STIFEL

Market Thoughts – Q3 2021

Confidence levels were up as we went into the new year armed with a vaccine and tired of isolation. Businesses were more than ready to reopen to satisfy our desires. It seemed the economy was ready to take off. Equity values sniffed this all out in our 2020 rebound rally, but it took some time as the COVID-19 pandemic persisted and mandates were lifted slowly.

Earnings are coming in for the second quarter, and out of the 296 companies that have reported as of August 3, 87.5% have beaten earnings expectations while 10.5% have missed – approximately 60% better than the second quarter of 2020.[1] This is to be expected, as the economy was essentially shut down for the better part of the past year. The most important component of earnings season this quarter will be the outlook and what is said on the post-report call. In most cases, I expect that to be relatively good.

In regard to the recent news of the delta variant, I think we are much more prepared this time, and it's likely not going to stall the recovery in a significant way. However, I am concerned with the Federal Reserve. The Fed will have to unwind all this stimulus at some point, as well as move rates higher. This unwinding – often referred to in the media as "the taper" – tends to have an effect on markets, since higher rates act to slow down an economy. If history is any guide, I would expect the Fed to stay accommodative for too long; the delta variant may keep them on the sidelines a little longer than they would like, which may work in our favor. The result would likely be good for earnings and equity prices, possibly carrying the rally into 2022. We will see.

I have always stayed with quality and big, knowable themes in my portfolio recommendations. We are still reaping some of the benefits of the cloud and rollout of 5G. Lately, airports have seemed as packed as ever, even with business travel well below pre-pandemic levels. People are ready to spend the stimulus money pumped into the economy for relief and recovery. It's logical – if you lock people down, give them extra money to spend that can't as easily be spent, and then set them loose, they will be determined to spend. Consumers are 70% of gross domestic product (GDP), so it's no wonder we've seen a boost in that number. In the second quarter, GDP increased at an annual rate of 6.5%. Other themes in play are pharma and the advancement in medical technology, artificial intelligence, the growth of sports betting, and cybersecurity. This is not a complete list, but it gives you a good idea of what I'm thinking.

So you might ask what worries me. What are the risks? The same answer goes for each question: inflation and the Fed. Certain components of this inflation are specific to restarting our economy. With a just-in-time inventory supply chain, hiccups are expected and understandable. However, I can't believe price increases are transitory. The consumer price index is up 5.4% versus a year ago and up at a 3.5% annualized rate since February 2020, pre-COVID. We added so much stimulus, and that much money – essentially with the same output – is destined to push prices higher in many cases. The M2 measure of money supply has soared 32% since COVID began, something that did not happen in the 2008-2009 financial crisis.[3]

An inflation hedge with commodities has worked well so far this year, and I will continue to keep that in place where appropriate. Hang on a little tighter, as I expect the market volatility to increase as we sort this out.

The longer I am in this industry, the more I realize that it's often more an art than a science. I'll keep my beret on and my head down going into the fall.

As always, I appreciate your business and confidence in me and Stifel.

Sincerely,
Larry D. Watts, CFP®, CPM®
Senior Vice President/Investments
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Sources:
[1] Confluence Investment Management, Daily Comment, 8/3/2021
[2] Bureau of Economic Analysis, U.S. Department of Commerce
[3] Brian Wesbury, Monday Morning Outlook, 7/26/2021

The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains. Past performance is no guarantee of future results.