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Market Commentary

Weekly perspective on current market sentiment **June 9, 2021**

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Last week's S&P 500 Index: +0.6%

Is bad going to be good, at least for now?

Key takeaways

- If last Friday's employment report is any indication, we believe the market is likely to look at important economic reports in terms of how they might affect Federal Reserve (Fed) monetary policy.
- This often occurs early in a cycle while policy is still accommodative but investors can see the economy is clearly improving.

Did you see how the markets responded to last Friday's employment report covering the month of May? The bond market responded as we would expect with the yield on the 10-year Treasury note inching lower by a handful of basis points (100 basis points equals 1%) in the wake of a report that came in below expectations in terms of job creation. And while the unemployment rate dropped just slightly more than expected, a contributing factor was people leaving the job market as the labor force participation rate moved lower (fewer working-age people considered themselves "in" the workforce). But the S&P 500 Index rallied close to 1% on the day, which carried the performance of the index into positive territory for the week.

As a result, we have received a number of questions from investors asking why the stock market posted a nice gain on the day when the labor market report was weaker than expected. Wasn't the report "bad"? The simple answer is, the market's line of thinking is that a weaker than expected labor market may very well cause the Fed to keep its foot on the monetary gas pedal and, therefore, delay making any policy adjustments or even talking about the possibility of making adjustments. Recall that the Fed is currently buying $120 billion of bonds in the open market each month, which pumps liquidity into the financial system. In addition, the fed funds (overnight lending) target rate has been held in the 0% to .25% range since the early days of the pandemic. These measures have helped the economy recover and push asset prices (i.e., stocks and home values) higher.

So how does this factor into our guidance? We believe the easy money policies of the Fed will last for some time. We do not expect the Fed to raise interest rates this year or next but do think it is likely our central bankers start to hint that they are thinking about tapering their bond purchases, possibly as soon as this fall. That means we continue to lean toward cyclical sectors that are sensitive to the ebb-and-flow of the economy. As the global recovery continues, we favor overweighting exposure tactically to large- and small-capitalization domestic equities as well as emerging market equities. Favored domestic large-cap sectors include Communication Services, Energy, Financials, Industrials, and Materials. In our view, rising interest rates and inflation early in a new cycle can be thought of as confirmation that the economy is climbing out of recession and demand is increasing. We believe inflation may continue to climb somewhat higher in the near term but decelerate as we move through 2022. Our preference for equity over fixed income reflects those beliefs.

In the near term, investors will likely interpret some of the more important economic reports in terms of how they might influence Fed monetary policy. So for now, bad economic news just might be good for stocks.

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