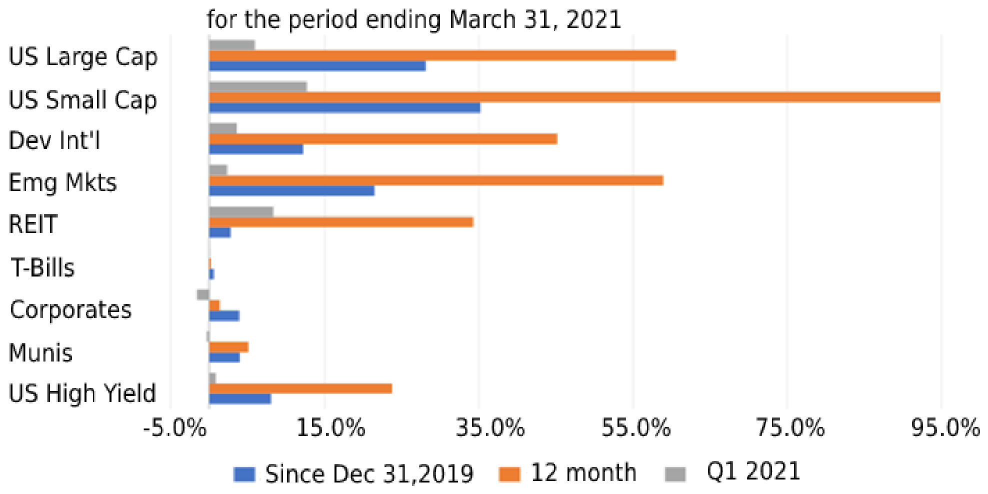
Economic Outlook: A Roaring Start to the 2020s

By Jane Swan, CFA and Roraj Pradhananga, MBA, CPA

Financial markets over the last 12 months have rebounded in an astounding way. The 12-month time scope obscures nearly all of the decline from the early weeks of the pandemic. For each asset class, we will look at the returns from the most recent quarter and the remarkable returns of the last 12 months. For perspective, we will also look at returns for the 5 quarters starting before the pandemic on December 31, 2019, and ending March 31, 2021. This shows us how much markets have grown from where we were before the first COVID 19 cases were discovered in the United States.

Large cap stocks were up approximately 5.9% in the first quarter of 2021, up 60.6% over the prior 12 months, and a still remarkable 28.1% since December 31, 2019. Small cap stocks were up 12.7% in the quarter, 94.8% in the prior 12 months, and 35.2% since the end of 2019. International markets had more constrained returns, but still higher than average. Developed international markets were up 3.6% in the quarter, 45.2% over the prior 12 months, and 12.2% since the end of 2019. Emerging markets suffered sharply in the early months of the pandemic and, like small caps, had a sharper recovery. They were up 2.3% in the quarter, 58.9% over the last 12 months, and 21.5% since the end of 2019. All sectors were positive in the quarter and wildly positive for the prior 12 months, with all but the energy sector higher than the end of 2019.

Index Returns



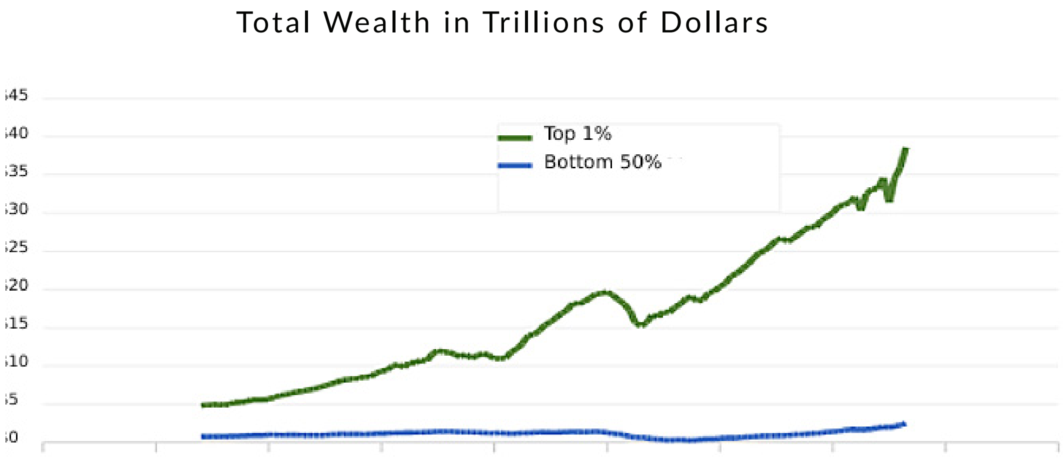
1

Fixed income markets quickly recovered from the initial volatility early in the pandemic. T-Bills, Corporate Bonds, and Municipal Bonds (munis) show positive 12 month returns. Up by 5.1%, munis outperformed corporates which were only up 1.4%. All are positive since pre-pandemic levels at the end of 2019 with munis returning 4% and corporates 3.9%. High yield (junk bonds) often behave more similarly to equity investments during periods of volatility. Among fixed income, they had the biggest decline in the early pandemic period but were buoyed by the two pandemic relief packages giving significant relief to businesses. High yield was up 0.8% in the quarter, 23.7% over the last 12 months, and 8% from the end of 2019.

2

The K-Shaped Recovery Continues

The boom in equity markets over the last 12 months serve as a reminder of the potential benefits of sticking to a long-term investment plan through market shocks, as well as a reminder of the disconnection between rewards to investors and the experiences of people across the globe. While the forecasted Q1 2021 US GDP growth implies that the economy has rebounded after being recessionary in 2020 from the ongoing pandemic, that recovery has not been uniformly experienced across all communities. Bloomberg economists measured that for those with annual



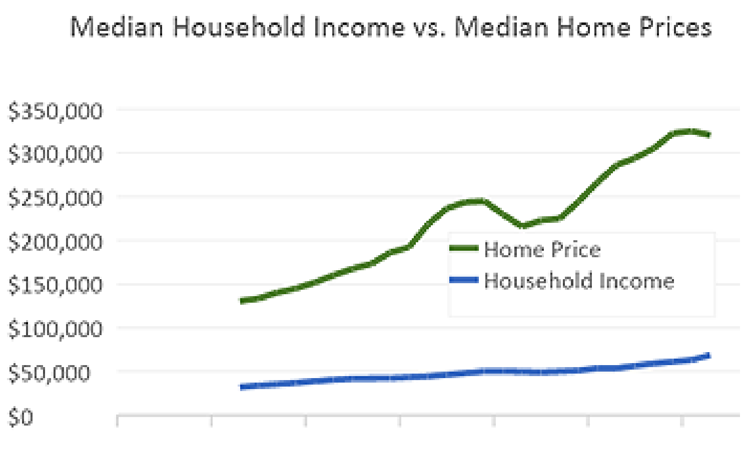
3

Compounding Impact of Inflation on Inequalities

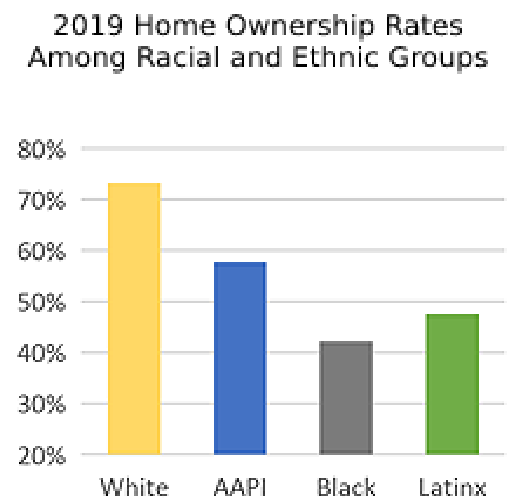
Recent federal spending to combat the devastating economic impact of the pandemic and proposed large spending efforts designed to rebuild America's infrastructure contribute to an increased possibility of higher inflation. In recent history, the Federal Reserve has intervened during periods of higher inflation, raising interest rates for the purpose of cooling the economy. However, the Federal Reserve has recently expressed reluctance to interfere if inflation increases in the near-term. Inflation is still at historically low levels unlike what was experienced in the 1970's.

It is notable that inflation has different impacts on different portions of the population. Recent pandemic-related inflation has been highest in two categories – food and fuel, that make a disproportionately large share of budgets for lower income families. This has compounded the K shaped recovery discussed in our two most recent newsletters. People with lower incomes have experienced greater impact of furloughs, permanent job loss, lower wealth creation and now higher inflation while yet to recover their incomes to pre-pandemic levels. While current inflationary trends hitting both fuel and food may be temporary as pandemic related supply and demand volatility settles, the steepening yield curve indicates increases in expectations for future inflation.

Many assets, including gold, homes, and often stocks, historically have maintained much of their value during periods of inflation. Stocks tend to react somewhat negatively to interest rate hikes, however the Fed's stated intention to refrain from intervening if we enter a higher inflationary period may further protect asset owners during inflation. This would leave much of the ill effects of increasing costs to be felt most heavily by those with few assets protected from inflation as prices for goods and services increase. This could exacerbate the problem of increasing inequality. incomes above $60,000, things have largely returned to normal. Those with incomes significantly lower continue to have incomes about 30% below pre-pandemic levels. They also found that 70% of wealth created in 2020 benefited the wealthiest 10% of Americans, while the bottom 50% of households received just 4% of that growth in wealth. This further compounds the wealth inequality trend of recent decades.



4



5

Homeownership, which has been a major source of wealth creation in the US, now seems further out of reach for the lower income half of the population—with increases in the median home price outpacing increases to median household income. In an inflationary period without corresponding increases to household income, daily expenses would even further impair home affordability for low-income renters.

Many impact investors are increasing their focus on this problem. Some impact investors have increased deposits with Community Development Financial Institutions (CDFIs) and other strategies aimed at decreasing impediments to lending access and addressing ongoing structural racism impacting the dream of homeownership for many populations. We are excited to be working with clients interested in using some of their wealth to address these inequities.

As in prior quarters, we take this opportunity to invite clients to review their spending expectations with their advisors. While we do not have a forecast for market declines, the last two years have demonstrated the benefit of planning for the unknown based on what we can know. They have also reminded us of the benefit to sticking with that plan through tumultuous times whenever possible. We also invite clients to reach out to us if they are interested in learning more about available impact investments that address racial and gender equity.

Sources

1 Source: Morningstar Quarterly Index Returns Report
2 Source: Morningstar Quarterly Index Returns Report
3 Board of Governors of the Federal Reserve System (US), Total Net Worth Held by the Top 1% (99th to 100th Wealth Percentiles) [WFRBLT01026], Total Net Worth Held by the Bottom 50% (1st to 50th Wealth Percentiles) [WFRBLB50107], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/WFRBLT01026, April 21, 2021.
4 U.S. Census Bureau and U.S. Department of Housing and Urban Development, Median Sales Price of Houses Sold for the United States [MSPUS],Real Median Household Income in the United States [MEHOINUSA672N], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/MSPUS, April 23, 2021.
5 Source: U.S. Census Bureau, Current Population Survey/Housing Vacancy Survey, March 10, 2020.