AndCo's Monthly Market Update

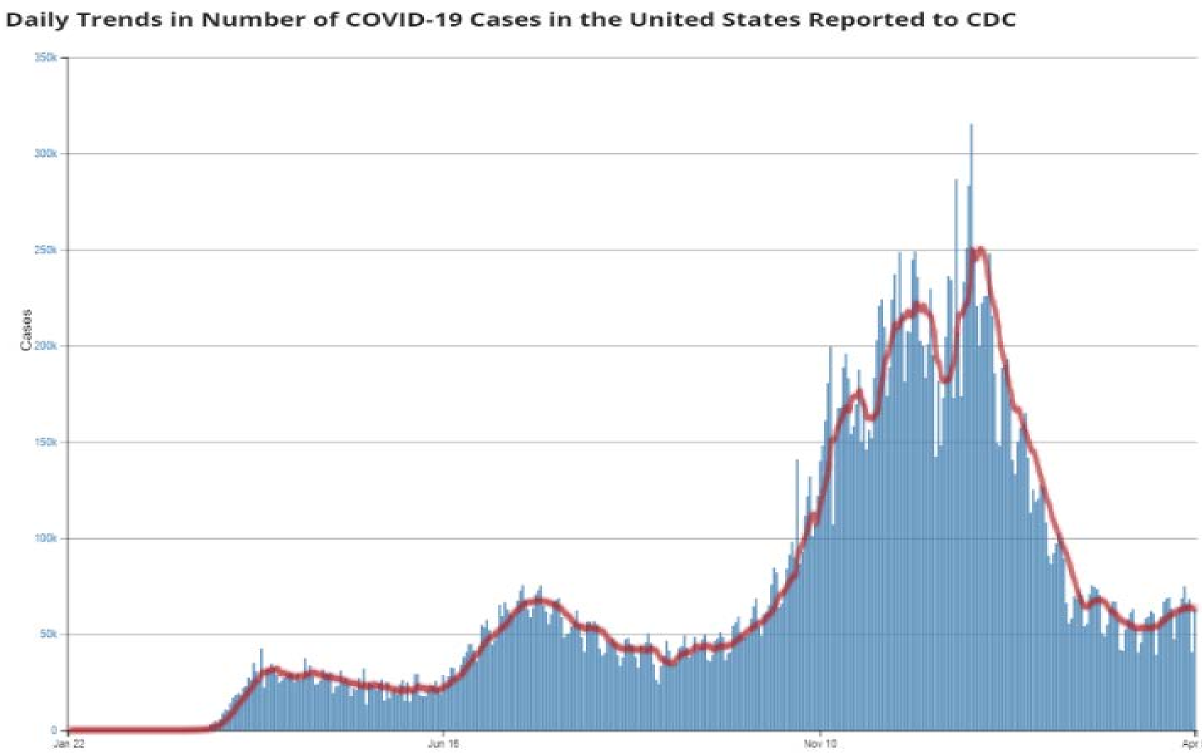
April 2021

THE ECONOMY

"A rolling stone gathers no moss…. but it sure gathers momentum" – Ankala Subbarao

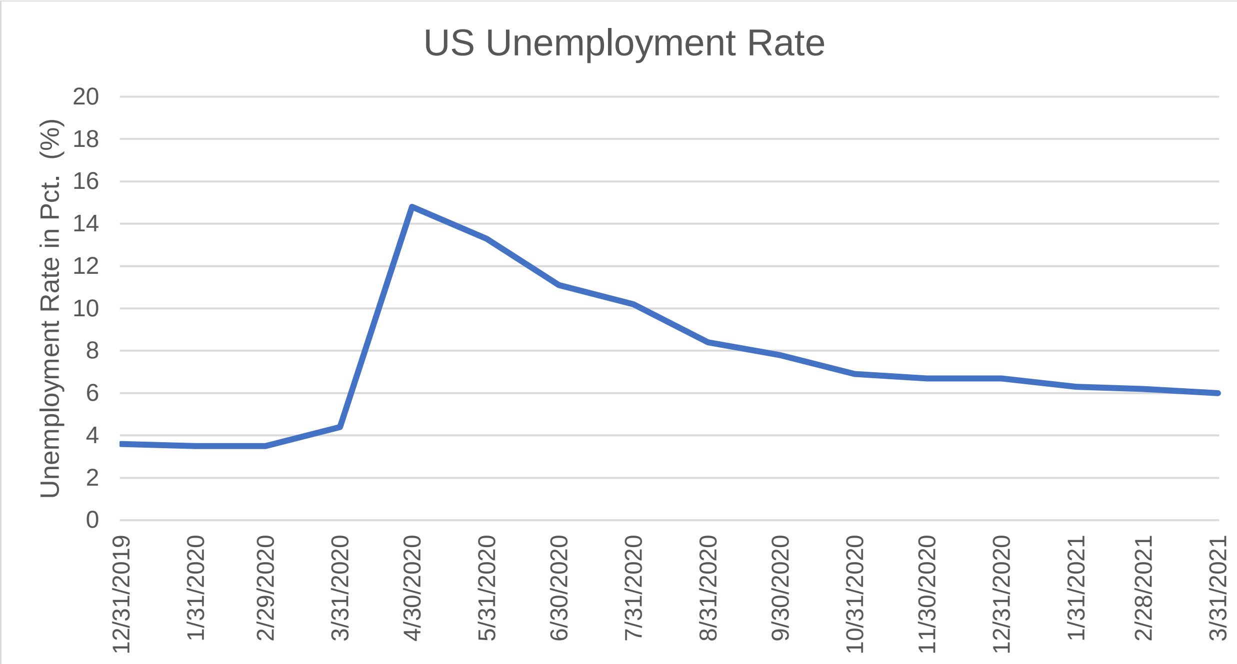
Recently, we passed the one-year mark since the onset of the COVID-19 (COVID) pandemic. While there remain numerous challenges to be overcome, slowly but surely the pandemic appears to be receding, and the great American economic engine is beginning to accelerate. We have highlighted in previous updates that most economic indicators we follow have been trending in a positive direction. While the broad US economy is nowhere near escape velocity, the positive momentum we see in recent economic activity is encouraging.

We acknowledge that much of our economic optimism is directly related to the recent improvements in both the reduced number of new COVID cases and the increased pace of vaccinations. As illustrated in the chart below, the number of new cases has dropped significantly since the beginning of the year. According to a recent University of Washington Institute for Health and Metrics Evaluation report, the primary contributor to the drop in new cases can be traced to the ramp up in vaccines.[1] As evidence, according to the Centers for Disease Control and Prevention (CDC), the number of Americans who have received at least one dose of vaccine now exceeds 30% of the total population, with those over 65 years of age receiving at least one dose now exceeding 75%.[2] It is reasonable to expect that as the number of Americans who have received a vaccine continues to climb, the momentum in the decline in the daily number of new cases should continue.

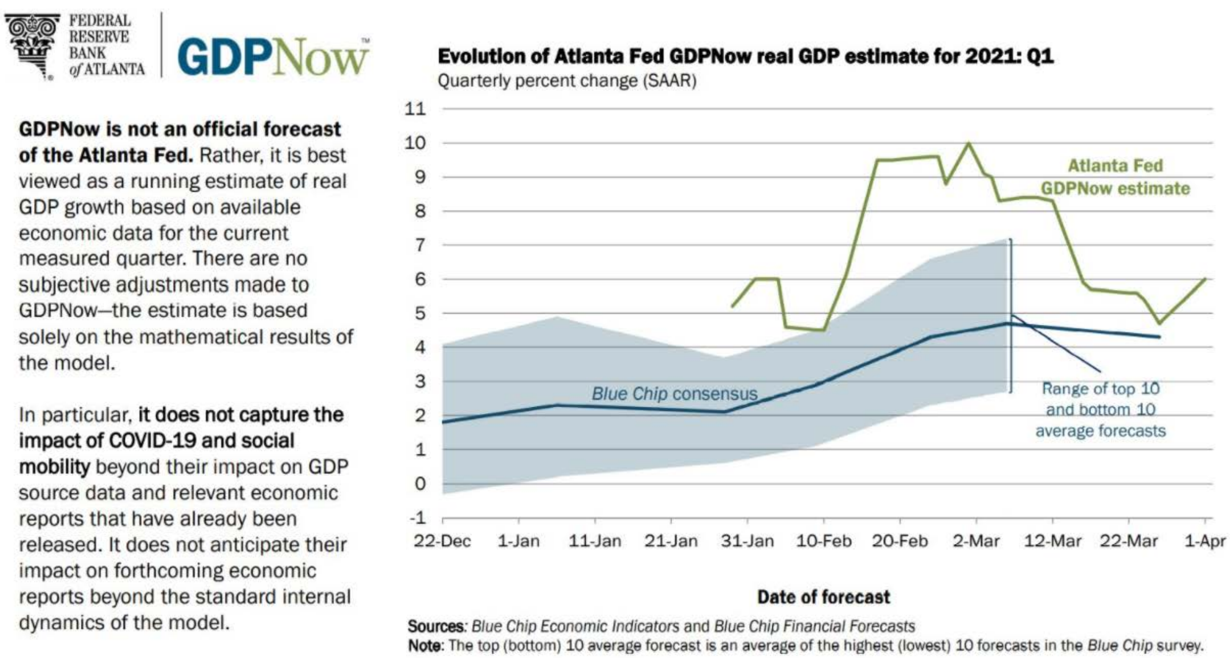


Source: https://covid.cdc.gov/covid-data-tracker/#trends_dailytrendscases as of April 5th, 2021

As the pandemic has begun to recede, we can see that economic activity is accelerating. One of the key indicators we monitor is the overall health of the labor market. Following last year's substantial increase in unemployment resulting from restrictions related to the pandemic, we have seen a strong recovery in hiring. As illustrated in the chart below, the unemployment rate continues to decline with the March report showing 6.0% and 916,000 new jobs added for the month.[3] Digging into the report, the growth in jobs was broad based with manufacturing, travel and leisure, and resturants all showing strong gains. Not surprisingly, as the labor market has improved, so to has consumer confidence. The University of Michigan Consumer Sentiment Index rose to 84.9, up from 83.0.[4] As consumers feel better about their current situation and prospects, they have historically increased consumption. As a result of these tailwinds, the Atlanta Federal Reserve GDPNow model is forecasting that the US economy will grow at approximately 6.0% in the first quarter, up from 4.0% in the fourth quarter 2020.[5,6]



Source: Bloomberg as of March 31, 2021



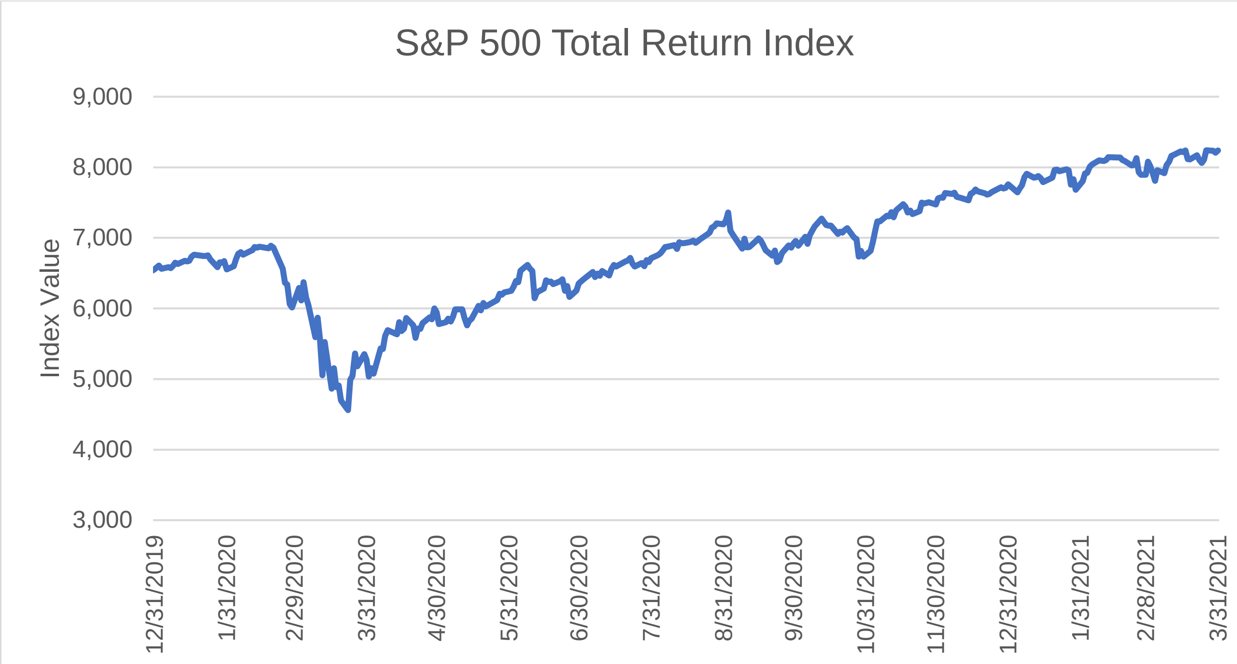
Source: https://www.frbatlanta.org/cqer/research/gdpnow as of April 5th, 2021

While we remain generally positive about the direction of the US economy, there are several key indicators that we are monitoring closely. As the recovery has gathered momentum, US interest rates have begun to rise in anticipation of increased economic activity. As a result, mortgage rates have begun to adjust higher which is a headwind for housing in general. We can see this in the recent release of both new and existing home sales which were lower for the month of February. In particular, the month-over-month decline in new home sales was dramatic, falling more than -18% for the month.[7] While rising interest rates are most likely the primary detractor for housing, the inclement weather experienced in Texas was also a contributor to the decline.

The increase in economic activity has implications for higher inflation in the US. While the monthly CPI reading for February remains below the Federal Reserve Bank's (the Fed) target at 1.7%, we are seeing signs of inflation in the economy.[8] Specifically, energy-related costs have surged since December as evidenced by the rise in gasoline prices which have jumped more than 27%.[9] Typically, as energy costs increase, there is a ripple effect across the economy that is disproportionately felt by lower-income workers as things such as food and transportation costs rise. While inflation as measured by CPI remains tame, we worry that the stimulus supplied in response to the pandemic, combined with an increase in US Treasury issuance to fund the anticipated infrastructure legislation, will lead to a combination of both rising inflation and higher US interest rates which could cripple the consumer and future economic growth.

EQUITIES

The positive trend for US stocks remained intact for the month across most market capitalizations and styles. Large company stocks resumed leading the market higher with the S&P 500 Index rising by 4.38% for the month followed by value-oriented small company stocks which rose 5.23% for the month.[10] While the primary driver of stock prices continues to be the story surrounding the continued re-opening of the global economy, it is interesting to note that the market's leadership shifted during the month from growth-oriented technology companies to more conservative utilities, consumer staples, industrials, and basic materials companies. We suspect that some of the relative outperformance of these defensive sectors can be attributed to a valuation rotation as evidenced by the fact that utilities companies trade at roughly 18.3x Price to Earnings (P/E) ratio on averaged compared to roughly 25.4x for technology-related companies.



Source: Bloomberg as of March 31, 2021

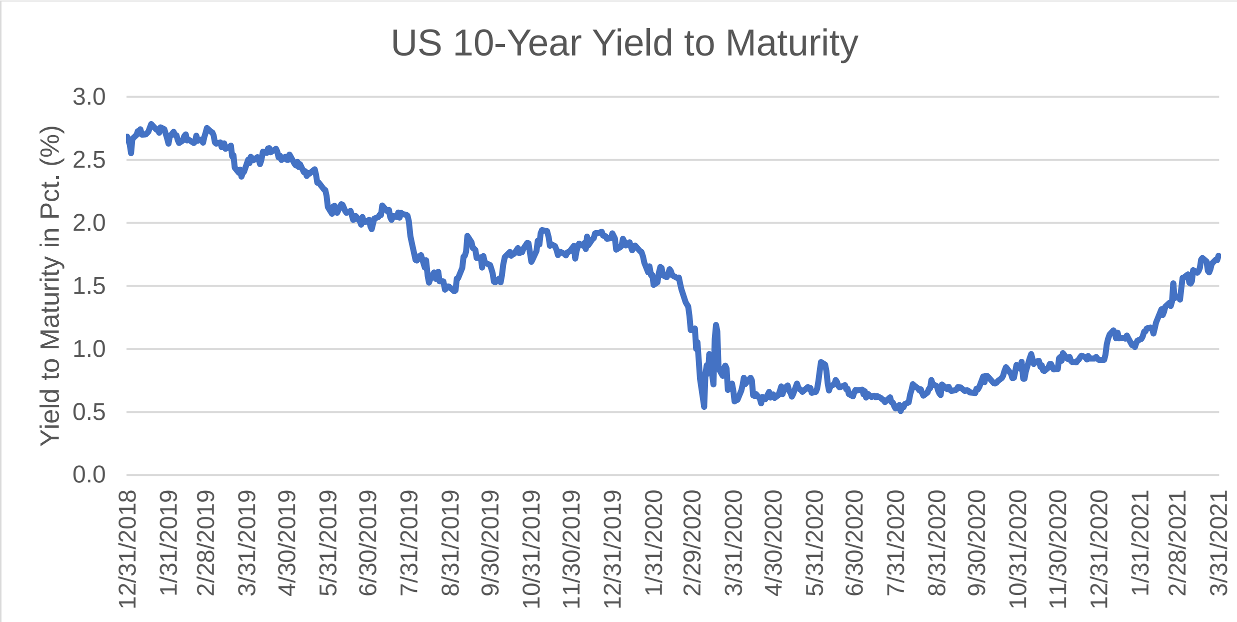
Sector	1 Month Total Return	1 Year Total Return
Utilities	10.51%	19.42%
Consumer Staples	8.19%	20.38%
Industrials	8.91%	69.61%
Basic Materials	7.58%	78.29%
Real Estate	6.81%	32.03%
Financials	5.80%	67.50%
Health Care	3.92%	34.04%
Consumer Discretionary	3.65%	70.29%
Telecommunications	3.13%	60.88%
Energy	2.79%	75.16%
Technology	1.69%	66.61%

Source: Morningstar as of March 31, 2021

FIXED INCOME

While the momentum in stock returns was decidedly positive during the month, that was not the case for fixed income returns. Investors saw the yield on the US 10-Year Treasury bond increase 29 basis points during the month.[11] As a result of higher government bond yields, the higher quality Bloomberg Barclays US Aggregate Bond Index returned -1.25% for the month.[12] Lower quality credit outperformed as evidenced by the Bloomberg Barclays US High Yield Bond Index which returned 0.15%, primarily due to the fact that the high yield index has a shorter duration profile (3.7 years) compared to the US Aggregate Bond Index (6.4 years).[13]

As shown in the chart below, US interest rates have recently trended higher. While it is reasonable to expect this trend will continue given the significant amount of US Treasury issuance expected in the future to fund the budget deficit, there are a few key points that may slow the rise in rates. First, the yield on the US 10-Year Treasury bond is now higher than the dividend on the S&P 500 Index (1.6% versus 1.4%).[14] While still relatively low in absolute terms, the level could be compelling for risk-adverse investors who are considering rotating out of stocks into bonds. Second, despite the recovery in the economy, the Fed has insisted it will remain accommodative by keeping short-term interest rates low and maintaining its bond purchase schedule. Importantly, having suffered one of the worst quarters on record, asset allocators will be inclined to evaluate their allocations and potentially rebalance into fixed income given the recent losses. At least in the near-term, these factors could slow the ascent of US interest rates. The one caveat to the thesis would be if inflation moves at a faster than anticipated rate which could spur the Fed to act by either reducing the rate of bond purchases or raising short-term interest rates. Presently, we see this as a low probability, but acknowledge that inflationary shocks have historically been short and acute, and as such, hard to predict.



Source: Bloomberg as of March 31, 2021

APPENDIX

1. https://www.advisory.com/en/daily-briefing/2021/02/17/coronavirus-cases
2. https://covid.cdc.gov/covid-data-tracker/#vaccinations
3. https://www.bls.gov/news.release/empsit.nr0.htm
4. Bloomberg, March 2021
5. Bloomberg, March 2021
6. https://www.frbatlanta.org/cqer/research/gdpnow
7. Bloomberg, March 2021
8. Bloomberg, March 2021
9. Bloomberg, March 2021
10. Morningstar, March 2021
11. Bloomberg, March 2021
12. Morningstar, March 2021
13. Morningstar, March 2021
14. Bloomberg, April 9th, 2021

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