From the Curb

Letter to Clients

Quarter Ending March 31, 2021

We hope this letter finds you well and enjoying this early New England spring. There is something about longer days and milder temperatures that help lift our spirits.

The opening quarter of 2021 was marked by several macro- and micro-economic surprises that resulted in increased market volatility. However, additional economic stimulus combined with accelerating COVID-19 vaccine distribution helped stocks surge upward. The result, a strong close to the quarter.

The first surprise of 2021 came on January 5th when both Democratic candidates won Georgia Senate seats in the runoff election, giving the Democratic party a majority in the Senate and control of Congress and the presidency. The very next day, during confirmation of the November 2020 presidential election results, protestors stormed the U.S. Capitol, causing a temporary delay to the election certification and marking a historically tragic day in the U.S. democratic process. Despite that short delay, Joe Biden was certified as the winner of the 2020 election and became president-elect of the United States. Both the surprise election results and the incident at the Capitol caused a volatile start to the new year.

In late January, after two weeks of relative calm, market jitters returned, this time driven by a historic short squeeze in videogame retailer GameStop (GME). The disorderly trading in GameStop and select other stocks caused broader market volatility, primarily due to fears of losses inflicted on large hedge funds. Those factors combined to pressure stocks and the S&P 500 finished January with a modest loss.

Fortunately, concerns of widespread losses due to GameStop trading ultimately proved unfounded. As trading returned to normal, investors began to focus on macro-economic positives. First, the Democratic controlled government immediately began steps to pass another massive stimulus bill that helped stocks rally in early February. Second, vaccine distribution throughout the U.S. meaningfully accelerated in the month. Increased distribution combined with the authorization of a single-dose Johnson & Johnson vaccine helped investors embrace the idea that the end of the pandemic was now possibly just months away. Finally, COVID-19 cases began to decline rapidly in the U.S., leading to economic re-openings in several states. The S&P 500 recouped all of January's losses and ended February slightly positive for the year.

Markets continued to rally in early March as investors began to price in an economic recovery following the March 11th passage of the massive $1.9 trillion economic stimulus bill. Combined with COVID-19 vaccine distribution reaching 2.8 million doses/day, optimism for a full economic reopening and recovery in the coming months increased as well as expectations for higher interest rates. The 10-year Treasury yield surged to fresh one-year highs and the rapid rise in bond yields weighed on stocks periodically throughout March. While the risk of higher yields was real, it was not enough to offset the reality of historic economic stimulus and improvement in the fight against the pandemic. As a result, stocks continued higher to finish the quarter with solid gains.

As we begin the second quarter, the outlook for markets remains broadly positive. Monies from the recently passed stimulus bill are now entering the economy on a personal, corporate and government level. Those funds should help spur economic activity in the months ahead. Additionally, while the COVID-19 outlook has recently dimmed in Europe, prospects for the U.S. remain generally positive. Vaccine distribution continues to build, with the goal of having vaccines available to all adults nationwide by May. As a result, it is not unreasonable to think the pandemic's impact on the economy will significantly wane as we enter the third quarter of 2021.

With improvement across multiple economic indicators, the outlook for a robust recovery remains bright. Further supporting investor confidence is the Federal Reserve's pledge to keep interest rates low and its quantitative easing (QE) program in place until the economy returns to pre-pandemic activity levels. While there is substantial support for markets as we begin the second quarter, there are always risks that need to be monitored. First, while we do not anticipate the pace of the rise in bond yields to increase, we can expect more stock and bond market volatility as higher interest rates impact investment returns and investor decisions.

Similarly, investors are expecting inflation to accelerate as massive stimulus fuels the economic recovery. At the moment, Federal Reserve officials expect any increase in inflation to be temporary. However, if that expectation proves to be incorrect, then the Fed will have to consider a reduction in the current QE program or a rise in rates, neither of which is reflected in current market prices.

From a fiscal standpoint, the multiple rounds of stimulus since the pandemic began have resulted in very large increases to the national debt and federal deficits. So far, markets haven't seen any negative impacts related to the growing debt or deficits, but these high levels represent longer-term risks to the stability of the U.S.

Finally, so far in 2021 markets have embraced the Democratic agenda of more economic stimulus and investment. But numerous prominent Democrats are also in favor of increased corporate, personal and investment taxes, and if those efforts gain momentum, we can expect that to potentially impact market volatility.

For now, these potential risks do not outweigh the actual positive influences pushing stocks higher, and as such, the macroeconomic outlook for the coming months remains positive. We understand the risks facing both the markets and the economy, and we are committed to continue helping you effectively navigate this still-challenging investment environment. Even intense volatility, like we experienced in the first half of 2020, is unlikely to alter a well-diversified approach aligned with your tolerance for risk and return requirements.

As you review your enclosed reports, take note of the very strong one, three and five-year returns for the period ending March 31, 2021. This is a direct result of four consecutive quarters of gains in stocks, fueled by the prospects of a return to normalcy combined with year-over-year compounding. Also, if you would like a copy of our Privacy Notice, please let us know. Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

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