Portfolio Manager Commentary

March 19, 2021

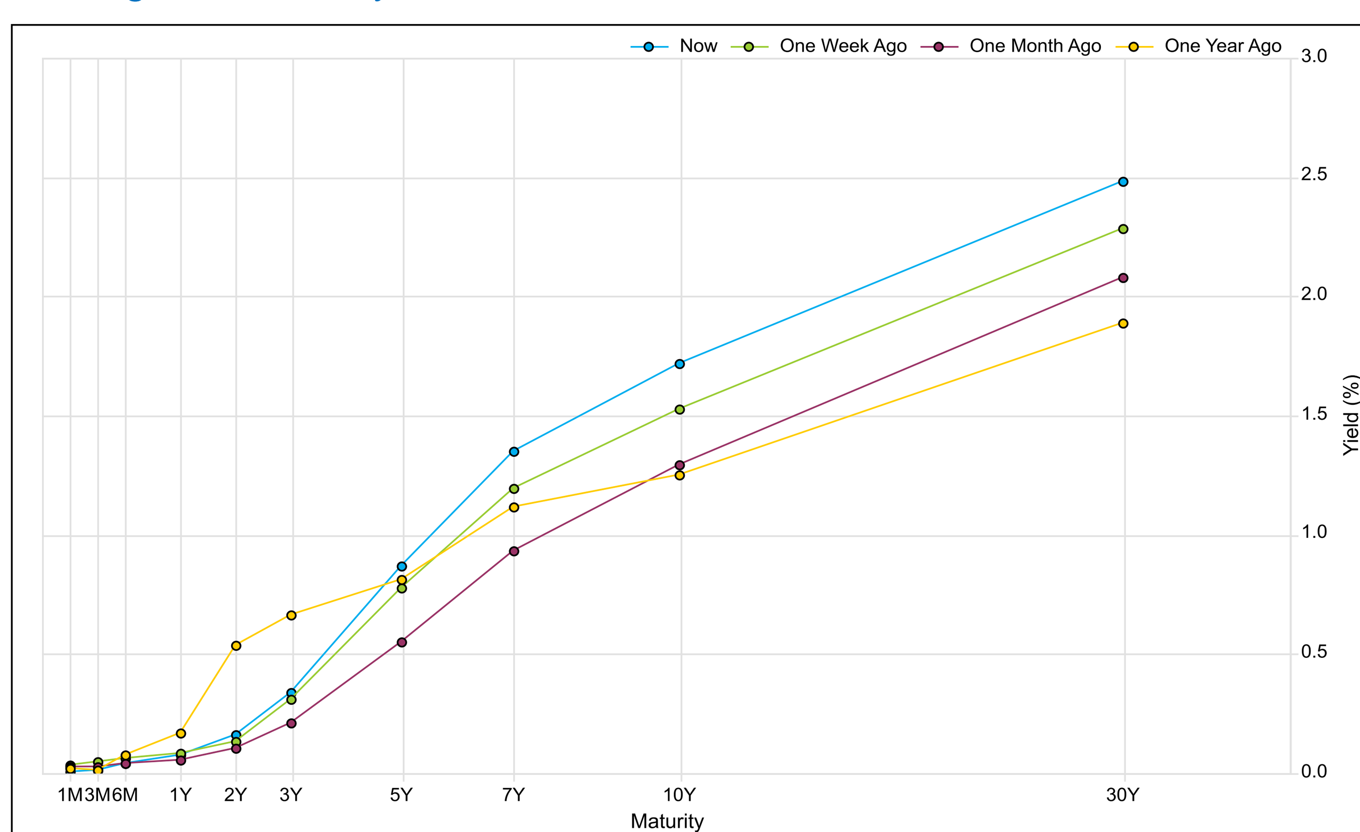
Economic Outlook

U.S. Retail Sales were down 3.0% for February, after having been up 7.6% in Janurary. Industrial Production was down 2.2% for February, a bit worse than the 1.1% rise in January. Capacity Utilization stood at 73.8% for February versus 75.5% for January. The National Association of Homebuilders Index came in at 82 for March versus 84 for February. Finally, the U.S. Index of Leading Economic Indicators was up 0.2% for February.

Fixed Income

A battered Treasuries market faces another trying week as it will have to absorb a massive slate of auctions focused in maturities that have gotten pummeled amid a brightening outlook for growth and inflation. It has been about a month since a disastrous seven-year auction sent the bond market into a tailspin that reverberated across financial markets and helped put benchmark yields on the path to prepandemic levels. Now that maturity is on the schedule again, with a $62 billion offering looming as a source of anxiety for dealers in the week ahead. The government will be selling into a market that has endured a painful stretch, driving an index of longer maturities into a bear market. A key part of the yield curve just hit its steepest in over five years after the Federal Reserve reaffirmed plans to keep short-end rates near zero through 2023. The seven-year part of the curve has been especially vulnerable to shifting speculation on monetary policy and has taken a beating as traders bet that the Federal Reserve will have to act on rates sooner than their stated plan. The seven-year note is underperforming surrounding maturities by the most since 2015. "Supply is going to be a very important part of this week," said Justin Lederer, a strategist at Cantor Fitzgerald. "We'll really see what type of end-user demand shows up at these auctions, and if the seven-year last month was so poorly sponsored because of volatility of that day or whether it's a continued theme. There's just a lot of volatility now and questions about whether higher rates are going to impact equities." In February, when investors were already stepping back from bonds amid stimulus talks and the vaccine rollout, the government received record-low demand for the seven-year auction. That result added fuel to a Treasuries selloff that now is in its seventh straight week. The fixed-income slump has hit longer maturities hardest. At the close of trading last week, a Bloomberg Barclays U.S. Treasury Index that tracks debt with ten years or more to maturity was down around 22% from its March 2020 peak, putting it in bear territory -- at least by this gauge. The ten-year yield traded as high as 1.75% last week, the highest since January 2020, before ending the week at a yield of 1.72%. Yields and inflation expectations also moved higher last week after Fed Chair Jerome Powell pushed back on any need to combat these events.

Change in Treasury Yield



Current Generic Bonds Yields

Treasuries		Agencies		Corporates		Municipals	
3 mo.	0.00%	3 mo	-0.07%	3 mo	0.19%	3 mo	0.18%
6 mo	0.02%	6 mo	-0.06%	6 mo	0.21%	6 mo	0.18%
1 yr	0.06%	1 yr	-0.02%	1 yr	0.26%	1 yr	0.22%
2 yr	0.15%	2 yr	0.18%	2 yr	0.35%	2 yr	0.27%
5 yr	0.88%	5 yr	0.80%	5 yr	1.18%	5 yr	0.67%
10 yr	1.72%	10 yr	1.81%	10 yr	2.31%	10 yr	1.27%
30 yr	2.43%	30 yr		30 yr	3.27%	30 yr	2.02%

Equity

U.S. equity finished the week lower as the S&P 500 Index closed -0.84%. After gaining a lot of traction, Energy (-7.54%) was hit the hardest this week as Communication Services (+0.96%), Health Care (+0.41%), and Consumer Staples (+0.35%) were the only positive sectors. The value outplaying growth trend remains in-tact as Energy and Financials are up 30.69% and 16.08%, respectively while Tech (-0.32%) is barely breakeven. Rates remain the key focus after a run-up in Treasury yields yesterday.

FactSet Research Systems notes that, according to BofA's latest Flow Show report, global equities attracted a record $68.3B in the week-ended March 17th. U.S. equities took in a record $53B. The firm noted that global equity funds have attracted $347B year-to-date with inflows annualizing at $1.6T. This compares to the prior record of $0.3T in 2017 (Reuters). The article pointed out that over the last four weeks, financials have seen a record $11.2B of inflows. This sector has been a big beneficiary of the higher rate backdrop and a recent WSJ article highlighted a near-term earnings tailwind from reserve releases. Consumer discretionary has attracted $2.2B over past four weeks, the second largest inflow on record. This sector benefits from reopening leverage (retail, travel). Tech has attracted $3.2B over last four weeks, the sixth largest inflow ever. Despite rate-driven scrutiny on growth factors, there seems to still be a good deal of reluctance to part with secular winners.

Index Returns	Last Week	YTD
Dow Jones Industrials	-0.50%	7.07%
S&P 500 (LCap)	-0.84%	4.51%
S&P 400 (MCap)	-1.22%	13.30%
Russell 2000 (SCap)	-2.77%	15.83%
NASDAQ Composite	-0.79%	2.54%
MSCI EAFE (Int'l)	0.20%	4.76%
iShares Real Estate	-0.91%	5.13%

Source: FactSet Research Systems

Asset Allocation

Current Sentiment

Asset Class	Sentiment
Cash	Favorable
Short FI	Neutral
Intermediate FI	Neutral
Inflation-Adjusted FI	Neutral
High Yield FI	Unfavorable
International FI	Unfavorable
Equity Income	Neutral
Large Cap Equity	Favorable
Mid Cap Equity	Neutral
Small Cap Equity	Unfavorable
International Equity	Unfavorable
Emerging Markets Equity	Unfavorable
Real Estate	Neutral
Commodities	Unfavorable

Summary below - Current stance on most asset classes:

Cash - Overweighting due to market volatility and uncertainty from Covid-19.

Short Term Bonds - Relative to Intermediate Bonds, the reduced duration is preferable given the oversold long-end of the curve.

Intermediate Term Bonds - The current trading range of intermediate bonds warrants a neutral position with limited upside potential. Some opportunities still remain in certain sectors.

Inflation-Adjusted Bonds - Low inflation expected in near-term providing zero real return.

High Yield Bonds - Spreads are rising given the market turbulence and exposure to unnecessary credit risk when compared to Treasuries would not be advised.

International Bonds - Foreign bonds offer good diversification qualities and higher yield opportunities, however, risks have been elevated recently and investment should be made cautiously.

Equity Income - High quality and higher-dividend-paying companies remain attractive for long-term investors given their favorable risk-adjusted profile and current yield curves.

Large Cap Stocks - A favorable weighting is recommended. Growth continues to be a more favorable style and should continue to be overweighed versus Value.

Mid Cap Stocks - Mid cap exposure remains neutral - more attractive than small caps but not as attractive as large caps.

Small Cap Stocks - In broad market corrections, small cap stocks will suffer most with increased volatility. Underweight until a clearer picture of recovery ensues.

International Stocks - Given most foreign investment is in developed markets and European countries, until sovereign debt concerns are alleviated, an underweight is recommended.

Emerging Market Stocks - Stronger balance sheets, less debt, and better growth potential make emerging markets more fundamentally attractive than developed countries longer-term. However, trade uncertainty and dollar strength provide a headwind for EM in the near term.

Real Estate - Pricing has begun to stabilize and long-term valuations appear attractive. Real Estate should continue to be a strong alternative to other asset classes.

Commodities - Global demand should support higher prices if the global recovery remains on track. Volatility will be higher, and commodities will be susceptible to short-term price shocks, however, if used in conjunction with other asset classes, risk can be reduced substantially within a diversified portfolio. Used alone though is not recommended as the short-term outlook is not favorable.

Sources of statistical information are Bloomberg and Ned Davis Research.

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