QUARTERLY ECONOMIC COMMENTARY | Q2 | 2021

Stocks closed out the first half of the year with double-digit percentage gains, powered by an economic recovery that many investors believe is still gathering pace. Data on everything from hiring to consumer spending has bounced back. Corporate earnings have shined, too; a record number of companies have issued positive earnings and sales guidance for the second quarter.

The S&P 500 is up 15% this year, closing June at a record high. Small-cap stocks have also been on a tear since last fall. The Russell 2000 index of small-cap stocks has advanced 49% since the end of September 2020, when promising Covid-19 vaccine trials inspired confidence that the economic future was bright. It is up 17.5% this year. According to many analysts, the next phase of recovery should give small caps a lift over large caps in part because their valuations are cheaper. The Russell 2000 is trading at 17.7 times projected earnings over the next 12 months, compared with 21.5 times for the Russell 1000 large-cap index.

Other equity groups, such as developed international and emerging market stocks, also produced double-digit returns. Although generally positive for the year, most bonds were stymied by the jump in treasury yield rates since last year. High yield and inflationary bonds fared best.

In this commentary, we raise three key questions that will shape markets in the second half of the year. First, will the V-shaped recovery continue? There are several long-term factors pointing to slower growth ahead, including a growing (often nonworking) older population, ballooning amounts of debt and a sharp rise in government budget deficits that will have to be pared back through tax increases or spending cuts.

Second, will rising inflation force the Fed to change their monetary policy? The May Consumer Price Index rose to 5.0%, the highest reading in 13 years. The largest contributors were energy, food away from home and car and truck rentals. Despite the shift, the Fed has stated the higher prices are “transitory” and would not cause them to sway from their accommodative interest rate policy.

Third, with inflation rising, why aren’t bond yields rising? The behavior of the bond market suggests that economic growth might be more muted than investors expected. The 10-year Treasury yield has fallen below 1.5% after eclipsing 1.7% in March. Another possibility is that until the Fed decides to reduce its $120 billion of monthly bond purchases, it will continue to overwhelm the supply of government bonds.

The combination of fiscal and monetary stimulus, along with the desire of businesses and consumers to return to normal spending patterns suggest the US economy will grow throughout 2021, albeit at a slower pace than the red-hot numbers so far.

We will continue to monitor and assess the importance of potential Federal Reserve policy shifts and President Biden’s infrastructure and tax initiatives, as well as the constant flow of economic and market data, as we strategically implement our philosophy of maintaining broadly diversified portfolios for you.

Miller Wealth Advisors

Planning for life. Preparing for a lifetime.

Sources:
- WSJ -Stocks Close Out Record Half
- Washington Post -What Happens to Economy When $5.2T in Stimulus Wears Off?
-Valmark – 2nd Quarterly TOPS Forum

Past performance is not a guarantee of future results. It is also important to note that one cannot invest directly into an index. Diversification cannot assure a profit or guarantee against a loss of value.

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