Quarterly Market Outlook

July 2021

The Economy Is Booming

Global growth has been very robust on the back of the vaccination rollout, led by the U.S. reopening. U.S. GDP grew at an estimated 10% annualized rate in the second quarter and is now above pre-pandemic levels.[1] With Europe not far behind and many emerging markets likely to follow in H2 2021, the world is on track for a strong synchronized recovery by year end.

Vaccinations Accelerate Globally but Slow in US

55% of the U.S. has already received at least one vaccine dose, and Canada, the U.K. and many E.U. countries (e.g., Italy, Spain, Germany) have now surpassed the U.S. in vaccinations per capita.[2] Most emerging countries continue to lag behind, however, and with the emergence of the highly contagious Delta variant, these countries may continue to suffer until distribution catches up. Slowing vaccination rates in the U.S. and the prospect of other variants remain risks.

Major Legislative Packages Are Still Being Negotiated

Congress continues to negotiate two major packages, a bipartisan $1.2 trillion infrastructure plan and the highly partisan $1.8 trillion American Families Plan. The latter would be passed exclusively by Democrats through budget reconciliation.[3] If the Democrats lose their majority in the mid-terms, it may prove difficult to sustain current levels of fiscal stimulus. The prospect of higher taxes, which would be required to pay for the American Families Plan, is another potential headwind to the recovery.

Inflationary Pressures Are Growing

Inflation concerns continue to dominate headlines, with U.S. CPI up 5.4% year-over-year in June, the highest reading in over a decade. The reopening has exacerbated supply chain disruptions, oil is now above $70/barrel, and new and existing home prices were up 18% and 24% year-over-year in May, respectively — among the highest increases on record.[4] Forward-looking inflation expectations have also increased and are now above the Fed's 2% target.[5]

Job Growth Is Strong as Wages Rise

Job and wage growth have likewise been strong. Unemployment fell to 5.9% in June, still above the pre-pandemic low of 3.5% but recovering rapidly.[6] While job openings are at record highs, so are unemployment benefits, which is keeping workers on the sidelines and pushing wages higher. Average hourly earnings are up 6.6% since February 2020, rising at a rate not seen since the early 80s.[7]

Fed Sparks Tightening Concerns

Against this backdrop, the Fed indicated in June that it could taper bond purchases and raise short-term rates earlier than expected, sparking concerns that tighter policy in the near term could jeopardize the recovery longer term. In response, the yield curve flattened as long treasuries continued their rally, with the 10-year yield falling from a post-pandemic peak of 1.74% at the end of Q1 to 1.47% three months later.[8] U.S. real yields are now back at long-term lows. This bond market pricing reflects an expectation that inflation pressures are likely to subside over the longer term.

Equities Continue To Rally, but Growth Gains Against Value

Global stocks continued to make strong gains, up 7.4% in Q2 and 12.3% YTD, as current and expected earnings improved.[9] But in a reversal from Q1, growth outperformed value, leaving sectors like industrials, financials and energy again at historically "cheap" levels vs. growth.[10] The more cyclical international markets are likewise trading at lower P/E multiples than U.S. stocks. Stocks still look cheap compared to bonds, but valuations remain high.

Looking Forward

Going forward, we see two major questions facing markets. The first is whether the recovery will be self-sustaining. Will consumers spend their pent-up savings and drive corporates to expand hiring and production, or will the economy falter as the stimulus is withdrawn? The second question is whether the recent inflationary spike will prove transitory. Will pressures subside as supply is brought back online, or will inflation persist, forcing central banks to react? How growth and inflation unfold will likely drive markets (and policymakers) in the second half of 2021.

Inflation hedges can offer valuable diversification benefits, particularly in this environment. And with long-term returns to stocks and bonds both likely to disappoint, high-quality private-market alternatives may offer a more compelling return to risk for investors who can access them.

FOOTNOTES

[1] Source: https://www.reuters.com/business/us-business-inventories-rise-may-autos-stocks-decline-2021-07-16/
[2] Source: https://ourworldindata.org/covid-vaccinations
[3] Source: https://thehill.com/homenews/morning-report/562005-the-hills-morning-report
[4] Source: Bloomberg (CL1 Comdty, CPRTUCT% Index, NHSLAVS% Index, ETSLMP%Y Index)
[5] Source: JPMorgan, Guide to the Markets, 3Q 2021, at 31
[6] Source: https://www.wsj.com/articles/june-jobs-report-unemployment-rate-2021-11625176511
[7] Id.
[8] Source: Bloomberg (GTII10 Govt)
[9] Source: Bloomberg (MSCI ACWI Index, symbol NDUEACWF Index); Evoke analysis
[10] Source: JPMorgan, Guide to the Markets, 3Q 2021, at 53