LIFESTYLE ASSET MANAGEMENT (LSAM)

Market Commentary

May 2021

Equity and Bond Market Update

(as of May 11, 2021)

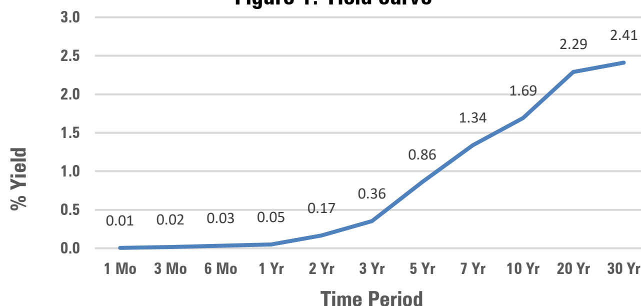
Index	YTD	1-Year
Dow Jones Industrial Average TR	+12.7%	+43.8%
S&P 500 Total Return Index	+11.1%	+44.1%
Russell 2000 Total Return Index	+12.1%	+67.9%
MSCI EAFE Index (net)	+7.8%	+42.5%
MSCI Emerging Markets Index (net)	+3.5%	+48.2%
Barclays US Aggregate Bond TR	-2.7%	+0.7%

Recent Economic Indicators

	Statistic	Data as of
Unemployment Rate	6.1%	Apr 2021
Gross Domestic Product (GDP)	+6.4%	Q1 2021
Consumer Price Index (CPI)	+0.8%	Apr 2021
Consumer Confidence (1985=100)	121.7	Apr 2021
30-year fixed mortgage rate	3.07%	5/12/2021
Housing Starts (single family)	1,238,000	Mar 2021
10-Year Treasury Yield	1.69%	5/12/2021

U.S. stocks, both large-cap and small-cap are the outperformers so far this year, with the S&P 500, Dow Jones Industrial Average, and Russell 2000 all topping the +10% mark year-to-date. Foreign developed market stocks are not far behind, and gaining some momentum over the last six weeks, while emerging markets are struggling to regain some of the advances they experienced earlier this year.

The 10-year Treasury rate has ballooned, in relative terms, over the last nine months from 0.5% to just under 1.7% recently. This benchmark rate is watched closely by investors as a gauge for comparison of possible returns on other assets, such as stocks or riskier corporate bonds.



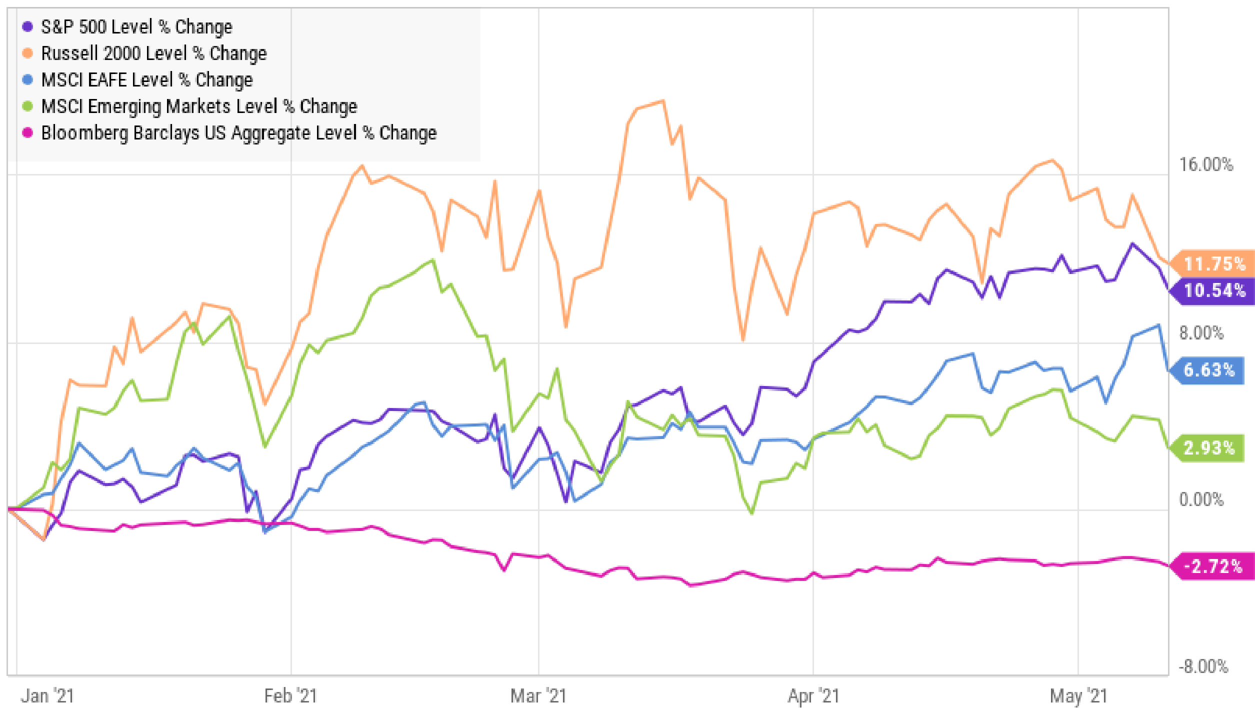
In theory, an increasing "risk-free" 10-year yield can be bad for stocks, because investors have less to gain from taking on more risk, all other factors equal. The rate has leveled out over the last three to four weeks after reaching 1.74%. During the last nine months the yield curve in general (Figure 1 shows the current curve as of May 11) has steepened quite a bit with rates under the 5-year mark inching closer and closer to zero, while longer-term rates 10 years and up ticking more and more up. Just today, after an eyebrow-raising inflation report from the federal government which we'll address shortly, all rates from 5 years out and above increased at least 5 basis points (+0.05%) just since that report came out.

So, what is driving these rates up? Bottom line is expectations on inflation. The report released this morning by the U.S. Bureau of Labor Statistics and can be found here stated that the Consumer Price Index (CPI) increased 0.8% in April, and has increased +4.2% over the last twelve months, the largest 12-month advance in over 12 years. The consensus expectation was that this 12-month number would come in at +3.6%, so the higher reported number spooked the market.

Now higher inflation can be a scary subject, just in terms of main street purchasing power being chipped away, but the overlying factor for investment markets is that the Federal Reserve will have to speed up their anticipated time frame to start bumping up short-term rates from their rock bottom current levels. These expectations are reflected in the slope and shifts in the yield curve from what investors are forecasting, but the Fed themselves are currently still holding the line that they will hold rates at depressed levels going into 2023. Keep in mind that the Fed does not watch the CPI number, but rather the Personal Consumption Expenditures, or PCE, number when it targets a long-term comfort zone. The Fed has historically targeted a PCE of 2%.

When we had runaway inflation in the mid-1970s, the core PCE price index (excluding food and energy) reached over 10%. More recently, core PCE year-over-year changes have averaged well below the 2% target level, and over the last year have averaged below 1.5%. The last reading we received from March was at a 2.3% annual increase, which is higher than the Fed target, but we have to take a couple of items into consideration when analyzing:

Major Market Indices Price Return (YTD through May 11, 2021)



First, we have to take into consideration that prices this time last year were overly depressed due to the inception of the COVID pandemic and government economic lockdowns. Therefore, it would only be natural for the percentage jump to be higher just to get back to the mean. Second, a reading over 2% should be viewed along with the below 2% target the PCE Index has been riding for over 10 years.

What we can gather from this is that both equity and bond markets are very nervous and using day-to-day short-term headlines to make what should be long-term decisions for their investment portfolios. If you want to speculate on interest rate spikes and inflation, that is one thing; but investors should not be positioning their portfolios for the long-term based on such short-term thinking. We are still coming out of a very severe recession and economic collapse which forced many companies to either go out of business, or accelerate the disruption that was going to inevitably happen due to technological advances. The dust is still clearing and long-term portfolio positioning that took place over the last twelve months can and may take up to a few years to materialize expected results. As we have stated before, if you are worried about whether stocks or bonds are overvalued, then you may need to take another look at how your risk tolerance has changed over the last year and make appropriate adjustments. Please contact your Lifestyle advisor to discuss an update to your risk profile.

Always keep in mind that fear, panic, and optimism are not investment strategies, but rather emotions that drive short-term markets.

Please contact Lifestyle Asset Management, Inc. at (281) 612-2035 or by email at **pjackson@lsaminc.com** should you have any questions or comments.

Sources:

- S&P Dow Jones Indices website (us.spindices.com)
- MSCI Barra website (http://www.mscibarra.com)
- The Conference Board (www.conference-board.org)
- Bureau of Economic Analysis (www.bea.gov)
- JP Morgan Guide to the Markets
- FTSE Russell (www.ftserussell.com)
- Bankrate.com (www.bankrate.com)
- Bureau of Labor Statistics (www.bls.gov)
- United States Census Bureau website (www.census.gov)

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