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Investment Institute

Weekly perspective on current market sentiment February 3, 2021

Scott Wren
Senior Global Market Strategist

Last Week's S&P 500 Index: -3.3%

The trend is your friend

Key takeaways

- The reflationary trends we are seeing in markets are likely to continue throughout 2021.
- We believe aligning portfolios with these trends will result in attractive portfolio performance this year.

There is something to be said about economies and markets that have been consistently moving in a particular direction with a certain degree of momentum. Of course, it is rare that either move in a straight line as there are usually at least a few stumbles along the way. It helps as well to be anticipating the direction of the momentum so portfolios can be positioned properly to take advantage of the opportunity before it becomes clear to the rest of the investing world. Optimally, we want to lean into a market move based on fundamentals and then get some help from underlying momentum that reflects those fundamentals. In the current case, we think the economic recovery is in the early stages. And that, as regular readers of this piece know, is just what our tactical positioning has suggested.

We have written frequently on the topic of the "reflation trade." The ability to take advantage of and position for the reflation trade is simply the result of fiscal and monetary policies that are implemented and targeted at increasing economic growth and asset prices. Optimally, only modestly higher consumer inflation is also a result and is our current expectation. The Federal Reserve (Fed) will likely keep interest rates near zero for some time in an effort to encourage borrowing and spending. Fiscal policy and the resulting stimulus measures taken by Congress are also aimed at boosting economic growth and pushing the recovery forward.

An example of asset classes that typically respond and outperform early in a reflation/recovery cycle are small-capitalization equities and commodities. We currently rate both as favorable. As investors anticipate recovery and favorable Fed policies, these assets typically see some early buying. A better appetite for risk taking sees money moving into smaller-cap companies whose fortunes will likely improve as the general economy lifts. In more uncertain or recessionary times, money tends to flow to larger companies that have better balance sheets and products and services that consumers will continue to buy even as growth slows or contracts. But as the skies clear, or are anticipated to clear, we think investors become more interested in assets that will benefit which might have been left behind and largely forgotten during the slowdown or recession.

Many readers likely know that crude oil prices have bounced meaningfully as they have seen the cost per gallon of gasoline jump over the last couple of months. A global recovery often translates into higher demand for fuel and other crude oil by-products. And the prices of some base metals such as copper are at their highest in almost a decade. This is also a reflection of anticipated (and realized) economic recovery.

We see these reflation trends continuing as we look through 2021. And as one of the oldest investing bromides will remind you, the trend is your friend.

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