The biggest risk to our view on equities would be a spike in interest rate or inflation expectations, or fiscal policy that scares the market.

Fixed Income

Fixed income continues to be tricky. As we mentioned above, rates went down more than the market had expected. As a result, the risk in “traditional” fixed income is as high as we can ever remember in the context of the current and future direction of rates (with the price of bonds moving inversely to the direction of rates). Credit spreads (the difference in yield between a U.S. Treasury and other debt securities of varying credit quality) are also very tight and the market is ripe for profit taking at some point. We continue to allocate to strategies that have a lot of flexibility in terms of exposure, in the name of safe yield. At this point, we would rather take less risk than expose our clients to increased interest rate volatility or potential losses.

Alternatives

We continue to be extremely positive on the use of alternatives in client portfolios at this point in the market cycle. Strategies which take advantage of liquidity needs, or specialize in sourcing unique opportunities, continue to find a meaningful place in our portfolios. We are focused on allocating more to these investments which allow for both risk mitigation and low correlations to public market volatility.

Conclusion

A balanced, diversified portfolio across asset classes is imperative. With lingering COVID issues and stretched valuations, we are watching risk levels closely while maintaining appropriate investment positions in the name of generating healthy, absolute performance returns. Key to optimal client risk-return is our well-defined portfolio construction process and thorough due diligence on an investment-by-investment basis.

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

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