INVESTMENT COUNSEL
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March 31, 2021

The first quarter of 2021 has brought a renewed sense of optimism that we're close to putting the worst aspects of Covid behind us; and, that a broad and diverse range of normal everyday activities will once again be part of our daily lives and our economy. Vaccinations have ramped up with almost 30% of the US having received at least one vaccination shot. Most Americans should be vaccinated by summer and schools will likely all be back on campus this autumn. Economic growth has accelerated off the mid-2020 lows with strong growth now expected for 2021 and 2022.

2021 will be a year in which year over year earnings increases may approach 25%! The broadest measure of unemployment, U-6 unemployment, spiked above 22% last April but has since fallen below 12% with continued improvement expected. Combining these profitability and employment gains along with the individual benefits within the recently passed $1.9T Covid Relief Bill makes it clear that most everyone will enjoy improved prosperity (less financial stress) in 2021 over 2020, even if it doesn't bring everyone back to pre-Covid 2019 levels.

Investors have already priced in much of this reversal and are already banking on the significant earnings growth yet to come in 2021-22. Going forward, we feel stock prices will increasingly revert back to the historically normal drivers – earnings and interest rates. As ironic as it was for stocks to do so well last year, there is the potential for stocks to have just modest appreciation this year despite all of the strong growth ahead; especially if interest rates continue to rise faster than previously thought likely. In Q1, 10-year US Treasury bond yields rose from roughly 1.0% to 1.7% and as interest rates rise, future earnings become less valuable and equity P/E multiples compress. Interest rate movements will continue to create equity price volatility in 2021.

We continue to believe that the secular global deflationary forces of the past decade remain in place and will partially offset the nominal growth coming from the extraordinary monetary and fiscal policies of governments around the world. We'll keep an eye on German 10-year bond rates (still negative) and Japanese 10-year bond rates (currently 0%) as indicators of inflationary pressures in those markets. Technology will continue to promote important productivity enhancements throughout the global economy which also promotes deflationary pricing. The existing slack in the workforce will moderate underlying wage inflation as workers continue to find their way back into jobs. Our view is that long term domestic interest rates may rise from current levels but will level off within the historically low range from 2%-3% that we've seen over the past decade. This should ultimately prove to be a good environment for stocks; but, given the obvious uncertainties about outcomes, volatility may increase while appreciation remains modest.

We'll continue to focus our investments on well-run, reasonably valued companies with competitive advantages in their respective industries; and that demonstrate their leadership by providing yearly dividend growth for their shareholders. We feel that portfolios with increasing dividend returns are best positioned to do well in a rising interest rate environment.

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