BMT
Management & Financial Consultants
A division of Christian Brothers Services

220 White Plains Road, 6th Floor
Tarrytown, NY 10591
Phone: 914-347-1600 Fax: 914-347-4113
bmtconsults.com

April 26, 2021

TO: All BMT Clients

FROM: Eileen Alexanderson, Christine Ackert and Dana Manganelli

cc: Kelly Murphy and John Tortolani

RE: **FIRST QUARTER 2021 MARKET UPDATE**

On the heels of a strong fourth quarter, equity markets continued to move higher during the first quarter of 2021. The investor rotation in the later part of 2020 into cyclical recovery plays, and away from technology and "stay at home" beneficiaries of the pandemic, continued. The Russell 1000 Value benchmark advanced 11.6% as visibility of the economic recovery grew; the Russell 1000 Growth Index rested and gained just 0.94%. Many technology stocks in that index experienced significant corrections of 20% or more. The tech heavy S&P 500 Index advanced 6.17% but the Equal Weighted S&P, a much better barometer of the broad market, rose 11.49%. The economically sensitive Russell 2000 Index of smaller companies tacked on an additional 12.7% on top of the huge 31.4% gain in 4Q20.

What a difference a year makes! During early April last year, in the midst of a global pandemic and economic shutdown, we pondered what the recovery would look like. Would it be V-shaped, would it be U-shaped, would it be L-shaped? There was great concern that we would be trapped in recession for an extended period of time due to the Pandemic lockdowns. However, vaccines came more quickly than most of us could have imagined and ironically, by February, markets came to worry that the recovery could actually be too strong. That worry about "too fast, too strong" sent interest rates up from the historical lows that Central Bank intervention brought us to in an effort to provide support through the Pandemic. "Too fast, too strong" implied a surge in inflation and concern that the Federal Reserve would increase interest rates to cool things off and potentially put the brakes on the recovery, or even worse, put us back in to recession. Fed Reserve Chair Powell, in response, has been vocal in stressing his intention to keep rates lower for longer until his dual mandate is reached: U.S. unemployment back to pre-pandemic levels and inflation back to the historic 2% average (with room on the upside past 2%). This prompted yields to settle back but the question of how much inflation we are likely to see hangs heavy in the air. The yield on a 10-year US Treasury bond ended the quarter at 1.72%, up from a low point of 0.57% in April of 2020, essentially back to the levels pre-Pandemic. The yield curve steepened as rates rose. Short and Intermediate-term fixed income strategies were less impacted since the biggest moves were in longer maturity bonds. The Barclays Intermediate Index declined 1.89% for the quarter while the Barclays Aggregate Bond Index, with a longer maturity profile, declined 3.37%.

220 White Plains Road, 6th Floor
Tarrytown, NY 10591
Phone: 914-347-1600 Fax: 914-347-4113
bmtconsults.com

While the greater visibility of the economic recovery is appreciated, the magnitude and speed of the moves by cyclicals and small cap stocks caught many by surprise. It can be explained, though, by the simple reality that these stocks were very under owned by investors. Our low interest rate environment has favored growth for many years and with growth scarce during the pandemic, investors migrated to growth and tech stocks at the expense of cyclicals, which had little visibility of profit growth to offer. Given the extended outperformance by growth stocks and rich values arrived at by such strong performance, investors have been on watch for the "great rotation" to value, and jumped in with both feet as it began. The favoritism toward cyclicals was further enhanced by the Biden Infrastructure bill proposal, perceived to offer great opportunity for industrial companies and alternative energy plays. The relative attractiveness of value and cyclicals was also boosted by the uptick in interest rates, which served as a catalyst for contraction in the P/E multiples investors judged appropriate for growth stocks.

COVID still represents a risk as the global distribution of vaccines has been less than smooth and variants continue to spread in the meantime. Proposed tax increases may pose an impediment for equity markets given the potential dent to corporate profits but with the expected strength of earnings progress, this is a time when we can most afford it, and the effort to cover at least some of the cost attached to Democratic spending plans seems prudent.

We view the recent pullback in aggressive growth and momentum stocks and corrections in some of the pockets of excessive valuations as healthy. Investors have somewhat abandoned the high flyer "story stocks" without earnings. Most recently, we have even seen a bit of a rotation back to certain parts of the growth stock universe, acknowledging value at lower prices. Strong cash flow, earnings, and balance sheets matter again. "Quality" growth managers outperformed the growth index in Q1. Looking forward, we do believe that as economies reopen, strong consumer and corporate balance sheets, pent up consumer demand, continued record amounts of government stimulus and support, and potential infrastructure spending should support economic growth for several years. This should be good for equities, though, as concerns about inflation come and go the road may be bumpy at times. The cyclical stocks value-oriented managers own, including financials, energy, industrials and materials, tied to the economy will likely lead near term. However, the acceleration of our transition to an increasingly digital and sustainable economy will be a strong and investable secular theme for a very long time as it touches almost every corner of the economy and of our lives. Fixed income returns will be modest at best, limiting returns on balanced portfolios. We suggest our clients stay invested. Be sure to check your asset allocation and rebalance as needed.