Quarterly Insights April 2021

The stock market recently marked the one-year anniversary of the 2020 bear market waterfall lows, providing an opportunity to examine what history suggests might occur this year based on the recent recovery. The S&P 500's four-quarter gain of 54% is the fourth-highest since 1926 and best since WWII. The recovery's primary catalyst was our government's immediate and drastic policy response, the largest since the Federal Reserve was created in 1913. Years following unusual market distortions such as last year more often regress toward lower market volatility associated with more common periods. In other words, repeating market action such as last year, whether downward or upward, tends to be the exception. However, the Federal Reserve's willingness to exercise unprecedented new monetary policy tools combined with additional trillions in fiscal stimulus from Congress makes any historical comparisons challenging. Corporate profit forecasts are now soaring. Wall Street is remarkably projecting that this year's earnings will catch up to pre-COVID 2020 peak levels. Our economy is expected to grow in 2021 by an astounding 6%. All this while inflation remains largely in check so far.

While the stock market has enjoyed enormous success, the bond market in 2021 has struggled, experiencing a decline not seen since 2013. The panic that time was triggered by a spike in Treasury yields after the Federal Reserve no longer supported low interest rates. The reason yields are rising and fixed income instruments are dropping this time is much different. Bond buyers today are largely concerned about the risk that the government's stimulus will result in higher inflation. It's easy to comprehend that inflation worries will grow as government stimulus checks start to be spent, creating a headwind for bond holders. They also understand that tying up money for an extended time is riskier if the value of fixed income interest payments and return of principal are eroded due to higher inflation. The instruments at greatest risk are long-term bonds, whether federal government, municipal or corporate. In any case, bond returns may be weak going forward. So why hold bonds now if they appear relatively unattractive? Because they serve as the most time-proven effective ballast against unexpected stock declines within a balanced portfolio.

Although the Federal Reserve is not anticipating inflation to remain above its two percent target for an extended period, investors are not as confident in this outlook. If longer-term inflation expectations accelerate, investors may panic, causing further bond declines. Their worry is warranted since the Fed has clearly stated that its priority is on restoring full employment over higher inflation. Similarly, the Fed has also communicated that it is willing to temporarily tolerate higher price increases in goods and services before taking measures to combat inflation. This potential risk to the bond market is a legitimate concern for investors. To counter such a threat, our firm does not advocate investing in long-term bonds. We regard these instruments as speculative. Instead, we use intermediate-term bonds to dampen price volatility during such circumstances.

A second risk everyone should be aware of is that investors are currently accepting larger degrees of credit risk when buying lower rated bonds over higher quality alternatives. By historical comparison, the marginal improvement in yields that lower quality bonds now offer inadequately compensates investors against potential higher price volatility, credit downgrades, or worse, defaults. With interest rates so low for all bonds, investors appear to be grasping for any potential incremental return on their investments at the expense of assuming larger degrees of risk. Contrary to this popular behavior, clients of The Investment Counsel Company are concentrated in high and highest credit rated bonds to manage such risk more effectively.

Likewise, gold has not proven to be an effective hedge against rising inflation lately, falling near double digits year-to-date. Unsurprisingly, investors continue to find stocks more attractive than other asset classes when considering risk. The current trend in global equity markets remains upward. The threat of a global recession is low with coordinated political efforts firmly committed to economic recovery. Low probabilities like this are historically consistent with strong equity market performance. Economic data is actually exceeding expectations all over the world, not just anticipating better times ahead.

While economic, political, financial and other risks never cease to surface, humanity's desire to thrive, not just survive, prevails. We find new ways to overcome these obstacles. This is evident with the stock market persistently climbing for over 100 years, providing long-term double-digit annualized returns. Always on top of investors' minds are what developments the future might hold. Looking ahead, next-generation vaccines already show revolutionary progress in simultaneously attacking a broad range of viruses from the common cold to multiple variants of COVID threats. With these ground-breaking innovations, and others on the horizon, countless opportunities will continue to materialize, all positive for investors. Your team at The Investment Counsel Company remains steadfast in our work to proactively uncover new opportunities and effectively manage risk on behalf of our valued clients.

Best regards,

Randy

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Chief Executive Officer