Marietta Wealth

Second Quarter 2021 Review & Outlook

"Although it's easy to forget sometimes, a share of stock is not a lottery ticket. It's part ownership of a business." **– Peter Lynch**

Review

The stock market continued its upward march during the second quarter, continuing its strong performance to start the year. Investors have enjoyed multiple all-time highs during the first six months of the year. For the second quarter, the S&P 500 Index increased 8.2%, which put it up 14.4% on the year, well ahead of a historical average year in the market. The Dow Jones Industrial Average (DJIA) and NASDAQ Composite also had solid quarters, up 4.6% and 9.7%, respectively. This put the DJIA up 12.7% for the first half of the year and the NASDAQ up 12.9%.

With the 2.2% gain in the S&P 500 in the month of June, the index has now been positive for five straight months. In addition, the positive result for the S&P 500 during the second quarter was the fifth consecutive quarterly gain. Also, its first half gain of 14.4% was the second best since 1998. The quarterly growth streak is especially noteworthy, with the S&P 500 gaining more than 5% in each of the past five quarters for only the second time since 1945. According to Barron's, "Since 1979, the S&P 500 has gained 10% or more 14 times during the first half of the year, and the index has gone on to average a 6.3% gain over the second half of the year. What's more, the index finished the second half of the year higher in 11 of those instances, or 79% of the time."

The recent drop in U.S. Treasury bond yields reveals investor concern about how strong the economy will continue to be over the next several years despite the recent increase in economic growth rates. The yield on the 10-year U.S. Treasury Note finished the second quarter at 1.44%, up from 0.91% at the end of 2020, but down significantly from the 1.74% level at the end of the first quarter. The Federal Reserve has kept short term interest rates near zero since March of last year. As a result, the 10-year Treasury bond yield is substantially below the current rate of inflation. This is referred to as a negative real yield, which has happened only one other time in the past 40 years according to The Wall Street Journal.

Home prices have continued to increase this year. The S&P CoreLogic Case-Shiller National Home Price Index, which measures average home prices in major metropolitan areas across the nation, rose 14.6% for the twelve-month period ended in April. The month of April marked the highest annual rate of price growth since the index began in 1987, driven by low mortgage interest rates and an ongoing shortage of homes for sale.

On the business front, the pandemic forced many business owners to aggressively invest in technology to enhance productivity. As a result, software investment rose 10.5%, adjusted for inflation, in the first quarter from a year earlier as businesses invested in more cloud computing, collaboration software, and electronic commerce. Many companies such as General Mills, Campbell Soup, J.M. Smucker, and Chipotle Mexican Grill are now reporting increasing prices to help cover their increased expenses for transportation, commodity, and labor costs.

U.S. consumer prices continued to climb in May, increasing by 5% from a year ago to reach the highest annual inflation rate since August 2008. Prices for used cars and trucks increased 7.3% from the previous month, driving one-third of the rise in the overall inflation index. Prices for furniture, airline fares, and apparel also increased sharply in May. One reason why the annual inflation results are higher than normal is due to the year over year comparison from 2020. Prices a year ago were depressed due to Covid restrictions causing a decrease in demand. Economists expect this effect to decline in the fall after we get past the results for May and June.

Outlook

The U.S. gross domestic product grew at an annualized rate of 6.4% in the first quarter of this year. Economic growth has been boosted by widespread vaccinations, businesses reopening, trillions of dollars in government relief programs, and spending from consumers. Many economists are forecasting the economy will have grown at an annualized rate of 8.1% for the second quarter, setting up this year to post the highest growth rate since the early 1980's.

We are now seeing a surge in new business startups. According to the Wall Street Journal, filings for new businesses exceeded 830,000 through early May, which was a 21% increase over the same period in 2006, the next highest year. However, it continues to be a challenge for business owners to find new workers in many industries, notably leisure and hospitality. But despite the worker shortage, the latest job figures showed 850,000 jobs were added in June, putting the unemployment rate at 5.9%. The labor market is approximately seven million jobs short of where it stood before the pandemic. Job growth should continue to be strong as more workers become comfortable returning to work. Additionally, the enhanced unemployment benefits that have ended in many states, or are due to expire in early September, plus the lure of increasing salaries, should help bolster the labor market.

Inflation is one of the top concerns of market participants. The shortages of many products such as lumber, washing machines, and computer chips used in automobiles, along with increasing labor expenses, have caused prices to dramatically increase. The strong rebound in the economy leads to the question of whether current inflation trends will be transitory or longer lasting. Price increases have been moderate over the past 30 years, and the Federal Reserve continues to reiterate that inflation is just a temporary issue. However, many on Wall Street are dubious of that viewpoint because of the enormous increase in the money supply since the pandemic began, along with increasing wage pressures on employers and dramatically higher energy and commodity prices. We know prices have been dramatically impacted by the disruption in supply chains. It is difficult to determine if these increases will be temporary. If the bond market and Federal Reserve are correct, the inflation surge should be temporary.

Corporate earnings have been strong thus far this year, with companies beginning to report second quarter results this month. According to Refinitiv, many analysts are projecting earnings per share for the companies in the S&P 500 will increase by 64% versus a year earlier. Granted, the comparison period in 2020 was the low of the pandemic, but the projection is still 8% above the level for the second quarter of 2019. Strong corporate earnings will be a tailwind to keep the bullish view of investors intact. The Wall Street Journal recently reported U.S. households increased their stock exposure to 41% of their total financial assets in April, which is the highest level on record dating back to 1952.

Despite the current bullish tone in the market, we would remind clients that pullbacks in the market occur on a regular basis. Sam Stovall, chief investment strategist at CFRA, notes that “as of June 25, the S&P 500 has gone 275 calendar days since its last decline of 5% or more, which took place before the election in September when the 500-stock index lost nearly 10%.” CFRA goes on to note that “since 1945, there have been 60 pullbacks (decline of 5%-9.9%), 23 corrections (declines of 10%-19.9%) and 13 bear markets (declines of 20% or more). The average timespan between these declines is 178 calendar days, making the current stretch the 19th longest since World War II.” Given the recent strong market performance, we would not be surprised to see an increase in market volatility in the near future.

Here are several developments that will help determine the path of the economy and the stock market for the rest of this year and in 2022:

(1) How long does the demand for goods and services outstrip supply, thereby keeping inflation higher than normal?
(2) What might happen in the economy to cause a slowdown to a more normal pace of growth?
(3) Will corporate earnings reports come through as strong as currently anticipated?
(4) Will the large amount of cash created since the pandemic began continue to be invested in stocks and other assets?
(5) How will the Federal Reserve signal its plans for a phase out of the crisis-era stimulative policies that it adopted last year?

Company Information

On May 17th this year, Sophia Padgett joined Marietta Wealth as a summer intern. Sophia is a senior at Kennesaw State University pursuing a degree in Finance. Sophia has been on both the President’s and Dean’s Lists for multiple semesters at KSU. She is scheduled to graduate in December. Should you stop in for a meeting, or happen to contact us by phone, please join us in welcoming Sophia!

A timely financial planning issue we have come across due to the substantial increases in the value of many homes is the need to review the replacement cost portion of your homeowner’s insurance policy. For the best protection, experts recommend insuring your home for at least 100 percent of its estimated replacement cost.

We are regularly posting investment and financial planning related articles to the “News” portion of our website that we trust you will find relevant and interesting. Please visit www.mariettawealth.com at your convenience. We also welcome you to follow us on our company Facebook and LinkedIn pages. If you would like to monitor your accounts online, please contact Pam Larkin at plarkin@mariettawealth.com to have your investment portal established.

Please let us know if anything has changed in your financial situation, and please stay safe and healthy.

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