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Investment Institute

Market Commentary

Weekly perspective on current market sentiment — **February 18, 2021**

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Last Week's S&P 500 Index: +1.2%

Necessary beliefs

Key takeaways

- Markets have been responding to good vaccine news, the Federal Reserve's easy money policies, and Congressional stimulus.
- We believe these will continue to be meaningful drivers over the balance of this year as we see further market gains ahead.

Stocks have made a big run higher since the March 23, 2020, low. Commodities, as measured by the Bloomberg Commodity Index, have also experienced a meaningful move to the upside as gold, oil, industrial metals, and agricultural staples like corn and soybeans all participated. In the fixed income arena, the yield on the 10-year Treasury note has moved above 1.3% and the demand for high-yield fixed income has resulted in narrowing spreads.

We have been favorable on U.S. large-capitalization equities for quite some time and recently added U.S. small-caps and emerging market equities to our list of overweight recommendations. We have also been favorable on the commodities complex as a whole – particularly gold and oil, which represent two major weights within the index. High-yield fixed income has typically performed well in the early stages of an economic recovery, and we have been favorable on this segment of the market.

Some of the major drivers behind the performance of these risk assets are tied to positive vaccine news, an easy Federal Reserve (Fed) that appears to be nowhere near hiking interest rates, and Congressional stimulus that provided economic help last year and appears likely to provide a big boost this year. Investors have done a good job anticipating these positive actions and influences over the last six to eight months, if not a bit longer.

We recommended considering incrementally adding risk to portfolios since March of last year, and our analysis suggests that these positive market influences will likely continue over the balance of 2021. Indeed, in January we boosted our economic growth projection, our yield expectation on the 10-year Treasury note, as well as our year-end targets for all five equity asset classes. We have consistently sought to take advantage of pullbacks in the stock market so that sidelined funds could be put to work.

From here, after an impressive performance over the last nine months or so, many investors are wondering if stocks, commodities, and high-yield fixed income will continue to offer attractive returns. In short, we believe they will as our year-end target ranges suggest.

A big part of our rationale for additional gains from here is dependent on a continued belief that the major drivers that helped carry the market to current levels will remain intact. The underlying foundational factors that will continue to support the economy and markets will continue to revolve around progress on vaccine distribution, a Fed that is willing to retain its easy money policies for at least the intermediate term, and additional stimulus from Congress that will help bridge the gap between now and when vaccines are widely distributed. These are the necessary beliefs investors need to have to stick with their plan and take advantage of opportunities to put sidelined funds to work.

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Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk. Although **Treasuries** are considered free from credit risk they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility.

Definitions

Bloomberg Commodity Index is comprised of 22 exchange-traded futures on physical commodities and represents 20 commodities weighted to account for economic significance and market liquidity.

An index is unmanaged and not available for direct investment.

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