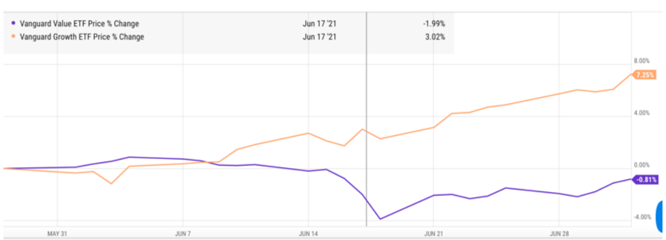
July 4, 2021

Overview

In June, US equities continued to forge ahead, with a return of growth stocks to the fore. The S&P's 500 was up **2.33%** on a total return basis but the Nasdaq Composite was up even more with a **5.55%** performance while the Russel 2000 (small caps) was up **1.47%.** Internationally, a rising USD hurt developed market equities. The EPAC BMI index was down **.97%** while the MSCI EM (emerging markets) barely moved **(.17%).** Frontier markets did better with the MSCI Frontier 100 up **2.96%** helped by rising oil prices.

Fixed income markets did generally well, with the long bond retracing part of its earlier losses. Most sectors progressed. US Corporate bonds were up **1.63%** while the Bloomberg High Yield index rose **1.34%** and the S&Ps' municipal bond index **.26%.**
What we saw in US equity markets in June was a partial reversal of the reflation trade (the belief that a growing economy will push inflation higher and end up favoring "traditional economy" equities). In June, most investors went back to the dominant theme of most of 2020: "Buy and stay with growth stocks". The chart below illustrates this:



In orange is the performance of VUG (Vanguard Growth ETF) since June 1. It is up **7.25%** over one month. VTV (purple line), is Vanguard's value ETF. It is down **.81%** over the same (short) period of time. The discrepancy in performance coincides relatively well with the release of the Fed statement on July 16 (vertical line), following their gathering of the previous two days. Investors appear to agree with the Fed that inflation is likely to be transitory and that a tightening of monetary policy is a long way off, justifying plowing more money into growth stocks and pulling some from the value sector.

In June, the performance of our clients' portfolios hovered between **.81%** and **1.90%.** Over the same period, a portfolio consisting of 50% ACWI (World Equity Index ETF) and 50% AGG (US bond aggregate proxy) rose **1.05%**. Year-To-Date (YTD), our clients' portfolios are up from **5.46%** to **7.56%,** net of fees. Our benchmark stands at **5.34%**. over the same period. The equity allocation in our clients' portfolios ranges currently from 40% to 70%, depending on risk profiles.

Market developments

Economic news throughout the month of June confirmed the continuation of the healthy rebound anticipated since the Covid vaccines became available late last year. The unemployment number in early June showed gains of 559,000, a little below estimates but with few signs of large wage pressures except in hospitality and leisure related sectors.

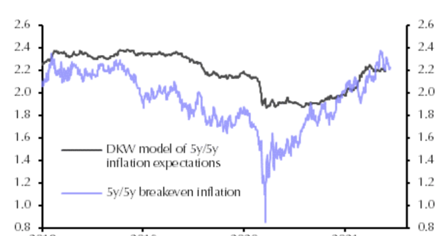
The economy in on pace for a 6.5% growth rate in 2021. With such a high level comes the legitimate concern of accelerating inflation and how the Fed might adjust its monetary stance as a result. Markets have been ebbing and flowing between, 1) Inflation will accelerate faster than the Fed thinks, 2) Inflation is actually transitory and the Fed's accommodative stance is adequate and unlikely to change for the foreseeable future.

In May, investors leaned towards the first interpretation and rewarded value stocks while continuing a withdrawal from the growth sector. In June, the second interpretation prevailed and growth stocks outperformed. We are likely to see this back and forth continue as new economic data becomes available and confirms the first or second option in investors' mind.

For now, the chart below encapsulates well how the experts at Capital Economics see the inflation picture in the US.

The black line reflects **investors' expectations** of future inflation. It has moved up significantly since the beginning of the health crisis. The purple line reflects **what the bond market is actually telling** us from an analysis of the yield curve. A persistently large discrepancy between the two lines is generally unsustainable. The good news for now is that both lines are overlapping almost perfectly. In other words: the (bond) market believes that investors' expectations of (low) long-term inflation of around 2.2% per annum are correct. This is supportive for equities going forward.

Chart 26: 5Y/5Y Forward US Treasury Breakeven Inflation & Investor Inflation Exp (%)



Tilts and Allocations

Equities have done well so far this year. I can't say that I see any reason for that to stop. It will have to at some point though. A slow-down is more likely. Valuations cannot go up indefinitely. Earnings need to catch up to justify them. That requires time. So, we could be coming into a period of underwhelming market performance. But I do not see a serious correction as a likely development over the next three months. The Fed is too accommodative and, so far, economic data have been strong but not pointing to a scorching rebound causing wide-ranging inflation that would justify a tightening of their monetary stance.

In this environment, I have refrained from changing allocations. Rather, I have adopted a more tactical approach, buying and selling more actively as specific stocks in our portfolio were either correcting a bit or appreciating fast.

A case in point is DLR, the Reit that serves the technology sector. I added to our position in late February after it had corrected to the $130-$135 level. In early June, I sold what we had bought then at $158. All portfolios are still invested in DLR. This is a long-term hold.

For those clients who have given me a specific nod of approval, I started buying a cryptocurrency ETF (GBTC) in May, after it had experienced a severe price drop. In early June, GBTC experienced another drop and I bought more at those levels. It has since bounced back 10%. We are nevertheless negative 8%-9% on this investment so far.

All of this illustrates the more tactical and nimble approach that I have followed since the pandemic started. I think that current market conditions require it.

For illustration purpose, below is a chart of the price of GBTC over the past three years:

Conclusion

Looking ahead, third quarter earnings will start coming out around mid-July and based on recent consumer and manufacturing sector surveys, should confirm the earnings rebound expected by most market participants. If that is the case and inflation numbers remain explainable within the general narrative of a "transitory" inflation scenario, equity market should maintain their positive tone.

That said, summer can be a season of heightened volatility due to vacation time on trading desks across the financial sector. It is important to keep this in mind when witnessing particularly wide price swings in specific equities.

I wish you all a great summer and look forward to seeing some of you soon, as our "mask-free" environment spreads and accelerates our return to normalcy.

Thank you for your continued trust.

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