JJ BURNS

2021: 1st Quarter Summary

"It's time to move on, time to get going / What lies ahead, I have no way of knowing" ***Tom Petty and The Heartbreakers, "Time to Move On"***

What a difference a year makes. Our first-quarter missive last year focused on the uncertainty in our lives due to the global COVID pandemic. The future was murky, a 'known unknown.' Markets careened wildly during that quarter, and investors fell in behind one of the Four Horsemen of the Investing Apocalypse, *Hope*. Equity markets have since rewarded investors with strong returns, and bonds (until recently) did as well. What we see in this year's Q1 returns is another of the Horsemen joining the herd, *Fear*. The fear isn't necessarily related to a virus, however; it's focused on something intangible – inflation.

Most investors believe that their benchmark is a market index (e.g. the S&P 500). They miss the point that the wealth-creation endeavor is designed to provide for levels of asset growth and subsequent drawdown that *exceed* the required payments of expenses, taxes and inflation. Wage and price inflation are necessary components of growth, but rather than focus on the expected post-vax resurgence, markets switched focus from one 'invisible' enemy, the COVID-19 virus, to another: *expected* inflation.

Regardless of which horse one tends to follow, the 'risk-on' horse joined the herd and rewarded equity investors with strong Q1-21 returns, especially in U.S. small-cap and value stocks. Non-U.S. stocks also performed well, as did U.S. REITs. Bonds, except for U.S. high-yield issues, suffered as the bond market reacted to inflation fears and expectations of future Fed actions, specifically interest-rate increases.

Index Returns
as of 3/31/2021

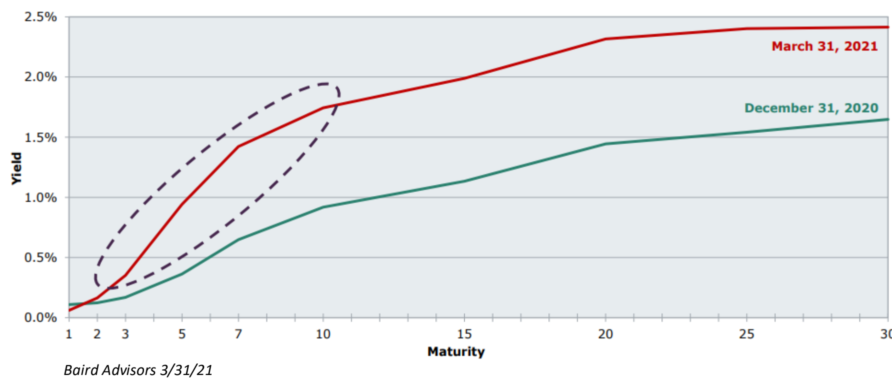
Index	1st QTR / YTD 2021	Q1-20	YEAR 2020	COVID BEAR 2020
BbgBarclays US HY 2% Issuer Cap	0.86%	<12.68%>	7.05%	<20.67%>
BbgBarclays Municipal	<0.35%>	<0.63%>	5.21%	<9.24%>
BbgBarclays Global Aggregate	<2.47%>	1.45%	5.58%	<1.36%>
BbgBarclays US Agg Bond	<3.37%>	3.15%	7.51%	<0.83%>
U.S. STOCKS				
Russell 1000 [Large-cap Stocks]	5.91%	<20.22%>	20.96%	<34.41%>
Russell 2000 [Small-cap Stocks]	12.70%	<30.61%>	19.96%	<40.49%>
S&P 500	6.17%	<19.60%>	18.40%	<33.66%>
INTERNATIONAL STOCKS				
MSCI ACWI Ex USA NR [All Stocks]	3.49%	<23.36%>	10.65%	<33.18%>
MSCI EAFE NR [Developed Markets]	3.48%	<22.83%>	7.82%	<33.01%>
MSCI EM NR [Emerging Markets]	2.29%	<23.60%>	18.31%	<31.32%>
REAL ASSETS				
U.S. Dollar	3.66%	2.76%	<6.69%>	3.39%
S&P GSCI Gold Spot	<9.47%>	4.83%	24.42%	<0.86%>
Morningstar US Real Asset Index	6.09%	<10.55%>	1.03%	<13.55%>
Bloomberg Commodity	6.92%	<23.29%>	<3.12%>	<17.65%>
S&P GSCI Crude Oil Spot	21.93%	<66.46%>	<20.54%>	<55.35%>
S&P United States REIT	8.72%	<26.90%>	<7.52%>	<43.74%>
S&P Global Ex US REIT	2.40%	<32.32%>	<9.34%>	<44.42%>

Source: Morningstar, Inc. USD data with dividends and interest

**Data from 2/17/20 to 3/23/20 are COVID BEAR 2020 bear market results*

“As you discover changing times / It's not so bad as you will find" *Earth, Wind & Fire, “Changing Times”*

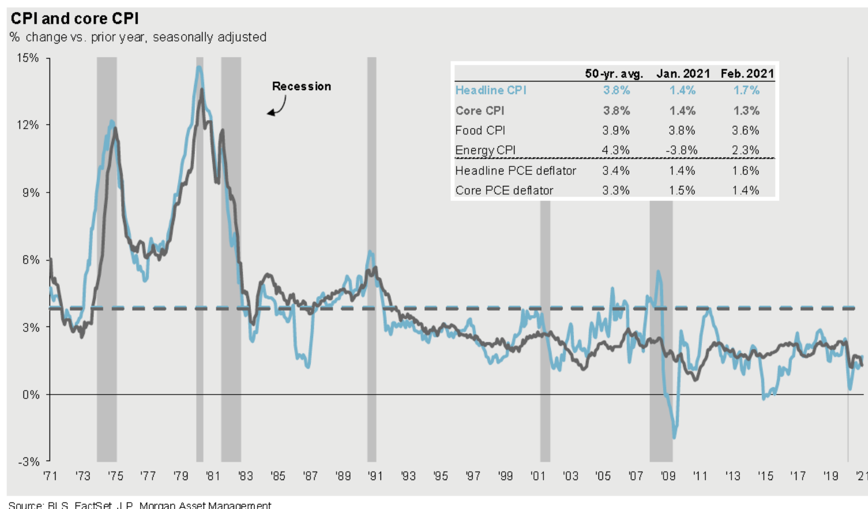
What’s confusing about the current market environment is the belief that things investors *should* see as market tailwinds are, in fact, considered headwinds. Recall the environment a year ago: severe economic shutdown, confined to our homes, consumed by fear of the unknown. Now think about where we are today. We have multiple vaccines and more knowledge about the virus; the U.S. recently passed $3 trillion in COVID bailout legislation that’s expected to fuel a ‘reopening wave’; unemployment is falling, and the Fed stepped in to support the markets with massive stimulus last year. Expectations for economic growth and earnings were too dire last year and have turned quite optimistic this year. All these actions have promoted optimism for a massive growth-and-spending surge. And yet…inflation fears have returned because investors assume this combined consumer-and-federal stimulus spending, on par with the spending during World War II, will lead to systemically higher prices and higher wages. Markets *don’t* appear willing to trust that the Fed will be able to maintain low interest rates in pursuit of higher inflation (above 2%) and ‘full’ employment (an unemployment level around 4%), and have pushed *up* Treasury-bond yields:



Baird Advisors 3/31/21

Treasury yields have risen along the curve as investors expect the Fed will raise rates sooner than they would like due to higher inflation readings and possible wage pressures. Bonds had one of their worst quarters in decades in Q1, creating opportunities for investors (dotted area).

We expect near-term inflation to tick up, partly due to oil’s recovery and partly due to comparisons to 2020. Repositioning the global supply chain, a longer-term U.S. goal, will also affect inflation, but will take time and the effects are extremely difficult to predict. The markets are pricing in interest-rate moves sooner than the Fed has indicated in the expectation that the Fed will have to sacrifice its unemployment mandate to control prices. This thinking ignores recent history, when the markets and the Fed worried about *deflation*, or falling prices. It also ignores the fact that inflation has been tame for long stretches since the oil-shock years of the 1970s, and core CPI has been under 3% for over a decade:



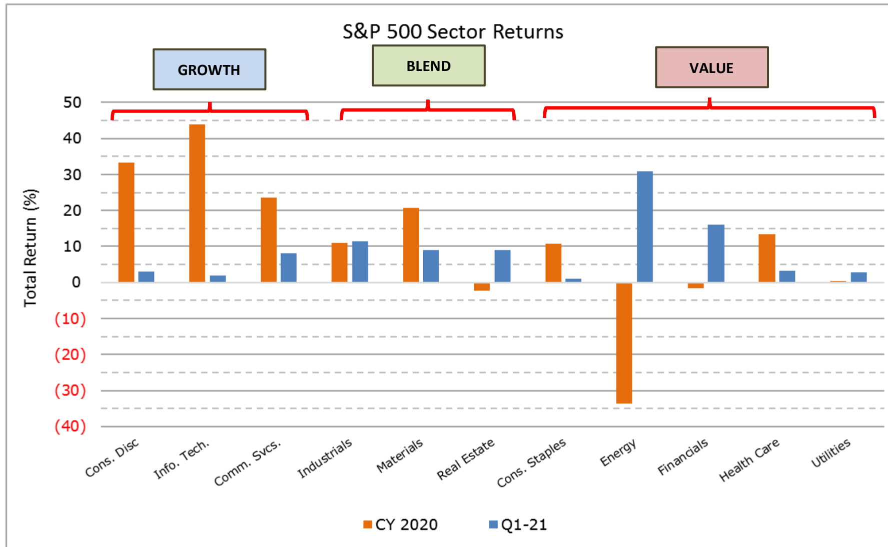
	50-yr. avg.	Jan. 2021	Feb. 2021
Headline CPI	3.8%	1.4%	1.7%
Core CPI	3.8%	1.4%	1.3%
Food CPI	3.9%	3.8%	3.6%
Energy CPI	4.3%	-3.8%	2.3%
Headline PCE deflator	3.4%	1.4%	1.6%
Core PCE deflator	3.3%	1.5%	1.4%

Source: BLS, FactSet, J.P. Morgan Asset Management.

Consumer inflation has trended at or below 4% since the early 1990s. Tepid wage growth, technology advancements, an expanding global economy and a robust global supply chain all contributed to this benign period of price expansion. It should be noted that housing is not included in these data, but rent payments are. We can also see that there are periods of inflation flares, but not enough to cause the pain felt in the 1970s.

“Can't take it with you when you're gone / But I want enough to get there on / And I ain't ever growin' old / So, I keep on rollin' with the flow” *Charlie Rich, “Rollin’ With The Flow”*

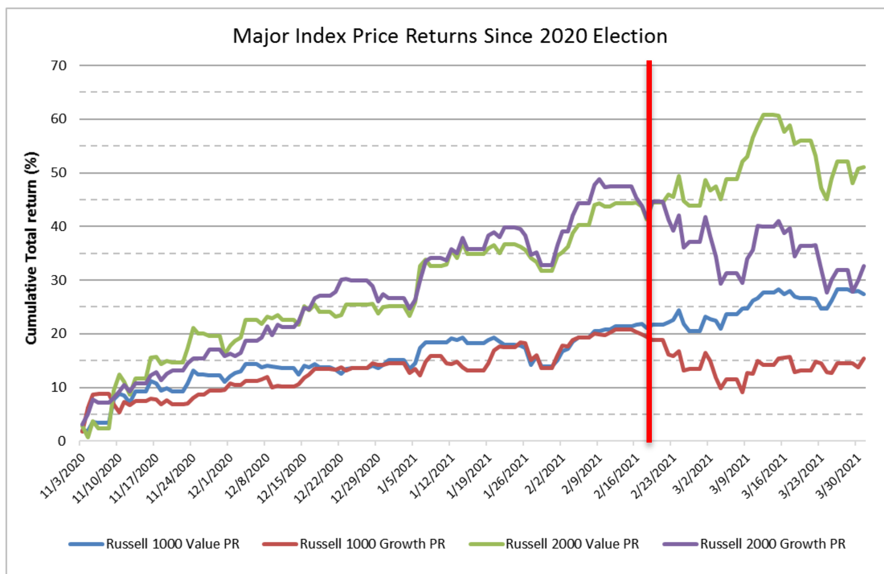
Investors are flagrant opportunists, so despite fears of rising inflation and interest rates, 1st quarter 2021 returns saw a rotation away from the market’s growth darlings to cyclical names that should benefit from the pent-up demand and sidelined spending to come.



Morningstar, Inc. Returns include dividends.

We can see that classic cyclical value sectors – financials, utilities, energy – are doing quite well compared to 2020 (orange data) and growth sectors thus far in 2021 (blue data). Other sectors that are tied to growth – materials, industrials, real estate – are also doing well thus far and are ahead of growth sectors. Note that the leisure and hospitality industries are considered discretionary stocks, and staples are names such as Clorox and Proctor & Gamble.

We can also see where the effects of strong Q4-20 earnings, movement on the Biden stimulus package and growing vaccination distribution shifted expectations away from favored growth investments to unloved domestic value names in the some of the industries detailed listed (red line below):



Morningstar, Inc. Price returns for equity indices.

Growth stocks are sensitive to changes in interest rates and, like some bonds, are also considered a ‘long duration’ asset. We can also see that U.S. small-cap stocks (Russell 2000) have outperformed their large-cap (Russell 1000) counterparts since the election, and value stocks have begun to separate from growth names.

While this rotation is welcome, it does *not* imply that the technology ‘revolution’ we’re experiencing is over, or that stocks of any type will avoid corrections.

“There's some hard times in the neighborhood / But why can't every day be just this good” *Travis Tritt, “It's a Great Day to Be Alive”*

We’re still convinced that the jobs recovery from last year’s recession and widespread vaccinations are the two keys to a sustained global recovery from the forgettable year of 2020. Global growth will still recover, if unevenly, and stocks should do well. There will continue to be some issues with bonds.

It seems premature to worry too much about inflation, as past evidence indicates that rash wage and price hikes create the inflation we seek to avoid. Finally, there is still much we don't know about the virus and its variants, and the usual geopolitical issues (e.g. managing relations with China, income inequality) are still present. We expect higher volatility going forward in 2021, as last year's hope rally seemed ahead of itself and will eventually meet reality. We expect our rebalancing efforts will be to move assets from stocks to replenish fixed-income allocations after the bond sales we executed to buy stocks during 2020.

We anticipate the reopening of the economy to be uneven due to supply-chain disruptions. The markets are anticipating good news and there will certainly be disappointments as we move through the year. That said, there appears to be quite a bit of pent-up consumer demand that should sustain the economy moving forward as we hopefully put the worst of the pandemic behind us.

As always, please take time to review your financial plan and portfolio(s) and contact us with your comments and questions.

-Your Wealth Management Team at JJ Burns & Company

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Unless otherwise stated, performance numbers refer to indexes, which cannot be invested in directly and have no fees or trading expenses associated with them. All index data provided by Morningstar, Inc.

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The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

The Barclays US Corporate High Yield 2% Issuer Capped Bond Index is an issuer-constrained version of the flagship US Corporate High Yield Index, which measures the USD-denominated, high yield, fixed-rate corporate bond market. The index follows the same rules as the uncapped version, but limits the exposure of each issuer to 2% of the total market value and redistributes any excess market value index wide on a pro rata basis. The Barclays U.S. Aggregate Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The Barclays US Municipal Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed tax-exempt bond market. The index includes state and local general obligation, revenue, insured, and pre-refunded bonds. The Barclays Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers. Returns hedged to various currencies are published for multi-currency indices.

The Morningstar® US Real Asset Index is a diversified portfolio of four different asset classes that have historically displayed high sensitivity to inflation. Real assets are defined as TIPS, commodity futures-based strategies, real estate investment trusts, and inflation-sensitive equities such as upstream commodity stocks and master limited partnerships

The S&P U.S. REIT Index defines and measures the investable universe of publicly traded real estate investment trusts domiciled in the United States. The S&P Global ex US REIT index is a comprehensive benchmark of publicly traded equity REITs listed in both developed and emerging markets, excluding the United States. The S&P 500® index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. The S&P GSCI is designed as a benchmark for investment in the commodity markets and as a measure of commodity market performance over time. It is also designed as a tradable index that is readily accessible to market participants.

The MSCI ACWI ex USA Index captures large and mid-cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 23 Emerging Markets (EM) countries. The MSCI EAFE Index is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the US and Canada. The MSCI Emerging Markets Index captures large and mid-cap representation across 23 Emerging Markets (EM) countries.

The Bloomberg Commodity Total Return index is composed of futures contracts and reflects the returns on a fully collateralized investment in the BCOM. The index currently represents 20 commodities, which are weighted to account for economic significance and market liquidity.