Adviser Outlook

SECOND QUARTER 2021

QUICK TAKES

- ✔ An accelerating vaccine rollout and third round of fiscal stimulus fueled investor optimism, helping to clear a path for reopening and economic growth in the U.S.
- ✔ Inflation concerns (which we think are overblown) ebbed and flowed as investors and economists speculated over whether the economy might overheat.
- ✔ Investors are showing signs of overconfidence, but with a rebounding economy, there is room for the stock market to gain ground.

The U.S. economy is back in business! Anticipating a release of pent-up economic activity, stocks rallied to multiple highs during the first quarter as the new administration quickly rolled out a $1.9 trillion stimulus package and an accelerated national COVID-19 vaccination program.

Barring a surprise event or market shock (Did anyone predict global supply chains would be stymied by a super-freighter plugging the Suez Canal?), we expect economic activity to expand rapidly in the second and third quarters. And when the economy is growing, it paves the way for further gains in the stock market.

This doesn't mean the road ahead will be smooth. Investors and traders are widely bullish today—and that's created a lot of noise in the market.

Speaking of noise, a speculative frenzy grabbed headlines in the first quarter as mostly millennial day traders poured into so-called "meme stocks." Online denizens reveled in their ability to spike prices for stocks like GameStop, Blackberry and AMC, culminating in Congressional hearings on what happens when short sales and social media collide.

Another frothy favorite, bitcoin, had its price double in the first quarter. And SPACs (special-purpose acquisition companies) have become one of the trendiest investments on Wall Street. But these shell companies—formed with the sole intent of combining with a private firm to take it public—have come under increased scrutiny from lawmakers and regulators in recent weeks, and their prices have begun to fall.

Finally, a new asset empowered by blockchain technology—non-fungible tokens (NFTs)—sparked a run on digital assets that had little to do with investing and much more to do with a small number of investors fanning the flames of short-lived fads.

As we've learned over the past year, it's often the risks that aren't on investors' radars that knock the market off course. However, one big concern that's front and center today is inflation. Simply stated, we think these worries are overblown—more on this later.

Both inflation fears and investor optimism are tied to the same burgeoning picture: A surge in economic growth, broad distribution of vaccines, fiscal stimulus and infrastructure spending, and the potential for higher corporate earnings as the pandemic recedes and reopenings progress. Economists' first-quarter growth projections are all over the map, but most

QUARTER REVIEW

- ✔ U.S. stocks advanced in the first quarter of 2021, thanks to aggressive federal stimulus and vaccine progress.
- ✔ Value stocks outpaced growth stocks, bolstered by cyclicals, which typically benefit disproportionately in the early stages of an economic recovery.
- ✔ The bond market stumbled, as fixed-income investors worried about inflation demanded higher yields, sending bond prices lower.

believe (and we agree) that we're moving quickly in the right direction.

First Quarter Review

March 23 marked the one-year anniversary of the pandemic bear-market's bottom and its historic rebound. The total return for the S&P 500 over that period was a remarkable 77.8%!

While extraordinary, returns of that magnitude are fleeting. At the end of March, the one-year return for the S&P was a still incredible, but reduced, 56.4%. Including that big one-year bump, three- and five-year annualized returns for the S&P were a less heady 16.8% and 16.3%, respectively.

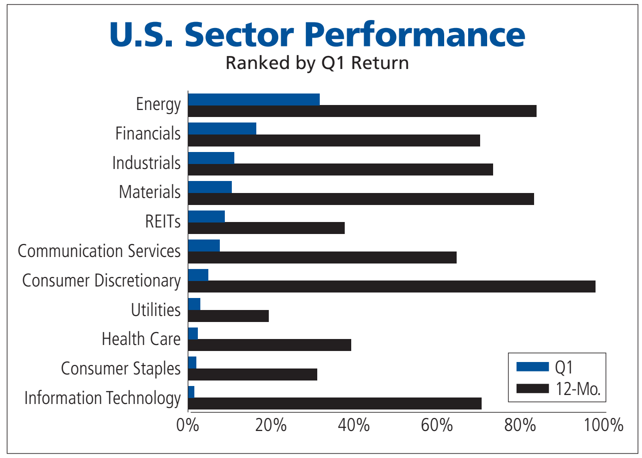
Mind you, we're not complaining. Stimulus checks, the vaccine rollout and the Federal Reserve's lower-for-longer interest rate assurances have kept the bulls running: The Dow Jones Industrial Average reached a new record in the final week of the first quarter and the S&P 500 closed above 4000 for the first time shortly after.

Stocks of smaller companies raced out of the gate and outperformed larger companies in January and February. Though they stumbled in March and fell briefly into correction territory, the benchmark Russell 2000 index still gained 14.1% for the quarter. Foreign stocks lagged, with the MSCI EAFE index, a measure of developed international stock markets, returning 3.5%.

Stocks Return to a Sustainable Pace in the First Quarter

	Q1	12-MO
Dow Jones Industrial Average	8.3%	53.8%
MSCI U.S. Broad Market	6.4%	63.1%
S&P 500	6.2%	56.4%
MSCI EAFE	3.5%	44.6%
MSCI Emerging Markets	2.3%	58.4%
Bloomberg Barclays U.S. Aggregate Bond Index	-3.4%	0.7%

Note: Ranked by Q1 returns. Performance numbers are total returns, reflecting reinvested dividends through 3/31/2021. Source: Morningstar.



Source: Morningstar.

All 11 broad market sectors generated positive returns in Q1. "Cyclical" sectors—those sensitive to economic momentum—led to start the year, building on outperformance that began with November's positive vaccine developments.

A return to travel and higher oil prices positioned energy as the quarter's top performer. Rising interest rates, and specifically a steepening yield curve, helped financials (banks and investment firms).

On the other end of the spectrum, health care, consumer staples and technology were the laggards. After leading for the first nine months of 2020, technology stocks ceded market leadership for a period—no sector outperforms all the time. While these sectors have trailed in Q1, we believe there are secular tailwinds in their favor.

Even as stocks were hitting all-time highs, bonds were taking it on the chin. The Bloomberg Barclays U.S. Aggregate Bond Index fell 3.4% during the quarter—its worst three-month return since April 1994. (For a more detailed bond update, visit **adviserinvestments.com/bonds-21q2/**.)

Some bond investors are suffering, yes, but we look at it like this: The worst three-month run in the bond market is nothing when you consider that it is equiva-

OUR OUTLOOK

- ✔ Economic growth is being propelled on multiple fronts, and would be boosted by the proposed $2 trillion infrastructure package from the Biden administration.
- ✔ We expect ongoing progress in the economic recovery in the U.S. as well as some associated growing pains, including a possible uptick in inflation.
- ✔ Stocks are likely to advance further in the second quarter but a short-term market pullback may be in the cards—it will present the opportunity to invest in quality stocks at a relative discount.

lent to a bad day or week in the stock market. And like the stock market, not all parts of the bond market are equal. Bloomberg Barclays' 1–3 Year Treasury Index declining 0.1% in the first quarter isn't upbeat, but it topped the broad market index and was a far sight better than the 13.5% slide for the index tracking long-term Treasury bonds.

Investors with allocations to bonds may be feeling that they missed the stock market's boat during the first quarter. In one sense, they did, but there is a reason most of us own bonds—their shock-absorbing qualities during periods when stocks are in decline.

Since the 10-year Treasury bond's record-setting August low of 0.51%, yields have more than tripled to about 1.75%. We do not expect another tripling in the coming year. Seeing bonds drop in price may not be fun, but there is a silver lining: Higher yields will lead to higher bond market returns over time and provide even greater protection when the inevitable stock market pullback arrives.

Our Outlook

The year is far from over and we think the stock market's rally has further to go. While the bond market's losses were relatively steep, the worst could be behind us and higher yields should have a soothing effect going forward.

We do think inflation could tick higher in the coming months. It comes down to simple math if you compare today's prices to where they were a year ago when we first entered lockdowns. But inflation also stems from economic growth. Demand for goods and services is coming back faster than suppliers expected, and supply chains are not fully up and running. (Think about something as simple as car rentals, where there's not enough inventory on lots for all the travelers today.) This will lead to higher prices—for a time—but supply will come back later in the year and prices will normalize.

The possibility of another "rotation" in the stock market is high. While the media is fixated on the

PERSONAL FINANCE FOCUS

RMDs: Back From Hiatus

THE CARES ACT waived required minimum distributions (RMDs) from IRAs and 401(k) accounts for the 2020 tax year as part of the pandemic relief effort. Now they're back—the recently passed American Rescue Plan *did not* extend the RMD hiatus for 2021. You must begin taking RMDs from tax-deferred retirement accounts on April 1 the first year after you turn age 72 so Uncle Sam can get his cut (and December 31 annually thereafter). The good news is that you can plan ahead:

- **Make the most of your money.** The December 31 deadline for RMDs allows you to wait as long as possible and let each dollar compound tax-free. But you can also put those withdrawals to work elsewhere. If you're planning to reinvest these withdrawals as a gift or in a loved one's 529 college savings account, sooner is better to get compounding working its magic.
- **Explore a Roth rollover.** Roth IRAs are usually funded with after-tax funds, so they are not subject to RMDs. Therefore, many people choose to roll their traditional IRA into a Roth. Yes, you'll face a bigger tax bill in the year you convert but, depending on your situation, you may save more and avoid RMDs down the road. Our special report, *The Rollover Advantage* (adviserinvestments.com/rollover/), explains the process and requirements for Roth IRAs in greater detail.
- **Plan charitable contributions carefully.** Starting at age 70½, you can use your retirement assets to support your favorite charities and reduce your tax hit at the same time. A qualified charitable distribution, also known as a "charitable IRA rollover," can help you avoid taxes on up to $100,000 annually in RMDs from your IRA. Visit adviserinvestments.com/charitable/ to learn more about charitable giving.

For more on RMDs, see our informative explainer at adviserinvestments.com/rmd-explainer/.

If you have any questions about RMDs, please don't hesitate to contact Adviser Investments. We'd be happy to help you.

COMPANY NEWS

Welcome to Adviser's Pandemic Hires

When the pandemic threw us all for a loop last spring, Adviser's IT department was prepared, and we adapted quickly to working from home. Despite the challenges, we're proud to say that we found ways to continue to grow and expand our services and team. Over the last year, we've added staff to our client services, tax, legal, IT, communications and marketing teams. Even if it's only over Zoom for now, it's been a pleasure for our veterans to get to know some new faces—and they're already bringing fresh thinking to help us serve you better. Please join us in welcoming eight new employees to the Adviser Investments team!

Clockwise from top left: Daniel Colony, Jacqueline Murphy, Chris Mirick, Connor Ronan, Hannah Serwadda, Ashlyn Melvin, Fran Lee and Guneet Rajpal.

growth-versus-value debate, there is another lens through which to view the markets. This past quarter's market rally was led by "lower-quality" companies—those with higher levels of debt and leverage, more variable earnings streams and cyclical businesses. Any detour from the robust path that is currently built into expectations and prices for many of these companies could quickly trigger a shift to larger, higher-quality companies with more consistent histories of earnings growth.

As we've said before, we do not consider ourselves "growth" or "value" investors. In fact, our goal is to uncover value among companies with strong growth potential.

Today we are relying on our ability to keep two seemingly conflicting thoughts in mind at the same time. For the most part, we are optimistic about the market opportunities ahead. At the same time, we know that it's only a matter of time before we face a stock market decline of some magnitude. On average, stocks fall 14% from their highs at some point during any calendar year—sometimes more and sometimes less.

Rather than try to anticipate and trade around each and every swing in the market—an impossible task—we acknowledge that drawdowns happen and that they represent buying opportunities for long-term investors like us.

ADVISER INVESTMENTS' QUARTERLY UPDATE

Listen to a replay of our *Second-Quarter Update: Inflation, Inoculation and Infrastructure—Defining the New Normal* at AdviserInvestments.com/webinar

THIS QUARTER'S CONTRIBUTORS

Daniel P. Wiener *Chairman*
James H. Lowell III *Chief Investment Officer*
Elizabeth Laprade *Research Analyst*
Jeffrey D. DeMaso, CFA *Director of Research*
Christopher Keith *Senior Vice President*
Jennifer Zebniak *Research Analyst*
Joshua Jurbala *Quantitative Investments Manager*
Charlie Toole, CFA, CFP® *Vice President*
Steve Johnson, JD, CPWA®, CFP® *Vice President*
Joshua McCourt *Equity and Quantitative Research Analyst*