MONTHLY MARKET UPDATE

May 2021

Prevailing market dynamics in May included generally encouraging Covid trends, persistent fiscal and monetary stimulus, and robust global economic 'reopening' data. The great inflation debate intensified during May with rising commodity prices, big upside surprises in headline CPI, and persistent supply chain issues driving the narrative. Financial markets and the Fed remained sanguine despite the near-term inflation dynamics, but policy makers began to condition markets for the eventual tapering of QE programs and wind downs of emergency Covid related measures. May also delivered an eye-popping Covid recovery earnings season with annual revenue and earnings growth over 10% and 50% respectively.

U.S. equity markets briefly notched a new record high in early May but finished up only 0.4% for the month. Reopening momentum benefited the cyclical economic sectors (energy, materials, industrials, financials) while the technology complex and rate sensitive utilities lagged. Developed international equity markets finished up 3.3% led by Europe (+4.2%) and South America (+8%) and emerging markets returned 2.3% despite little contribution from Chinese markets.

Interest rates managed to fall slightly in May despite what seems to be a fairly robust global economic and earnings recovery and signs of inflation pressures building. Commodities and the USD continued their respective trends in place since the end of the first quarter with commodities gaining 2.7% and the USD losing 1.4% on the month.

Market Anecdotes

- First quarter earnings season came to an unofficial end in May with blended revenue of 10.7% and earnings of 51.9%. Unfortunately, those numbers were greeted with a yawn from the markets—despite EPS and revenue beat rates of 75% and a net 16% of all reporting companies raising guidance, the average earnings day performance was -0.45%.
- Financial market reactions to the highly anticipated move higher in inflation was informative with volatility pronounced in longer duration growth stocks, a relatively muted reaction in U.S. treasury markets, and commodities (oil, gold, metals) tracking higher across the board.
- Technicals for the S&P 500-tracking SPY ETF remain bullish, with the index's multi-month uptrend holding nicely the last time support at the 50-DMA was tested in mid-May.
- A number of Fed speaking engagements sought to reassure markets the FOMC is not blinking in the face of the higher 'transitory' inflation data. However, at least five Fed officials have publicly commented on the likelihood of tapering conversations at the upcoming Fed meetings.
- With the BoC and BoE having announced plans to taper, timing of other major central banks looms. The Fed timing hinges on both inflation expectations and labor market improvements.
- Interest rates, after a surge higher in the first quarter, managed to retrace slightly in May with nominal and real 10yr rates falling from 1.65% to 1.58% and -0.76% to -0.84% respectively.
- POTUS unveiled a $6t fiscal 2022 budget package in May bolstered by $1.8t in deficit spending and tax increases to pay for the increase in spending.
- Negotiations continued on the $1.7t Jobs Act ("infrastructure") with both sides working on bipartisan talks and hopes of avoiding budget reconciliation to get the package through.
- Corporate taxes are likely to rise as part of the Jobs Act later this year which, under current proposal, represent an approximate 8% hit to forward earnings but tax credits and compromise will likely water that down to 5%.
- The American Families Plan proposed increase to the capital gains tax rate is more significant than the increase in the top marginal bracket. Tax motivated selling would be very likely, but BCA points out that a structural increase in the equity risk premium is not so clear.

- Bianco Research highlighted BEA and Bloomberg data illustrating the history of U.S. government transfer/assistance payments averaging 12%-15% for decades leading up to the GFC when assistance spiked to 18%. This figure dropped to 16.8% in February 2020, surged to 33.5% in March 2021, and currently sits at 22%.

- Bianco Research visited the active/passive debate by illustrating ICI reported asset and fee trends. Active equity mutual funds charge 0.71%, equity index ETFs charge 0.18%, and equity index mutual funds charge 0.06%. Passive mutual fund and ETF products now account for 40% of all fund assets and ETFs accounted for 20% of all trading volume in 2020.

- PE funds last year raised $660 billion (compared to only $185 billion in 2010) and have already raised $345 billion so far in 2021. Dry powder (funds raised but not yet invested) now exceeds $2.2 trillion.

- Bitcoin again proved susceptible to public narrative and speculation. Comments from Elon Musk, China, and the U.S. government (IRS) sent a surge of anxiety into the crypto markets.

- Per Case-Shiller, U.S. home prices are rising at their fastest 8-month clip on record with inventories low and new supply creation still depressed. That said, we expect the overall housing market and home prices to remain sensitive to interest rates and the economy.

- Commodity prices moved higher again in May due to the global growth recovery, supply chain disruptions, and inflationary concerns, resulting in a YTD return of 20.6%, the best 5-month total return for commodities since the inception of the data series in 1973.

Economic Release Highlights

- The May jobs report registered 559,000 jobs vs expectations for 650,000 but the unemployment rate fell .1% to 5.8%.

- Record high job openings illustrated by the April JOLTS report (9.286mm), falling labor market participation (61.6%), and increasing average hourly earnings (MoM +0.5% / YoY +2.0%) are raising questions about work incentives and concerns that employers are being forced to raise wages to overcome labor shortage issues.

- The May CPI report left inflation very elevated with headline and core MoM readings of 0.6% and 0.7% respectively and YoY readings of 5% and 3.8%.

- Monthly and annual headline PCE Price index increased 0.6% and 3.6% while core PCE readings came in at 0.7% and 3.1% respectively. The PIO report showed MoM personal income contracting 13.1% and personal consumption expenditures increasing 0.5%.

- April Retail Sales report fell short of expectations coming in flat MoM versus 1% consensus after a 9.8% surge in March.

- The U.S. April manufacturing PMI improved to 61.5 while services improved to a lofty 70.1. U.S. composite improved from 63.5 to 68.1, a new record high.

- Eurozone April manufacturing PMI hit 62.8 with record growth of backlogs while services activity rose at the fastest pace since January 2018 to 55.1.

- The May ISM Manufacturing Index came in above expectations at 61.2 v 60.9. The JPM Global Manufacturing PMI also improved marginally in May to 56.0. The May ISM Services moved higher over the last two months to 64.0, above consensus estimate of 63.1.

- New (863k v 955k) and Pending (-4.4% v +0.4%) Home Sales both fell short of expectations after a surge in March. The Case-Shiller Home Price Index showed a 13.3% YoY (1.5% MoM) jump in home prices, well beyond the 11.8% consensus.

- April Housing Starts (1.569M v 1.705M) and Permits (1.760M v 1.755M) were slightly mixed after a strong beat in March.

Positioning

A continuation of improving Covid trends globally alongside extraordinary fiscal spending and steadfast monetary accommodation lead us to believe the broad-based strength in the stock market will persist, albeit with more susceptibility to pockets and periods of volatility given what is currently priced in. While we remain constructive on growth stocks over the intermediate and long term, we feel the rally in cyclicals and value-oriented areas in place since last September will resume (after a pause in April) so long as economic growth and interest rates remain biased toward the upside. We are favoring developed market international equities relative to domestic equities given our downward biased view of the USD and likelihood of improving Covid trends in Europe becoming more pronounced as we move toward the middle and latter half of 2021. We remain neutral on credit risk in the bond market and are maintaining a short duration bias with a reminder to clients that duration remains one of the few and reliable hedges to equity market volatility. We do not feel the U.S. tax policy proposals are a significant concern at this early stage while the sizable government debt and deficits are reinforcing a weak dollar and sub-trend growth view over the longer term.

Equity	Level	1 Mo	3 Mo	YTD	1 Yr	3 Yr
Dow Jones	34529	2.37	12.18	13.76	38.80	14.32
NASDAQ	13749	(2.05)	4.41	6.98	47.85	23.94
S&P 500	4204	0.66	10.72	12.62	41.02	17.79
Russell 1000 Growth		(1.83)	7.14	6.32	41.29	22.94
Russell 1000 Value		2.39	12.69	18.41	44.33	12.65
Russell 2000		(1.43)	3.34	15.30	63.81	13.23
Russell 3000		0.16	9.42	12.34	44.60	17.86
MSCI EAFE		3.36	9.10	10.39	39.02	8.73
MSCI Emg Mkts		2.34	3.35	7.36	51.51	10.05
Fixed Income	**Δ Yield**	**1 Mo**	**3 Mo**	**YTD**	**1 Yr**	**3 Yr**
US Aggregate	2.00	(0.06)	(0.15)	(0.14)	(0.50)	(0.44)
High Yield	4.78	(0.11)	(0.31)	(0.33)	(0.96)	(0.83)
Municipal	1.87	(0.02)	(0.07)	(0.04)	(0.19)	(0.33)

Commodities	5/31/21	3/31/21	12/31/20	9/30/20
Oil (WTI)	69.21	59.19	48.35	40.05
Gold	1900.00	1691.10	1887.60	1886.90

Currencies	5/31/21	3/31/21	12/31/20	9/30/20
USD/Euro ($/€)	1.22	1.17	1.23	1.17
USD/GBP ($/£)	1.42	1.38	1.37	1.29
Yen/USD (¥/$)	109.83	110.61	103.19	105.58

Treasury Rates	5/31/21	3/31/21	12/31/20	9/30/20
3 Month	0.01	0.03	0.09	0.10
2 Year	0.14	0.16	0.13	0.13
5 Year	0.79	0.92	0.36	0.28
10 Year	1.58	1.74	0.93	0.69
30 Year	2.26	2.41	1.65	1.46

Style Returns

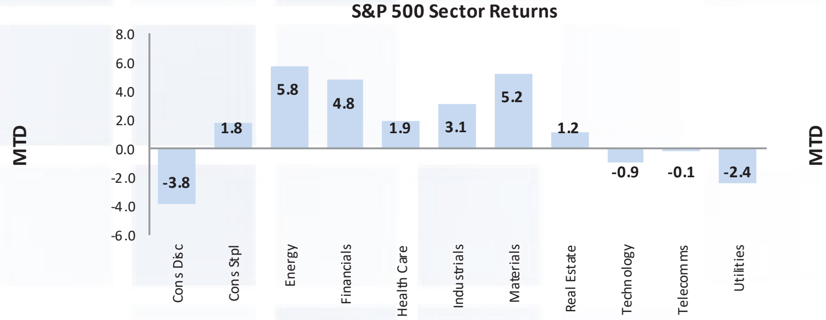
MTD

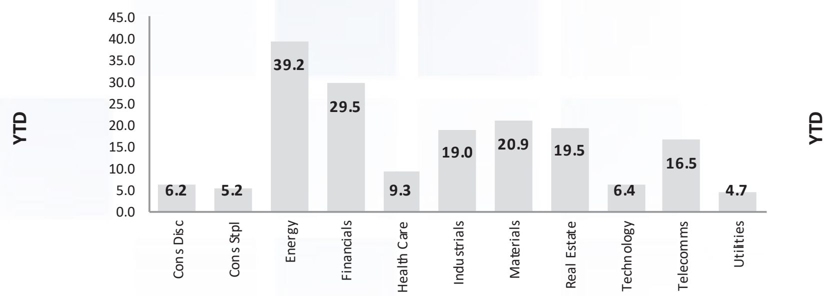
	V	B	G
L	2.33	0.47	-1.38
M	1.97	0.80	-1.53
S	3.11	0.21	-2.86

YTD

	V	B	G
L	18.41	12.14	6.32
M	20.86	14.56	3.42
S	27.47	15.30	4.10

S&P 500 Sector Returns





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