# *Marketline July 2021*

## *Stocks:*

Stocks made decent progress in July, with all three indices rising 1.3% to 2.3%. Reflecting belief in the growth of our economy, value and smaller stocks performed well this month. Broad based economic growth can carry a broader base of stocks upward, and that's what happened. When growth is scarce, technology stocks tend to stand out as better performers.

Meanwhile, earnings reports are coming in strong for yet another quarter. "Strong" means that actual earnings reports are even exceeding rosy projections by analysts. Earnings – along with interest rates – is the major driver of stock prices, helping to explain the indices' steady upward progress.

Overseas, things were tougher. Europe struggled to post just about zero percent on the FT SE index of large companies – the index was actually off a hair. Mexico was the best of the lot, up about 1%; but Canada lagged, as its borders remained substantially closed to many travelers. Too, Canada is suffering wildfires, the cancellation of a pipeline to the US, high home prices, renewed lockdowns and other issues that are restraining its economy.

Looking ahead, we think earnings reports will begin to present a barrier to returns in a couple of quarters as comparisons become tougher. Government support is also set to wane at the consumer level. Consequently, investors could become more cautious through the summer and into the fall. That said, we notice that every time Congress passes through another phase of negotiating the infrastructure or social services bills, the market perks up. The prospect of all that spending is, for the moment, viewed positively by investors.

More granularly, we welcome Citrix back to our buy list. Citrix is a technology company that runs intranet services used widely by corporate customers. These services do facilitate working remotely, but have also been used for years to protect intra-company information flow from outside eyes. Citrix is moving to a new payment model, a playbook that we have seen with a number of our other companies – F5 Networks, Cisco, Oracle. This shift always damages earnings in the short run, which is why Citrix has fallen to a price we can tolerate.

## *Bonds:*

Interest rates fell across the curve last month. The ten year yield fell hard, from 1.47% to 1.23%, helping to put mortgage rates below 3% again. The long bond dropped precipitously as well, from 2.09% to 1.9%. As we write this however, part of that decline has been reclaimed, with a pop upward in yield towards 1.3% on the ten year.

The market is struggling to decide which trends will be ascendant – inflation and strong growth, or a slowdown due to the Delta version of covid and other factors. The first set of trends auger for higher rates; but the second set results in lower rates. We have a different viewpoint on the market: we think we could see both inflation and a slowdown, and since the Fed is more likely to respond to the slowdown, interest rates will remain repressed. In fact, looking at the forest instead of the trees here, we see the bond market evolving away from responding to inflation – or *being able to reflect inflation*, more accurately – and we also see the Fed evolving towards permanent support of the US and *world* economies. These circumstances will likely result in lower interest rates rather than higher rates, and low 'real returns' from bonds. When you are facing a bond that pays 1% but inflation is running at 4%, you are losing 3% a year on that bond in purchasing power. That is a negative real return, and this unhappy circumstance can persist for years.

We have planned for this outcome for years by pushing average maturities out, and using bonds from municipalities and corporations including some of lower quality, capturing higher than average returns that so far have bested inflation.

***Note:*** Due to Governor Brown's new mask mandate and concerns around the Delta variant of the Covid virus, we have once again closed our offices to the public. We are more than happy to meet with you by video or outside our offices; just let us know when and where you'd like to see us!