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A REGISTERED INVESTMENT ADVISOR

Investment Review & Outlook
2021 Second Quarter Investment Market Report

The U.S. investment markets continued to defy gravity in the second quarter of the year, closing out the month of June—and the first half of 2021—at new record highs. This is the fifth consecutive quarter where the U.S. markets posted gains.

Everywhere you looked in a diversified portfolio, you saw gains in the second quarter. Looking at large cap stocks, the widely-quoted S&P 500 Index of large company stocks rose 8.17% in the second quarter, to post a 14.41% return so far this year.

The Russell 2000 Small-Cap Index is up 17.54% in the year's first six months. The technology-heavy Nasdaq Composite Index gained 11.25% in the second quarter and is sitting on a 12.73% gain so far this year.

International investors saw their stocks rise over the second quarter, but not with the same bullish intensity that we are experiencing in the U.S. The broad-based EAFE Index of companies in developed foreign economies gained 4.37% in the second quarter, for a 7.33% return for the first half of the year. In aggregate, European stocks were up 6.37% for the quarter, gaining 10.11% for the first half of the year, while EAFE's Far East Index has returned just 1.47% so far in 2021. Emerging market stocks of less developed countries, as represented by the EAFE EM Index, gained 4.42% in dollar terms in the second quarter, and finished the first half of the year with a 6.46% gain.

In the bond markets, the rates on longer-term securities jumped from historically low rates to simply low rates. Coupon rates on 10-year Treasury bonds are yielding 1.465%, while 3-month, 6-month and 12-month bonds are still sporting barely positive yields. Five-year municipal bonds are yielding, on average, 0.51% a year, while 30-year munis are yielding 1.57% on average.

Five consecutive quarters of gains! All-time highs becoming a routine part of the news cycle! Have the markets banished volatility altogether?

Of course, the answer is no. This investment climate is not unprecedented (the late 1990s come to mind), but the current investing climate is clearly far from normal. Stock market investing always comes with a certain amount of risk, even if the risks are sometimes temporarily hidden from view.

Just a few weeks ago, there were widespread concerns that the economy was about to experience higher inflation; a 5% single month increase in the Consumer Price Index was the highest jump in 13 years. Investors were startled, to the extent that the U.S. Federal Reserve Board felt compelled to put out a statement saying that it expected the gain in consumer prices to be merely 'transitory'. Apparently investors took the Fed economists at their word; a quick drop in 10-year Treasury yields, when converted to the mathematics of bond market expectations, signals an expected inflation rate of 2% or less. Of course, the biggest investor in Treasuries at the moment (to the tune of $120 billion a month) is the Fed itself, so this may be an example of a government agency fulfilling its own prophecy.

But elsewhere, there does not seem to be any obvious cause for alarm. Hiring and consumer spending are rising, and small business owners' confidence has bounced back above its pandemic lows. Congress may pass some kind of a stimulative infrastructure bill, and interest rates remain low. Corporate earnings are projected to come in at record levels by the end of the year.

Of course, that does not mean we couldn't hit some rough patches in the second half of the year. Investor sentiment can be tricky, and bull markets tend to end unexpectedly. The new variants of COVID-19 are an unknown factor, and eventually the government will have to stop juicing the economy with ever-greater amounts of money. We ought to be able to enjoy the gains we have experienced so far in the year without trying to project them out into the unknown future.

The FAM Team