Quarterly Playbook

2nd Quarter 2021

Current Financial Planning and Investment Themes

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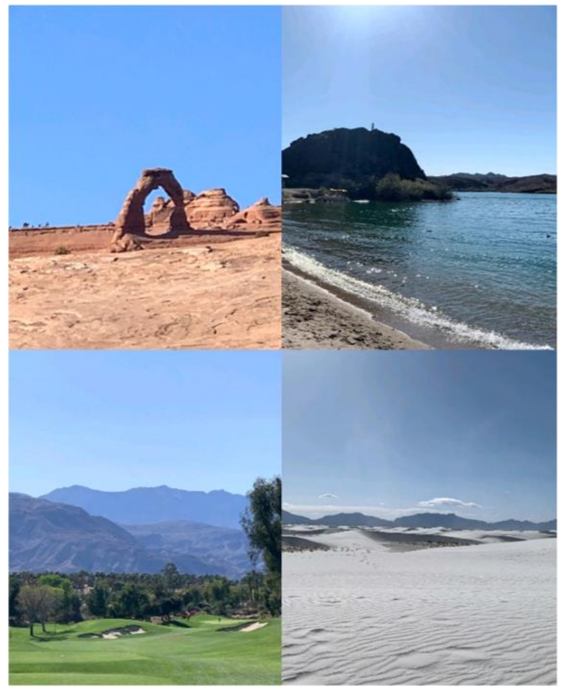
"Assessing the lay of the land"

We have been so focused on getting to this point that we find ourselves in unfamiliar territory. It is time to take a closer look at our surroundings. Just like the adventurer that has many miles under their belt and needs to mark their location, investors need to also assess their positions.

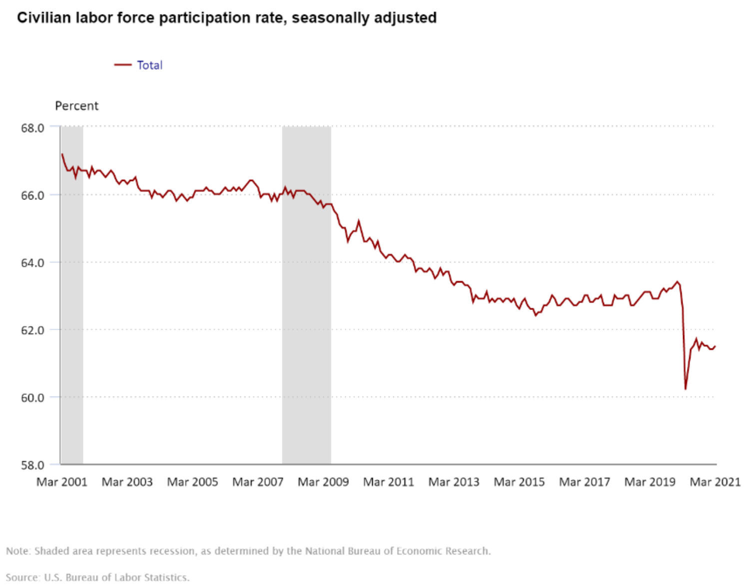
"Some beautiful paths can't be discovered without getting lost." – Erol Ozan



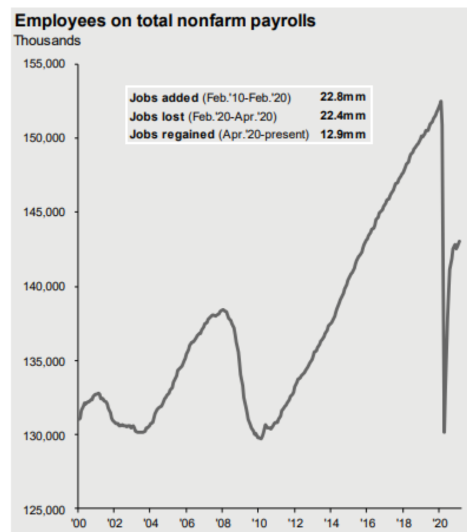
US Economics

We have had our head down and focused up to this point with just recovering from the horrific drop in GDP exactly one year ago. It's time to pause and "look around" so that we can understand how far we've come and how far we still have to go. If we think about GDP growth from 2016 -2020, we averaged a respectable 2.5%. Remembering back to the 2nd quarter a year ago when GDP plunged 31.4% due to the global economic lockdown, we have come a long way with the 33.4% gain in the 3rd quarter and 4.3% gain in the 4th quarter. But to truly say that we have "recovered", we need to see what growth rate it would take to get us back to as if the COVID-19 shutdown never happened. That number is approximately 5% from here. As it turns out, the current estimate of 1st Quarter 2021 GDP from the GDPNow model estimate is 6% - good news! Even the Fed has started to recognize the path we are traveling on and raised their 2021 GDP range to 5.0% - 7.3%, up significantly from their December projections of 0.5%-5.5%. Other good news can be seen as the unemployment rates are making their way out of the desert slowly but surely. The March U-3 (official) unemployment rate came in at 6.0%, falling from 6.7% back in December. Additionally, the U-6 (broader definition including part-time) unemployment rate also fell to 10.7% from the December read of 11.7%.

However, the labor participation rate is still lost in a canyon at 61.5% as of March 2021. The reason this is so



important is that GDP growth is a function of the growth in workers (labor participation) multiplied by the growth in productivity. If we are to continue the elevated levels of quarterly GDP growth needed to catch up to the recent trend, we need more Americans to want to work again. As noted in the JP Morgan chart, the number of jobs lost during the depths of last year were approximately equal to the total number of jobs gained for the prior decade. We are a little over half way there in the current jobs recovery.



Source: Bureau of Labor Statistics, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of March 31, 2021.

US Equity Markets

The US Stock market has certainly been traveling on a path that sparkles and shines despite many caution signs such as high P/E ratios, inflation expectations rising, interest rates expected to rise, and major tax hikes on the horizon. That said, the easy road rarely leads to some place interesting, and we are certainly in interesting territory! **The S&P 500 has hit a new all-time high 18 times already in just the first quarter of 2021.** It wouldn't be out of touch to ask when does the fun stop? Well, not any time soon from our analysis. The environment for US stocks is extremely supportive. Even though valuations are high, there are several factors that have shined light on the path higher including, very accommodative monetary policy, re-opening deployment of pent-up demand, huge amounts of stimulus cash injections and our old friend T.I.N.A. (There Is No Alternative). That last point is a powerful one. With bank yields still near zero, bond investments losing value due to sharp declines in price,

…continued

international markets still mostly in lockdown, inflation expectations on the rise, plenty of cash to invest across both consumers and businesses, the US stock markets are the destination of choice.

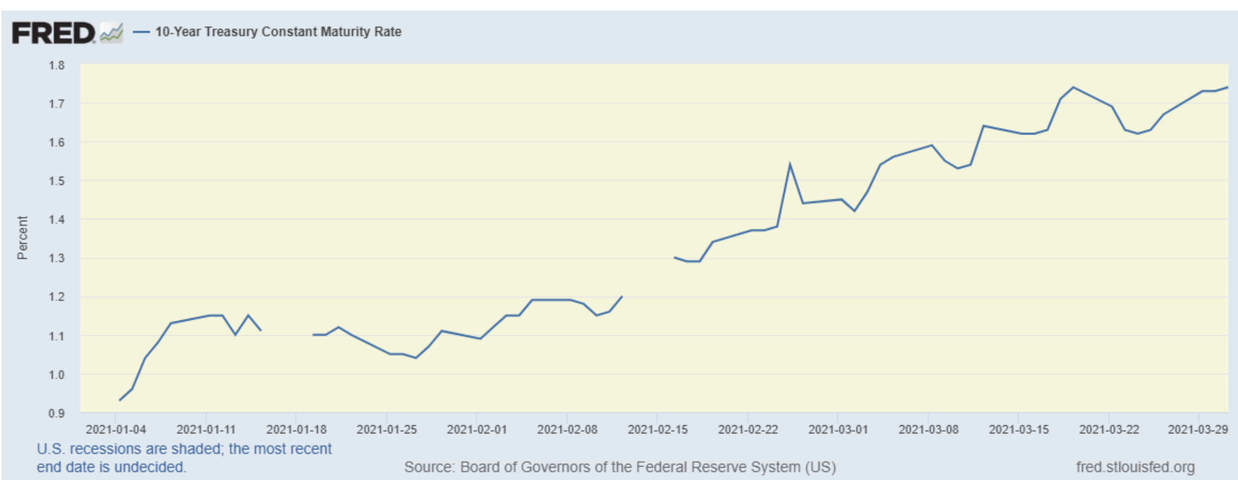
Looking under the hood though, the gains in the stock market this year have been almost all from the Value side of the ledger. Unlike the last few years where Growth dominated, Value is hastily catching up. From a broad-based index perspective, we expect low to mid-teens for the S&P 500 full year return at this point.

YTD

	Value	Blend	Growth
Large	11.3%	6.2%	0.9%
Mid	13.1%	8.1%	-0.6%
Small	21.2%	12.7%	4.9%

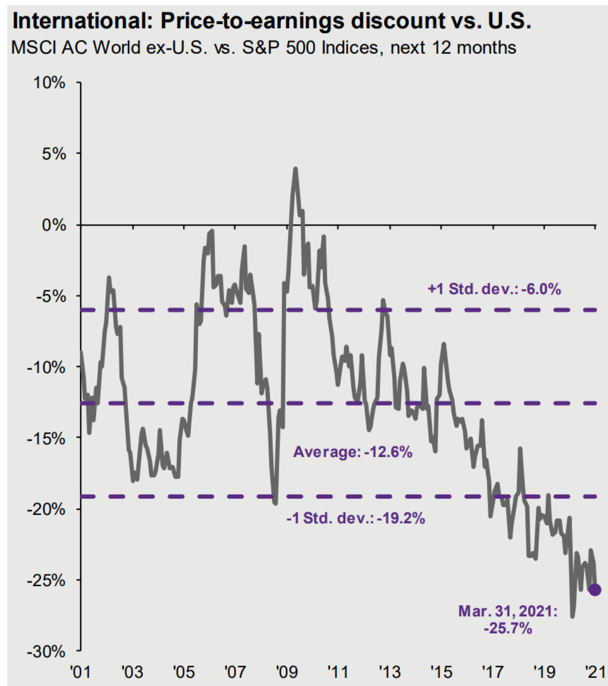
US Fixed Income

The bond market turned down a dark and scary path to start the year. With inflation fears rising, pushing yields up quickly, bond prices have fallen down a hole. The US Aggregate bond index finished the 1st quarter down -3.37%, mostly lead lower by Government and Investment Grade Corporate Bonds. However, High Yield and Convertibles are still doing OK and should provide some positive gains for the year. As far as obstacles, we still see continued upward pressure on yields due to rising inflation expectations as well as the coming, albeit distant, realization that the Fed will eventually stop their bond buying programs. In fact, the huge decline in bond prices and spike in yields contributed largely to the stock market volatility we experienced in the 1st quarter. Although since the magnitude of the price and yield adjustment was so large, the market view is that most of the moves have already been priced in.



International Markets

Well the race between the US and international equities has been a slow start for the international side. While still posting a positive return for the 1st quarter, it the MSCI ACWI ex US was only up 3.49% vs 6.2% for the S&P 500. However, the valuation difference remains strongly in favor of international equities as there is a 25.7% undervaluation compared to the S&P 500. The environment that international investments find themselves in does not appear to be as favorable as economic restrictions remain much more strict overseas. Given the balance of data, we still believe that International and US equities will finish the year neck and neck.



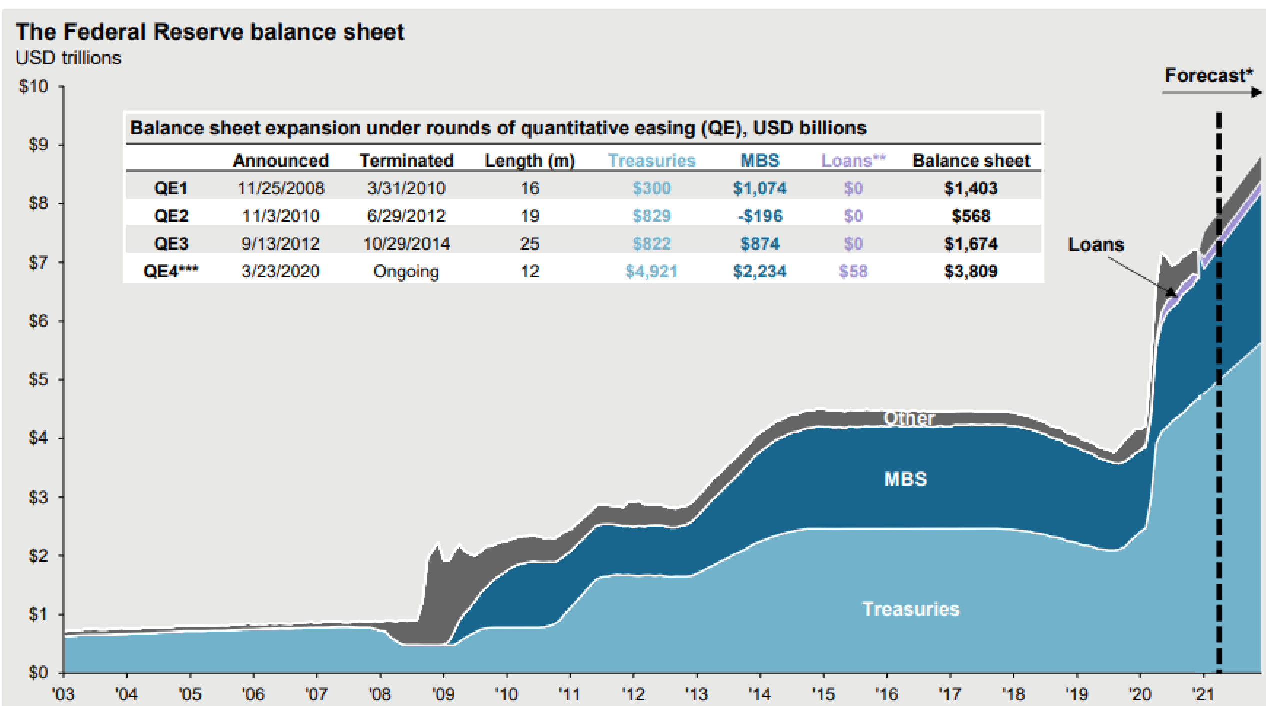
Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of March 31, 2021.

Real Estate

REITs currently find themselves in a great landscape. With a massive amount cash floating around in the system and interest rates at exceptionally low levels, the time is optimal for REITs this quarter. We believe as COVID restrictions ease even further; the Real Estate market will benefit greatly. The backdrop of both consumers and businesses being flush with cash along with the prospect of rising inflation makes hard assets, particularly Real Estate, very much in demand. A strengthening economy can also give landlords greater ability to raise rents, which has historically supported attractive REIT returns. All in all, we think that listed Real Estate will be a major player in the re-opening trade that appears to have already started…

Interest Rates & the Fed

The Fed is acting as a generous guide through a treacherous landscape. Carefully reassuring travelers that, despite the "cliffs" on either side, they can lead us down a narrow path to safety. Fed chair Powell recently stated that the Federal Reserve is working off a three-part test before they will consider tightening monetary policy. Those three requirements are: 1) A recovery in the labor market effectively achieved 2) Inflation reaching 2% and 3) Inflation on track to run moderately above 2% for some time. These are broad and high hurdles to achieve which gives them plenty of "cover" to maintain their easy-money policies for years and years. Even as the March projections raised the GDP growth rate this year to 5.0-7.3%, up from 05.-5.5% in December, they are all but guaranteeing they will not raise interest rates this year. In fact, the median Fed Funds rate for 2023 is still 0.1%, the same as today. Inflation expectations rose also in the Feds March projections which is 2.1 – 2.6% for this year, up from 1.2 – 2.3% in December. In my view they may be laying the groundwork for a shift from ongoing legislative stimulus over to ongoing monetary stimulus. Things are far less messy while the need for transparency and accountability is far less at the Fed than at Capitol Hill.



	Announced	Terminated	Length (m)	Treasuries	MBS	Loans**	Balance sheet
QE1	11/25/2008	3/31/2010	16	$300	$1,074	$0	$1,403
QE2	11/3/2010	6/29/2012	19	$829	-$196	$0	$568
QE3	9/13/2012	10/29/2014	25	$822	$874	$0	$1,674
QE4***	3/23/2020	Ongoing	12	$4,921	$2,234	$58	$3,809

Source: FactSet, Federal Reserve, J.P. Morgan Investment Bank, J.P. Morgan Asset Management.

Legislative Affairs

And then came the taxes….. While we expected tax increases to be forthcoming since the Democrats swept the Whitehouse and Congress, we didn't think the proposals would be out this soon. That said, what has come out so far is a long way from becoming law. Possibly, the reason these proposals have come this early is to negotiate their way through the end of the year or next year. Here is what we have seen so far:

Sen. Bernie Sanders, I-Vt., released the "For the 99.5% Act", legislation that would restore the estate tax exemptions to the 2009 thresholds of $3.5 million per individual and $7 million per married couple from the current exemptions of $11.7 million and $23.4 million. In a shift, larger estates would be subject to higher tax rates. The current 40% tax rate would be raised to 45%. Taxable estates greater than $10 million would be taxed at 50%, amounts greater than $50 million at 55%, and amounts greater than $1 billion would be taxed at 65%, according to the Joint Committee on Taxation.

Sen. Elizabeth Warren, D-Mass., unveiled the Ultra-Millionaire Tax Act, which would impose a 2% annual tax on the net worth of households and trusts between $50 million and $1 billion.

President Biden introduced a $2.3 Trillion package called "The American Jobs Plan" which is touted as an "Infrastructure Bill" that includes a flurry of tax increases including raising the corporate tax rate up to 28%, the highest personal income rate back to 39.6%, and a reduction in the estate tax exemption to $3.5 Million. Other items include additional Social Security taxes for taxpayers earning more than $400,000, and the end to the "step-up in basis at death".

For now, none of these proposals look ready to be signed into law. However, we reiterate our view that tax planning in 2021 may be the biggest opportunity ever!

Financial Planning Corner

Understanding short-squeezes and meme-trading

How GameStop stock went from $40 to $483 in 2 weeks

By the end of 2020, GameStop's stock had begun to make a recovery after a steady decline over the few years prior. A share was under $3 in April 2020. And by December, it was just shy of $20. This was likely due to the optimism around how well the video gaming industry might fare during COVID restrictions. And then, thanks to one specific trader named "Roaring Kitty", a Reddit group called wallstreetbets, and the power of social media, that modest recovery turned into something practically indescribable.

GameStop YTD stock chart from Yahoo Finance

For several months leading up to January 2021, a stock trader (who was later discovered to be an employee of MassMutual) named "Roaring Kitty" hosted a YouTube channel and participated in online trading forums where he talked highly of GameStop stock. Since mid-2019, he shared opinions on his "bullish outlook" for the company saying the stock was undervalued, and, eventually, his opinion that the stock was ripe for a "short squeeze". And that's exactly what happened.

GameStop stock was caught in the middle of what's called a "short squeeze"

And that short squeeze is what caused the stock price to takeoff like a rocket. But what's a short squeeze and how did it happen? First, let's define the "short" part. A "short sale" of a stock is where an investor *borrows* stock shares from a Broker/Dealer of securities and sells them in the open market. Then, within a certain timeframe, that investor must buy those shares in the open market and *return* them to the Broker/Dealer (this is called covering their position). If the stock price went up between selling the borrowed shares and buying them back, the investor lost money. If the stock went down, the investor made money.

So why sell a stock short? If you felt the price was going to come down from where it is today, then you could make money by borrowing shares to sell today, and then waiting for the price to decline before buying the shares back from the open market to repay your borrowed shares. Mind you, this is an advanced strategy that we personally don't endorse, nor feel is suitable for our clients. Only the most speculative of investors (including hedge funds) typically practice short selling. That's because you can only gain as much as the stock price declines. But you can lose by a theoretically infinite amount. Meaning, a stock price has the ability to go as high as the market decides, and if you have to purchase shares to repay your borrowed shares by a certain date, you have to pay whatever that stock price is.

This is where the "squeeze" comes in

Keith Gill aka "Roaring Kitty" on YouTube

A short squeeze is where too many investors have sold a stock short while other investors are buying that same stock at the same time. What ends up happening is the investors who sold the stock short are waiting for the price to go down to "cover" their positions. Meanwhile, some optimism around the stock formulates. It could be from positive financial/company news, but in this case, it was primarily from Roaring Kitty's YouTube and forum posts, and later the wallstreetbets Reddit group. Once enough investors rallied together around the idea that GameStop was being heavily shorted by Hedge Funds and Wall

Street firms, and that they could drive the price up to force a short squeeze, that's when they started buying and sending the stock soaring.

As those investors started buying more and more GameStop stock and, in turn, bidding the price up, the short sellers were forced to either buy the stock to return their borrowed shares, or wait it out and hope the price didn't continue going higher. Imagine having a quarter tank of gas on a desert highway and you only pass a gas station every few miles. Gas cost $2 gallon at your last fill-up, and you felt that was a fair price. But the price of gas is suddenly $10 at the gas stations you're passing now. And as you keep driving, you see the price continue to climb. It's at this point, when you know you have to get gas soon, and you're watching an insanely high price only move higher, you have to decide whether to stop for gas now or wait until you're nearly on 'E'.

That's the position the short sellers were put in. They had to decide whether to hold out for cheaper gas (GameStop stock price to go down), or go ahead and pay the gas prices now to avoid the possibility of the price continuing to go up. Many of them reached a point where they had to cut their losses, so they also purchased the stock to repay their borrowed shares, and this caused lowered supply and increased demand which further bid up the price.

In February, the dust started to settle and most of the short sellers had covered their positions, so the price began to come back down. The surge of GameStop's stock price had nothing to do with the value of the company in terms of better financial performance or promising business news. Rather, this was a once in a decade event that was made more possible by social media and was purely speculation on the short sale volume circumstances. Retail investors simply rallied together on the speculation that they could cause GameStop to reach a short squeeze if they all bought, and that's what they did. It's been said that hundreds of thousands of investors joined apps like Robinhood to buy GameStop…

What's the real takeaway?

Events like this can be fun to follow, but we recommend watching from the sidelines. The more you move away from investing based on fundamentals and company cash flows, and instead take larger gambles based on speculation, the greater the chances of extreme losses. Yes, some people made money on the GameStop frenzy, but many retail investors also lost their savings.

So, when you see the next short squeeze stock in the news, now you'll know exactly what's going on!

We're here to help. If you have questions about these or any other topics, don't hesitate to call us at (855) AFS-4545.