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Market Commentary
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Introduction

With the Coronavirus Pandemic's effects continuing to fade in the United States, the second quarter has been characterized by positive momentum in both markets and the economy. As expected, GDP growth has continued to rebound as the economy returns to normal, rising at a 6.4% annual rate in the first quarter[1], compared to a 4.3% increase in the prior quarter[1]. The labor market has also continued to steadily improve with the U-3 unemployment rate at 5.9% as of June, down from 6.0% to begin the quarter[1]. Though the labor market recovery has slowed in recent months, the pace of its recovery is strong relative to recent history; The unemployment rate did not cross below 6% until 2014 following the recession in 2008. Fears of rising inflation have continued to unnerve markets as they try to anticipate potential policy response by the Federal Reserve. The Consumer Price Index (CPI) is up 5.0% year-over-year as of May[1], and the question has now shifted to whether this pickup is 'transitory,' and likely caused by supply chain disruptions typical of an economy coming out a recession, or whether it will be sustained in the longer term due to the extraordinary levels of fiscal and monetary stimulus that policymakers put in place to keep the economy afloat during the pandemic. 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

After the market's initial crash in March of 2020, most investors were not counting on a "V-shaped" recovery; however, on the backs of government stimulus and vaccine developments, equities climbed back quickly. For the second quarter of 2020 the S&P 500 posted its best quarter since 1998 with a 20.54% gain[1], but volatility remained in the market as the index saw 36 days with moves greater than +1% or -1%[2]. Government restrictions and social distancing were still weighing heavily on most industries, but the economic recovery was underway. Today, we continue to see stocks march higher as the economic picture continues to improve. All but four states have completely removed restrictions as the number of people vaccinated increases day by day. This coupled with still accommodative monetary and fiscal policy helped stocks to finish the quarter higher, with the S&P 500 returning 8.55% for Q2 of 2021[1]. We continue to see more cyclically oriented value stocks outperform their growth counterparts on the year due to sustained confidence in the economic recovery, however, growth stocks have started to close the gap in the second quarter. The Russell 1000 Value index returned 5.21% for the second quarter versus 11.93% for the Russell 1000 Growth index[1]. Small cap stocks were the best performing asset class within the equity sector at the start of the recovery but have since cooled off due to a climb higher in inflation. Investors fear that small cap stocks do not hold the pricing power to pass along rising prices to the consumer, which could ultimately hurt their bottom lines. As a result, small cap stocks have underperformed their larger cap peers. Small caps returned 4.29% for the second quarter versus 7.50% for mid-caps and 8.54% for large cap equities[1]. We acknowledge that if inflation surprises persist, or a sizable shift in Fed policy occurs, equity markets could see a pullback. However, we would consider this a buying opportunity and remain bullish on US equities over the longer-term.

International Equities

International developed equities and emerging market equities returned 5.17% and 5.05% for the first quarter, respectively, both lagging the S&P 500[1]. Much like the second quarter of last year, this underperformance in foreign equities was largely due to the struggle by international economies to contain the spread of the Coronavirus amid slow vaccination rollouts. However, the outlook for international equities is more optimistic moving forward. The OECD's Composite Leading Indicators (CLI), which aggregate economic data that tends to lead changes in economic activity, point to steadily improving growth for most of the global economy as the index hit its highest level since July of 2018[1]. More specifically, Euro-Area confidence hit its highest level in 21 years as restrictions are lifted and economies begin to reopen[1].

Within emerging markets, there is underlying momentum for growth as those areas hit by slumps in tourism and commodity exports continue to recover. The International Monetary Fund projects that emerging market and developing economies will grow by 6.7% in 2021[3]. If this comes to fruition, this would be the highest level of growth since 2010. Higher oil prices could serve as a tailwind for corporate earnings and ultimately performance of emerging market equities moving forward as emerging market countries generally feel the economic impact of higher oil prices much more than developed markets. This is not only because of their smaller size, but also because of the nature of their economies, with the majority of oil-producing countries located in the emerging markets.

Fixed Income

The fixed income market, as measured by the Bloomberg Barclays US Aggregate Bond index, returned 1.83%[1] during the second quarter due to a sharp decrease in long-term interest rates, as market participants began to accept the Federal Reserve's messaging that inflationary pressures are 'transitory' in nature. Both treasury and investment grade corporate bonds felt the benefits of the decrease in interest rates, while high yield bonds continue to benefit from a risk on environment. The 10-year U.S. Treasury yield sits at 1.47% as of quarter end, down from 1.74% to start the quarter, a decrease of 0.27%[1]. As short-term rates remain anchored by the Federal Reserve in the short term, the difference between long and short-term rates decreased to 1.21% as the yield curve began to flatten[1]. Though the Federal Reserve has indicated that they are not going to raise short term interest rates in the near term, we believe the projected path for interest rates is up from here, as a growing economy coupled with above trend inflation may support higher rates. Moving forward, we believe fixed income securities will provide diversification benefits to equities but may be under pressure if rates continue their upward path on the year.

Alternatives

Alternative assets have continued their climb from Q1 into Q2 as investors weigh the effects of higher inflation expectations. WTI crude prices have reached levels they have not seen since 2008, ending the quarter at $73.47, up from the beginning of the quarter at $59.16 a barrel[1]. Continuing vaccinations across the United States and easing restrictions have led to an uptick in the demand for petroleum products. OPEC+'s next scheduled meeting comes with expectations amongst analysts to see a rise in oil production to match the increased demand they are seeing in the marketplace, which may help to stabilize rising oil prices. Hedge Fund-like alternatives continued to move higher on the quarter, up 2.07%, as measured by the Morningstar Diversified Alternative index[2].

Real Estate

Economic data pertaining to real estate and the housing market has been somewhat mixed so far in 2021. In the second quarter of 2021, the median price for new home sales surged to roughly $350,000[1], indicating a robust recovery from a lackluster year for home sellers in 2020. However, recent surges in the price of key inputs for housing developers, such as lumber, has affected production in recent months, with building starts slipping by 3% in May[1]. Meanwhile, existing home sales and new home sales simultaneously decreased by -0.9% and -5.9% month-over-month in May[1], respectively. Both the reduction in building permits and sales for single family homes are reflective of pricing pressures effecting both producers and home buyers. The increases in input costs and home prices ultimately offsets some of the benefits that low borrowing costs create for consumers. In the near to intermediate future, we expect these pricing pressures to dissipate for producers as various supply constraints found primarily in commodities markets are resolved or reversed. However, the outlook for commercial real estate is much cloudier, as it is unclear whether changes in consumer behavior catalyzed by the pandemic will persist beyond the duration of economic shutdowns.

Conclusion

As the United States continues its path to easing restrictions and re-opening, certain areas of the economy that were affected the most by the pandemic, like travel, leisure, and restaurants, are surging back. The pace of recovery in the labor market points to the strong recovery path the United States is on, but the absolute level of unemployment is indicative of how far we still have to go to return to pre-pandemic levels. Although inflationary data has become a real concern, the Federal Reserve has done what it can to calm investors, maintaining its stance that the inflationary pressures are transitory. As the recovery rolls on, more volatile economic data is expected; however, pent up consumer demand coupled with unparalleled levels of stimulus should allow the United States to continue its course to a robust recovery.

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[1] Data obtained from Bloomberg as of 6/30/2021
[2] Data obtained from Morningstar as 6/30/2021
[3] https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC