FROM THE DESK OF BOB CENTRELLA, CFA ***July 9, 2021***

I hope you all had a great 4th of July weekend and celebrated our independence unmasked, safe and with friends or loved ones. The fireworks were a fitting close to a great first half of the year for stocks. Speaking of fireworks, Italy plays England on Sunday for the Euro Cup and there should be plenty of them. *Forza Italia*!!

Although Covid remains a public health threat and probably always will, we are getting on with life and the V-shaped recovery is underway. There is huge pent-up demand that is driving consumer and business spending and as new cases decline activity rises rapidly. Yes, there are now questions arising about variants, but as more people get vaccinated the potential for anything close to what happened in 2020 is much less likely. Government stimulus seems to have sustained us through the worst of the shutdowns and now hopefully vaccines and people back to work can keep it going. Over the holiday we saw a huge number of people travelling, eating out and getting out.

The economic reopening and vaccine rollout was also behind another strong quarter for stocks and many asset classes. Earnings growth remained robust and we will start getting results in coming weeks. For the quarter the S&P 500 gained 8.36% while the Nasdaq 100 climbed 11.2%. Below is a look at Asset classes for Q2 and YTD.

Asset Class Performance June, Q2, and First Half - Total Return (%)

US Related

ETF	Description	June	Q2	First Half
SPY	S&P 500	2.25	8.36	15.25
DIA	Dow 30	-0.05	4.88	13.74
QQQ	Nasdaq 100	6.26	11.19	13.24
IJH	S&P Midcap 400	-1.12	3.53	17.55
IJR	S&P Smallcap 600	0.34	4.33	23.52
IWB	Russell 1000	2.44	8.40	14.91
IWM	Russell 2000	1.87	3.97	17.38
IWV	Russell 3000	2.37	8.10	15.06
IVW	S&P 500 Growth	5.62	11.84	14.27
IJK	Midcap 400 Growth	1.05	3.37	12.31
IJT	Smallcap 600 Growth	1.67	3.54	16.43
IVE	S&P 500 Value	-1.13	4.90	16.30
IJJ	Midcap 400 Value	-2.89	3.68	22.91
IJS	Smallcap 600 Value	-0.71	4.90	30.41
DVY	DJ Dividend	-2.86	3.05	23.29
RSP	S&P 500 Equalweight	0.02	6.70	19.06
FXB	British Pound	-2.53	0.29	0.99
FXE	Euro	-2.84	0.86	-3.43
FXY	Yen	-1.20	-0.50	-7.36
GBTC	Bitcoin Trust	-1.36	-40.43	-6.84
ETHE	Ethereum Trust	-11.27	25.04	44.32
XLY	Cons Disc	3.46	6.39	11.39
XLP	Cons Stap	-0.55	3.09	4.96
XLE	Energy	4.19	10.88	45.07
XLF	Financials	-3.05	8.17	25.50
XLV	Health Care	2.29	8.31	11.84
XLI	Industrials	-2.29	4.33	16.36
XLB	Materials	-5.27	4.90	14.67
XLK	Technology	6.88	11.38	14.01
XLC	Comm Services	2.95	10.63	20.41
XLU	Utilities	-2.22	-0.51	2.38

Global

ETF	Description	June	Q2	First Half
EWA	Australia	-1.49	6.26	9.99
EWZ	Brazil	5.78	23.05	11.04
EWC	Canada	-0.98	10.13	21.59
ASHR	China	-3.75	4.97	1.20
EWQ	France	-1.81	9.88	15.07
EWG	Germany	-1.65	5.23	10.76
EWH	Hong Kong	-3.57	1.95	9.98
PIN	India	0.57	4.97	11.39
EWI	Italy	-2.16	4.05	11.36
EWJ	Japan	-0.79	-0.71	0.70
EWW	Mexico	0.53	10.35	12.51
EWP	Spain	-6.23	5.24	6.61
RSX	Russia	3.02	12.28	20.00
EWU	UK	-1.59	6.20	13.53
EFA	EAFE	-1.08	5.38	9.59
EEM	Emerging Mkts	0.95	3.84	7.20
IOO	Global 100	2.34	8.50	13.84
BKF	BRIC	1.19	4.07	5.05
CWI	All World ex US	-0.53	5.56	10.37
DBC	Commodities	3.49	15.89	30.95
DBA	Agric. Commod.	0.22	9.98	15.43
USO	Oil	9.82	23.07	51.11
UNG	Nat. Gas	24.33	36.53	42.17
GLD	Gold	-7.15	3.54	-7.14
SLV	Silver	-6.49	6.70	-1.42
SHY	1-3 Yr Treasuries	-0.17	-0.05	-0.14
IEF	7-10 Yr Treasuries	1.02	2.47	-3.41
TLT	20+ Yr Treasuries	4.42	7.02	-7.87
AGG	Aggregate Bond	0.83	1.77	-1.66
BND	Total Bond Market	0.90	1.93	-1.78
TIP	T.I.P.S.	0.72	3.21	1.47

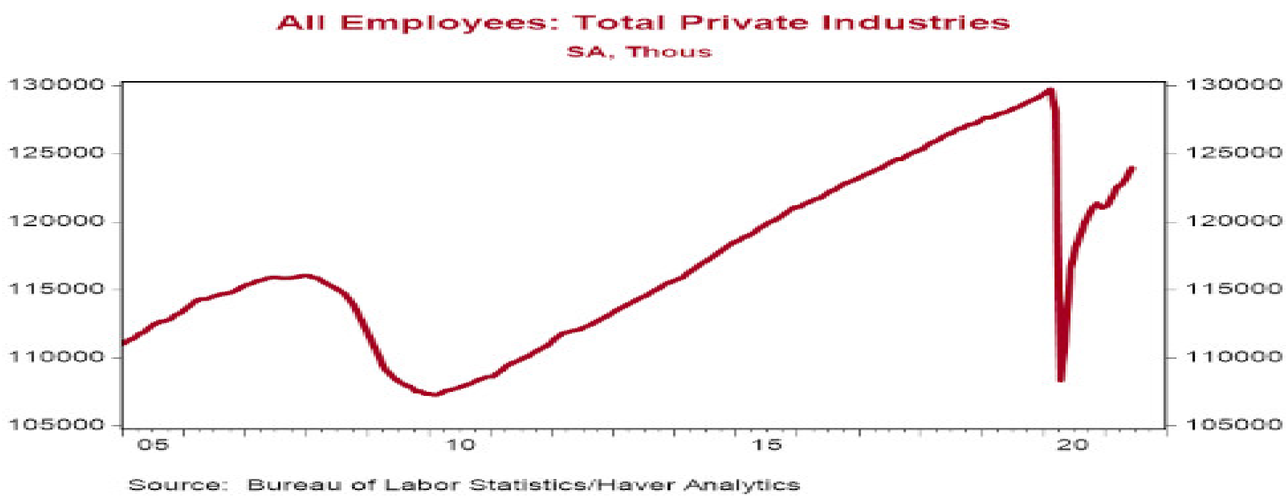
In Q2, growth stocks gained back on value, large-cap outperformed mid and small, and Bitcoin fell back to earth with a 40.4% decline. By sector, Energy +10.88% and Technology +11.38% (strange bedfellows) led the way while only Utilities (-.5%) declined. Cyclical stocks such as Industrials +4.3% and Materials +4.9% lagged but that was coming off a strong Q1. International stocks gained in the quarter as well with Brazil +23% snapping back while European countries climbed between 4% to 10%. Japan declined and China lagged while overall the world index ex-US rose 5.5%. Commodities jumped as inflation reared its head to a 23% rise in oil prices and a 36.5% pop in natural gas. Finally, Gold +3.5% and Silver +6.7% rose but are both still down YTD.

10 KEY TAKEAWAYS

I thought I'd do something a little different this quarter and make comments on some key takeaway points rather than go thru Equity, Fixed and Economic sections. I'll try to cover them all here.

1. <u>The economy is hot right now</u> and should remain so. US GDP rose 6.4% in Q1 and is expected to grow 7.9% in Q2 and 6.4% for the full year. For 2022, current estimates are for growth of 3.2% as things normalize. Housing, consumer spending, and manufacturing are booming but inflation is a wildcard.
2. <u>Bond rates remain stubbornly low</u> with the 10-yr UST now trading around 1.25%. There may be some technical reasons for the yield recently backing up including continued buying by the Fed and large financial institutions. Remember at the close of Q1 the 10-yr yield was 1.73% as inflation fears stoked a rise in rates. Well, those inflation fears are still there but many feel that inflation is transitory due to the V-shaped recovery. However, given current inflation and strong economic growth, it would make sense that yields should rise in the 2nd half. Personally, I admit to not being able to figure out yields as they just don't want to go up. But if I were you and have not refinanced my mortgage yet, now is a great time.
3. <u>Don't fight the Fed</u>. The Federal Reserve is still very accommodative, and money is easy. Although normalization is coming, it's not likely until late 2022 at the earliest. Fed watchers are trying to interpret any statements made by Fed governors but Chair Powell has been steadfast in support of maintaining easy money. Fed tapering is now being talked about, but any rate adjustments are not predicted for at least a year.
4. <u>Equity valuations for the market may be full</u> but companies can grow into valuations with strong earnings. There are individual stocks with attractive valuations. The V-shaped recovery is extending to company earnings and better than expected earnings should translate into better valuation but still allow equities to move higher. For Q2, the estimated EPS growth for the S&P 500 is 64%, up from 53% expected 3 months ago. Since analysts tend to underestimate, growth over 70% is possible as we lap the weakest quarter from a year ago. Although the forward PE seems high at 21.4x compared to the 10-year average of 16.1x and the 5-yr average of 18.1x, we are in the midst of a profit boom and recovery. For all of 2021, earnings growth is now expected to be 36% compared to just 24% last quarter. Stocks follow earnings so the increase in stocks this quarter followed upward revised earnings.
5. <u>TINA – There is no alternative – good or bad</u>? With rates so low, investors have little alternative than to invest in stocks. It is said that **<u>high valuations don't cause bear markets, recessions do</u>**. We are now in the beginning of a recovery and barring a return of Covid or some other unseen event, a recession is nowhere in sight. So, TINA is correct until bond yields rise substantially giving investors another alternative. Oh, and forget about Bitcoin. Right now, it is an alternative asset class at best and not big or stable enough to garner a big portion of investor funding. Bitcoin is now in a bear market but nobody is looking at it that way.

6. <u>Covid variants may be the biggest risk</u> to the recovery and markets. With vaccines becoming more widespread the threat of Covid seems to be lessening. But several new variants continue to pop up and a more deadly variant is likely one of the biggest risks going forward. Tokyo today declared a state of emergency and banned spectators from the Olympic games due to a rise in the Delta variant. The news hurt stocks globally. It is believed that the current vaccines still offer protection and importantly cut down on the severity. So, a pandemic like last year's peak is very unlikely and companies and people have adapted with work from home, social distancing, and digital advancements. But the variant issue is a big risk to the recovery and financial markets.
7. Another risk is that <u>people don't want to work</u>! Many are making more or the same by staying home and living off the government handouts. It's time for the government to stop the handouts and get people back to work. Companies want to hire and the lack of workers is thwarting the recovery. When did this country become lazy all of a sudden?



8. Government giveth and taketh away. Since Covid started, the US government has acted fairly quickly in getting money into the economy and consumers hands to sustain things while the economy recovers. But at some point, those bills come due. Talk and actions by the current administration to re-regulate and increase taxes, while still proposing even more huge spending plans ($6 trillion more), opens a big unknown – the tug of war between giving and taking. I've said many times that financial markets don't like unknowns.
9. <u>International markets</u> and economies continue to lag the US. In general, the global recovery is behind that of the US. The US was first to offer central bank support, government support, vaccine readiness and has been fairly quick to vaccinate which kept it ahead of most of the world in terms of a recovery. As such, international equities are rising but at a slower pace. If world economies can step it up without the Covid variants slowing progress, international growth should pick up and its stocks would be poised to outperform.
10. <u>Big tech dominates the market</u>. The "market" is often thought of as being represented by the S&P 500. However, the S&P is now dominated by 5 stocks which make up 22% of stock weights (Apple $2.6 Trillion cap, Microsoft $2.06T, Amazon $1.8T, Google $1.8T and Facebook $1T). Diversification is not what it used to be and these tech stocks often set the tone. These are great companies no doubt, but talk (or action) of breakup and regulation could have a negative effect on stocks overall.

FINAL THOUGHTS

Last quarter I stated I liked stocks but not necessarily valuations, and that I still preferred stocks to bonds. Given we are early in the recovery cycle I continue to prefer stocks to bonds. Stocks are slightly cheaper compared to last quarter on forward earnings and growth in earnings is hefty. At some point bond yields need to rise and that has its own set of ramifications to both asset classes – if too high too fast then stocks will drop too. The months of August and September are 2 of the worst months seasonally for stocks. Given the runup we've had, I wouldn't be surprised to see a pullback during Q3. But July is one of the better months for stocks, so we could first see strength if earnings are strong . A 5-10% correction happens almost every year at some point. I feel any pullback is a buying opportunity and is likely to be shallow and short as there is still a lot of cash on the sidelines. So, having some extra cash available by taking some gains and trimming winners now is not a bad idea. For stocks I stick with my diversified barbell strategy of owning cyclical and growth stocks as well as midcap, smallcap, and international exposure. For now I still like US over international but do want to own some international indexes or companies. For fixed income I like alternative plays such as high yield, convertibles, preferred and floating rate. If buying quality, I would sacrifice yield for safety in staying short-term. So overall, I continue to favor a diversified approach to investing for the long term.

Have an awesome summer, stay safe and enjoy the warm weather. Feel free to call or drop me an email.

-Bob