Advisor Group
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MARKET MATTERS

MONTHLY FINANCIAL PROFESSIONAL UPDATE

April 12, 2021

Executive Summary

- Recent COVID-19 developments in the U.S. are generally positive, although variants pose a risk.
- Economic indicators are largely upbeat, but employment still needs to increase.
- Although annual inflation is now trending above the Fed's 2% target, the Fed board is focusing on the average over time.
- Likely infrastructure spending will push inflation higher, but the increase could still be temporary.
- Markets reacted as expected to risk-on news in March.
- Archegos dominated headlines in late March, but the practical impact on diversified portfolios was minimal.

COVID-19 Update: Mostly Positive News in U.S.

Recent COVID-19 developments in the U.S. are generally positive with some potentially ominous clouds. As tracked by the New York Times, the majority of businesses are now open across most states; vaccine eligibility has widened or will soon widen in all 50 states; over 3 million vaccine doses are being administered daily, and 35% of Americans have received at least one vaccine dose as of April 10. (70% to 90% of the population needs to be fully vaccinated to achieve community immunity).

Dampening the positive news is the spread of the B.1.1.7 variant of the coronavirus, which was first detected in the U.K. in December 2020. The U.S. Centers for Disease Control and Prevention (CDC) stated the B.1.1.7 strain, which is more virulent than previous variants, is now the dominant strain in the U.S. and is creating hot spots of new cases in some states, particularly Michigan. Health officials fear a resurgence in cases could occur in other states as prevention policies are lifted or even discouraged. The good news is existing vaccines are highly effective against the new variant, which adds urgency to vaccination efforts.

Unfortunately, developments in many other countries are not so reassuring. India, where the initial impact of COVID-19 was not as drastic as feared, is now seeing a severe spike in new cases as it deals with a virus showing mutations from three separate variants seen in South Africa, Brazil, and California. Brazil is still faring poorly with its variant. Several European countries dealt with a spike in cases in March while some, such as France and Germany, are still grappling with an early April spike in cases resulting from the B.1.1.7 variant.

As tracked by Bloomberg, there is significant disparity in vaccination rates between wealthy and poor nations. The wealthiest 27 countries have administered 40% of vaccines while many of the poorest countries have administered less than 1% of vaccines. Low vaccination rates leave more room for mutations in the coronavirus to occur and spread globally, as already seen with several variants. The good news is increased doses from more vaccine providers are becoming available.

Economic Indicators				
	12/31/2020	**1/31/2021**	**2/28/2021**	**3/31/2021**
3-Month Treasury Rate	0.09%	0.06%	0.04%	0.03%
10-Year Treasury Rate	0.93%	1.11%	1.44%	1.74%
ICE BAML High Yield OA Spread	3.86%	3.84%	3.57%	3.36%
Fed Funds Rate Upper Target	0.25%	0.25%	0.25%	0.25%
Unemployment Rate	6.7%	6.3%	6.2%	6.0%
WTI Crude Oil Spot ($/bbl)	$48.52	$52.20	$61.50	$59.16
VIX Index Level	22.8	33.1	28.0	19.4
U.S. Manufacturing PMI (IHS Markit)	57.1	59.2	58.6	59.1
U.S. Service PMI (IHS Markit)	54.8	58.3	58.8	60.4
Consumer Sentiment (Michigan)	80.7	79.0	76.8	84.9

Sources: Federal Reserve Economic Data (FRED), Trading Economics, Bloomberg, CBOE.

Economic Update: Upbeat

Economic indicators were largely upbeat. The U.S. economy added 916,000 jobs in March, well above the market expectation of 650,000 and the most since August 2020. The unemployment rate fell to 6% in March, the lowest rate in a year. March manufacturing activity saw the second-highest level of growth on record after January 2021, according to IHS Markit, while service activity jumped to the highest level on record, according to ISM. The University of Michigan reported consumer sentiment reached the highest level in a year.

On the negative front, initial jobless claims unexpectedly trended up in late March and early April. Eyes were also on inflation. The Consumer Price Index increased a seasonally unadjusted 2.6% year-over-year in March and has been trending up since October 2020. The inflation rate is above the Federal Reserve 2% target, but the Fed is targeting an average over time. The Producer Price Index, which can be a leading indicator of consumer inflation, rose an unadjusted 4.2% year-over-year in March, the highest in a decade. One reason for the higher reported numbers is because today's prices are being compared to prices during the early part of the pandemic, when economic activity declined materially.

President Joe Biden's proposed $2.3 trillion infrastructure plan adds to inflation concerns. The market consensus seems to be the inflationary impact from the additional spending will lessen once pent-up demand is met and remaining weaknesses in the economy have a dampening effect. For example, there are still 8.4 million fewer jobs now than there were in February 2020. Additionally, employment recovery among minorities and those without a high school diploma has lagged. That could improve as the service sector reopens.

As we have discussed in prior issues of Market Matters, there is data to support both sides of the inflation debate. Investors in or nearing retirement are most at risk to surprise inflation and can use a variety of tools to hedge some of that risk, such as exposure to real assets, a diversified global equity portfolio, bond ladders, Treasury inflation-protected securities (TIPS), floating-rate fixed income, and potentially some global exposure within the fixed income allocation.

Market Index Trailing Total Returns				
as of 3/31/2021	**MTD**	**YTD**	**1 Year**	**3 Year**
S&P 500	4.38%	6.17%	56.35%	16.78%
Russell 2000	1.00%	12.70%	94.85%	14.76%
MSCI EAFE USD	2.30%	3.48%	44.57%	6.02%
MSCI Emerging Markets USD	-1.51%	2.29%	58.39%	6.48%
Bloomberg Barclays U.S. Agg Bond	-1.25%	-3.37%	0.71%	4.65%
Bloomberg Barclays U.S. Corp High Yield	0.15%	0.85%	23.72%	6.84%
Bloomberg Barclays Global Agg Bond USD	-2.42%	-5.29%	7.15%	1.15%

Periods longer than a year are annualized. Returns include dividends or interest. Source: Morningstar.

Market Update: As Expected

In March, markets responded as expected to the recent positive developments around COVID-19 and economic metrics described above. The S&P 500 and some technology stocks reached new record levels by early April. Value and small-cap stocks, which tend to perform better during times of economic growth, outperformed growth and large-cap stocks. There were some reversals in early April, but that is normal.

With the impact of recent COVID-19 stimulus packages and the potential for a large infrastructure package (the details will change but some sort of an infrastructure package seems likely), we expect at least temporary inflation, higher interest rates, and an equity-friendly risk-on environment over the next one to three years. After that, the stimulus plans' impact can be priced into markets or fade. While investors should be aware of potential short-

term impacts, it is more important to maintain a long-term investment posture as markets are impossible to predict.

The Archegos Debacle

Late March was dominated by news surrounding Archegos Capital Management, a family investment fund that made concentrated investments in a handful of stocks via total return swaps. The stocks experienced significant losses, prompting a further selloff, and several investment banks reported major losses.

Total return swaps are a way to invest indirectly. An investment firm promises to pay a certain fixed or variable rate to an investment bank in exchange for the return of a particular investment (if the return is negative, the investment firm owes money to the investment bank). It is also a form of leverage as the notional exposure can be far larger than the invested cash. Archegos was reported to have $10 billion in its fund but notional exposure of $30 billion. Investment banks hedge their exposure by holding the reference stocks of the swaps.

In late March, the stocks Archegos invested in via swaps saw large enough declines that the investment banks feared Archegos wouldn't be able to pay the negative returns and closed down the swaps. To limit their losses, the investment banks sold their stock holdings at the same time, causing even larger negative movements in those holdings. Outlets like Bloomberg and the Wall Street Journal have more detailed explanations.

Total return swaps may sound scary but are widely used and have legitimate applications. They are even found (typically as small allocations) in mutual funds, ETFs, interval funds, and business development companies (BDCs) to achieve higher diversification or exposure to hard-to-access securities. The reason many investment banks seemed to be caught off-guard (despite the head of Archegos having a known history of risk-taking) is that there is no public disclosure of indirect stock ownership by swap investors. The investment banks may not have known about each other's holdings. More details are pending, and it is still unclear if regulators will push for more disclosure requirements.

The upshot for investors is that the impact on diversified portfolios was minimal. Additionally, mutual funds and ETFs from established sponsors that use their own total return swaps tend to have risk controls over leverage and derivative exposure.

Correction

In recent issues, we have displayed the table below, which compares the performance of value and growth equity indices. We inadvertently showed performance for the Russell 2000 Growth Index, which is an index of small-cap growth stocks, instead of the Russell 1000 Growth Index, which is an index of large-cap growth stocks. That has now been corrected. We regret the error.

Value vs. Growth Trailing Total Returns				
as of 3/31/2021	**MTD**	**YTD**	**1 Year**	**3 Year**
S&P 500 Value	6.26%	10.77%	50.37%	11.83%
S&P 500 Growth	2.64%	2.12%	59.43%	20.58%
Russell 1000 Value	5.88%	11.26%	56.09%	10.96%
Russell 1000 Growth	1.72%	0.94%	62.74%	22.80%

Periods longer than a year are annualized. Returns include dividends or interest. Source: Morningstar.

Information Portal

Be sure to visit the Coronavirus Response Resource Center on Advisor Portal—your one-stop online hub for resources on COVID-19's impact on the markets. On this page, you'll find relevant and timely insights from the Advisor Group Product Research Team and our Strategic Partners. Check back frequently for the most up-to-date information.

Advisor Group is closely monitoring market conditions and is here to help you review developments. The current volatility serves to remind your clients how important it is to maintain diversified portfolios across multiple asset classes. Timing the market is a very difficult task as market conditions can change abruptly. It is prudent for clients to maintain a long-term investing approach.

If you have any questions about financial markets or investments offered at Advisor Group, please contact the Sales Desk at 800-558-7735 or email Product Research at agr@advisorgroup.com.

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