LaFleur & Godfrey
PRIVATE WEALTH MANAGEMENT

Summer 2021 Commentary

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Is The Recovery Sustainable?

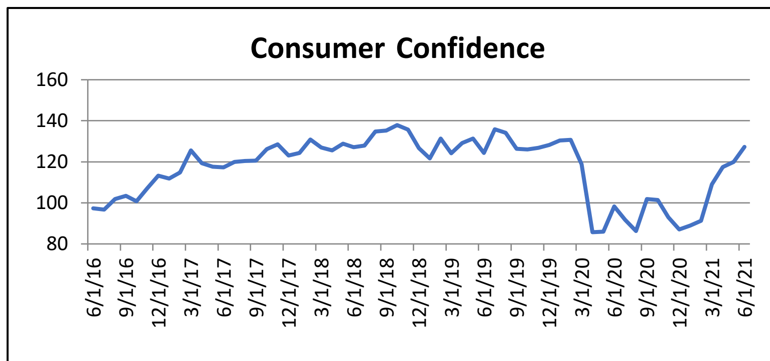
Economic Perspective:

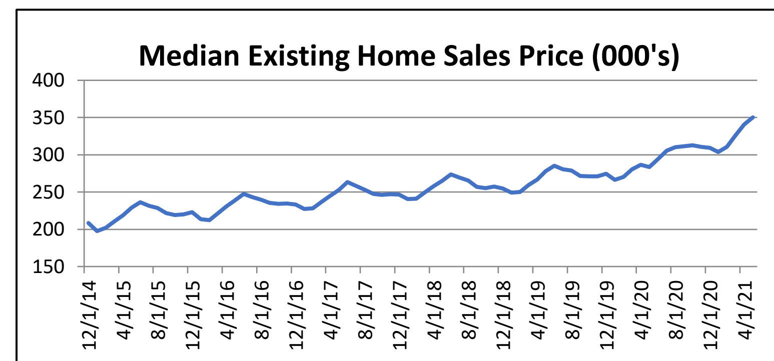
Consumer activity makes up over 70% of the U.S. economy. With most of the country now living an unrestricted life on the other side of COVID, economic activity remains robust. In fact, mid-single digit economic growth is expected for the next 6-18 months. Even the most ardent economic bears would admit that this has been an amazing recovery!

Recent non-farm payroll gains added +850,000 new jobs – its highest gain in over ten months. The surge in demand has led to a ramp up in business production and increased hiring activity. While we are still a long way off from pre-COVID employment levels (we are still down 7 million from the pre-COVID high), recent gains have boosted consumer confidence. Consumers continue to lead the way during this V-shaped economic recovery. Not only are wages up for the employed but home values and 401K account balances are also at record highs.

Looking ahead, another round of government stimulus beginning this month in the form of an expanded child tax credit could help sustain the advance. We are also encouraged by the rebound in business investment with recent examples being Intel and Taiwan Semiconductor building new chip plants in the U.S. We view this pickup in Capex to be vital to our recovery. Typically, business investment cycles are multi-year in nature and have been effective in prolonging economic cycles. Odds are that this cycle could yield the same results.

However, a balanced perspective is warranted. Bottlenecks and shortages in the supply chain have moderated but remain a drag on economic growth. This will keep the economy from growing even faster. Higher raw material and labor costs are leading the inflationary pressures. While both should moderate as the year progresses, pent-up demand for both will keep inflation above-trend. Lastly, government policy remains very uncertain. Infrastructure, income tax, capital gains and even human capital investment proposals are all on the table. Trying to predict winners and losers coming out of D.C. can be risky. We prefer to wait-and-see what is likely to get passed before potentially repositioning our equity portfolios.





Market Perspective:

Given the increasing likelihood of a sustained economic recovery, we are cautiously optimistic that the bias is upward for equities into the second half of 2021. There are several market-related tailwinds that support our case. First, bank stress tests came out very favorable. The Fed estimates that banks have over a $700 billion capital cushion to withstand a severe economic downturn. As a result of this excess capital, the Top 6 U.S. banks are expected to double share repurchases and dividend payments to shareholders in the upcoming twelve months. We have long believed that bank health is a reliable barometer for the underlying health of our economy. Second, there has been 'insatiable' foreign demand for U.S. Treasury securities – especially from the Asia-Pacific region. The strong demand for our sovereign debt has lowered the 10-year rate from a peak of 1.85% in mid-February to approximately 1.35% as we write this. As a point of reference, the 10-year was yielding 3.25% just three years ago. Low, sustained rates are favorable for equities. Lastly, with rates down and profits up, valuations have come back to more reasonable levels. S&P 500 Index earnings per share is expected to be around $190 this year and rise to over $210 in 2022 for a low-teens percentage gain. With rates down, inflation moderating and the economy continuing its advance, equities are more inexpensive today than they were just 3-6 months ago.

As always, there are still headwinds to equities. We are in a seasonally weak time of the year. The phrase "sell in May and go away" has been used to describe the historically weaker six-month period of the year from May to October (versus stronger returns from November through April). Lighter trading volumes and liquidity oftentimes results in above average volatility during this period. In addition, we are beginning to see a 'narrowing of the tape' with market leadership less broad-based than in previous months. Many individual securities are trading below their 50 and 100-day moving averages. Typically, this type of risk aversion can lead to a sideways trading kind of market. Clarity from the Fed regarding monetary policy changes (tapering) and/or additional information regarding the sustainability of our economic growth into 2022 could help broaden the market. Finally, with the economy 'running hot' we expect more 'tough talk' from the Jerome Powell & the Fed. In reality, we expect 'more bark than bite' regarding potential rate hikes as most professional investors know the Fed is backed into a corner (because of significant debt levels) and cannot allow rates to rise too high, too fast. It is more likely that the Fed tapers its asset purchases to slow monetary policy accommodation in lieu of raising rates. FYI, the market expects the first rate rise in 2023.

Looking Ahead:

In our opinion, the positives from the tailwinds mentioned above (relative to the headwinds) have us constructive on equities for the second half of the year. Weak seasonal trends could keep us range bound for the next several months. However, we expect more clarity from the Fed as to their tapering intentions into year-end as well as a near resolution on the transitory versus persistent inflation debate. If the Goldman Sachs economic team is correct that we are headed towards 5% economic growth in 2022 along with 10-year U.S. Treasury rates between 2.0 to 2.25%, we are confident in our forecast for an upside bias to equities. However, we remain vigilant looking for news and/or events that could sidetrack our forecast. We hope you have a happy, safe & healthy summer!

This document contains forward-looking statements, predictions, and forecasts ("forward-looking statements") concerning our beliefs and opinions in respect of the future. Forward-looking statements necessarily involve risks and uncertainties, and undue reliance should not be placed on them. There can be no assurance that forward-looking statements will prove to be accurate, and actual results and future events could differ materially from those anticipated in such statements.