

COMMENTARY

US small caps shoot above long-term moving average

The S&P 600 Index, tracking the small-cap segment of the U.S. equity market (stocks with market values of US\$0.7bn-US\$3.2bn), has gained substantially recently as the market continues to rotate out of larger cap stocks (those with market values above US\$10bn). It is now 30% above its 200-day moving average (the blue line in Chart 1, often used as a proxy for the long-term average), the highest in five years, driving up the forward price to earnings ratio from around 10x at the March 2020 lows to over 20x currently. This begs the question: How will this be resolved? It will be either through price correction, with the index level (or price) falling, reducing valuations, or time correction, with prices remaining high, but earnings eventually growing enough to lower the valuations.



ECONOMIC HIGHLIGHTS

S&P 500	3,714.24
DIJA	29,982.62
NASDAQ	13,070.69
OIL	\$52.20 /BARREL
GOLD	\$1,850.30/OUNCE
10-YEAR TREASURY YIELD	6.70%
UNEMPLOYMENT	6.90%
GDP	4.0%
PPI	0.76% Year-Over-Year
CPI	1.36% Year-Over-Year

Source: ycharts.com



International (particular Emerging Markets) are showing signs of taking a leadership role in the markets.



Sentiment seems too heavy to the bullish side short-term, but not overly done from a longterm perspective.



Market Breadth has weakened some as less and less stocks are staying above their 50- and 200- day moving average.

Yields picking up off bottom, but likely to remain low long-term

While Treasury yields were range-bound from 2011 until COVID hit in March 2020, they plummeted as the government responded to the crisis with a major monetary and fiscal stimulus and investors also fled into US bonds for safety (Chart 2). However, yields look to



have bottomed (for now), and we expect that 10-Year U.S. Treasury yields will continue to pick-up this year, reaching 1.40%-1.50%. While long-term we expect yields to remain relatively low, in a range of 0.50%-3.00%, this assumes no major pick-up in inflation; the Fed's dual mandate to support growth but maintain price stability would likely drive it to intervene with rate hikes if consumer prices really took off.

In the middle of a secular bull market, but short-term volatility may remain elevated

Long-term we believe that we are still in the middle of a secular bull market, although volatility could remain elevated, as bullish sentiment from clear progress on the global health crisis, including on vaccines, is periodically cooled by news of rising cases and many major economies in various degrees and stages of lockdowns. We continue to look for intermediate-term and long-term opportunities while following our disciplined rebalancing process, which calls for adjusting portfolios between equities and fixed income as levels of exposure move outside of their targeted risk bands.

INDEX	3 mo	1 yr	3 yr	5 yr
S&P 500	14.05%	17.25%	11.70%	16.16%
MSCI EAFE	19.58%	8.94%	2.23%	8.84%
BAR AGG BOND	0.40%	4.72%	5.49%	4.00%

Source: Morningstar Direct



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The index, a member of the Dow Jones Total Stock Market Indices family, is designed to measure the performance of large-cap U.S. equity securities that are classified as "value" based on a multi-factor analysis.

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