FROM THE DESK OF BOB CENTRELLA, CFA *April 8, 2021*

FIRST QUARTER REVIEW AND 2021 OUTLOOK

Happy belated Easter (and Passover) and hoping you and family members are well and safe. I was on a plane twice in the past month and although the airports are still quiet, both flights were pretty full. Hopefully, that is an indication that life is getting back to a new normal and we can all get on with getting on. After a rough and cold winter, I think we are all ready to get outside, go on vacation, hang with friends, go out to eat, etc…

The first quarter of 2021 came to a close a bit more civil than what we experienced in 2020. Last year, we were in the beginning of the pandemic, stocks had crashed and economies were closing around the world and about to enter recession. Now, markets have been rising since bottoming in March last year, economies are reopening, and people are getting vaccinated. After declining 20% in Q1 of 2020, the S&P 500 has risen 60% for the past year! Fortunes were lost and fortunes made over the last year. Below is a look at asset classes for the first quarter.

Asset Class Performance March, YTD, and 2020 - Total Return (%)

US Related

ETF	Description	March	YTD	2020
SPY	S&P 500	4.54	6.35	18.37
DIA	Dow 30	6.92	8.45	9.61
QQQ	Nasdaq 100	1.71	1.84	48.62
IJH	S&P Midcap 400	4.71	13.54	13.58
IJR	S&P Smallcap 600	3.53	18.39	11.28
IWB	Russell 1000	3.84	6.00	20.77
IWM	Russell 2000	1.39	12.90	20.03
IWV	Russell 3000	3.67	6.43	20.55
IVW	S&P 500 Growth	2.77	2.18	33.19
IJK	Midcap 400 Growth	2.41	8.65	22.44
IJT	Smallcap 600 Growth	1.33	12.45	19.22
IVE	S&P 500 Value	6.39	10.87	1.21
IJJ	Midcap 400 Value	6.97	18.55	3.53
IJS	Smallcap 600 Value	5.61	24.32	2.63
DVY	DJ Dividend	9.51	19.64	-4.91
RSP	S&P 500 Equalweight	6.05	11.58	12.71
FXB	British Pound	-1.11	0.70	2.87
FXE	Euro	-2.89	-4.24	7.94
FXY	Yen	-3.77	-6.89	4.61
XLY	Cons Disc	4.46	4.70	29.63
XLP	Cons Stap	8.49	1.82	10.15
XLE	Energy	2.98	30.83	-32.51
XLF	Financials	5.86	16.02	-1.67
XLV	Health Care	4.02	3.26	13.34
XLI	Industrials	8.99	11.52	10.96
XLB	Materials	7.59	9.31	20.52
XLK	Technology	1.83	2.36	43.61
XLC	Comm Services	2.62	8.84	26.91
XLU	Utilities	10.55	2.90	0.57

Global

ETF	Description	March	YTD	2020
EWA	Australia	1.14	3.51	8.27
EWZ	Brazil	4.86	-9.77	-20.33
EWC	Canada	5.84	10.41	5.52
ASHR	China	-6.49	-3.59	36.30
EWQ	France	2.83	4.72	2.85
EWG	Germany	4.47	5.26	10.56
EWH	Hong Kong	1.03	7.87	4.19
PIN	India	4.06	6.12	18.54
EWI	Italy	5.31	7.03	1.67
EWJ	Japan	0.44	1.42	15.41
EWW	Mexico	7.80	1.95	-3.05
EWP	Spain	1.33	1.29	-3.96
RSX	Russia	5.48	6.87	0.01
EWU	UK	3.10	6.90	-11.80
EFA	EAFE	2.51	3.99	7.59
EEM	Emerging Mkts	-0.73	3.23	17.03
IOO	Global 100	3.14	4.93	18.61
BKF	BRIC	-3.45	0.94	16.54
DBC	Commodities	-0.72	12.99	-7.84
USO	Oil	-1.89	22.78	-67.79
UNG	Nat. Gas	-7.17	4.13	-45.43
GLD	Gold	-1.14	-10.32	24.81
SLV	Silver	-7.95	-7.61	47.30
SHY	1-3 Yr Treasuries	-0.06	-0.09	3.03
IEF	7-10 Yr Treasuries	-2.39	-5.73	10.01
TLT	20+ Yr Treasuries	-5.24	-13.92	18.15
AGG	Aggregate Bond	-1.15	-3.37	7.48
BND	Total Bond Market	-1.27	-3.64	7.71
TIP	T.I.P.S.	-0.26	-1.68	10.84

The first quarter was a very positive one for US (and world) equities across different styles and sectors. At the index level, the Dow led the way surging 8.45%, but the S&P 500 was also very strong, returning 6.35%. Large Cap Tech was an area of relative weakness, but even the Nasdaq 100 was up 1.8% (just about all of which came on the last trading day of the month). Continuing a trend that has been in place all year, value stocks left growth in the dust, more than doubling the gains of growth stocks. And Small-cap (+18.39%) and Mid-cap (+13.54%) stocks outperformed Large-caps. At the sector level, we saw cyclicals lead the way higher with Energy rallying 30.8%, Financials up 16% and Industrials climbing 11.5 %. While no sectors were down in the quarter, Consumer staples lagged the most rising only 1.8% while Technology was up 2.4%.

International stocks mostly lagged US stocks but Canada led the way with a 10.9% gain while Hong Kong rose 7.8% and Italy climbed 7%. On the downside, Brazil with its high covid rate declined 9.8% while China dropped 3.6%.

Fixed income investors experienced some volatility that's normally reserved for stocks. The 10-year US Bond Yield jumped from .96% to 1.73% causing bond prices to drop significantly. The 20-year bond price declined 13.9% while the 7-10 year fell 5.7%. More on bonds later.

Finally, on the commodity front oil rallied 22.8% as economies reopened while safe-havens Gold (-10.3%) and Silver (-7.6%) declined. ***The biggest winners were in the digital currency world as Bitcoin jumped 104% hitting $60,000 and Ethereum shot up 158%.*** Oh, and my favorite, Lean Hogs, were up 43.8%. That's a lot of bacon!

BACKDROP & ECONOMY

The first quarter offered some more positive hope in the face of the relentless Covid pandemic. Below is a sampling of data as provided by First Trust Economics. Notice the year ago column.

Indicator	Date (2021)	Level	Year Ago Level	% Change YOY	% Change MOM	% Change WOW
Initial Jobless Claims	March 26	719,000	5,985,000	-88.0%	-5.5%	+9.3%
Continuing Jobless Claims	March 19	3,794,000	3,094,000	+22.6%	-13.4%	-1.2%
ASA Staffing Index	March 28	92.7	70.4	+31.7%	-2.0%	-0.4%
Weekly Retail Sales[1]	March 27	+9.8%	+6.3%	NA	NA	NA
Box Office Receipts	March 26 - April 1	$39,756,682	$5,250	+757170.1%	+86.9%	+84.6%
Rail Car Traffic (cars)	March 26	521,731	449,372	+16.1%	+7.3%	+1.6%
Steel Production (net tons)	April 5	1,766	1,526	+15.7%	+0.6%	+0.3%
Hotel Occupancy	March 21-27	57.9%	36.6%	+21.3%	+10.4%	-1.0%
Hotel Average Daily Rate	March 21-27	$108.31	$82.94	+30.6%	+12.0%	-0.4%
Hotel Revenue per Available Room	March 21-27	$62.68	$30.34	+106.6%	+36.6%	-1.5%
Opentable State of the Restaurant Industry[2,3]	April 5	NA	NA	-18.7%	+19.1%	+7.1%
TSA Checkpoint Data (7-day moving average)[2]	April 5	1,436,435	126,399	+1036.4%	+44.6%	+4.6%
Supply of Motor Gasoline in the US (Mbbl/d)	March 26	8,891	6,659	+33.5%	+9.1%	+3.2%

As we sit here, we are seeing millions being vaccinated, states reopening, companies beginning to hire, sports allowing fans in the stadium and some states like FL and TX fully opened and having good results. Worldwide, vaccines have had some hiccups and there are Covid variants but we seem to be headed in the right direction. Politically there is plenty of government stimulus money ($2-3 trillion!), and a huge so-called infrastructure bill (another $2 trillion) that could be passed. On the downside, higher corporate and personal taxes would be forthcoming and the debt situation for our country is enormous.

Expectations for economic growth have been on the rise with GDP in Q1 estimated 4.8% compared to 2.7% in December and 5.7% for all of 2021 compared to 4% at beginning of the year. Part of the rise is driven by higher commodity prices and interest rates which are increasing earnings for Energy, Financial and Industrial companies. Housing is still booming and home prices are up across the country. Homes are being snapped up in many areas as rates are still relatively low.

BONDS

As I mentioned earlier, bond yields have moved higher causing a loss of principal for intermediate to longer term bonds. So much for safety in owning bonds! Going forward it seems rates must eventually go higher causing even more pain. The bond bubble has finally broken. As the economy comes back and grows there is some growing worry of inflation beyond the 2% objective of the Fed. The Fed has done and said everything right and that rates are likely to stay put into 2023. But, as life gets back to the new normal and assuming we don't enter another covid variant outbreak and lockdown, the Fed will need to raise rates. For sure bond yields will rise further and another push towards 2% on the 10-Yr UST will likely hurt stocks until expectations reset. My preference is to sacrifice yield for safety with short term fixed income securities. These can be buffeted with alternative fixed income such as floating rate, variable preferred, short-term high yield, and convertible securities.

EQUITIES

Equities right now are on a sugar-high. Indices are making new highs but there is some speculative feel to pockets of the market. Cyclical stocks that would benefit from the reopening have been on a tear since late last year while NASDAQ stocks have pulled back this year. The rotation to Value from Growth continues but growth stocks are starting to stabilize. With the background I mentioned earlier it should be good for stocks. However, my concern is that valuation is stretched and plenty of good news is baked into stocks. The forward 12-month PE of the market is 21.9x compared to its 5-year average of 17.8x and 10-year of 15.9x. Earnings growth in Q1 is expected to be 24% and a whopping 52% in Q2. There are high expectations for this quarter as estimates have moved higher by 6% over the quarter. (Interestingly, the S&P gained about 6% in Q1.) Each quarter this year will be double digit growth. For all of 2021 EPS growth is estimated at 26%. But, with the forward PE at 21.9x, we would need more upside surprises for broader stock gains. For 2022, there is a lot of question marks, especially whether there will be a corporate tax hike. This would cause a 5-10% hit to earnings which at some point would need to be reflected in stock prices. And right now S&P earnings are forecasted to grow 7% in 2022. So, if we get a corporate tax increase you could actually see earnings decline in 2022 – I don't think the market is going to like that. We stay focused on 2022 as this year progresses.

International stocks seem a bit more attractive on a valuation basis. But there are some speed bumps on the handling of the coronavirus. In the past year most world indexes have lagged the US, so perhaps there is some catching up to do. I recommend an allocation to ex-US stocks and it can include both developed and emerging markets. Just beware of rising rates and owning emerging market stocks. My preference is a bias towards Europe and owning the All World index.

FINAL THOUGHTS

I like stocks, but I don't necessarily like valuations. But I definitely prefer stocks to bonds and still think we have upside from here. So, the way to play this market is to choose stocks wisely and own both Value (cyclical) stocks and Growth companies. We also must watch rates as an increase in rates will further hurt stock valuations and of course bond prices. I have always believed in buy and hold strategy but from here we might have to be a little more nimble and periodically take profits on big winners while doing some rotation. My allocation recommendation is owning a barbell US stock strategy including small- and mid-caps with an allocation to International equities. For bonds I stay short-term and in alternative fixed assets as discussed earlier to generate yield.

Have a great Spring and feel free to give me a call or drop an email. *-Bob*