Market **Insights**

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Q2 2021

Economy

As a nation, we must start to move past the devastating fallout from the pandemic toward a return to a more "normal" life. Whatever that may look like. As in past generations, living through these surreal and historic events will forever change our collective psyche and perhaps bring a newfound appreciation for our freedoms and the simple things in life. Today, infection rates have plummeted, and more than 150 million Americans have been fully vaccinated as the economy roars back to life. Yet, the fallout left in the pandemic's wake is broad and far-reaching. It could forever alter, both positively and negatively, our economic, business and social landscape for years. While solving these issues may require difficult decisions and a test of our nation's mettle, history has proven that we are up to the challenge.

Already, our economy has shown remarkable resiliency as it continues to claw its way back from the economic abyss during the depths of the pandemic. For instance, the manufacturing sector is experiencing a surge in activity. Optimism at its highest level in years as consumers aggressively spend on all types of products. Yet, companies are struggling to meet the high demand due to material shortages, higher commodity prices and a worker shortage. It could take a year or longer to work through these manufacturing bottlenecks, with higher consumer prices as a direct consequence. The housing sector is another bright spot for the economy. New housing starts, and existing home sales are near multi-year highs. A surge in housing demand from the new stay-at-home environment has resulted in bidding wars for homes and, consequently, a surge in home prices across the nation. Finally, as most states have started their reopening phase, the services sector of the economy jumped to the highest level ever recorded, dating back to 1997. Recreation, retail, transportation, and construction sectors led the charge as all 18 industries have reportedly showed growth. While the rate of expansion is strong, capacity constraints, material shortages and employment challenges could hinder growth in the months ahead. Still, overall economic growth is expected to top 6 percent for this year and about 4 percent for 2022. A healthy pace compared to historical averages.

A rebound in economic growth remains heavily supported by actions from both the Federal Reserve (Fed) and the U.S. government. First, the Fed continues to suppress interest rates and use unconventional programs to aid the credit markets, including an expansion of their balance sheet to around $7 trillion, up from about $3 trillion at the start of the pandemic. Monthly, the Fed is buying about $80 billion in U.S. Treasury bonds along with $40 billion in mortgage-backed securities in the open market. These actions are artificially keeping market-based interest rates historically low, which has benefitted borrowers and investors. But, it's also raising concerns about how long the Fed can control interest rates and what happens to the economy and capital markets when it begins to exit some of these programs. The government has also dramatically increased their spending during the pandemic to cushion the impact on businesses, consumers and the unemployed. However, the cost to help our economy is enormous. The federal budget deficit has exploded to around $3 trillion this year, while the nation's total federal debt has increased about $5 trillion in a little over a year. Already, the consequence of this spending binge is felt in higher inflation and a declining U.S. dollar.

Amidst this environment of higher growth, support by the Federal Reserve and a renewed sense of optimism, the capital markets have responded accordingly. Small- and mid-cap stocks have outpaced large-cap stocks, and economically sensitive "value" stocks have crushed growth stocks. After a rough year during the pandemic and shutdowns, corporate earnings are roaring back with expectations to grow double-digits through the end of this year. It is a very good sign since stock valuations are near all-time highs, and if earnings grow as expected, these heightened valuations will recede. Meanwhile, a jump in inflation and concerns about deficits and unlimited support by the Fed has left the bond market reeling. The more interest-rate sensitive, higher quality and longer duration bonds have tended to underperform lower quality "junk" bonds. Finally, most commodity prices have surged due to higher demand and general supply constraints.

Looking ahead, the economy will benefit as states fully reopen, vaccinations increase, and consumers resume to their normal spending habits after a year in isolation. While obstacles and risks remain, it appears we are on a much better path as a sense of normalcy is returning. Investors have already accounted for most of these positive economic developments. Now they are awaiting confirmation that corporate earnings are sustainable at these higher levels and for indications when the Federal Reserve might begin to reduce their financial support for the capital markets. Since stock returns are up substantially already, we expect more muted returns for the remainder of the year. In bonds, higher consumer inflation and better economic growth will probably hinder returns. 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

The stock market continued to climb higher during the quarter as a direct result of an improving economy and investor enthusiasm. International also did well while emerging market stocks lagged. Interest rates fell slightly which helped bonds produce modest returns during 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 June 30, 2021

	2nd QTR	YTD	1 Year	Annualized 3 Year
S&P 500	8.55%	15.25%	40.79%	18.67%
Dow Jones Industrial	5.08%	13.79%	36.34%	15.02%
Nasdaq Composite	9.68%	12.92%	45.23%	25.72%
Barclays Aggregate Bond	1.83%	-1.60%	-0.33%	5.34%
FTSE USBIG Corporate	3.69%	-1.08%	3.53%	7.90%
MSCI World	7.74%	13.05%	39.04%	14.99%

Economy from a Historical Perspective

	Latest	Average*	Definition	Comments
U.S. Unemployment Rate	5.80%	6.10%	Represents the number of unemployed persons as a percent of the labor force	Steadily declining
Consumer Price Index	5.00%	4.00%	Represents changes in prices of all goods and services purchased for consumption	Sharply higher
U.S. Capacity Utilization	75.20%	80.00%	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+	6.40%	2.80%	Total value of all goods and services produced indicates strength or weakness of the economy	Historicallly high
10 Year Treasury Yield	1.46%	6.10%	Yield on the current 10 year treasury bond	Historically low
Annual Housing Starts	1,572,000	1,431,000	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.

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