Client Note

March 2, 2021

February was a bit of a roller coaster, as the S&P **500 gained 6.5% into mid-month, then fell back 3.5%** to end with a monthly gain of 2.7%, **and year to date at 1.6%.** Gold continued its drawdown, losing almost 10% year to date. Interest rates have been rising for over a year now. The rise in rates, news of commodity gains (rising for year as well), and thus inflation concerns are in the headlines which likely means we are likely to see a reversal in these trends of some degree soon.

With our current and recent equity exposure overweight energy and technology we have been able to offset the negative impacts of bonds and precious metals, providing year to date gains for moderate and aggressive portfolios. Conservative portfolios will likely get in the game as interest rates pull back.

Inflation, 'reflation-trade', and the rise in interest rates lately is very much in the news. All have been rising since the market crash in Spring of 2020. Recent readings **remain below pre-covid levels**. In September 2019, the CPI index was rising at 1.75% annual rate and the 10-year Treasury bond yielded 1.7%. Today we see 1.4% inflation and 1.41% on the 10year Treasury. CPI has been at 1.2%-1.4% since August. While the inflation rate has remained relatively flat, market interest rates after initially lagging inflation have caught up recently. **This recent surge in rates catching up, is what is in the news.**

What drives market rates are expectations of inflation. Vaccine roll-out and a dramatic decline in deaths and hospitalizations is allowing for predictions of robust growth to gain traction. The assumption is that mass vaccinations will allow people to return to work, earn and spend money, growing the economy to pre-covid levels (2007-2019 GDP averaged 2.3% annually). I have doubts as to how quickly we will get back to pre-covid employment levels. Here in Florida, we have had in-school teaching since August and bars and restaurants fully open back in September. Since then, the Florida unemployment rate dropped from 7.3% to 6.1% in December. The US unemployment rate went from 8.4% to 6.7%. There may not be significant improvement in employment nationally for quite some time. **But in the very near term**, a new round of stimulus will go out in March and impact short term spending and income statistics just as the first stimulus did, potentially giving us a false read on how strong incomes and spending are, **and thus an 'overshoot' on inflation and interest rates**.

Inflation is a slow moving, long term phenomenon. Over the long term, stocks and gold hold their value against inflation. For income investors the days of the bond mutual fund are over. Buying short term bonds to hold to maturity then reinvesting the principle into another bond as rates rise is a short to medium term strategy. The rise in rates has overshot inflation, and longer term were likely to remain range bound between 1.5% and .9% on the 10-year treasury. Right now, I am not seeing any scenario of rapid uncontrolled increase in inflation or interest rates.

Adam Waszkowski, CFA