WALL STREET IS FURTHER ALONG THAN MAIN STREET

Markets continued to move higher in the past quarter as support programs continued and potentially increased with an infrastructure stimulus to join other historic stimulus programs. In addition, the Federal Reserve continues their asset purchase program. Despite GDP not having fully recovered, personal income in aggregate did not decline as in other recessions resulting in an unbalanced demand with supply chains which should come in to balance over time. Transitory inflation should not be a surprise, but long-term inflation is likely to be tempered by the deflationary forces of debt, demographics, and technology productivity. After all, we had difficulty achieving target inflation before the pandemic. Higher than expected inflation, reversal in stimulus policy or lack of pandemic progress could upset the markets.

Fixed Income

After the Federal Reserve signaled it was on watch for inflation pressures, bonds partially recovered from a rough first quarter. The Treasury 10-year yield fell 29 basis points from its high in March to 1.45%. High-yield bonds continue to outpace government and corporate bonds. Fixed income demand from pension funds and foreigners could influence rates going forward. Two key indicators are not signaling an inflation concern so far: wage growth is trending lower at 3% versus a 4% threshold, and break even rates on 5 year TIPS are at 2.25% versus a 2.75% threshold according to the Atlanta Federal Reserve.

Equities

Quality investment strategies continue to be out of favor. This involves investing in companies with superior fundamentals. These are the kinds of stocks that have performed well over the long term but have underperformed since Vaccine Monday. Meanwhile companies with poor fundamentals are enjoying price momentum as a recovery trade. Our active equity strategies exhibit superior fundamentals which have encountered headwinds in the short term but tail winds in the long term. Superior fundamentals do win in the end.

In U.S. equity markets, one of the most dominant trends from late 2020 and the first quarter began to fade: the outperformance of value stocks over growth stocks. This shift came as the Federal Reserve indicated in June that it may raise rates somewhat sooner than expected amid signs inflation was beginning to take hold. Markets weren't spooked. In fact, stock market volatility fell to levels unseen since before the pandemic. In the U.S. market, volatility fell to its lowest level since 2019. International stocks continue to lag the U.S. market, with China a drag on returns. Renewed demand for oil pushed prices higher and energy stocks topped the sector list, followed by technology stocks. Utilities and industrial sectors dragged.

According to Factset, analysts are projecting earnings growth of 35.6% and revenue growth of 12.6% for calendar year 2021. The forward 12-month P/E ratio is 21.4. This P/E ratio is above the 5-year average of 18.1 and above the 10-year average of 16.2.

Asset Allocation

The combination of fiscal and monetary interventions is unprecedented. The resulting liquidity has led to unprecedented stock valuations, particularly in technology, and the belief that the market's continuing ascent is assured because the government has our back. Despite more than a decade of various Federal and Congressional interventions and supports, economic growth continues to trace a declining trend line. Neither economic growth nor earnings growth has come close to stock price growth over the past decade.

For these reasons we continue to focus on balance and diversification in our portfolios and why we continue with our target asset allocation.

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Monroe Vos has over $6.5 billion under advisement for 100 clients. Recent rankings are as follows:

- The 3rd largest independent registered investment advisor ("RIA") in Texas
- The 8th largest independent RIA in the Southeast
- The 60th largest independent RIA in the United States

As reported by *Financial Advisor* magazine in August 2020