MONTHLY MARKET UPDATE

JULY 2021

AVESTAR CAPITAL

Index Returns	Month To Date	Year To Date
S&P 500 TOTAL RETURN INDEX	2.83%	17.02%
MSCI INTERNATIONAL DEVELOPED EAFE INDEX	1.60%	8.08%
MSCI EMERGING MARKETS INDEX	-5.76%	-1.04%
MSCI ALL COUNTRIES ACWI INDEX	1.35%	12.06%
MSCI US REIT INDEX	4.46%	25.58%
BLOOMBERG COMMODITY INDEX	3.14%	23.34%
BLOOMBERG BARCLAYS US TREASURY INDEX	1.17%	-1.25%
BLOOMBERG BARCLAYS MUNICIPAL BOND INDEX	0.82%	1.90%
BLOOMBERG BARCLAYS AGGREGATE BOND INDEX	0.96%	-0.50%
HFR GLOBAL HEDGE FUND INDEX	-0.37%	3.35%

Data: Bloomberg / Table: Avestar Capital

SUMMARY

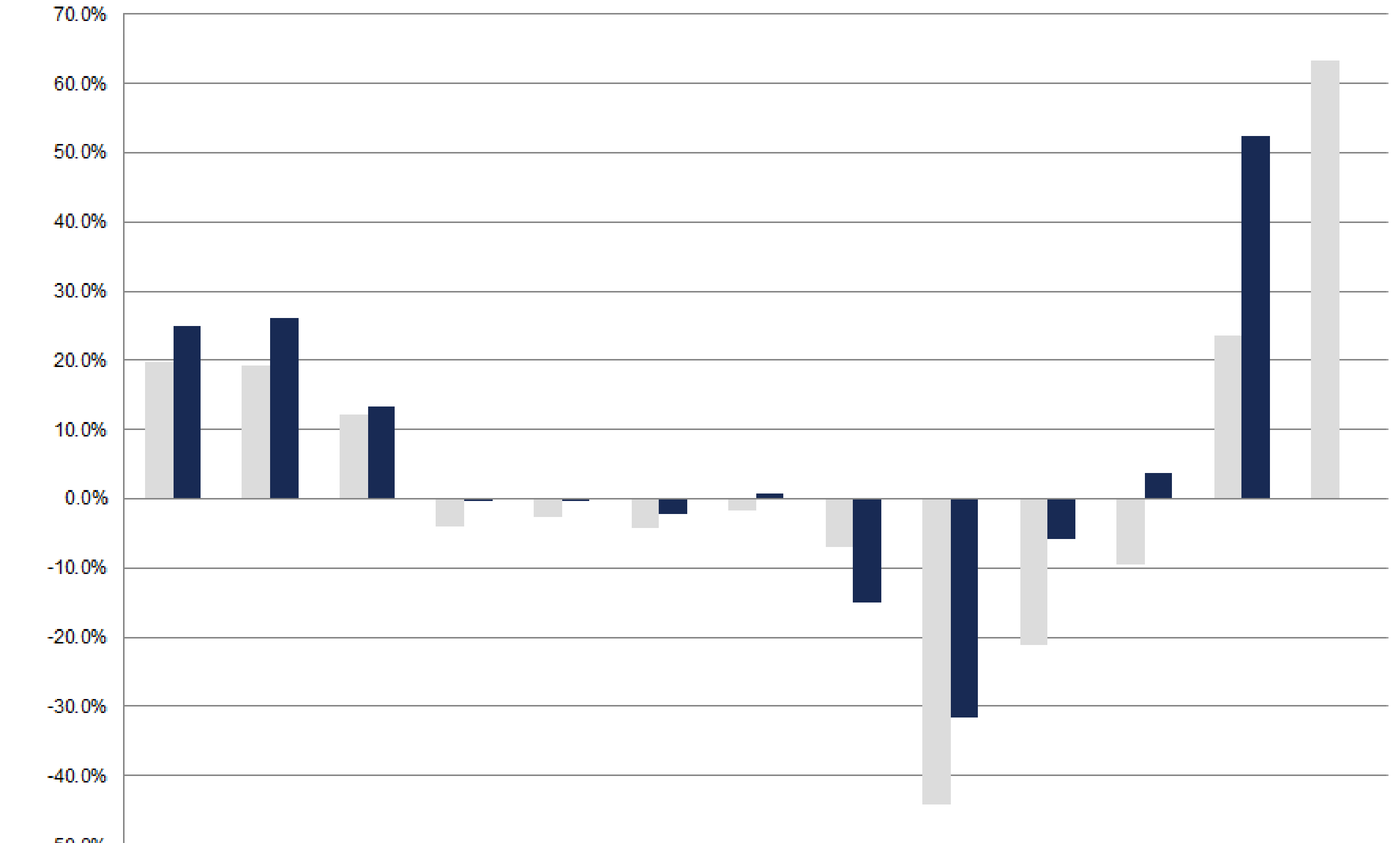
- The S&P 500 gained 2.83% this month and treasury yields dropped significantly.
- Analysts expect second quarter S&P 500 year-over-year earnings growth of 64% due to the base effect.
- Revenue has climbed back to pre-pandemic levels with earnings per share much higher.
- Market volatility may feel higher this past month but is still quite low historically.
- There is a disconnect in the historical correlation of stocks and treasuries and most cannot explain why.
- The U.S. economy grew at an annualized 6.5% rate last quarter, less than expected due to supply constraints.
- The delta variant is complicating the global recovery and could peak in the US in mid-October.
- Emerging Markets have significantly underperformed due to the delta variant and China tech clampdown.
- Transportation bill, Fed tapering, and debt ceiling discussions are what may lead markets next.

COMMENTARY

The S&P 500 gained 2.83% this past month hitting new highs. Yields dropped with the 10-year treasury closing out the month yielding only 1.22%. A far cry from the 1.75%-2% most economists were expecting going into the back half of this year.

Earnings season is here, and companies are reporting second quarter results. Analysts are expecting year-over-year growth in second quarter S&P 500 earnings of 64%. Given that most S&P 500 companies report actual earnings above estimates, it is likely we see earnings growth above 64%. This could be the highest earnings growth reported by the S&P 500 in more than 10 years. So far, 59% of the companies in the S&P 500 have reported actual results for Q2 2021 to date. Of these companies, 88% have reported actual EPS above estimates, which is above the five-year average of 75%. It is important to take these numbers with context. Q2 of 2020 had a sharp drop in earnings due to the pandemic, so the year-over-year comparisons are distorted due to the base effect.

S&P 500 Earnings Growth: End of Qtr. Estimate vs. Actual
(Source: FactSet)

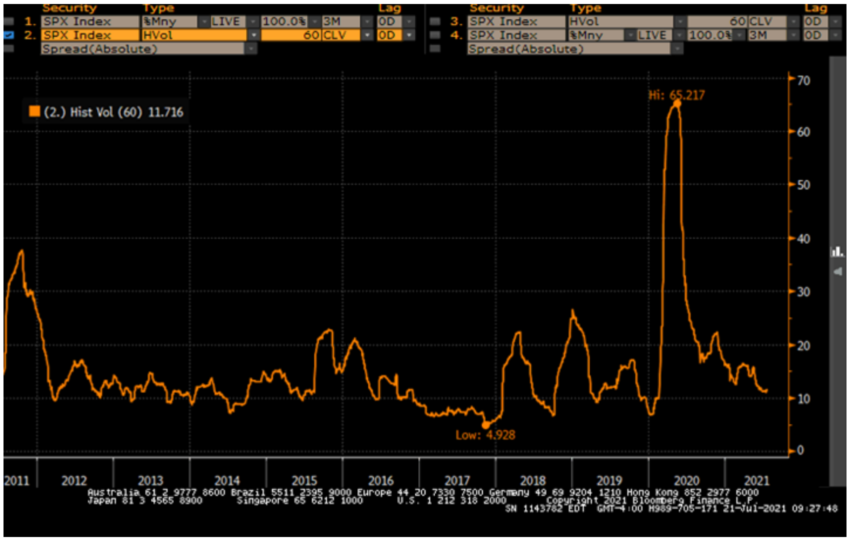


	Q218	Q318	Q418	Q119	Q219	Q319	Q419	Q120	Q220	Q320	Q420	Q121	Q221
End of Qtr.	19.7%	19.3%	12.1%	-4.1%	-2.7%	-4.2%	-1.8%	-7.0%	-44.2%	-21.2%	-9.4%	23.7%	63.3%
Actual	25.1%	26.1%	13.3%	-0.3%	-0.2%	-2.2%	0.8%	-15.0%	-31.6%	-5.7%	3.8%	52.5%	

The base effect in earnings growth does not deter that revenue from S&P 500 companies has climbed back to pre-pandemic levels with earnings per share higher as companies became more efficient during the pandemic. Moderate inflation may even help companies be even more profitable as revenues are “inflated” higher with operating cost rising at a slower pace. Margins can stay the same or potentially increase.

Source: Bloomberg

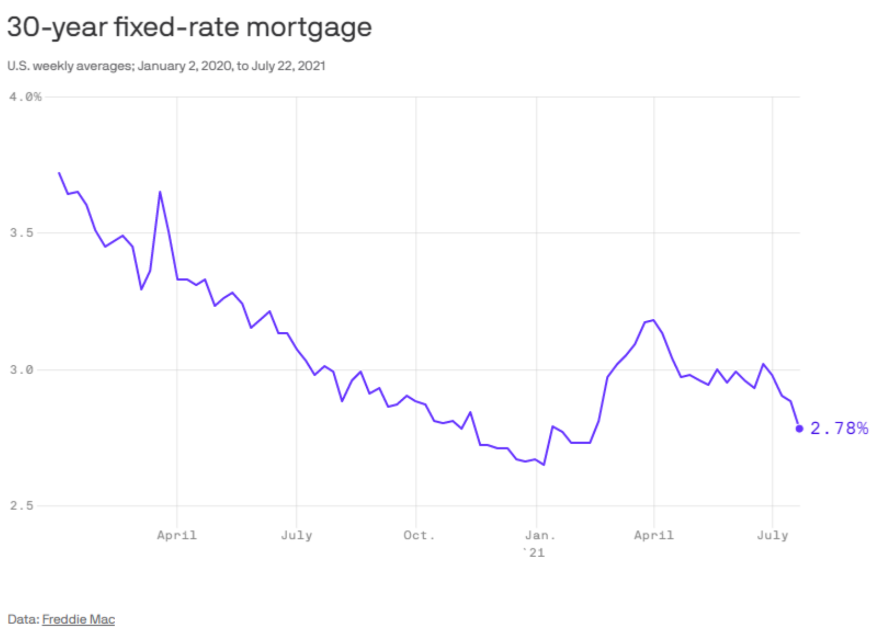
Volatility in the stock market may have felt like it increased over the past month with the S&P 500 dropping 1.6% on July 19th, but market volatility is still low on a historical basis. These large absolute swings are still smaller on a percentage basis since index values are much higher today than in prior years. For example, a 700 point move on the Dow Jones from 35,000 is 2% but a 700 point move from 27,000 (where the index traded around a year ago) is 2.6%. It is important to view these swings with the proper context.



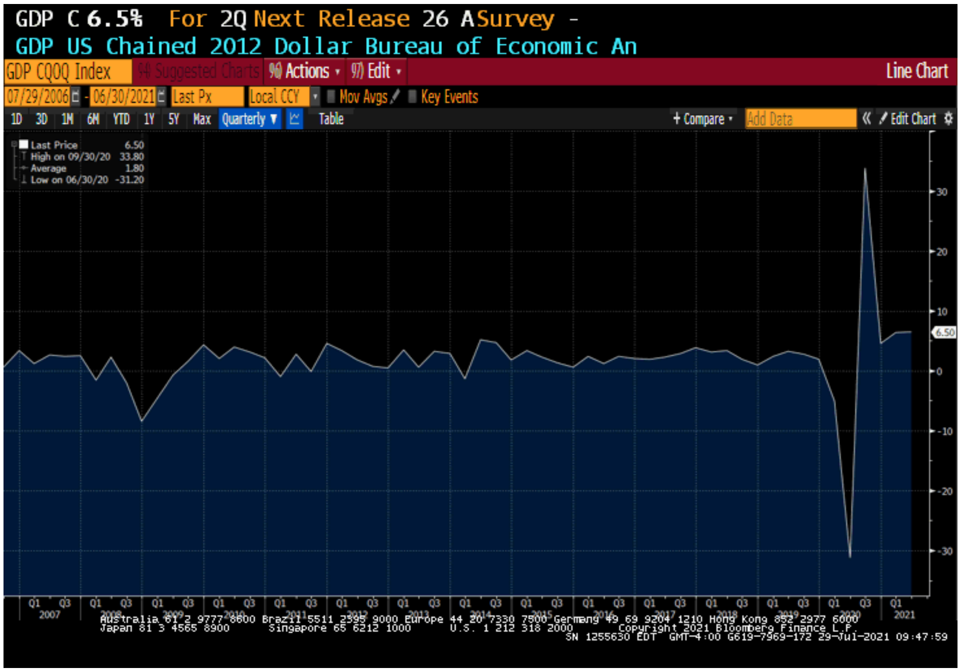
Source: Bloomberg

There is a big disconnect between the stock and credit markets. Historically, credit yields and stocks are positively correlated whereas bond prices and stocks are negatively correlated. To put simply, when stocks go up, treasury prices go down. Investors sell bonds to buy stocks. But there is a disconnect, prices of treasuries are going up (yields down) and stock prices are going up. This could be signaling that the bond market is not convinced global growth is past the COVID-19 threat or that inflation is transitory, so the Fed does not need to raise rates quickly.

The good news, with yields down, mortgage rates have also fallen which could signal another re-financing wave.



The U.S. economy grew at an annualized 6.5% rate last quarter, slower than the 8.4% economists expected. It came as the economy made strides toward further reopening, vaccinations rolled out, and government stimulus bolstered spending. Supply crunches held the pace of growth back. A drop in inventory investment, or what's available for businesses to sell, weighed on growth. So did a drop-off in new housing, a sign that supply shortages crimped construction. The economy is bigger now than it was before the pandemic, officially recovering from its pandemic-induced plunge. But output is still less than where it could have been, had there been no pandemic. Simply put, the US economy was trending higher than where it is now if there was no COVID-19.



Source: Bloomberg

All eyes are on the delta variant as the world tries to recover from COVID-19. The daily average of confirmed coronavirus cases in the U.S. has roughly quadrupled during July, rising from about 13,000 per day to over 43,000 now. New projections released July 21st by the COVID-19 Scenario Modeling Hub, a consortium of researchers working in consultation with the CDC, predict that the current coronavirus surge will accelerate through the summer and fall. The surge is predicted to peak in mid-October, with daily deaths triple the level they are now. Biden officials see a booster shot among at least some vaccinated Americans as increasingly likely. Though unclear still, the Biden administration has purchased enough doses of the vaccine to ensure that the U.S. will have enough for anyone who wants a booster to receive one. The rest of the world, however, is likely to question why Americans should receive a third shot while billions of people around the globe wait for their first.

Emerging market equities have underperformed. The delta variant has caused concerns for the lesser vaccinated countries to reopen fully and the Chinese clampdown on technology companies that trade overseas has caused concern in emerging market equities. It is important for vaccination rates to climb across the globe to support the global recovery efforts.

Additionally, what we at Avestar Capital are watching in the months to come that may affect markets are the bi-partisan transportation bill making its way through Congress, the budget reconciliation portion of the infrastructure bill, the Fed tapering monthly bond purchases, and Congress raising the debt ceiling.

Interestingly, the debt ceiling cannot do what it purports to do, which is control the amount that the government borrows. The tax and spending bills passed by Congress are legally binding, and the debt ceiling neither enables nor constrains them. When Treasury needs to borrow money to follow the law, it has no choice but to raise the debt ceiling. The alternative is to default, which is unthinkable. The treasury is sitting on $450 billion in cash and Congress is set to recess for the summer, so expect posturing over the debt ceiling in early Fall.

The Fed has signaled it will start discussing how and when to start tapering its historic emergency support. This will start with reducing its asset purchases which is currently $80 billion in Treasuries and $40 billion in mortgage-backed securities a month.

With yields conflicting with market valuations, debt ceiling discussions, and potential Fed tapering, it may be more prudent to follow the credit markets heading into the fall than equity valuations for where the market will head into next year.

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