THE REBOUND CONTINUES

JULY 2021

July 19th's volatility is a good example of our belief that the "path to normalcy" might not be straightforward, as we discuss in this newsletter. While the themes are broadly similar, keep an eye out for more analysis of this week's market news coming soon!

Markets reached new highs in the first half of this year, driven by a pandemic rebound and all the optimism that entails. Year-to-date returns for the S&P 500 are 14.41% through June 30, the 18th best start to a year for stocks.[1]

All said, businesses are doing well in the pandemic rebound.[2] S&P 500 companies are expected to post earnings-per-share growth of almost 63% for the second quarter, compared to the second quarter of 2020.

Obviously, the same period last year was marked by broad economic shutdowns, but this does go to show that a recovery seems to be taking hold, at least in the U.S. In this note, we'll cover more about the economy and what might lie ahead.

QUICK TAKE

Jobs are an interesting microcosm of the recovery: many people are looking for work and yet millions of jobs remain unfilled. There are a number of pandemic-related factors that could be involved, illustrating that the path to "normalcy" may still take a while to navigate. In the meantime, with short-term inflation spiking, we're looking ahead to prospects for slightly-higher inflation over the coming few years, as even a moderate 2% annual inflation rate will be a change of pace from the last several years.

Jobs Are Coming Back—But Staying Unfilled

Employment is an interesting area right now—one that not only helps illustrate some of the complexities of the pandemic, but which directly impacts many of our business owner clients.

The unemployment rate is at 5.9% and we're still down about 7 million jobs since the onset of the pandemic. This May, about 9 million Americans said they wanted a job but couldn't find one. At the same time, job openings are at record highs, with 9.2 million positions available (again, as of May).

Why the disconnect?

Index Returns
(June 2021 and Year To Date)

Bloomberg Barclays Aggregate Bond Index US investment grade bonds	0.70% for June*	-1.60% for the year*
S&P 500 Index Large US Equities	2.22% for June*	14.41% for the year*
MSCI World Index Large/mid developed world equities (ex-US, CAN)	1.52% for June*	13.33% for the year*
MSCI Europe Index Large/mid developed european equities	-1.33% for June*	12.28% for the year*
MSCI Emerging Markets Index Global emerging market equities	0.21% for June*	7.58% for the year*

* As of June 30, 2021

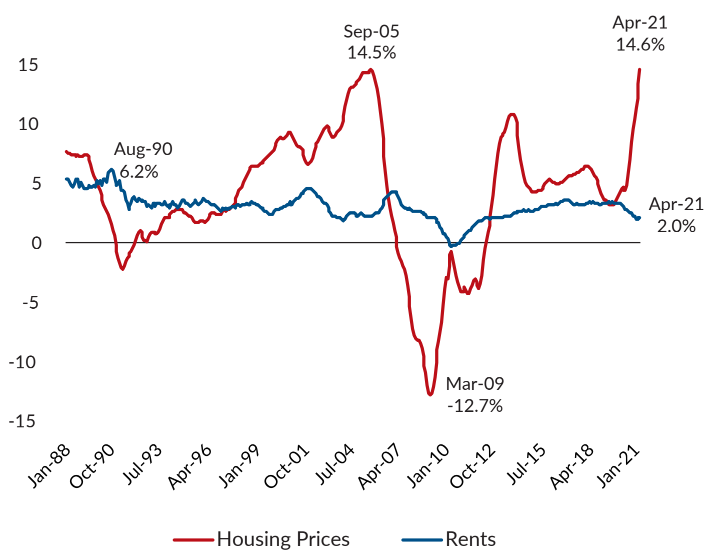
There's likely some level of skills or location mismatch between open jobs and job seekers, and in some cases workers are preferring to maintain remote work rather than returning to the office. In other cases, extended unemployment benefits have given workers more flexibility to be selective in their job search.[3] There are also those who've stayed out of the workforce in order to care for children and/or aging parents.

Taken together, these factors could be helping to drive a complicated jobs recovery—one which still has more than a few knots to unravel.

It's also important to note that there are about 2.6 million workers who have retired since the pandemic, about 1.5 million more than would normally be expected.[4] Taken together, these factors could be helping to drive a complicated jobs recovery—one which still has more than a few knots to unravel.

Of course, with school starting in the fall and federal unemployment supplements ending, we could see a more rapid return to "business as usual" later this year. While the employment situation isn't something we're concerned about, it does drive home the point that the recovery isn't necessarily going to be complete, immediate, and without the occasional bump in the road. This has become obvious as the indoor mask mandate returns to Los Angeles County starting Sunday, July 18 – and it's impossible to predict the economic impact of the Delta strain.

Housing Prices and Owners Equivalent Rent
(12-month rolling, 1/1/88-4/30/21)



Source: Bureau of Labor Statistics and Standard and Poors, as of 5/31/21

What About Inflation?

Another interesting bump in the road has been inflation. If you've filled your gas tank or looked at buying property recently, you've probably noticed an immense increase in prices from a year ago. Gas prices are up 40% for the year, reaching their highest level in seven years.[5] Home prices have jumped so fast this year that we've hit the largest-ever difference between home price inflation and rent growth.[6]

While these types of data points are, in large part, driven by the tumult of a rapid recovery, we could be seeing some inflation trends that persist into the future.

The Federal Reserve revealed two new rate hike projections for 2023 and higher inflation projections for 2021.[7] Recent inflation measures have exceeded the 2% average annual target, though the Fed has continued to reiterate that it will need to see sustained progress beyond the immediate recovery period before making any policy changes.

That said, even an average 2% annual inflation rate will be a change of pace. A Wall Street Journal survey of economists found an average forecasted rise in inflation of about 2.3% annually in 2022 and 2023—higher than we've seen since 1993.[8] While this is not a bad thing, a slightly higher average inflation rate could have an impact on everything from borrowing to portfolios, making it an important data point to monitor going forward.

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Continuing to Adapt

Whether we're adapting to a new regime in inflation, confronting new and future challenges from the ongoing pandemic, or navigating a recovering labor market, there's a balance to be made between long-term strategic thinking and short-term adaptation. We do think there will be some necessary changes in strategies over the coming years based on shifting economic conditions, but we caution—as always—against rash or emotional decision-making.

Of course, right now that can be difficult (especially if you want to buy a house). With so much pent-up demand and pandemic-related complexities, there's a bit of noise in the economic data. This doesn't make the data wrong, it just means it's a good idea to exercise caution and prudence before taking next steps.

As always, please don't hesitate to reach out to us with your questions, thoughts, or concerns. We're here to help. And in the meantime, we hope you're enjoying a wonderful summer with friends, family, and loved ones.

The Bloomberg Barclays U.S. Aggregate Bond Index measures the investment-grade U.S. dollar-denominated, fixed-rate taxable bond market and includes Treasury securities, government-related and corporate securities, mortgage-backed securities, asset-backed securities and commercial mortgage-backed securities.

The S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market.

The MSCI World Index is a broad global equity index that represents large and mid-cap equity performance across 23 developed markets countries and covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI Europe Index captures large and mid-cap representation across 15 developed markets countries in Europe and covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.

The MSCI Emerging Markets Index captures large and mid-cap representation across 26 emerging markets countries and covers approximately 85% of the free float-adjusted market capitalization in each country.

Gross domestic product (GDP) is a monetary measure of the market value of all the final goods and services produced in a specific time period. GDP is the most commonly used measure of economic activity.

SOURCES

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Performance table sources:

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