



Client Note

June 8, 2021

After a brief pullback in early May, the S&P500 continued its upward grind, managing to eke out a slight gain, .66%, for the month. Foreign shares did much better with Europe up more than 4% on the month. Precious metals were the big winners with gold up 7.6% and silver gaining 7.8%. Precious metals outpaced other commodities, which generally fell during May. Lumber is almost 25% below its peak in early May. After an initial rise, bond prices were flat as interest rates stabilized.

We may be seeing the initial *switch back to technology and small-cap* stock outperformance after a few months of underperformance. Technology shares fell sharply early in the month and despite a solid rebound ended down 1.2% on the month. **However, since mid-May, the value-over-growth meme that we have seen the past few months has begun to reverse.** Small stocks and tech have begun outpacing cyclicals/value. I expect this to continue through the summer. Stocks remain in an uptrend. Technology and small companies are seeing prices revived; gold has caught back up to equities and interest rates have been easing. Sentiment indicators have moved from short term negative to neutral. For me, **this means the market has room to move up** as it climbs a 'wall of worry' regarding inflation. Once no one is worried, and everyone has 'bought in', THEN we need to be concerned as there will be fewer buyers left to buy.

The main, seemingly only topic, in the news is **inflation and the employment situation**. The current narrative is that inflation is being caused not only by **supply chain issues**, but also by **wage pressures**. The idea behind wage pressures is that, if wages continue to climb, prices for goods and services will increase as well, resulting in inflation.

There is little reason to think that the pace of wage increases coming out of the recession will **continue to climb at the current pace after this summer**. We still have more than 7 million fewer people working than at the end of 2020. During the recession low wage areas like food service and hospitality bore the brunt of the layoffs. As people leave unemployment benefits, their new wages will be very similar to the benefits they have been receiving. Some may earn less. We are now seeing the peak of wage gains and expectations. Upward pressure will ease over the summer hiring season ends and bottlenecks dissipate.

The key idea is that wages and prices **dropped dramatically and have now rebounded**. This **base effect**, comparing last year to this year is very substantial. The error is assuming this pace of gain will continue. The rate of increase in employment, wages, inflation and possibly, earnings will likely level off and slow. How stock prices react in that environment will be interesting. Sustained higher stock prices due to low inflation/low interest rates, or will slower growth be seen as a risk to earnings and thus stock prices.

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