March 1, 2021

Weekly Viewpoint

Yields Rise, Stocks Fall

Performance for Week Ending 2.26.2021

The Dow Jones Industrial Average (Dow) finished off 1.78%, the Wilshire 5000 Total Market Index[SM] (Wilshire 5000[SM]) lost 2.97%, the Standard & Poor's 500 Index (S&P 500) dipped 2.45% and the Nasdaq Composite Index (NASDAQ) closed down 4.92%. Sector breadth was negative with 10 of the 11 S&P sector groups closing lower. The Utility sector (-5.05%) posted the biggest loss followed by Consumer Discretionary (-4.90%) and Technology (-3.95%). The Energy sector (+4.33%) posted the biggest gain.

Index*	Closing Price 2/26/2021	Percentage Change for Week Ending 2/26/2021	Year-to-Date Percentage Change Through 2/26/2021
Dow	30932.37	-1.78%	+1.06%
Wilshire 5000	40508.68	-2.97%	+2.67%
S&P 500	3811.15	-2.45%	+1.47%
Nasdaq	13192.35	-4.92%	+2.36%

Market Observations: 2/22/21–2/26/21

The major market indices finished the week lower but still posted solid gains for the month of February. Volatility has picked up in recent weeks as bond yields have started to back up. After surging to as high as 1.608% intraday on Thursday, benchmark 10-year note yields, settled the week at 1.404% and are up from 0.91% from the start of the year. The action in the bond market in recent weeks has been the key determinant of the stock market's direction as investors have been resetting their assumptions for growth and inflation linked to improving economic data and the likely passage of President Biden's $1.9 trillion stimulus bill. Investors are worried about the potential 'collateral damage' from the uptick in rates, including margin pressure from higher borrowing costs, more options for investors who had seen few alternatives to stocks, and less favorable valuation models, especially for highly valued sectors like Technology.

Fed Seems Unmoved by the Tightening Financial Conditions: Testifying before the Senate Finance Committee on Tuesday and House Financial Services Committee on Wednesday, Fed Chair Powell said that "the economy is a long way from our employment and inflation goals, and it is likely to take some time for substantial further progress to be achieved." The statement was viewed as a clear indication that, even with more massive fiscal stimulus this year, the Fed is not likely to slow the pace of its asset purchases anytime soon and interest rate hikes are not likely in the foreseeable future. Powell also downplayed concerns about the potential for higher inflation but acknowledged that prices could rise later this year if Americans engage in a burst of spending as the coronavirus comes under control. Powell, however, emphasized that he doesn't expect sustained price increases. Inflation has been held down for decades by greater international competition, growing online commerce, and other trends that take time to change, he said.

Echoing Fed Chair Powell, Vice Chairman Richard Clarida said "the development of several effective vaccines and the passage by the Congress in late December of a package of fiscal relief measures indicate to me that the prospects for the economy in 2021 and beyond have brightened and the downside risk to the outlook has diminished." Clarida also emphasized the Fed's new strategy on controlling inflation will be more flexible and less tied to old rules. Inflation has been low for years and he said he expects it to stay that way.

Economic Roundup – The Recovery Continues: Durable goods orders increased 3.4% in January, the most since last July. The gain was driven by sizeable uptick in both civilian and defense aircraft orders. Excluding transportation, durable goods orders were up a smaller 1.4%. Nondefense capital goods orders ex-aircraft, which are viewed as a proxy for business spending, rose 0.5%, up for the ninth consecutive month. On a year-over-year basis, durable goods orders were up 4.4%, while core business orders increased 8.7%, the most since August 2018. Meanwhile, the Labor Department reported that initial jobless claims dropped 111K to 730K, the lowest level in nearly three months, and much lower than the forecast of 820K. Elsewhere, the Conference Board's Leading Economic Index (LEI) increased 0.5% in January, up for the ninth consecutive month, and above the consensus forecast 0.4%. Seven of its ten components made positive contributions, led by building permits. The six-month rate of change of the LEI posted 5.1%, which is off its peak in Q4, but still near the fastest pace since May 2004. The report suggests a continued economic recovery in the near-term, with growth at an above-trend pace. Lastly, new home sales increased 4.3% in January, up for the second consecutive month, to a 923K unit annual rate, and solidly above the 856K forecast by economists. Additionally, the prior three months were revised up by a total of 69K units. On a six-month average basis, sales are near their highest level since February 2007. Demand has strengthened as a result of fiscal stimulus and near record-low mortgage rates. On a y/y trend basis, the median new home price increased 6.4%, near its fastest pace in three years.

Q4 Earnings Wrapping Up -- Results Much Better than Feared: Fourth quarter earnings season continued to wind down. Through Friday, 482 members of the S&P 500 have reported results with 79% surprising to the upside. Aggregate earnings are currently up 5.3%, well ahead of the 9% decline that analysts were forecasting in early January. The better than feared results have forced analysts to upwardly revise their quarterly expectations, with current estimates calling for a 5.85% gain in earnings when all is said and done.

Sector wise, the biggest upside in aggregate earnings growth has come from Materials, Financials, Technology, Health Care.

Market View: We maintain our constructive views on the equity market and believe the bullish narrative remains intact. Our favorable view is based on the supportive macro environment which we feel provides a sturdy backbone for additional upside as we look forward. Through our lens, the economic recovery appears durable, earnings expectations continue to trend higher, and the Federal Reserve is committed to maintain its very accommodative monetary policy for the foreseeable future. In addition, the Covid vaccine is being rolled out, which in turn, will allow the economy to open back up and get people back to work. However, with the S&P 500 trading near record levels and valuations a bit stretched, a near-term period of consolidation cannot be ruled out. If a pullback were to occur, we would view it as corrective in nature and not the start of a broader leg lower. Hence, a pullback would be viewed as a buying opportunity as we continue to believe the return profile over the next 12 to 24 months favors additional upside.

The Week Ahead: We kick off the month of March with a few focal points, including the February PMI reports and the monthly payroll data on Friday, while attention will also focus on central bank speakers including Fed Chair Powell on Thursday. With the rise in bond yields, investors are expected to pay close attention to Powell's speech for clues on the Fed's thinking. Other data reports of interest include; January construction spending, the ISM Services Index for February, and January Factory Orders. In addition to Fed Chair Powell's speech, nine other members of the Fed are scheduled to present. Fourth quarter earnings season will continue to wind down with 14 members of the S&P 500 scheduled to report.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Wilshire 5000 Total Market IndexSM represents the broadest index for the U.S. equity market, measuring the performance of all U.S. equity securities with readily available price data. The index is comprised of virtually every stock that: the firm's headquarters are based in the U.S.; the stock is actively traded on a U.S. exchange; the stock has widely available pricing information (this disqualifies bulletin board or over-the-counter stocks). The index is market cap weighted, meaning that the firms with the highest market value account for a larger portion of the index.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

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