The Rotation is Real!

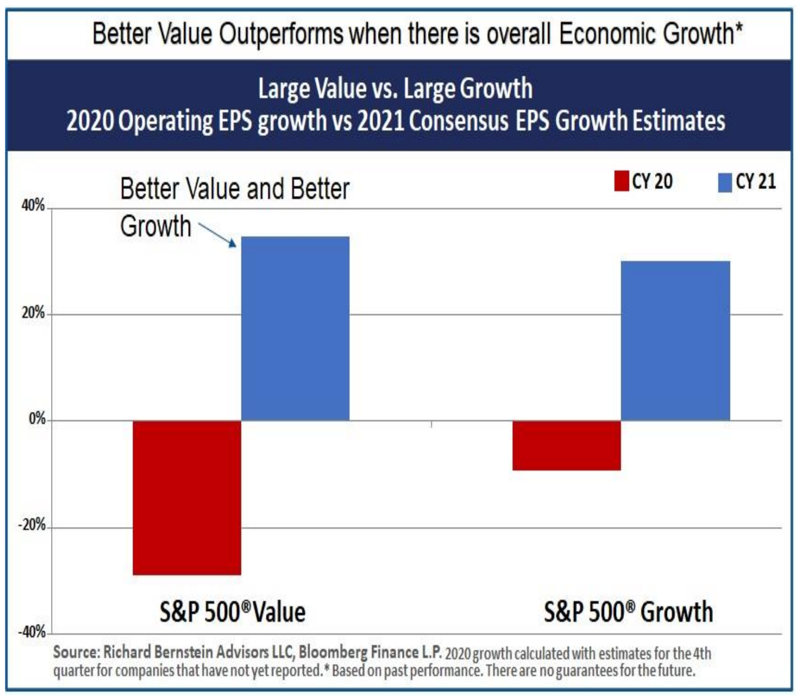
Despite a couple of attempts to sell-off the stock market ended the quarter at all-time highs. The S&P 500 gained 6.2% during the quarter but the biggest news was confirmation of a stock market rotation from Growth to Value. To take one example the iShares S&P 500 Value ETF returned 10.7% versus only 2.1% for the iShares S&P 500 Growth ETF, quite a change from the past. Fortunately, we significantly increased our weighting towards the Value factor at the end of 2020. Small capitalization stocks also did well with returns in the low double-digits. International stocks started off strongly but then lost momentum as several major economies once again had to shut down due to Covid-19 outbreaks. The catalyst for the rotation was a sharp rise in interest rates. The iShares 7-10 Year Treasury Bond ETF declined by -5.8% while the iShares 20+ Year Treasury Bond ETF fell by a whopping -14%! We have maintained short durations in our fixed income holdings and only experienced minor losses, generally less than 0.5%.

Normally, a breakout rally like we are experiencing means more good times ahead, and there are plenty of positive developments for bullish investors. The vaccination program is in full force with an average of over 3 million shots a day. Investors are anticipating our daily lives to get back to normal and a subsequent economic boom. This outcome is not a fantasy as household balance sheets are in terrific shape and people want to get back to their normal lives and spend. The Economist estimates households worldwide saved $6 trillion in the first three months of 2020. Moreover, they write: “(i)n America excess savings may soon exceed 10% of GDP, in part because of President Joe Biden’s $1.9trn stimulus plan.”

All signs point to a rapid rebound in the economy. Federal Reserve officials sharply upgraded their growth forecasts yet signaled that they expected to keep interest rates close to zero until at least 2024, an ideal scenario for risk assets like stocks. U.S. employers added 916,000 jobs in March, the best gain since August, and the unemployment rate fell to 6.0%, a pandemic low. All of this is before the Biden administration’s multi-trillion American Jobs Plan which will further juice the economy. Our take is that a smaller and more targeted bill will ultimately pass and will be money well spent if it addresses the miserable state of our infrastructure.

Businesses are finding no obstacles in raising money. Overall, companies raised $400 billion in the first three weeks of 2021, including $79.4 billion for SPACs, or blank-check companies, which is generally a more speculative investment. With the Federal Reserve intent on keeping interest rates at rock bottom levels, generous credit markets, and stimulative fiscal policy, the economy should power ahead.

The biggest risk with all this money creation and spending is inflation. Over the next year inflation figures will certainly rise and at times could be alarming as the economy works through the gyrations caused by the Covid-19 collapse. However, the Federal Reserve has prepped the markets that they believe this increase will only be temporary, and they will not raise interest rates. The last ten plus years has taught us that there are strong deflationary forces at work in our economy most likely due to our aging population, a declining birth rate, and a shrinking workforce. However, rising interest rates are the biggest risk for investors, and we will be diligent in assessing *a permanent and damaging* change in the trend of interest rates.



At the end of the quarter, we trimmed our Growth ETF and increased our Low Volatility ETF, reducing overall risk in the portfolios. The Low Volatility factor has been a big underperformer over the last year but usually does well during riskier market environments.

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