Market **Insights**

Economy | **Capital Markets**

Q1 2021

Economy

After 12 painful and unprecedented months dealing with the global pandemic, the proverbial light at the end of the tunnel is growing brighter. Yet, the potentially long-lasting social, economic and psychological damage inflicted could take years to work through. Already, scientists have developed three viable vaccines. Approximately 25 percent of the American population has received one, with millions more within the next few months. New virus cases, along with hospitalizations, have declined markedly, which prompted many states to reopen their economies. Airlines, travel and leisure sectors are roaring back to life as people eagerly anticipate a return to “normal” in the near future. While obstacles remain, a renewed sense of optimism is beginning to permeate the psyche of consumers and investors. All indications point to a dramatic rebound in economic growth in the months ahead.

After the devastating repercussions of nationwide lockdowns, recent trends point to a noticeable rebound in activity across a broad spectrum of the economy. First, the Institute for Supply Management recently reported that its gauge of manufacturing activity rose to its highest level in over three years. Although manufacturers are dealing with lingering pandemic issues and supply-chain shortages, they are benefiting from a shift in spending, with more Americans spending money on homes and other projects. Manufacturers are also wrestling with lengthening delivery times for components, consequences of global supply shortages, which could hold back the recovery in manufacturing output in the coming months. Yet, the President recently signed an executive order intended to boost manufacturing jobs by strengthening supply chains for advanced batteries, pharmaceuticals, critical minerals and semiconductors.

The housing market is another bright spot in the economy. Historically low mortgages rates helped fuel a housing boom that started last year as more Americans sought more space, with homes serving as offices and classrooms during the pandemic. This demand surge has left inventories lean and pushed home prices higher. At the same time, builder backlogs remain elevated. This indicates residential construction will stay firm in the coming months and contribute to economic growth.

While positive economic signs are emerging, the pandemic scars are deep and may take years to fully resolve. The employment picture exemplifies this struggle: the nation’s jobless claims remain well-above average, the unemployment rate is hovering around 6 percent, and nearly 10 million individuals remain unemployed. However, the job openings rate recently hit a one-year high. Employers, which struggled for months with pandemic-related disruptions to their work forces, are looking to increase employee headcounts as the economy strengthens and vaccination rates increase. Already, job openings have increased in the construction, manufacturing and health care industries.

Amidst the nascent recovery, both the Federal Reserve (Fed) and U.S. government continue to supply unprecedented stimulus to consumers, businesses and the financial system. The Fed recently reiterated their commitment to keep short-term interest rates low through 2023. It will also continue to buy Treasury bonds and mortgage-backed securities, and support credit throughout the financial system. The U.S. government has embarked on massive deficit spending. The most recent being a $1.9 trillion stimulus plan, which includes direct payments to consumers and extended unemployment benefits. These combined efforts are expected to significantly help growth in the coming quarters. In fact, recent estimates suggest growth in the second and third quarters could top 10 percent annualized, before moderating during the second half of the year. Yet, this free spending comes at a big cost. The federal budget deficit is expected to explode to around $3 trillion this year and stay above $1 trillion for the next couple of years. As government debt soars, interest rates have spiked, and the value of the U.S. dollar has fallen by about 10 percent over the past year.

Although investors are generally confident in the road ahead, some trepidation remains with stock valuations near all-time highs and bond yields rising. Further, massive deficit spending and a reliance on continuous government stimulus is concerning, particularly if it subsides. Not to mention, the cost of paying back all the debt in the future. While we are concerned about valuations, there are some opportunities both domestically and around the world. Over the past decade, growth stocks have trounced value stocks. Now, value stocks are surging back while the high growth names have stalled. Further, higher interest rates and a falling dollar has helped many foreign stocks relative to those in the U.S. Finally, although low-quality or high-yield bonds come with added risk, they have held up well during the recent rise in interest rates. Looking ahead, we expect the capital markets to remain somewhat volatile as the economy works through the pandemic-related issues and valuations remain high. We continue to work diligently to analyze the environment and make strategic investment moves in client accounts as appropriate.

As always, investing in capital markets comes with some risk and uncertainty. We thank you for your continued support of our investment process as we work hard to deliver positive risk-adjusted portfolio returns to our clients. Should you have any questions, please do not hesitate to reach out to your financial adviser.

Capital Markets

An improving economy along with continued stimulus helped underpin the capital markets. For the quarter, domestic small and mid-cap stocks outpaced large, while international stock returns were modestly positive. U.S. government bond yields pushed higher amidst rising inflation and deficit spending, which negatively impacted most bond returns for the quarter.

Disclosure: It is not possible to invest directly into an index. The indices listed above are unmanaged and are not affiliated with the Advance Capital Companies.

Market Index Performance (%)
As of March 31, 2021

	4th QTR	YTD	1 Year	Annualized 3 Year
S&P 500	6.17	6.17	56.35	16.78
Dow Jones Industrial	8.29	8.29	53.78	13.61
Nasdaq Composite	1.76	1.76	68.88	27.01
Barclays Aggregate Bond	4.92	4.92	54.03	12.81
FTSE USBIG Corporate	-4.60	-4.60	8.84	6.25
MSCI World	-3.37	-3.37	0.71	4.65

Economy from a Historical Perspective

	Latest	Average*	Definition	Comments
U.S. Unemployment Rate	6.20%	6.05%	**Represents the number of unemployed persons as a percent of the labor force**	High, but improving
Consumer Price Index	1.68%	3.93%	**Represents changes in prices of all goods and services purchased for consumption**	Sharply lower
U.S. Capacity Utilization	73.76%	80.05%	**The greatest level of output that a plant can maintain within the framework of a realistic work schedule, accounting for normal downtime**	Low, but improving
Gross Domestic Product⁺	-1.16%	6.31%	**Total value of all goods and services produced indicates strength or weakness of the economy**	Low, but improving
10 Year Treasury Yield	1.73%	6.17%	**Yield on the current 10 year treasury bond**	Historically low
Annual Housing Starts	1,421,000	1,426,000	**New privately owned housing unit starts annualized rate**	Trending higher

*Average from 1966 to Present ⁺ Annualized *Source: Bloomberg*

Disclosures: Investments are not insured, and may lose money. Client should be prepared to bear the risks associated with investing.

Past performance is no guarantee of future results. This commentary contains the current opinions of the author as of the date above, which are subject to change at any time. This commentary has been distributed for informational purposes only and is not a recommendation or offer of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable, but is not guaranteed.

Investment advisory services are provided by Advance Capital Management, Inc.