



## Client Note

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August 5, 2021

July saw another positive month for **most** US equities. The S&P500 gained 2.3%, led by growth stocks. Top sectors were technology, healthcare, and utilities. A return to growth stocks by investors aided technology shares, while a decline in interest rates gave a lift to utilities. **Energy and value stocks were down** on the month, alongside emerging market equities. And finally, **large cap stocks dramatically outperformed small cap stocks**. Essentially, it's a moderate investors market. The riskiest areas, like small cap and emerging markets, after a stellar start to the year, have been very much sideways the past few months, while the broad indexes continue to grind upward. Energy is similar in having had a dramatic beginning of the year and now, since early June has been consolidating. I am optimistic that the areas that have been languishing the past few months **are near the end of this consolidation** and should see higher prices into the third quarter.

**Bond prices have generally risen** as interest rates have fallen. Junk bonds were flat **while higher quality bonds saw price gains**. Given the weaker small cap performance and junk bonds underperformance, markets appear in a slightly risk-off mode, even as the major stock indexes continue to climb. This is generally reflective of the doubt regarding the continued **rapid economic** growth experienced over the past 12 months. Riskier stock price stopped going up in March, bond yields peaked in May, and only recently we have gotten **worse than expected economic data** in a lower revision of Q2 GDP growth and a few misses in employment data. PMI and ISM indicators are meeting and beating slightly, almost exclusively due to 'prices paid' factors. Higher prices are a positive, even if selling a similar amount of product.

**Inflation**, on a year over year basis is running "hot", posting a 5.4% (CPI June). CPI for May was 5%. July is expected to be 5.3%. There **are two key items to remember when looking at inflation data**. The US was only starting to come out of lockdowns last summer (case effects) and the federal government was sending checks to all households (direct stimulus), working and non-working. **This glut of cash has caused serious anomalies in the CPI figures**. Used car prices up almost 100%. New cars up 7% and travel costs up substantially, from depressed levels. Today, supply chains and businesses have re-opened to a large extent and there are no more checks forthcoming. **I expect inflation numbers to come down substantially** for the remainder of the year, which should support bonds, dividend paying stocks and to a lesser extent, precious metals.

Looking ahead, I maintain my **upward bias towards stock prices**, with the caveat that we will likely see more volatility, 2-4% weekly variations perhaps. **Interest rates could ease further** as economic data comes in slower and slower, as we **have now passed the peak growth period**. The US economy **will continue to expand**, albeit more slowly. If we could see mid- and small- cap stocks do some catching up, it would give me more confidence that financial markets have more room to the upside, but this has yet to take hold.

Adam Waszkowski, CFA

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