Market Update

February 12, 2021

Is Inflation Coming?

- The headline Consumer Price Index rose 0.3% in January and was up 1.4% year-on-year. Removing food and energy prices, the core index was flat on the month and slowed to 1.4% year-on-year from 1.6% in December.
- Small business optimism deteriorated for the third month in a row in January. Underneath the headline, the employment indicators remained broadly positive. Initial jobless claims also edged lower to 793k last week.
- Health metrics moved in the right direction this week. New COVID-19 cases continued to trend down, falling below 100k per day. Meanwhile, the vaccine rollout continued to pick up, averaging 1.6 million per day.

Given the scope of fiscal and monetary policy supports to-date and the large fiscal package currently in the works, a lively debate is taking place in economic circles regarding the potential for inflation to accelerate beyond desirable levels. A pickup in inflation is highly likely as economic restrictions are lifted. But, given where inflation stands today, there is some room for it to run before it reaches a concerning pace. Supporting the narrative of higher inflation is the fact that many small businesses plan to raise prices. According to NFIB data, the share of firms planning to do so rose by 6 points to 28% in January – among the highest levels in the post-Great Recession period.

While the U.S. labor market struggles to dig itself out of the winter slowdown, there appears to be a light at the end of the tunnel. New COVID-19 cases continued to trend down this week, falling below 100k per day recently, for the first time this year. At the same time, the pace of vaccinations is accelerating, with daily jabs averaging 1.6 million in recent days. The vaccine rollout should continue to gather speed, hastening the end of the pandemic.

The S&P 500 and most other major market indices are hovering near all time highs. They appear to be poised to stay at these levels should the full economic relief package of $1.9 Trillion get passed and produce what some are suggesting could be high real GDP growth number of 6% through 2021. We see the market as a bit over bought, or highly priced right now. This can remain for some time, but a 5% to 10% pull back in the market. at some point in 2021, is likely, as the market continues to remain at the lofty levels. Longer term yields are starting to tick up a bit and Gold is trending slightly downward, currently. The price decline in longer term bonds is creating this uptick in rates however, the yield curve remains positively sloped. Historically, this indicates a good economic environment, particularly for stocks.

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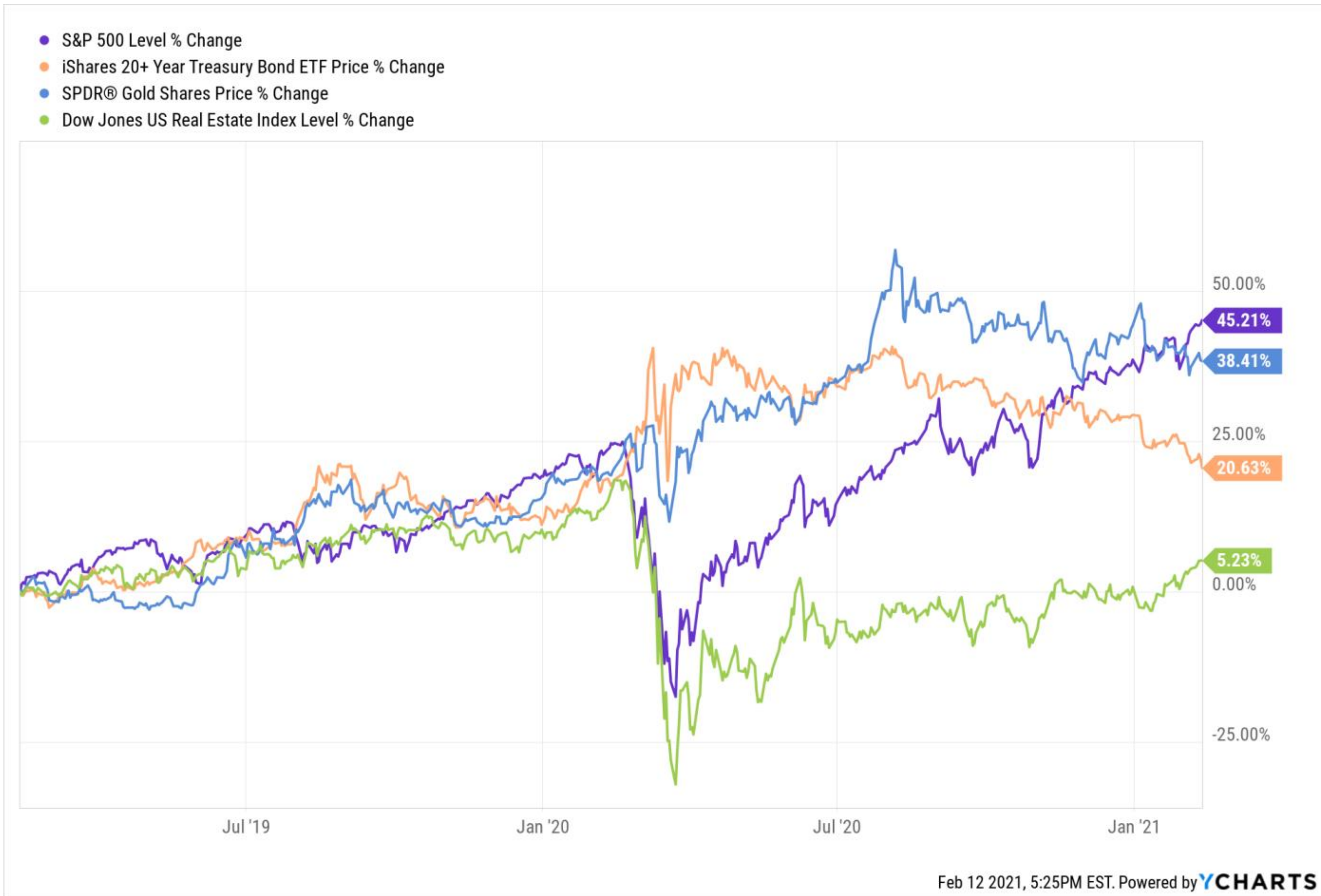

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Long term treasury yields ticked up a little since last month, although the interest rate environment remains low. The shape of the yield curve remains positively sloped, which is a good indication that the Federal Reserve's policies are working and helping financial markets. Banks tend to do better with a positively sloped yield curve. Banks being able to perform well is often discussed as necessary, for the economy and markets to do well.

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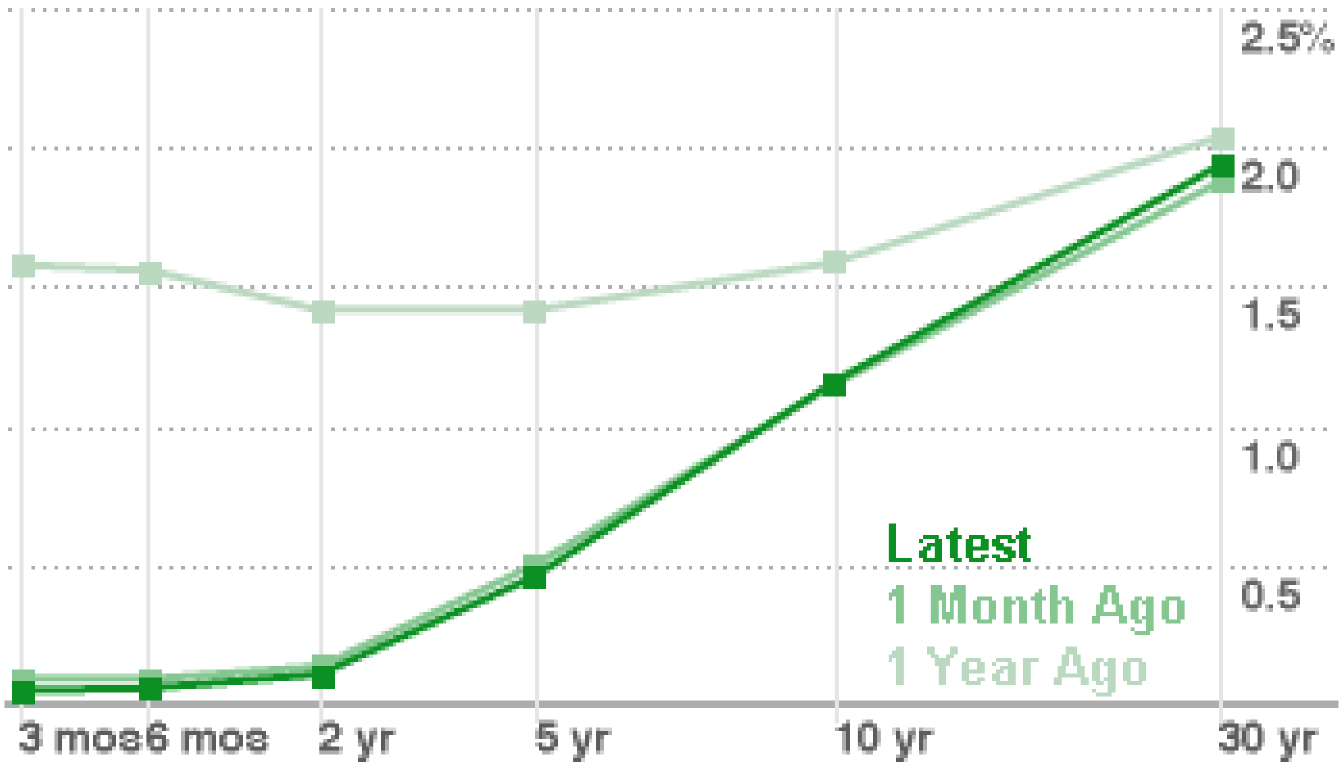

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We discussed Game Stop in several important daily email market updates. There seems to be an attempt to spread this type of short-term phenomenon to other areas such as Pot Stocks, Silver, and Bitcoin. Caution regarding these types of momentum driven events is necessary. We see in the case of GameStop that a price can come down just as quickly as it went up, and often does, in these types of trading environments.

We are still seeing the anticipated broadening in the market toward value stocks and anticipate this trend to continue, as the year goes on. We also believe that there are some overheated areas of the markets and would expect a short term pull back, as discussed earlier, coming sooner. This would be healthy for the market and will allow for new money to enter the market, at cheaper prices, when it does occur.

Having a disciplined investment and risk management process, regardless of market action, is the foundational elements to our portfolio designs. It is this portion of the approach of portfolio management, that helps consistently reduce the long run risk taken in a portfolio of investments. Speculating about near term directions in the markets can be and often is a difficult and risky proposition. We can control the risk and process we take in our portfolio construction, but we cannot control market performance.

Overall, we prefer domestic equities over international equities. We prefer more value-oriented stocks vs. growth stocks for longer term growth, as we see growth stocks as more fully valued. However, high quality growth stocks are likely to continue to outperform the market in the short term. We are currently neutral to bearish on fixed-income and interest rates. It is important to maintain discipline regarding long-term strategic asset allocation. However, as market conditions dictate, we are looking at tactical opportunities to reduce risk in portfolios, if necessary.

If you have questions or would like to discuss this further regarding your personal portfolio, please contact me at 310-433-5378.

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