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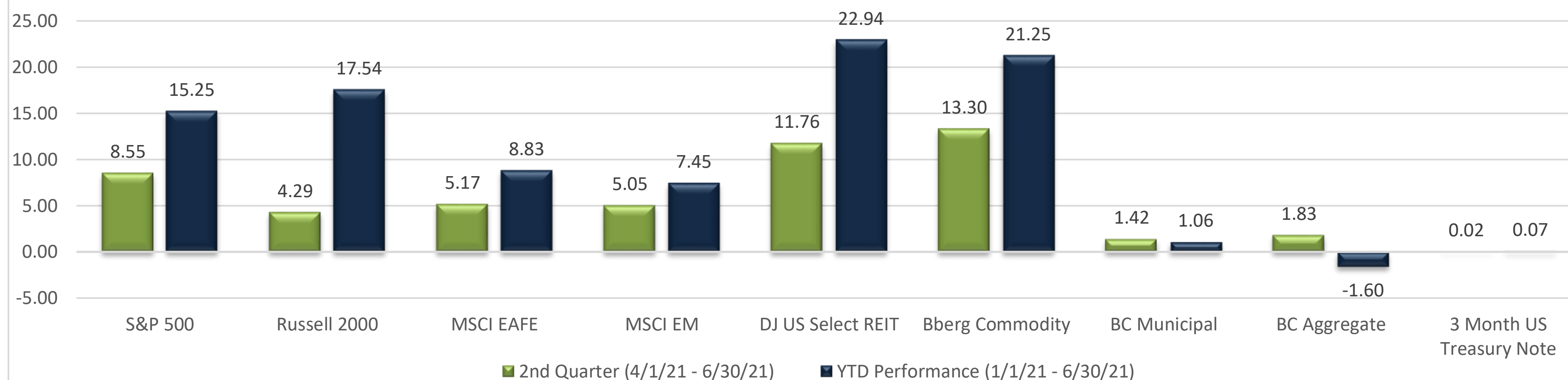
Wealth Management

Revenge of the Normal

Schneider Downs Wealth Management Advisors, LP
Q2 2021 Market Commentary

Big Thinking. Personal Focus.



The second quarter of 2021 had a "revenge of the normal" vibe reverberating through April, May, and June. From a way of life standpoint, as the number of people vaccinated climbed higher, pre-COVID activities like traveling, dining, and gatherings of friends and family became more common. Markets, pricing in humans, well, being humans, rallied on strong consumer confidence and spending reports with gains from domestic and international equities to publicly listed real estate and commodities. The strong performance of risk assets was a welcome sign for investors and their portfolios who were still apprehensive less than a year removed from the greatest economic recession since the Great Depression, and largest market drop since the Great Financial Crisis. This is not to say that everything was perfect in the quarter, far from it. Investors, commentators, and portfolio managers jostled over the appropriate interest rate level on the benchmark 10-year U.S. treasury bond, whether inflation was "transitory," as Chairman of the U.S. Federal Reserve insisted, if the extreme accommodations and liquidity measures of global central banks were widening the income inequality gap, and if the S&P 500 had reached peak valuations. To be sure, we spoke about COVID-19 and its Delta variant, but it was merely part of a much larger and broader conversation. Indeed, the second quarter really was a *Revenge of the Normal.*

Despite a more modest start to the year, curtailed by a surprising and sharp move in interest rates that affected some of the long-time market leaders (e.g. Amazon, Facebook, Microsoft, and Apple), large cap domestic equities rebounded with a strong second quarter. With the benchmark S&P 500 up ~8.6%, it pulled year-to-date performance up to ~15.2%. While in the first quarter the rise in interest rates capped equity returns, a reversal in rates from a peak yield of 1.75% on the U.S. 10-year treasury bond to ~1.4% spurred a strong rally in higher-growth stocks that had been lagging the market for the better part of nine months. Indeed, in the month of June, growth stocks outperformed value stocks by almost 7.5%, the largest gap in over 15 years.[1] The push-pull dynamic of growth versus value was a constant theme throughout the quarter as investors tried to position their portfolios to capture the cyclical upswing associated with the reopening of the economy after 16 months of COVID rolling lockdowns and the possibility of slower growth in 2022. While taking a breather after a strong 12 months of performance, small- and medium-sized companies

[1] https://www.marketwatch.com/story/whats-next-for-the-stock-markets-great-rotation-as-growth-vs-value-battle-searches-for-direction-11624969679

domestically still had very solid returns for the quarter, keeping both the Russell 2000 and Russell Mid Cap indices ahead of their large cap cousins for the first six months of 2021.

Internationally, the returns in the second quarter were better than they were in the first, with both international developed and emerging market equities returning greater than 5%. Yet as we look back on the first six months of the year, the returns in the international space, while positive, have somewhat surprisingly not kept up with domestic equity markets. In prior letters, we have expressed our sanguine outlook for international equities despite consistent relative underperformance against U.S. equities over the past five years. Our outlook has not changed and our expectation for the second half of 2021 is for international equities to gain ground against their U.S. equity counterparts. In particular, the investment team has moved emerging market equities to an overweight position, as both valuations and future growth prospects appear more attractive (valuations) and robust (future growth). In the interim, there will be volatility, especially as China tries to reign in its tech-enabled platform companies (Alibaba, TENCENT, Weibo, DIDI, among others), but looking through the short-term noise, the longer-term trajectory of emerging market equities is an attractive and upward one.

Bond market returns have been lackluster at best and could most aptly be described as uninspiring. While yields rose sharply in the first quarter, they declined almost as sharply in the second quarter as investors priced in a return to lower economic growth in 2022 as well as agreeing that inflation is most likely transitory. The inflation narrative out of the U.S. Federal Reserve has consistently been that pent-up demand being released into the economy in 2022 would cause higher inflation that would be temporary/transitory in nature. Rather than try to predict the outcome of inflation being sticky or transitory in nature, we have focused on current yields and their implied future expected rates of return. With yields on municipal, U.S. treasury and agency, and high yield bonds at historically low levels on an absolute and spread (e.g. how much additional yield a high yield bonds has versus a comparable U.S. treasury) basis, the investment team has shifted the fixed income allocation more toward real asset strategies that offer exposure to farmland, timberland, infrastructure and high-quality commercial real estate. Real assets offer the ability to grow cash flows should we have more persistent inflation, but they don't need higher or lower interest rates to be a catalyst for returns like traditional bonds. Leaning into mainly private real assets creates additional portfolio diversification and higher yields/income into the portfolio.

In the spirit of the title of this quarterly letter, Revenge of the Normal, we wanted to end by reinforcing and emphasizing some key tenets about wealth management and financial planning. At SDWMA we believe that financial independence is simply the ability to live the life that you want for as long as you want. Of course, no matter how much money you have, there are still limitations to living the life that you want. Our team at SDWMA works hard every day to help you quantify what is attainable and, as important, help keep you on track. The essence and underpinning of our role as advisors is to help you articulate and define your goals and to create a portfolio that will help you meet those goals over the long-term. There is no stronger power in investing than the power of compounding interest/returns. The power of compounding is more powerful than Elon Musk's twitter feed or Reddit AMC/GME to the moon threads. Keeping portfolios invested by having a plan in place, diversifying one's holdings and not getting too excited or too pessimistic over market volatility through the various market cycles ensures that the power of compounding can take place, which gives people the ability to reach their goals and live the life that they want to live. That is our definition of success.

This is the first quarterly letter written from our offices since January 2020, and the excitement of being with our colleagues is palpable. While we adapted to doing business during the pandemic, there is nothing better than being around our colleagues and being able to meet with our clients in person. We hope that you and your families are doing well and enjoying your own version of "Revenge of the Normal" this summer. Thank you as always for your trust, and we look forward to seeing you (in person) soon!

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