Marketline April 2021

Stocks:

April added to the strong numbers posted by stocks this year so far. The Dow rose 2.7% while both the S&P and the Nasdaq rose over 5%. In Canada, returns were in the 2% area, but Europe was stronger, up almost 4%. Europe has some scope for improvement, as its vaccination program has lagged. An acceleration is coming, though, promising a better economic result later on this year.

Technology stocks saw a strong lift in the month as interest rates drifted down. This relationship is now obvious to even casual observers: on days when the long Treasury yield rises, tech tanks, and vice versa. At the same time, many tech stocks are wildly overvalued. We looked at Snowflake (a cloud computing company) on behalf of a client, and recoiled at its $56 billion market capitalization when the company is only expected to sell a few billion in product this entire year and *has never made a profit*. SNOW also has considerable competition. No thanks!

As we write this, Congress is negotiating a large package of spending on infrastructure, and on its heels will come another package focused on safety net spending. Meanwhile, stimulus checks will wind down later this year; some politicians have already called for making these checks permanent. As noted in our last market comment, the mentality of 'constant stimulus' is enjoying wider acceptance. The fly in the ointment is the emergence of modest inflation, prompting Yellen to opine that perhaps the Fed would need to pull back on all this largess at some point. The instantly-ensuing horror show in the markets caused a quick retraction, wherein she said she really didn't mean it. As we noted last month, it is likely that inflation will trend higher for some time, but we doubt there will be an acceleration of inflation numbers akin to the 1970s. And for those wondering, yes, a broad swath of stocks do tend to perform well under a *modest* inflation scenario, because companies can exercise pricing power to recoup their higher costs. We see this now - at the grocery store, restaurants, the gas station. But much of this price action is due to flush consumers spending on whatever is available in a newly-opened world – what economists call "pent up demand'. Once the recovery has normalized, we will likely revert to a slower growth rate.

Bonds:

Rates declined a bit last month, just a few hundredths of a point here and there. But here in mid May, rates are higher than month end. The inflation narrative is picking up speed in the media and that sentiment is starting to show in bond yields. Rates now exceed "end of 2019/first quarter of 2020" numbers in most maturities on the yield curve. Evidence is mounting that the mortgage market is slowing, setting up the feedback loop that suppresses economic growth every time rates rise these days. Meanwhile, the Fed is buying $80 billion in bonds every single month, exerting what is known as yield curve control. This falsifies market signals and neuters the bond market's role as a capital allocator. If you have wondered why crypto coins are skyrocketing, look no further.

So let's say that inflation rises from here but then eases: what does that actually look like for bond investors? Well, it was just two years ago that the long bond sold at 3%, and that level was ubiquitous through part of 2017, all of 2018 and at least most of 2019, give or take a few tenths of a percentage point. During that stretch, inflation was running between 2% and 2.5% per annum. We'll assume that scenario replays. A correction to a 3% yield in the long Treasury bond will cause its price to fall somewhere around 20%. However, inside a portfolio, other bonds can be traded away to buy at new higher yields. And we don't own many Treasuries at all; most of the bonds in your portfolios are municipals, corporates and agency issues, all of which offer, at least to some degree, a higher interest rate already than prevails in the Treasury market. Finally, we can allocate funds from stocks into bonds, too, in order to capture higher yields. All these moves can set up portfolios to profit if rates fall again.

Note: Oregon's OSHA Covid rules, set to expire on May 4, were extended indefinitely. These rules require us to perform a risk assessment evaluating our site for our employees, tenants and visitors, follow masking and sanitation protocols, keep a log of visitor and employee Covid symptoms and exposure, report on our ventilation system to the state, along with other measures. Due to the difficulty of complying with these measures if we host clients here, we have elected to continue to prohibit client visits to our offices until OSHA rules are relaxed. We are happy to meet outside our offices, and of course by phone or video; just let us know if you would like to see us!