Economic Update

A Review of Second Quarter 2021

2021 is half over, and most states have now fully re-opened without restrictions. We did not meet President Biden's target goal of 70% of U.S. adults having received at least one shot by July 4, but we did come close with roughly 67%. On one hand, that is a large enough portion of the population to probably head off another national coronavirus wave. On the other hand, the vaccinations have not been evenly dispersed. There still are many communities with significant vaccination hesitancy, which is starting to result in pockets of localized infection surges as the more contagious Delta variant takes root.

As restrictions continue to be lifted, our economy continues to rebound. Annualized first quarter GDP growth during the first quarter of 2021 was 6.4%. As of this writing, second quarter GDP growth is expected to be roughly 8%. Economists are also expecting strong GDP numbers for the rest of the year, leading to what should turn out to be a historically strong 2021 overall.

U.S. Economy

Markit survey manufacturing PMI increased from 62.1 in May to 62.6 in June, which is a record high. Meanwhile, the services PMI fell from 70.4 in May, which was a record high, to 64.8 in June, which is still the second highest reading on record. Readings above 50.0 predict economic expansion.

Job numbers tell a similar story. The U.S. economy added 850,000 jobs in June. This was the highest number of jobs added since August of last year. Still, that only makes a small dent in our current labor shortage as U.S. employers had 9.3 million job openings in April, which was also a record high. The unemployment rate is now 5.9%.

Employers are becoming increasingly desperate to hire. However, some combination of lingering health concerns, childcare responsibilities, and relatively generous unemployment payments continue to keep many workers on the sideline. Retaining current workers has been difficult as well. More people quit their jobs in April than any month on record prior to that. Wages have responded as a result, posting an 0.4% increase in May and a 0.3% increase in June. That raised the year-over-year increase in wages to 3.6%.

The residential housing market has been red-hot as of late. Housing supply is low due to shortages of labor, lumber and other building materials. Housing demand is high due to our strengthening economy and relatively low interest rates. The net result is higher prices for existing home sales. Per Redfin, which analyzes more than 400 metro areas nationwide, a record-high 51% of homes sold for more than their list price in the four-week period ending May 23, 2021.

Millennials are now moving into prime home-buying age, and they are often employed in high-wage industries where the ability to work remotely is anticipated to continue even after the pandemic ends. Not surprisingly, homebuilder confidence remains strong, even higher than it was pre-pandemic.

Unfortunately, while the U.S. economy is undeniably growing once again, the cost of this growth is high. The Congressional Budget Office projects that the U.S. logged a federal budget deficit of $3.1 trillion last year. For 2021, they are expecting roughly the same amount at $3.0 trillion. This is equivalent to 13.4% of our annual GDP.

The combination of a strong economy and increasing government debt has resulted in a surge in inflation expectations. The Consumer Price Index for All Urban Consumers rose 0.6% on a seasonally adjusted basis during May. It has now risen 5% total over the last 12 months, which is the highest mark since August 2008. Whether or not this inflation will persist has divided the economic community. Fed chair Jerome Powell has argued that higher inflation is mostly transitory, but some well-regarded investors such as Paul Tudor Jones are openly questioning that assumption.

Even the Fed seems to be hedging its bets a little, as they recently moved their expectation for future interest rate increases forward by a few quarters. Now seven of the 18 members are expecting at least one rate increase before the end of 2022, and most members are expecting multiple rate increases during 2023.

International Economy

Markit survey PMI readings for the United Kingdom also indicate strong growth in June. Like the United States, both the U.K. manufacturing survey and the service survey registered above 60.0, which portends economic expansion. They also are dealing with the same labor shortages, supply constraints, and inflation concerns that we are finding here in the U.S. One issue unique to Britain, however, is Brexit. For the first four months of 2021, British exports to the European Union are down 27.1% year-over-year per the E.U.

The Eurozone is also experiencing a surge in PMI readings. Markit projects that the regional economy is now growing at its fastest pace in the last fifteen years. The biggest near-term risk for the region seems to be the Covid Delta variant, which has moved to the continent after making its way through the U.K. just prior to that.

Japan seems to be the only outlier among the major developed economies. PMI readings remain tepid as the country has been slow to lift restrictions relative to the rest of the world. Vaccine rollout has been slow in that country. After largely avoiding major covid outbreaks up until this point, the country is now experiencing a surge due to the Delta variant as well. This is very poor timing as the country is set to host the Olympics later this month. Foreign fans have already been banned and the number of domestic fans allowed to attend has been severely limited. Prime Minister Yoshihide Suga has also kept open the possibility that the games could proceed with no spectators at all.

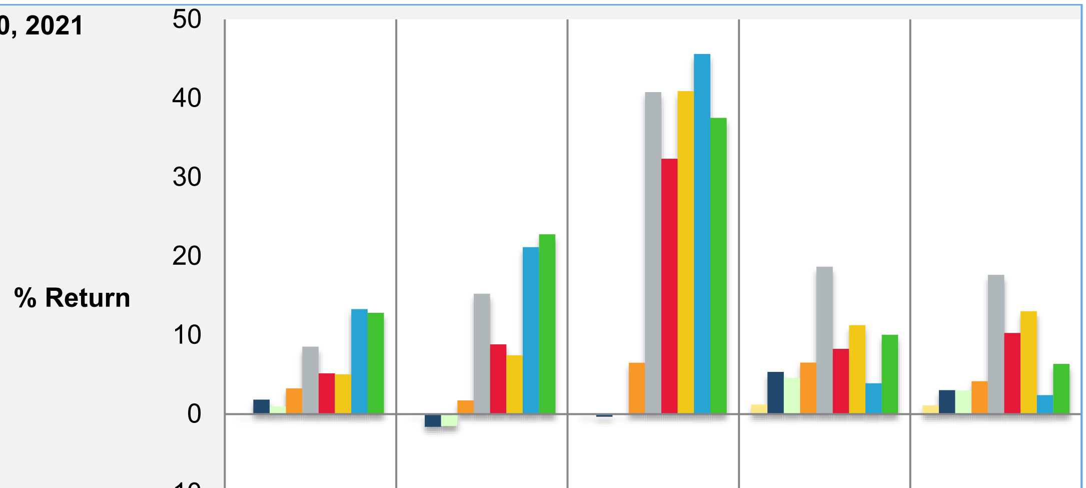
Markets

Equity markets had a great quarter as economies throughout the world continued to re-open. U.S. large-cap equities, as represented by the S&P 500 Index, gained 8.55% during the quarter and are now up 15.25% for the year thus far. Developed international equity markets, as represented by the MSCI EAFE Index, have also done well, albeit not quite at U.S. levels. The MSCI EAFE finished the quarter up 5.17% and is now up 8.83% for the year.

Emerging markets slightly underperformed relative to developed ones, but still put up a solid quarter as well. The MSCI Emerging Markets Index finished the quarter up 5.05% and are now up 7.45% year to date. Recent inflation concerns continue to benefit both real estate and commodities. The Dow Jones UBS Commodity Index and the Wilshire REIT Index have gained 21.15% and 22.78% respectively for the year so far.

Bond indexes gained back some of their losses from the first quarter as interest rates moderated. The Barclays U.S. Aggregate Bond Index was up 1.83% for the quarter but is still down 1.60% for the year. The Barclays Global Aggregate Bond Index gained 0.98% during the last three months, but it is still down 1.52% year to date. The Barclays U.S. Inflation-Linked Bond Index, however, has fared a little better due to the previously mentioned inflation expectations. That index is up 1.73% for the year so far.

Through June 30, 2021



	Quarter-to-Date	Year-to-Date	1-Year	3-Year	5-Year
T-Bills	0.01	0.02	0.07	1.20	1.12
Barclays US Agg Bond Index	1.83	-1.60	-0.33	5.34	3.03
Barclays Global Agg Bond Index	0.98	-1.52	0.08	4.59	2.98
Barclays US Infl Linked Bond Index	3.25	1.73	6.51	6.53	4.17
S&P 500 Index	8.55	15.25	40.79	18.67	17.65
MSCI EAFE Index	5.17	8.83	32.35	8.27	10.28
MSCI Emerging Markets Index	5.05	7.45	40.90	11.27	13.03
DJ UBS Commodity Index	13.30	21.15	45.61	3.90	2.40
Wilshire REIT Index	12.84	22.78	37.52	10.06	6.36

Outlook

There are very strong tailwinds for the global economy right now. Business sentiment is at near-record levels. Global trade is recovering. Job growth is strong. The housing market is red hot. Stimulus programs are still in place throughout the world. Consumers have money in their pockets and, in many cases, also have a pent-up urge to go out and spend it. All these elements combine to support economic strength and therefore potential continued stock market gains.

On the other hand, market valuations are not cheap at these levels. The emergence of a newer, deadlier, Covid variant that vaccines are not effective against would likely cool off hot markets quick. Alternatively, a bout of sustained inflation could hurt our economy as well. So, while we remain somewhat optimistic about equity markets overall, we still recommend some caution. A diversified portfolio containing a reasonable amount of equity exposure is always recommended for any investor with a long enough time horizon.

Barclays US Aggregate Bond Index: The Aggregate Bond Index is a broad-based benchmark that measures the investment grade, dollar-denominated, fixed-rate taxable-bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS. The Aggregate rolls up into other Barclays Capital flagship indices such as the multi-currency Global Aggregate Index and the Universal Index, which includes high-yield and emerging markets debt. The Aggregate Index was created in 1986, with index history backfilled to Jan. 1, 1976.

Barclays Global Aggregate Bond Index: The Global Aggregate Index provides a broad-based measure of the global investment grade fixed-rate debt markets. The Global Aggregate Index contains three major components: the Aggregate (USD 300mn), the Pan-European Aggregate (EUR 300mn) and the Asian-Pacific Aggregate Index (JPY 35bn). In addition to securities from these three benchmarks (94.0% of the overall Global Aggregate market value as of Dec. 31, 2010), the Global Aggregate Index includes Global Treasury, Eurodollar (USD 300mn), Euro-Yen (JPY 25bn), Canadian (USD 300mn equivalent) and Investment Grade 144A (USD 300mn) index-eligible securities not already in the three regional aggregate indices. The Global Aggregate Index family includes a wide range of standard and customized sub-indices by liquidity constraint, sector, quality and maturity. A component of the Multiverse Index, the Global Aggregate Index was created in 1999, with index history backfilled to Jan. 1, 1990.

Barclays Global Inflation-Linked Index: The Global Inflation-Linked Index (Series-L) includes securities that offer the potential for protection against inflation as their cash flows are linked to an underlying inflation index. All securities included in the index have to be issued by an investment-grade-rated sovereign in its local currency. The list of eligible currencies is the same set of currencies eligible for inclusion in the Global Aggregate Index. The Global Inflation-Linked Index (Series-L) represents a stand-alone multi-currency index exposed to the real yield curve for each relevant currency. As such, the index does not contribute to the Global Aggregate Index. The Global Inflation-Linked Index (Series-L) was created on Oct. 31, 1997.

S&P 500® Index: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market. It measures the movement of the largest issues. Standard & Poor's chooses the member companies for the 500 based on market size, liquidity and industry group representation. Included are the stocks of industrial, financial, utility and transportation companies. Since mid-1989, this composition has been more flexible and the number of issues in each sector has varied. The returns presented for the S&P 500 are total returns, including the reinvestment of dividends each month.

MSCI EAFE Index: The MSCI EAFE® Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed-market equity performance, excluding the U.S. and Canada. As of April 2002, the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

MSCI Emerging Markets Index: The MSCI EMF (Emerging Markets Free) Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. As of April 2002, the MSCI EMF Index consisted of the following 26 emerging-market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey and Venezuela.

DJ UBS Commodity Index: Dow Jones-UBS Commodity Index℠ and Dow Jones-UBS Commodity Index Total Return℠ the DJ-UBSCI℠ family includes both the DJ-UBSCI℠, which is calculated on an excess-return basis, and the DJ-UBSCITR℠, a total return index based on the DJ-UBSCI℠. The former reflects the return of underlying commodity futures price movements only, while the latter reflects the return on fully collateralized positions in the underlying commodity futures.

Wilshire US REIT Index: Introduced in 1991, the Wilshire REIT index is intended as a broad measure of the performance of publicly traded real estate equity securities. The index is market-capitalization weighted of publicly traded real estate securities, such as Real Estate Investment Trusts (REIT), Real Estate Operating Companies (REOC) and partnerships. The index is composed of companies whose charters are the equity ownership and operation of commercial real estate.

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