SANCTUARY WEALTH

MUIRWOOD PRIVATE WEALTH

SANCTUARY CIO CORNER

A WORD FROM JEFF KILBURG

SANCTUARY ASSET MANAGEMENT

Halftime 2021

A Historic Year

As markets continue to make new highs, investors have largely benefited thanks to the accelerated reopening of the U.S. economy in the first half of 2021. In the first quarter of 2020, the COVID-19 pandemic hit U.S. shores, resulting in a 1929-like depression. Yet, within less than a year, a spending boom reminiscent of the World War II wartime boost has injected confidence and resources into the economy.

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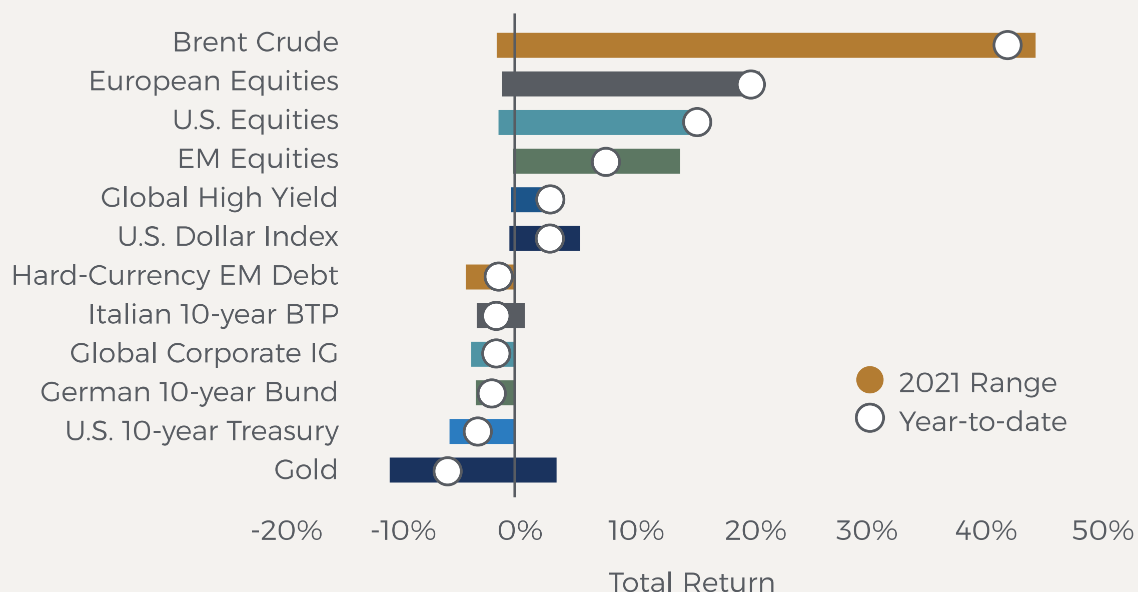
Amid tremendous uncertainty, we witnessed companies drastically reduce operations during the early stages of the pandemic. This created new paths to profitability that were highlighted in both Q1 and Q2 2021 earnings reports.

After the U.S. government pressed pause on nearly the entire domestic economy, we swiftly experienced historic monetary and fiscal stimulus to assist the economy and marketplace during the pandemic. Despite the recovery being somewhat dislocated across the country, the U.S. economy and markets quickly found footing and equities have established new all-time highs domestically as the second quarter closes.

Assets in Review

Selected asset performance, 2021 year-to-date and range



Past performance is not a reliable indicator of current and future results. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from Refinitive Datastream as of June 17, 2021. Notes: The two ends of the bars show the lowest and the highest returns at any point this year to date, and the dots represent the current year-to-date returns. Emerging market (EM), high yield and global corporate investment grade (IG) returns are denominated in U.S. dollars, and the rest in local currencies. Indexes or prices used are, in descending order: Brent Crude, MSCI Europe Index, MSCI USA Index, MSCI Emerging Markets Index, Bank of America Merrill Lynch Global High Yield Index, ICE U.S. Dollar Index (DXY), spot gold, J.P. Morgan EMBI Index, Refinitiv Datastream Italy 10-year benchmark government bond index, Bank of America Merrill Lynch Global Broad Corporate Index, Refinitiv Datastream Germany 10-year benchmark government bond index and Refinitiv Datastream U.S. 10-year benchmark government bond index.

Looking Ahead

The question as we head toward the second half of the year is whether the recovery is sustainable. The reboot of the U.S. economy is unequivocally outpacing expectations. The Fed has repeatedly revised its growth estimates for U.S. gross domestic product (GDP) upwards over the past 12 months to considerably higher than original estimates. GDP is expected to surpass pre-COVID levels this year, rather than taking several years as initially expected. Let's dig into the data to attempt to better understand.

In the Q2 of 2020, GDP shrank by -31.4% on a quarter-over-quarter annualized rate. That was followed by an eye-popping initial rebound of +33.4% in the Q3 of 2020, then more moderate growth of +4.3% in the fourth quarter of 2020 and +6.4% in the first quarter of 2021.

Growth in the Q2 of 2021 is expected to jump to +9.4% as the economy further reopens, according to Bloomberg's tracking of economists' estimates. These consensus estimates suggest Q2 2021 will be followed by steadily descending, but still positive, growth rates for the back half of 2021.

Looking ahead to the second half of 2021, I remain constructive on equity markets yet, there are some significant market risks to consider. Possible risks include the potential peak earnings growth rates, higher inflation, Fed policy and the developing undertones of mixed investor sentiment.

Specific to Fed policy, the Fed has been trying to establish inflation. Surpassing $8T on its balance sheet in the month of June, it continues to put the pedal to the metal on its policies. Formally, the Fed has shifted its reaction function associated with both its mandates—inflation and employment—from being "outlook" based to "outcome" based. In essence, the Fed has moved the proverbial goalposts and in doing so, will most likely achieve its inflationary goals. However, there is overarching risk that the markets may view otherwise.

We recently endured the market's inflationary concerns as the 10-year note nearly tested the 2% level in Q2 2021 in a feverish manner. It has since settled back to being tethered to 1.5%, causing the inflation alarmists to head back to the sideline for now.

To make things even more challenging for investors to gauge inflation, there are multiple measuring sticks to lean into:

- **Consumer Price Index (CPI):** CPI is a measure of the average change in the prices paid by urban consumers for a market basket of consumer goods and services. Data is sourced by collecting data from 75 urban areas throughout the country and from about 23,000 retail and service establishments. Data on rents are collected from about 50,000 landlords or tenants. This index effects more than 80mm people because of adjusting income payments for Social Security, union beneficiaries, Federal civil service and SNAP, the food stamp program, recipients. (As of May 2021, CPI has gone up 5.0% over the last 12 months, not seasonally adjusted. With the biggest changes coming to Energy up 28.5% and used cars/trucks up 29.7% https://www.bls.gov/news.release/cpi.nr0.htm.)

- **Producer Price Index (PPI):** This program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services. https://www.bls.gov/ppi/home.htm

- **U.S. Personal Consumption Expenditure Core Price Index (PCE):** PCE tracks overall price changes for goods and services purchased by consumers in the United States. This captures inflation (or deflation) across a wider range of consumer expenses and reflects changes in consumer behavior. It is published by the BEA (Bureau of Economic Analysis) not the BLS (Bureau of Labor Statistics) as the other Indexes are. Read more at https://www.barrons.com/articles/inflation-is-in-the-cpi-of-the-beholder-the-feds-favored-gauge-pce-explains-its-policy-stance-51622228401

Closing Out

In conclusion, I am constructive on equities all the while expecting some volatility in the back half of 2021, as Fed policy continues to be measured, deciphered and scrutinized. My conviction is predicated upon the belief that the Fed's recently augmented "outlook" will not translate into significantly higher rates any time soon. This, combined with the powerful restart of our economy, should provide a green light for investors.

With large cap blended growth and value offering potential opportunities, I prefer to take risk in equities focused on owning essential blue-chip names, cyclical and industrials, and I believe in having selective and deliberate exposure to S&P 500 sector and sub-sectors. With a range bound U.S. Dollar Index between 90-94, I also favor exposure to international equities.

We absolutely must anticipate bouts of market volatility as markets will test the Fed's resolve to deliberately stay "behind the curve" on inflation. However, welcome any pullbacks in equity markets that will most likely push the VIX back up towards 30 as they should be shallow and swiftly met with buyers as nearly $5T remains in cash poised for a dip. The historic large cash balances held by investors provides additional confidence.

Please feel free to reach out as we seek to be assistive to you by incorporating a more thoughtful, active and dynamic approach to the marketplace for the back half of 2021, which should provide an opportunity to harness alpha. We welcome any re-balancing or weighting questions in client portfolios that you may have.

Contact:

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