The *Philadelphia* Story

A Quarterly Commentary on the Economy & the Financial Markets April 2021

From: *Philadelphia* Investment Management Group

OVERVIEW

- ***The First Quarter of 2021 Began With an Unprecedented Challenge With Our Democracy But Ended With a Surge of Vaccinations that Boosted Optimism Among Consumers.*** *Once the outcome of alleged voting irregularities was resolved, attention then focused on the initial thrust to eliminate the COVID-19 crisis.*

- ***An Unparalleled Wave of Liquidity has Been Orchestrated by the Federal Reserve.*** *Never before has the country demanded such levels of stimulus to get business and individuals back to work.*

- ***The Interest Rate and Inflation Questions and Concerns Arising From These Extreme Liquidity Measures are Being Debated Daily by Leading Economists and Market Strategists.*** *We are, to a large extent, in uncharted territory with respect to the economic and financial outcome of the levels of stimulus, both monetary and fiscal.*

THE ECONOMY

There is no question that policy and Congressional approvals in the past quarter and the most recent announcement of major infrastructure spending will have profound effects on our economy throughout this year and into 2022. The Federal Reserve is determined to keep interest rates in the low single-digits and inflation at no more than a 2% positive rate. In addition, these ultra-easy policy decisions continue on with the $120 billion of monthly bond purchases. All of these directives are to be in place until the labor market reaches maximum employment.

How do the markets view these events? The futures markets cast some doubt after the strong jobs numbers just released. The 5-year and 10-year Treasury market had some weakness, as did the longer-term bond areas. This was a reaction as the Federal Reserve reported seeing Gross Domestic Product (GDP) growth of 6.5% for 2021, while private forecasters are seeing a 7% increase.

What about fiscal policy? We know what the Fed wants to do with monetary policy. The stimulus money will be fading towards the end of the year, and there will be a need by the Government to raise taxes to pay for all the infrastructure spending. And we are talking about corporate, capital gain and income taxes. Higher interest rates may well come about once unemployment has been substantially reduced, and the Government must now finance its massive spending programs, not to mention the fact that higher interest rates will certainly result in greater attraction for U.S. Treasury debt. Bottom line to all of this is some uncertainty and confusion as to the outlook for the economy over the next two years, as acknowledged by all the leading forecasters.

FINANCIAL MARKETS

EQUITIES

Equities this past quarter saw a lot of confusion on the part of most investors as to how best to manage their portfolios in these times of slightly higher interest rates and the concerns expressed for higher inflation resulting from improved business conditions and declining unemployment. In spite of these concerns, the U.S. equity market, for the quarter and as we write this commentary, is still in rally mode, one day for value stocks and another day for growth companies. While value trumps growth all day long with its conservative valuations, its staying power may not be as secure as one would think looking at company fundamentals.

Infrastructure spending, of which there is forecast to be an enormous amount, will certainly benefit many value-oriented industries, such as Materials, Industrials and Energy, to name a few. The companies within these industries, for the most part, had good returns in the first quarter and may well continue to perform. But solid growth companies, such as Information Technology, Consumer Discretionary and Communication Services, cannot be overlooked, and the volatility of these businesses can be far less than with the cyclicals, whose profits rise and fall with business conditions.

After a volatile start to the year, as reflected in the chart below, all of the indexes ended in positive territory for the first quarter of 2021, with the Russell 2000 Index of small companies having the highest performance for the period. Smaller companies are more tied to the strength of the U.S. economy and were among the best performers during the three months. Following January's negative returns for the large capitalization S&P 500 and Dow, good news regarding the rollout of COVID-19 vaccinations, the

Fed's signal that it would remain with an accommodative stance for an extended period of time and optimistic economic news lifted the markets for February and March. In addition, although not shown, the performance of the indexes soared for the one-year period ending March 31st, with the S&P ahead 56.35%, the Dow and NASDAQ 53.78% and 72.04%, respectively, and the Russell 2000 an extraordinary 94.85%.

	Equity Returns*			
Index	**Jan**	**Feb**	**Mar**	**1st Qtr**
S&P 500	-1.01%	2.76%	4.38%	6.17%
Dow	-1.95%	3.43%	6.78%	8.29%
NASDAQ	1.42%	0.93%	0.41%	2.78%
Russell 2000	5.03%	6.23%	1.00%	12.70%

*Total: price change + reinvested dividends

The following table shows that all sectors of the S&P 500 again had positive returns for the quarter, with Energy and Financials continuing their outperformance. On the other hand, after flying high in 2020, Information Technology stocks stalled in the first quarter and significantly underperformed the broad market, as did Consumer Staples.

	S&P 500	
		Returns*
Sector	**Weight***	**1st Qtr**
• Energy	2.8%	30.85%
• Materials	2.7%	9.08%
• Industrials	8.9%	11.41%
• Cons. Discretionary	12.4%	3.11%
• Consumer Staples	6.1%	1.15%
• Health Care	13.0%	3.18%
• Financials	11.3%	15.99%
• Info Technology	26.6%	1.97%
• Communication Svcs	10.9%	8.08%
• Utilities	2.7%	2.80%
• Real Estate	2.5%	9.02%

03/31/21
*Price + income
Source: S&P Dow Jones

If one thought the timing of owning growth companies was difficult, so too is the length of time cyclical value companies can continue to perform positively. It is our belief that a combination of companies, both value and growth, with powerful long-term secular trends is the best recipe for a portfolio of equities.

FIXED INCOME

Fixed income returns for the quarter were somewhat negative, with the benchmark 10-year U.S. Treasury rising 82 basis points to end March at 1.74%. The yield curve steepened, particularly in the 2- to 10-year range, as the 2-year rate was anchored by the Fed's expectations that short rates will need to remain near zero percent. Continued accommodative monetary policy, coupled with large fiscal stimulus packages and an accelerating pace of vaccinations provided the fuel to lift interest rates to higher levels at quarter end and gave concern over the prospects of higher inflation numbers ahead.

Fixed Income Returns

Index	**1st Qtr**
Corp/Govt	-4.43%
Int. Corp/Govt	-1.80%
Long Corp/Govt	-10.79%
U.S. Government	-4.61%
- Intermediate	-1.73%
- Long	-13.24%
Corporate	-4.50%
- Intermediate	-2.06%
- Long	-8.73%
- **Quality**	
- AAA	-7.39%
- AA	-5.29%
- A	-4.91%
- BBB	-3.96%
Municipal	-0.36%
- Intermediate	-0.25%
- Long	-0.43%

Source: ICE BofA

As stated above and as shown in the above chart, returns were negative across the full spectrum – intermediate, long, taxable and tax-exempt. The longer maturities fell the most for both corporate and government, while municipal bonds fell the least during the quarter. Further, the lower investment grade triple-B corporate bonds performed better than the higher-rated corporates.

Having said the above, we are optimistic on U.S. growth prospects and believe it is unlikely we will see a repeat of the first quarter's fixed income performance in this second quarter. We believe there are strong structural forces that will keep inflation contained and interest in the low single-digit numbers. With the 30-year Treasury bond approaching 2.5%, strong support will come from both home and abroad as foreign government debt continues to trade at a negative yield.

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In conclusion, this past quarter ended with an advancing equity performance about equal among all market capitalization segments. Growth and momentum stocks had some weaker performance due to the concern of higher interest rates and inflation fears. As this commentary goes to print, the market for these stocks has recovered somewhat as fears of higher interest rates and inflation concerns have abated to some extent. A diversified stock and bond portfolio that will capture the swings in the stock and fixed income markets remains our primary objective.

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