Cambridge ADVISORS inc.
INVESTMENT MANAGERS

INVESTMENT PERSPECTIVE MARCH 2021

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MARKET COMMENTARY

Stocks are off to a good start in 2021. Large cap stocks in the S&P 500 are up 6.17%. Small cap stocks continued to outperform as the Russell 2000 gained 12.70%. International stocks in developed markets were up 2.29%. Bonds are not fairing as well because interest rates have risen sharply. The Barclays U.S. Aggregate Bond Index is down -3.37% so far this year.

After leading the charge for the last several years, technology stocks have stalled in 2021 and are only up 2%. It appears that value is slated to outperform growth for a while as energy and financials were again the best performing sectors this quarter, and analysts are favoring them as economic growth rebounds coming out of the pandemic.

Fourth quarter GDP growth was 4.3%. For the full year 2020, GDP contracted -3.5%. This was the largest annual decline since World War II. Looking ahead, David Kelly, chief strategist with JPMorgan, expects first quarter 2021 growth to be 4.0% - 4.5%. He then expects a sharp uptick in the second quarter to 10% followed by 8% in the last two quarters. Year-over-year could see 7.5% GDP growth. That would make it the strongest annual GDP growth since the 7.2% achieved in 1984.

The projected strong growth is due to several factors. First, Kelly expects that 85% of the population will be vaccinated by the end of June which would put us in the herd immunity zone. The economy should then be pretty much fully open. Second, the new administration has passed a nearly $2 trillion stimulus package which includes $1,400 payments to individuals at the time when the economy is open and it can be spent. It also includes extending emergency unemployment benefits until September and provides relief to state and local governments. The stimulus is front loaded and about $1.1 trillion will be spent in the next 5 months which is expected to turbo-charge the economy. Third, the government is currently working on an additional infrastructure package which could add another $2 trillion to the economy.

The employment picture is also improving. As of the end of March, total payrolls were still 8.4 million below pre-COVID levels but March saw payrolls increase over 900,000. First Trust believes some months in 2021 will see job gains over 1 million. The unemployment rate has declined to 6% in March. It peaked last April at 14.7%. Kelly projects that it could be 4.2% by year end and down to 3.5% by the end of next year.

Profits were down -22% for the S&P 500 in 2020. Kelly expects corporate profits will surge 40% in 2021. Zacks projects first quarter earnings will increase nearly 20% over the first quarter of 2020 partly due to easy comparisons. They project second quarter earnings growth of more than 50% compared to second quarter 2020 when the economic repercussions of the pandemic were the worst. The rapid increase in earnings should bring price/earnings valuations down as long as earnings increase more than stock prices.

The recovery is global. Europe is lagging the US in growth because they are behind us in vaccinations by a few months. China had less COVID spread so their economy reopened faster than others but their vaccination rollout is also slower than the US. As the world gets vaccinated, analysts are expecting a broad, global recovery.

2021 BENCHMARK RATES OF RETURN

INDEX	FIRST QUARTER	YTD
S&P 500	6.17%	6.17%
Russell 2000	12.70%	12.70%
International	3.48%	3.48%
Fixed Income	-3.37%	-3.37%
JPMorgan Diversified*	3.46%	3.46%

*25% S&P 500 large cap stocks,10% Russell 2000 small cap stocks, 15% MSCI EAFE international stocks, 5% MSCI EME emerging market stocks, 5% REITs, 25% Barclays US aggregate bonds, and 5% each in short term Treasuries, high yield global bonds, and commodities.

We value our relationship with you, and we are always available to meet with you in person or by phone. Please do not hesitate to call or email us with any questions that you may have. Also, if your situation has changed, please contact your advisor so we can determine if any changes are needed in your account.

Inflation has stayed in check so far. In February, the Core PCE deflator (which the Fed uses as its measure of inflation) was 1.4%. David Kelly thinks it could be 2% in April on a year-over-year basis and reach 2.3% to 2.4% by year end. The Fed is monitoring inflation and looking for sustained inflation to average 2% before it would act to increase short-term interest rates. So, even if inflation was above 2%, the Fed wouldn't have to act right away because it has been below the 2% target for years. Most analysts expect some transitory inflation due to the pent up demand for leisure and entertainment goods and services at a time when consumers have money to spend and the economy is finally open. Other areas may also see inflation due to supply chain shortages that will need a little time to get worked out.

The Federal Reserve cut its benchmark interest rate from 1.50%-1.75%. to 0%-0.25%. The Fed has indicated that they are expecting to hold short-term rates there through 2023; however, the market is starting to project that the Fed will raise rates beginning in 2022. The Fed's bond purchases would likely taper before they raised rates.

With a low Fed Funds rate, money market funds will continue to earn near 0%. We are seeing a steepening of the yield curve, though. Long-term yields have been rising at a rapid pace this quarter. The 10-year Treasury bond yield rose from 0.91% at the end of 2020 to 1.75% at quarter end. Treasury bonds are not generating a lot of income and the rise in yields has resulted in negative returns to bondholders so far this year. More risk averse investors will still want to include bonds in their allocations because they are less correlated to stocks than most alternatives. Yields are not likely to continue to rise as quickly the rest of the year —many analysts think the 10-year Treasury yield will top out around 2% in 2021—so hopefully the performance will not be as dismal as first quarter's -3.37%.

Analysts are favoring stocks over bonds this year but note that there are challenges to overcome. The income inequality and wealth gap continue to increase and more attention is being paid to addressing this dynamic, mostly in the form of taxes. The stimulus spending is also expected to result in higher taxes as a means to pay for it. Changes in taxes would likely negatively impact stocks. Higher corporate tax rates will lower corporate earnings so price/earnings ratios may remain high or not fall to what would be considered reasonable levels without a decrease in prices. Anticipated higher capital gains tax rates may result in investors selling stocks this year so that they can pay the taxes under current lower rates. High selling pressure could also push prices lower. Higher income taxes could also result in either lower spending or lower savings so lower demand for stocks. Estate taxes may also be affected by lowering the exemption. Some investors may try to make changes this year before tax reform is passed. Beware, though, as tax reform could be passed near the end of the year and made retroactive to the beginning of 2021-analysts are not ruling this option out.

We continue to encourage investors not to try to time the market but to align your investment portfolio with your risk tolerance. That way, you can withstand the risk and not be tempted to sell out when stocks go down or sell too soon and miss out on continued upward stock performance. We use Riskalyze software to help us measure your risk tolerance so we can help ensure you have the appropriate risk in your investments. One tool we have with Riskalyze is that we can send you a link to take a quick measure of how you are feeling about risk and then compare your risk score to the risk score of your investment portfolio to see if adjustments might be necessary. If you are unsure about the risk in your portfolio or have any questions, please talk to your advisor.

CAMBRIDGE ADVISORS NEWS

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Just a reminder that we can participate in video chat meetings with clients who do not feel comfortable coming into our office. We can share our screens and conduct review meetings easily for our clients who wish to meet virtually rather than in person.

Also, remember that we have a client portal where you can view your accounts on our system as well as past reports. If you need help accessing the client portal or would like to initiate a logon, please let your advisor know.