Beacon Trust
INNOVATING WEALTH STRATEGY

Market Outlook 2Q 2021 Review **July 6, 2021**

Second Quarter Summary

Quite simply, U.S. stocks have been on a roll. The S&P 500 increased for the fifth consecutive month *and* for the fifth consecutive quarter, closing the quarter at an all-time high. It also achieved a trifecta of 5's with each quarterly gain at least 5%. Its first-half gain of 14.4% was the second-best since 1998, surpassed only by the index's 2019 performance. As usual, a combination of events resulted in the performance surge. Specifically, there has been a strong economic recovery, good progress on the COVID-19 vaccination front in the U.S., robust earnings, a forthcoming sizeable infrastructure package, and an accommodative Federal Reserve. If those statistics aren't enough fireworks for you, a new space race has been launched with Richard Branson's Virgin Galactic and Jeff Bezos' Blue Origin set to officially kick off the space tourism industry this month. It's a story literally out of this world that may *eventually* become as routine as getting on a Boeing or Airbus jet plane.

Growth stocks surged ahead of Value stocks in the second quarter (+11.9% vs. +5.2%) and narrowed the gap on a year to date basis (+13.0% vs. +17.1%). Small Cap stocks continued their solid performance as well, rising 4.3% for the quarter and 17.5% over the first half of the year. The initial public offering (IPO) and special purpose acquisition company (SPAC) machines remain active, despite cooling a bit near the end of the quarter. High profile companies that are now publicly traded include Coursera, Coinbase, 23andMe, Oatly, The Honest Company, Topps, Universal Music Group, and DiDi Global, often called "the UBER of China." Trading app, Robinhood, is slated to go public later this month to feverish demand among its client base. It is not only stocks that are red hot. Real estate prices increased 14.6% over the past year according to the Case-Shiller Home Price Index, its highest gain in 30 years of Case-Shiller data. Not to be outdone, oil prices continued their ascent, rising to a 6 year high of $74 a barrel, up roughly 55% year to date.

The Fed took a step closer to changing its monetary policy for the first time since the early days of the COVID-19 pandemic by deciding to retire the phrase, "We are not even thinking about thinking about raising rates." Of course, the parlor game now begins with speculation as to when they will actually implement a change in policy. In our view, they will signal by the end of the year a taper to their massive bond buying program. According to Fed "dot plots," which enable voting members to signal their views on future interest rates, short-term rates will not increase until 2023. However, if inflation numbers continue to be elevated – the most recent reading was at a 5% annualized rate - the Fed's hand may be forced to raise rates in 2022. Currently, market participants don't seem too worried about long-term heightened inflation, as evidenced by the benchmark 10-Year U.S. Treasury rate of 1.35%.

Market Outlook

We believe a pause in the torrid price appreciation since the depths of the COVID-19 pandemic is likely, but we still favor stocks to bonds over the intermediate to long-term. The largest pullback year to date has been an anemic 4% - among the lowest on record. Although we don't foresee a near-term bear market, the average peak to trough drop intra-year has been about 14%, so we favor a diversified portfolio to ride out the inevitable bumps in the road. Other signs of near-term market froth include high yield bonds averaging a modest 4.5% due to significant price appreciation and the once problematic Greek sovereign 10-year bond yielding a miniscule 0.78%, a rate roughly half that of the U.S. 10-year Treasury Note.

We continue to expect the 10-Year to trade in the 1% - 2% range throughout the calendar year, with the likelihood of an upward drift in rates as inflation numbers continue to exceed long-term historical levels. As noted above, the Fed is likely to discuss, perhaps as soon as at its August Jackson Hole meeting, its plan to reduce its purchase of U.S. Treasuries and mortgage-backed securities. This taper announcement may result in the catalyst for an upward move in interest rates as well as a pullback in equity and real estate prices.

In addition to high inflation and Fed tapering, the primary risks to most asset classes are geopolitical in nature, including the unknown path of the COVID-19 pandemic. Current vaccinations appear to be effective against the highly contagious "Delta" variant, but the efficacy against future permutations of the virus remains unknown.

Cyberattacks continue to emanate from Russia with the global software firm, Kaseya, being the latest firm to be shaken down for $70 million. During the recent summit in Switzerland between President Biden and President Putin, the U.S. delegation issued a warning to Russia regarding continued cyberattacks. A significant U.S. response to the cyberattack threat may put the financial markets on edge. Tensions between the U.S. and China continue to remain at heightened levels. China remains a crucially important export market for giant U.S.-based multinational firms, including Apple, Starbucks, GM, Tesla, and McDonalds. China is also reinforcing its control over domestic firms, with Didi Global falling in excess of 20% after the government announced a regulatory probe of its business operations.

As we look out to 2022, the risk of higher taxes remains a concern. The details are still being hammered out in parallel to the infrastructure package making its way through Congress, but they are likely to include higher corporate and personal income taxes. We are delighted with the extremely strong performance over the first half of the year but think it is prudent to expect more tempered returns in the back half of the year despite the strongest economy in decades.

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