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FIRST QUARTER 2021 MARKET RECAP

Uneven Economic Recovery; Rising Long-Term Interest Rates

COVID Infection Trends and Vaccine Rollouts Will Continue to Dictate Global Stock and Bond Market Results

Global stock market results were uneven during first quarter 2021. U.S. stocks managed to post another strong quarter of gains while foreign stocks, both international developed and emerging markets, took a breather. The pace at which economies reopened was the key driver of stock gains during the quarter. Improving COVID-19 infection trends and a robust increase in vaccinations helped the U.S. economy reopen much faster relative to other countries. Within the U.S., rising prices of cyclically-oriented stocks more than offset headwinds from an abrupt rise in long-term interest rates and a decline in "stay-at-home" stock valuations. As the reopening of the U.S. economy gains steam, we expect shares of companies with strong linkages to the economic recovery to continue to drive market returns over the course of this year. Outside of the U.S., the economic recoveries in many developed and emerging market countries were hampered by rising COVID cases and vaccine shortages, which pressured foreign stock valuations (relative to U.S. stocks) during the quarter. For this reason, we see better opportunity in foreign stocks moving forward. Foreign stocks are not only cheaper relative to U.S. stocks, but they have a longer "runway" to compound returns due to being earlier in their economic recoveries.

We expect global long-term bond yields to remain elevated over the near-term in response to improving economic growth trends. Higher yields and tighter credit spreads (the yield differential between U.S. Treasury bonds and non-Treasury bonds) will continue to serve as headwinds to bond returns thereby reinforcing "TINA" or the view that "There Is No Alternative" to owning stocks. For this reason, we are moving many of our clients' exposure to stocks back to their long-term, strategic weighting for these assets. We will also consider increasing weightings to real assets and alternative assets to lower portfolio risk versus having to own more bonds. These "real" and "alternative" assets also provide viable hedges against rising inflation expectations over the coming months.

Ultimately, we agree with the U.S. Federal Reserve's assertion that the inflationary pressures driving rising longer-term interest rates will be "transitory" versus "structural" due to temporary supply channel constraints and persistently high unemployment (60% of closed businesses do not expect to reopen[1]). As the global economic rebound progresses and the base effect associated with economic recoveries annualize, inflation expectations will begin to moderate and long-term interest rates should stabilize. This is why we continue to advocate owning high quality bonds. These assets provide stability to portfolios, especially during periods of heightened market uncertainty, and allow returns of riskier assets within client portfolios (i.e., stocks) to compound more efficiently over time.

U.S. Stocks Grind Higher

The Standard & Poor's 500 Index ("S&P 500"), which measures the performance of the 500 largest publicly traded companies in the U.S., rose 6.2% during first quarter 2021. The S&P 500 finished the quarter at an all-time high due to an improved outlook for the U.S. economy. The expanding rollout of vaccines and the steady decline in COVID-related deaths and hospitalizations enabled more and more states and localities to ease restrictions thereby allowing the U.S. economic recovery to gain steam. Shares of small and large companies in sectors most sensitive to changing economic conditions led U.S. stock gains during the quarter. The rotation into these "cyclical' sectors more than offset weakness in the handful of "stay at home" stocks (shares of primarily large capitalization technology companies that benefited from people sheltering in place and working from home) that drove stock returns most of last year. U.S. stock sentiment experienced a further boost from the recently approved $1.9 trillion American Rescue Plan Act and the Biden Administration's plan to push through a $2.3 trillion infrastructure spending package.

Within the S&P 500, energy (+30.9%), financials (+16.0%), and industrials (+11.4%) were the best sectors in the first quarter while utilities (+2.8%), technology (+2.0%), and consumer staples (+1.2%), were the sectors with the poorest results. During 1Q 2021, value stocks, or shares of companies that generally have slower growth prospects and higher dividend payouts, rose 10.8% while growth stocks, or shares of companies growing sales and profits faster than the broader market, increased 2.1%. The Russell 2500 Index, a measure of domestic small and mid-capitalization stocks (U.S. companies with a market capitalization lower than $10 billion) increased 10.9% in 1Q 2021.

Foreign Stocks Take a Breather

The MSCI EAFE Index ("Europe, Australia-Asia, and Far East"), which measures the U.S. dollar-denominated ("USD") return of medium-to-large company stocks in developed markets outside of the US and Canada, increased 3.5% during the first quarter, and developed international small-to-mid ("smid") cap stocks, as measured by the MSCI EAFE SMID Cap (U.S. dollar) Index, rose 3.6% during the same period.
After outperforming in 4Q 2020, international developed market stocks lagged their U.S. counterparts due to the slower pace of economic recoveries taking hold in these markets. The rebound in economic activity within many international developed market economies, especially in Europe, has been hampered by a third wave of COVID infections. Many European countries experienced difficulty containing resurging infections due to the public's resistance to a third national lockdown. Europe's ability to combat COVID has also been impacted by vaccine supply shortages and hesitancy over taking the Oxford-AstraZeneca's (adenovirus-delivered) vaccine given the nominally heightened risk of developing blood clots. The 3.7% rise in value of the U.S. dollar versus a basket of key U.S. trading partner currencies did help boost international developed market exports into the U.S. but it also served as a headwind to international developed stock valuations.

Emerging market stocks (countries with less than a $25,000 per capita income), as measured by the MSCI Emerging Markets USD Index, rose 2.3% (on a U.S. dollar-denominated basis) in 1Q 2021. Weakness in Chinese stocks, which account for 38% of the value of the MSCI Emerging Markets Index[2], weighed on emerging market stock results during the quarter. The decline in the MSCI China (U.S. dollar) Index of 0.4% during the first quarter was largely a byproduct of decelerating economic growth trends and profit taking after outperforming U.S. and other developed market stocks last year. The weakness in Chinese stocks can also be attributed to China's Securities Regulatory Commission warning that it may crackdown (via increased regulations) on "hot money flows." Regulators are concerned that strong capital inflows into China due to its strong economic recovery and relatively high interest rates could "endanger" the stability and "healthy development" of its markets. Stocks within the broader Asia Pacific, as measured by the MSCI AC Asia Pacific ex-Japan (U.S. dollar) Index, rose 2.7% during first quarter.

Real Assets

The S&P Real Asset Index rose 3.3% in first quarter 2021. The S&P Real Asset Index measures the results of securities tied to physical assets including those that can produce relatively stable income streams, such as real estate and infrastructure assets, and inflation-sensitive real assets (e.g., hard commodities, natural resources, and inflation-linked bonds). During the first three months of 2021, real asset valuations were supported by rising inflation expectations associated with an improving global economic outlook. Within the U.S., another round of stimulus checks, the broader rollout of COVID vaccines, and improving employment trends boosted consumer confidence, further fueling expectations of a broad-based, albeit temporary, rise in prices.

The Alerian US Midstream Energy Index, which measures the results of U.S. companies that gather, process, transport, and store oil and gas, increased 21.6% during the first quarter. Value investors continued to be attracted to midstream energy companies (transporters of energy that do not drill for or refine energy) given their deeply discounted valuations, resilient earnings, and stable cash flows. The midstream energy sector also continued to rally on a favorable macroeconomic outlook and rising oil prices.

Alternatives

The Wilshire Liquid Alternatives Index, which measures the returns of investment assets/strategies that have very low correlation to traditional stocks and bonds (i.e., "alternatives"), rose 2.2% in first quarter 2021. Alternative assets provided stability during the quarter given their bond-like risk characteristics. Their low relationship to rising interest rates provided a viable option to owning more bonds to lower portfolio volatility while reducing credit and interest rate risk.

U.S. Fixed Income (U.S. Bonds)

The Bloomberg Barclays US Aggregate Bond Index ("Barclays Agg"), a measure of high-quality U.S. bonds of all types (i.e., "core bonds"), declined 3.4% in 1Q 2021. Investment grade corporate bonds, as measured by the Bank of America Merrill Lynch U.S. Corporate Bond Index nominally underperformed U.S. Treasury bonds dropping 4.5% during the quarter versus a 4.3% decline for the Bloomberg Barclays Aggregate Treasury Index. Investment grade bond valuations were under pressure due to the rise in longer term interest rates during the quarter. The yield (interest rate) on the 10-year Treasury bond, a widely tracked measure of long-term interest rates, rose from 0.93% on 12/31/20 to 1.74% on 03/31/21. The 81 basis point (81/100 of one percent or 0.81%) rise in long-term rates was driven by an improved growth outlook for the U.S. economy (long-term rates typically rise in anticipation that the U.S. Federal Reserve will need to increase its short-term policy rate in the future to slow economic growth and contain inflationary pressures). While an 81 basis point rise in interest rates over a 3-month period would normally infer a substantial rise in inflation expectations, it is important to note that the 10-year Treasury yield was trading near an all-time low at the beginning of the quarter and the prevailing rate is still substantially below its historical average yield of 5.75%[3].

The S&P National Municipal Bond Index, which is designed to measure the returns of the investment grade, tax-exempt bond market, declined 0.4% in 1Q 2021. While nominally down for the quarter, muni bonds outperformed taxable investment grade bonds given the fiscal boost the American Rescue Plan Act will provide to state and local municipalities. Muni bond valuations were also supported by the improved outlook for rising tax revenues as the U.S. economy continues to reopen.

International Fixed Income (Foreign Bonds)

Outside of the U.S., the Bloomberg Barclays International Aggregate Bond USD ("U.S. Dollar") Index, a measure of international developed markets investment grade bonds of all types, declined (in US dollar terms) 5.3% in 1Q 2021. During the quarter, the S&P International Government Bond Index dropped 6.5% while the S&P International Corporate Bond Index fell 4.6%. International developed market investment grade bond prices were negatively impacted by rising rates during the quarter. Like in the U.S., solid economic data trends within multiple developed market economies catalyzed inflation expectations causing long-term bond yields to rise. International developed market bond prices were also negatively impacted by worsening pandemic trends within international developed markets and slower vaccine rollouts.

The Bloomberg Barclays Emerging Markets Aggregate Bond Index, which measures the results of U.S. dollar-denominated debt of emerging market government and corporate issuers, declined 3.5% in first quarter 2021. While emerging market bonds outperformed international developed bonds, they were still not immune to rising long-term bond yields (in response to improving economic growth trends) and increased concerns over a resurgence in COVID cases in a number of key emerging market countries.

Staying the Course With a Diversified Portfolio of Stocks and Bonds

The U.S. economic recovery is in full swing and it is a matter of when, not if, most foreign economies follow suit. The rebound in economic growth will continue to drive stock prices while bond returns will remain tenuous in the face of rising inflation expectations. Ultimately, perceived inflationary pressures will moderate, and bond yields will stabilize. Owning a diversified mix of stocks and predominately high quality bonds will allow clients to capitalize on the expected rise in stock prices while reducing overall risk during tumultuous market environments.

We Want to Help You Attain Your Financial and Personal Goals!

The general information in this report is not intended to reflect our specific recommendations for any client portfolio. Please contact us with any questions to discuss your personal goals and your investment portfolio.

We invite you to visit our new website at www.ginsburgadvisors.com. Here you will learn more about our services, client value proposition, and our team. The site also has a useful "Resources" section where you can access our previous market commentaries, watch informative videos, download our latest staff contact list, and access useful financial calculators and web links. Please be sure to check our website periodically, as we will be updating the functionality of the site to include a client portal and other useful applications.

We welcome the opportunity to discuss your goals and the most appropriate strategy to attain them. We are also honored to speak to any of your friends, associates, or relatives should they have an interest in our financial planning or investment management services.

Please stay healthy and safe!

References:
[1] (09/16/20). Sundaram, A. “Yelp data shows 60% of business closures due to the coronavirus pandemic are now permanent”. www.cnbc.com
[2] (03/31/21). MSCI Emerging Markets Index (USD) Factsheet as of 03/31/21. www.msci.com
[3] (04/08/21). FRED Economic Data. Historical average for the period 01/02/62 to 04/08/21. Fred.stlouisfed.org.

Index descriptions:

-Alerian Midstream Energy Index. The capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a price-return basis (AMNA) and on a total-return basis (AMNAX).

-Bank of America Merrill Lynch U.S. Corporate Bond Index- BofA Merrill Lynch US Corporate Index – ETF Tracker. The Index is an unmanaged index comprised of U.S. dollar denominated investment grade corporate debt securities publicly issued in the U.S. domestic market with at least one-year remaining term to final maturity.

-Bloomberg Barclays Emerging Markets Aggregate Bond Index- The emerging markets bond index (EMBI) is a benchmark index for measuring the total return performance of international government and corporate bonds issued by emerging market countries that meet specific liquidity and structural requirements. Despite their increased riskiness relative to developed markets, emerging market bonds offer several potential benefits such as portfolio diversity as their returns are not closely correlated to traditional asset classes.

-Bloomberg Barclays International Aggregate Bond USD ("U.S. Dollar") Index- The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

-Bloomberg Barclays US Aggregate Bond Index, or the Agg, is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States.

-Credit Suisse Liquid Alternatives Index- The Credit Suisse Liquid Alternative Beta Index (CSLAB), which aims to reflect the performance of the global hedge fund industry, finished up 0.58% in August. The Event Driven strategy was the strongest performer for the month, and finished up 1.39% in August, and up 7.87% year-to-date

-MSCI China (U.S. dollar) Index- The MSCI China Index captures large and mid-cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g., ADRs). With 711 constituents, the index covers about 85% of this China equity universe.

-MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. & Canada.

-MSCI EAFE SMID Cap Index captures mid and small cap representation across Developed Markets countries around the world, excluding the US and Canada. With 2,865 constituents, the index covers approximately 28% of the free float-adjusted market capitalization in each country*

-MSCI Emerging Markets Index stands for Morgan Stanley Capital International (MSCI), and is an index used to measure equity market performance in global emerging markets.

-Russell 2500 Index is a broad index, featuring 2,500 stocks that cover the small- and mid-cap market capitalizations.

-S&P (Standard & Poor's) 500. A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the US stock market. It measures the movement of the largest issues. Standard and Poor's chooses the member companies for the 500 based on market size, liquidity and industry group representation. Included are the stocks of industrial, financial, utility, and transportation companies. Since mid-1989, this composition has been more flexible and the number of issues in each sector has varied.

-S&P International Corporate Bond Index- S&P International Corporate Bond Index is an investable index of non-U.S. Dollar corporate bonds issued by non-U.S. investment grade issuers. The index seeks to measure the performance of corporate bonds issued in the non-U.S. Dollar G10 currencies

-S&P National AMT-Free Municipal Bond Index is a broad, comprehensive, market value-weighted index designed to measure the performance of the investment-grade tax-exempt U.S. municipal bond market. Bonds issued by U.S. territories, including Puerto Rico, are excluded from this index.

-S&P Real Assets Index is the first index of its kind designed to measure global property, infrastructure, commodities, and inflation-linked bonds using liquid and investable component indices that track public equities, fixed income, and futures.