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**Market Commentary**

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## **Introduction**

With Coronavirus cases continuing to fall and mass inoculations taking place, the first quarter has seen a continuation of generally positive momentum in markets and the economy. Growth has continued its rebound in the United States with GDP up 4.3% on a quarter-over-quarter basis in the fourth quarter of last year, compared to 33.4% in the third quarter. The labor market has improved with the U-3 unemployment rate at 6.2% as of February, a sharp recovery compared to the high of 14.7% in April of 2020. Lastly, though fears of rising inflation have surfaced recently, spikes in the short-term have failed to materialize, with the Consumer Price index (CPI) up 1.7% year-over-year as of February. While we are seeing signs of a recovering economy, concerns over the continued spread of the Coronavirus have upheld loose monetary policy and immense fiscal stimulus supporting that recovery. Most recently, in March the U.S. government has enacted the \$1.9 trillion American Rescue Plan Act, which includes broad measures such as stimulus checks, child tax credits, jobless benefits, vaccine-distribution funds, healthcare subsidies, and restaurant aid. This type of fiscal stimulus, along with a steady decline in new cases from the beginning of the year and successful vaccination efforts, have led to increasing growth expectations for 2021 and beyond; As an example, the Federal Reserve recently upgraded their forecast for Real GDP growth in 2021 from 4.2% to 6.5% and lowered their projection for unemployment rate from 5.0% to 4.5%. While economic data may be volatile in the months ahead, we believe the pent-up demand from a strong pre-pandemic consumer combined with historic monetary and fiscal packages in place today, will keep the U.S. firmly on the path to recovery.

## **Domestic Equities**

At this time last year, U.S. stocks posted their worst quarter since the 2008 financial crisis, and investors witnessed the fastest bear market in history, with the S&P 500 index declining -33.9% from the February 19, 2020 peak until the March 23, 2020 low. The index finished the quarter down -19.6%. We have come a long way since then and amazingly, we are now in the second year of the new bull market. Since World War II, there have been six other bear-market declines of at least 30%, and in every single case the S&P 500 moved higher in the second year of a new bull market, up 16.9% on average. This trend looks to be continuing with stocks returning 6.17% for the first quarter. However, a new leader has been established in the market. A steady climb higher in interest rates coupled with increasing confidence in the economic recovery has propelled value stocks to outperform growth stocks, with the Russell 1000 Value index returning 11.26% for the first quarter versus 0.94% for the Russell 1000 Growth index. For similar reasons, small cap stocks have outperformed their larger cap peers. Small caps returned 12.70% for the first quarter versus 8.14% for mid-caps and 5.91% for large cap equities. With vaccination efforts fully underway we do not believe the Coronavirus presents as great of a risk for markets going forward. However, as we continue to receive positive economic data, long-term interest rates should naturally trend higher, which could cause bouts of volatility in the stock market over the coming months. Still, we remain bullish on US equities over the longer-term, as stocks have historically proven to be resilient in rising rate environments.

## **International Equities**

International developed equities and emerging market equities returned 3.48% and 2.29% for the first quarter, respectively, both lagging the S&P 500. Much of this underperformance in foreign equities was due to the struggle by international economies to contain the spread of the Coronavirus amid slow vaccination rollouts. In Europe, lockdowns remain in place in countries like Italy and France, which have seen rising infections, and could delay the speed of their reopening relative to other developed economies. While vaccination efforts have started slowly, there is some cause for optimism; EU Commissioner Thierry Breton signaled that the region should receive 100 million doses in April and 120 million in May, which should help to get the most vulnerable parts of the population inoculated in the coming months. Despite these headwinds, positive economic growth is projected in the Eurozone, with the area forecasted to grow at a 4.2% rate in 2021.

Within emerging markets, there is underlying momentum as the global economic recovery begins. Industrial production continues to show strength as global demand has begun to pick up from the low base of a year ago. For example, Chinese exports are up 60.6% from a year ago through the first two months of 2021. The Chinese economy is poised to continue its expansion this year, with China's Manufacturing Purchasing Managers Index (PMI) standing at 50.6 in February, and the Non-Manufacturing PMI (services sector) at 51.4. Led by China, Emerging Market economies are forecasted to grow at a 5.3% pace in 2021.

### **Fixed Income**

The fixed income market, as measured by the Bloomberg Barclays US Aggregate Bond index, returned -3.37% in the first quarter due to a sharp increase in long-term interest rates, as market participants began to reprice growth and inflation expectations for the months ahead. Both treasury and investment grade corporate bonds were not immune to this pressure, ending the quarter in negative territory, while high yield bonds finished slightly positive, up 0.85%. Since hitting an all-time low in 2020, the 10-year U.S. Treasury yield sits at 1.74% as of quarter end, up from 0.91% to start the year, an increase of 0.83%. As short-term rates remained anchored by the Federal Reserve, the difference between long and short-term rates widened to as much as 1.57% as the yield curve began to steepen. We believe the projected path for interest rates will remain stationary, as the Federal Reserve has signaled that they are committed to maintaining rates at zero even if the economy overshoots its forecasts. Moving forward, we believe fixed income securities will provide diversification benefits to equities but may stay under pressure if rates continue to rise.

### **Alternatives**

Alternative asset classes staged a strong recovery start the year. WTI crude prices surged during the quarter, rising from \$48.52 to \$59.16. The rise in prices was twofold. First, global economies pressed ahead with their vaccination campaigns which excited investors about a return to "normalcy" and thus a return of demand for petroleum products. Secondly, OPEC and its allies agreed to extend most of their production cuts through April, easing fears over a supply glut. Hedge Fund-like alternatives also outperformed during the first quarter exemplified by the Morningstar Diversified Alternative index which ended the quarter with a return of 5.74%

### **Real Estate**

The housing sector had a great year in 2020 as low rates, changing demographics, and a move from the cities to the suburbs supported demand. So far in 2021, the sector has cooled off, with rising mortgage costs and higher home prices impeding demand. In February, home starts and building permits both declined more than -10% while existing home sales and new home sales decreased -6.6% and -18.2%, respectively. Some of the sales data in February could have been affected by the inclement weather across the U.S. but it appears that overall, higher costs and low supply could be capping demand. Looking forward, we could expect the housing market to be supported as the economy recovers and individuals return to work.

### **Conclusion**

It appears that we are nearing the other side of the pandemic with several vaccines being widely distributed throughout the U.S. and across the world. Substantial government assistance has helped many Americans and the economy recover from the steep drop in economic activity in early 2020. We believe we are now poised for significant growth over the course of 2021 as we expect a gradual return to normalcy with states reducing restrictions over the coming months. While a pickup in volatility would be normal at this stage of a strong bull market, we believe vaccine distribution, fiscal and monetary stimulus, and a robust economic recovery point to a good year ahead for markets.

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