MONTHLY MARKET UPDATE

MAY 2021

Index Returns	Month To Date	Year To Date
S&P 500 TOTAL RETURN INDEX	0.55%	11.93%
MSCI INTERNATIONAL DEVELOPED EAFE INDEX	3.21%	9.03%
MSCI EMERGING MARKETS INDEX	0.98%	5.38%
MSCI ALL COUNTRIES ACWI INDEX	1.33%	10.04%
MSCI US REIT INDEX	0.79%	17.33%
BLOOMBERG COMMODITY INDEX	2.73%	18.92%
BLOOMBERG BARCLAYS US TREASURY INDEX	0.34%	-3.20%
BLOOMBERG BARCLAYS MUNICIPAL BOND INDEX	0.30%	0.78%
BLOOMBERG BARCLAYS AGGREGATE BOND INDEX	0.33%	-2.29%
HFR GLOBAL HEDGE FUND INDEX	0.26%	3.21%

SUMMARY

- The S&P 500 gained 55 basis points this month and credit yields subsided slightly.
- Inflation concerns are rising and are showing up in economic data but may not be bad if driven by the right forces.
- Executives are increasingly talking about inflation on earnings calls.
- SPACs are dominating the IPO market but are under renewed scrutiny.
- The US housing market remains hot and is expected to remain so until late autumn.
- Asset valuations are high, but with companies beating and raising guidance, multiples are compressing.

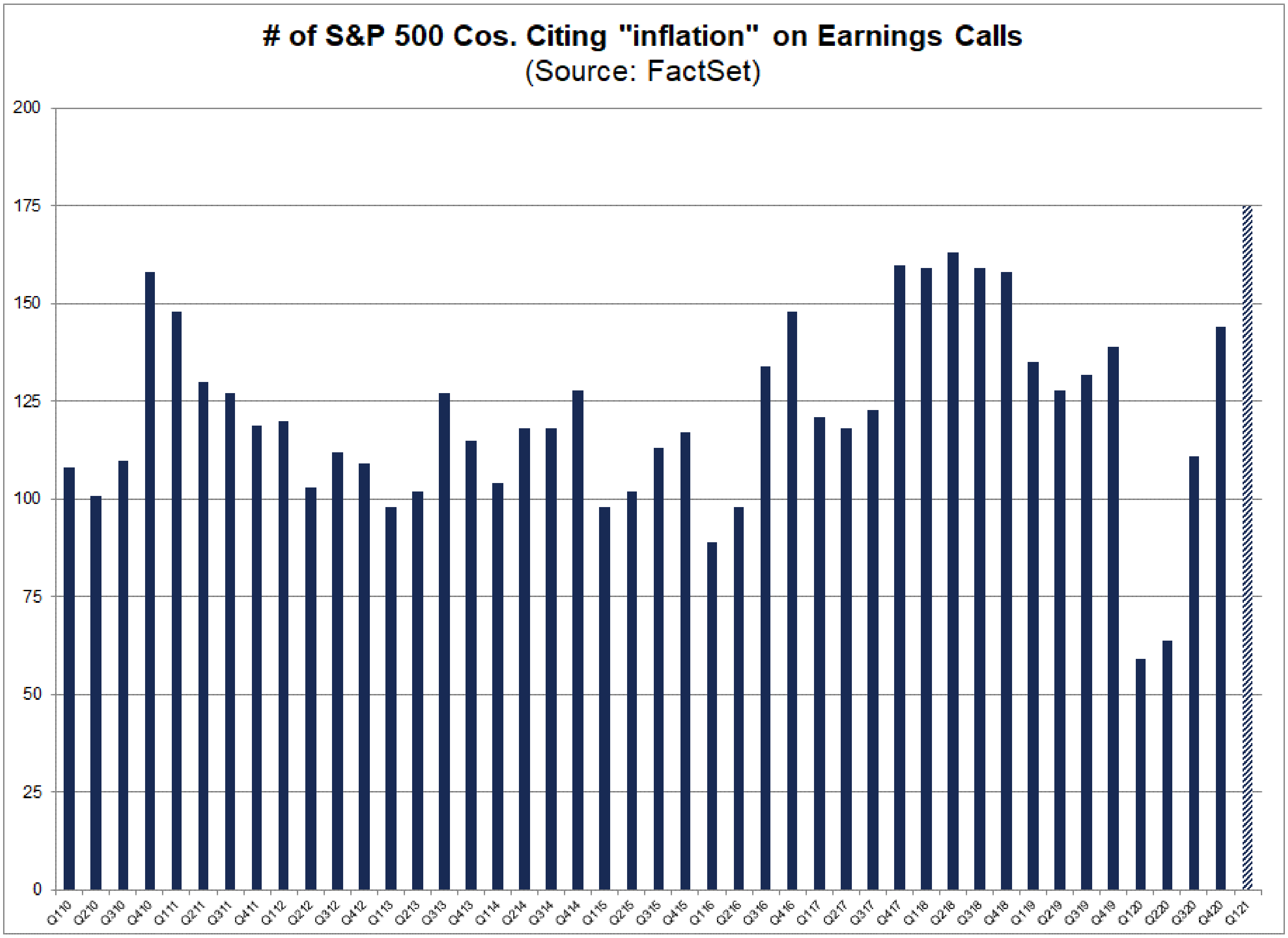
COMMENTARY

The S&P 500 gained 55 basis points this past month but came off its high that was set on 5/7. Treasury yields subsided a bit even with higher-than-expected inflation data points.

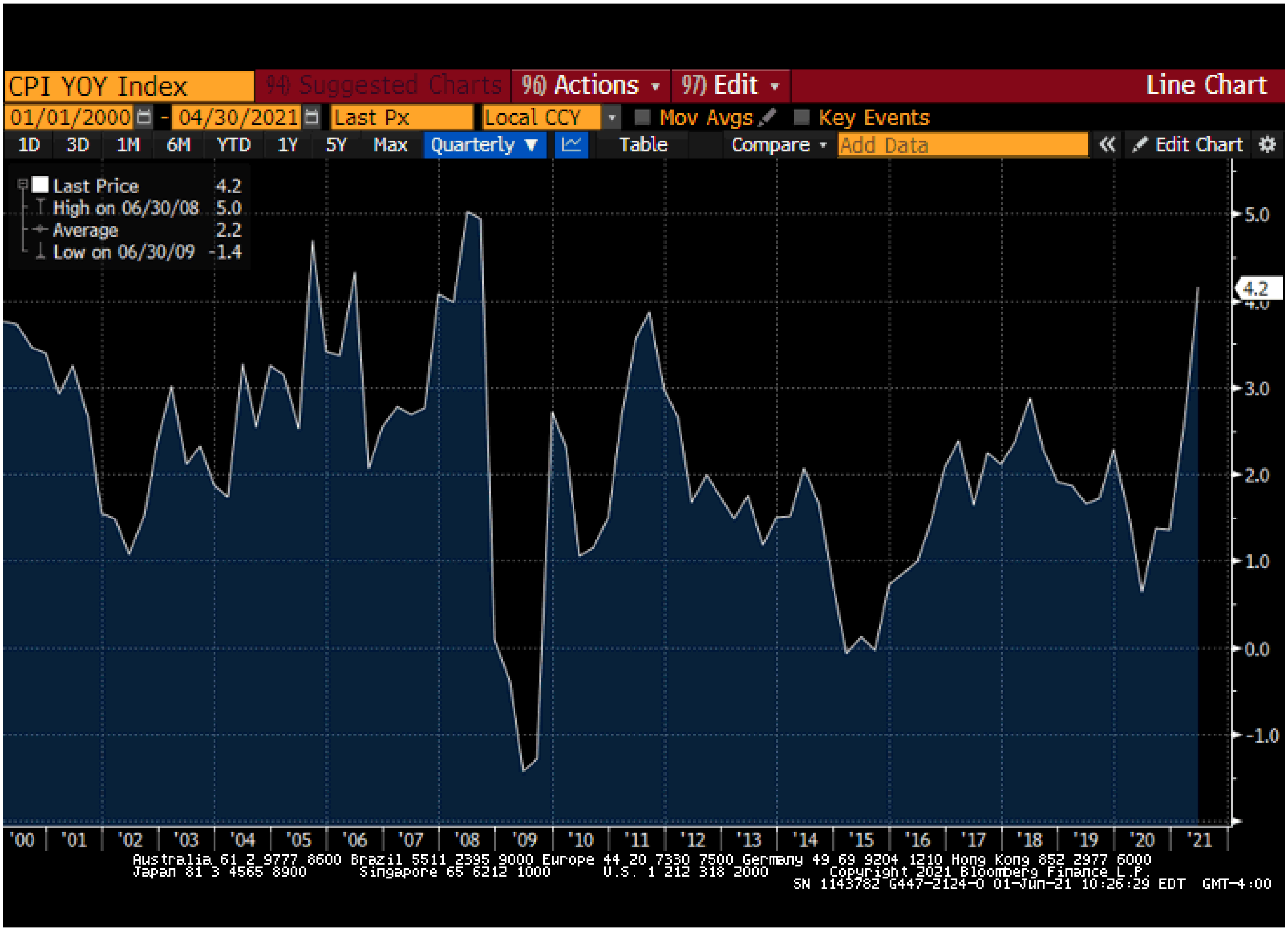
Concerns about inflation are rising. Consumer prices increased 4.2% in April, which marked the largest year-over-year increase since September 2008 (5.0%). The rise in consumer inflation is being driven by higher energy prices, which jumped 25% compared to a year ago. Producer price inflation also came in higher than expected for the month. The April PPI was up 6.2%, which was the largest year-over-year increase since the U.S. Bureau of Labor Statistics began tracking this measure in 2010. The year-over-year jumps were largely expected because around this time last year we saw deflationary pressure due to the start of the pandemic. Even taking the year-over-year base effect into account, the projections were slightly higher than economist had forecasted.

But inflation is not necessarily a bad thing. It is good for borrowers as existing debt is less costly, yet bad for savers, as their dollars are worth less in terms of purchasing power. If inflation is being driven by wage growth, that is good. Workers are earning more and can spend more money boosting the economy. If inflation is driven by healthcare, housing costs, or college tuition, that is bad. It adds medical bills or locks a portion of the population out from upward mobility by limiting access to higher education or increasing debt burdens. The Fed and the majority of economists continue their stance that inflation will be “transitory” or will subside in the following months as the extra money and pent-up demand works its way through the system. There is a reason that the Fed is taking a firm stance on inflation and reiterating that it will be short-lived. If the market expects inflation, then inflation tends to happen. Companies raise prices in anticipation of increased costs and buyers try to quickly purchase items before prices go up further creating a demand spike.

Executives are increasingly talking about inflation on earnings calls because everyone continues to ask how inflation impacts their businesses and if they are seeing an uptick in costs. We can see in the graph below the increased mentions relative to past quarters.

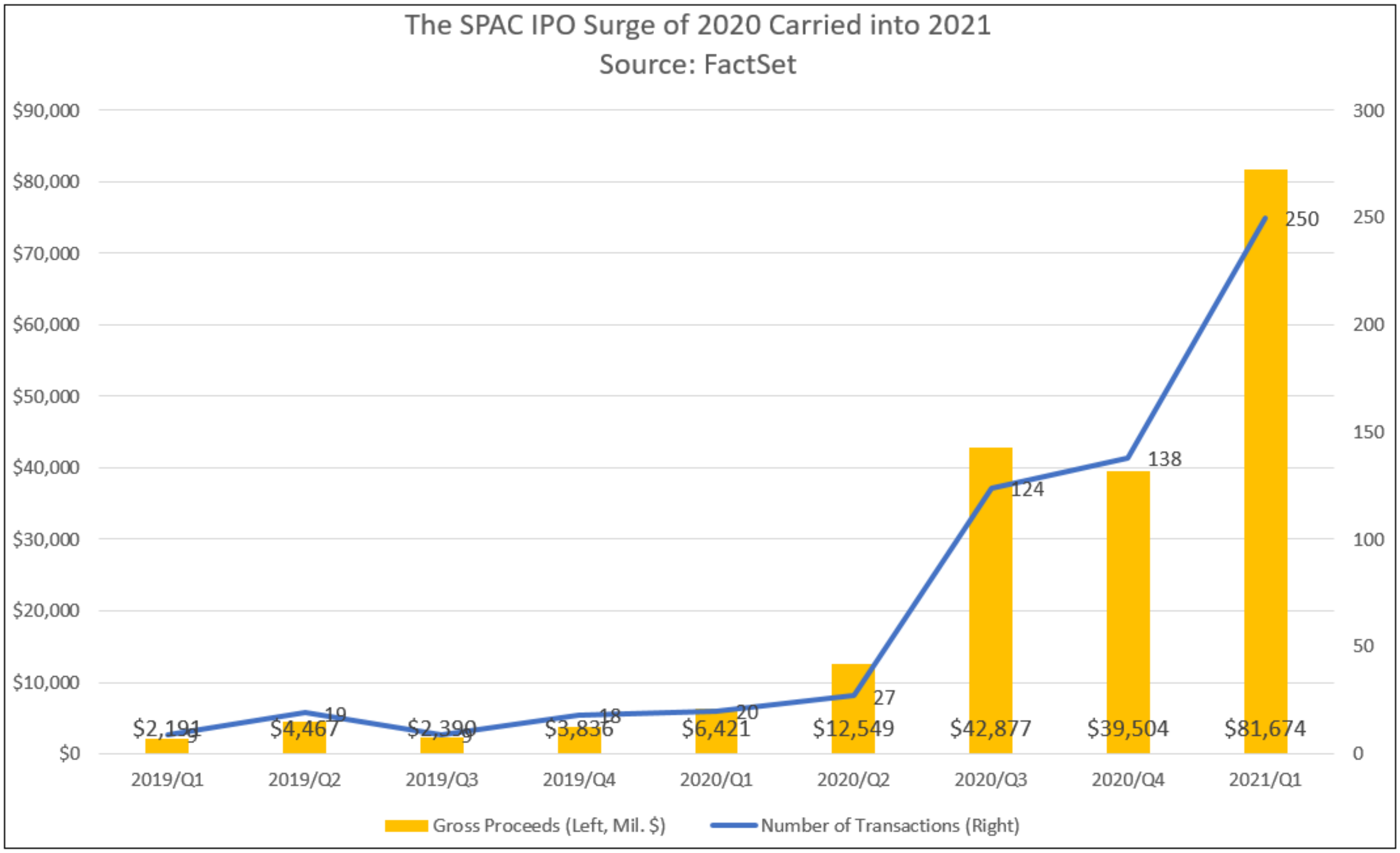


As more economic data comes out over the new few months, it is important to note that the data does not always tell the full story. For example, Consumer Price Index (CPI) tends to concentrate on smaller and arguably less important things, like the price of jewelry, or postage, or "sauces and gravies". Personal Consumption Expenditures (PCE) is the preferred measure of inflation for the Fed because it reflects the changing composition of spending, which better aligns with consumer behavior, but also has its limitations.

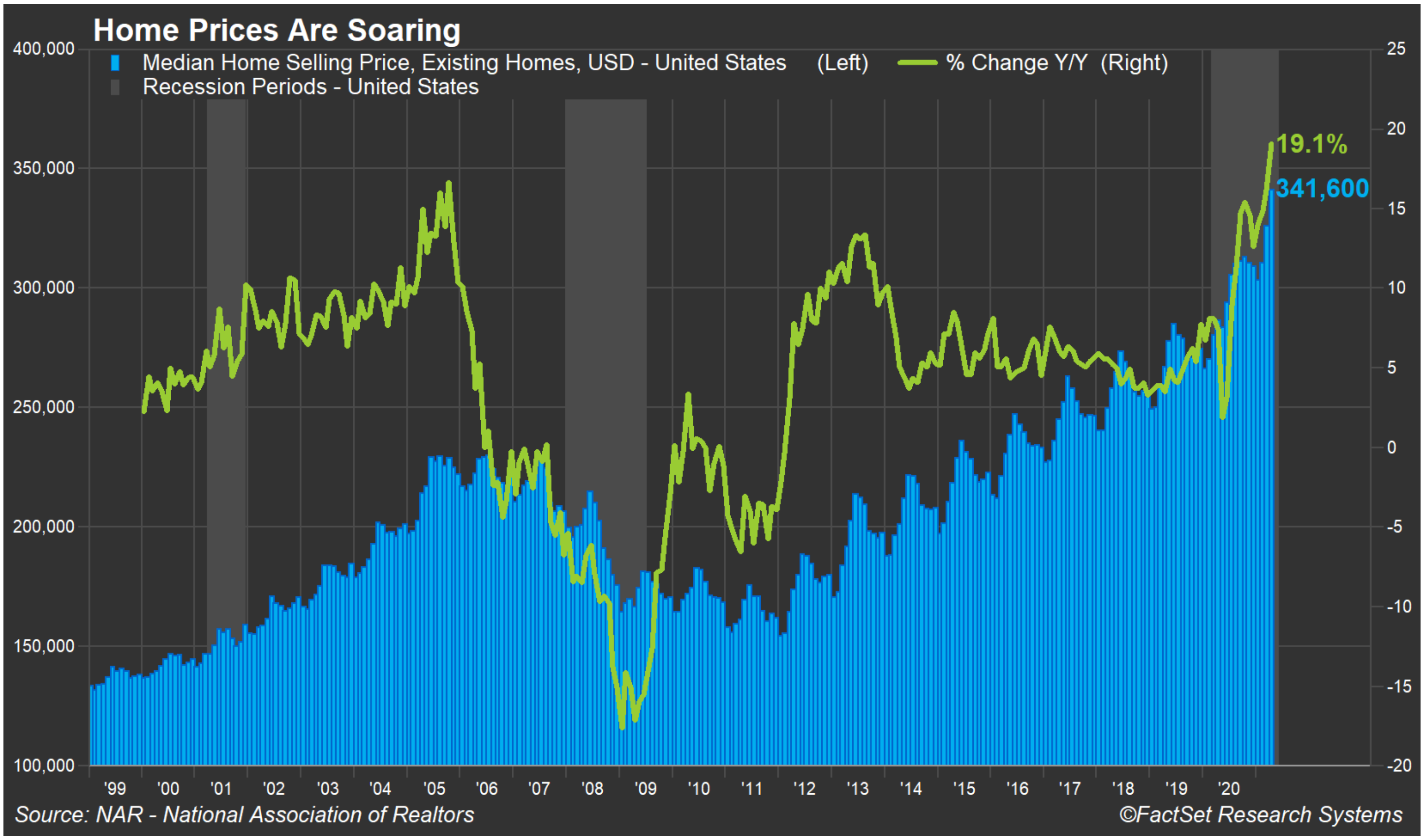


Source: Bloomberg

SPACs, which stands for Special Purpose Acquisition Company, are continuing to dominate the IPO market. Last year SPACs accounted for 55.7% of all IPOs; in the first quarter, SPACs represented 68.5%. This past month, there has been renewed SPAC scrutiny by investors and regulators. Investors are dumping high flying SPACs that are trading above their trust value while regulators are looking into questionable practices. But what are SPACs? Essentially, investors pay $10 into a trust, the sponsors use that money to acquire a private company and make it public. If there is no deal after a certain period, investors get their $10 back. For their services, the sponsors typically get a large chunk of the new equity for free, up to 20% of the floating shares outstanding. This conflict of interest incentivizes sponsors to do a deal, even if it is a bad deal, for the free shares they would receive. Recently, investors were paying above trust value for these SPACs in hopes that after a deal is announced, the shares would pop in value, betting that sponsors would do accretive deals. Unfortunately, what we are seeing is SPAC sponsors paying exorbitant amounts to buy companies and some SPACs starting to trade below their trust value. Investors are becoming increasingly skeptical, and regulators are scrutinizing the forward projections and accounting methods used by SPACs that are not allowed during other traditional IPO processes.



The U.S. housing market remains hot. Most people are aware that working from home and the need for more space is a large driver of the demand for homeowners but the trend that started last summer has only accelerated in 2021. This surge in demand coupled with lack of supply is driving up the prices of existing homes. Construction materials costs for new homes are surging as demand for materials far outstrips current supply. When will housing cool off? Experts predict that the real estate market will not slow down until late autumn, and even then, home prices will remain high, according to the National Association of Realtors. More new construction homes will be coming onto the market, evening out supply. Until then, it is a sellers' market.



Home Prices Are Soaring
Median Home Selling Price, Existing Homes, USD - United States (Left)
% Change Y/Y (Right)
Recession Periods - United States
19.1%
341,600
400,000
350,000
300,000
250,000
200,000
150,000
100,000
25
20
15
10
5
0
-5
-10
-15
-20
'99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14 '15 '16 '17 '18 '19 '20
Source: NAR - National Association of Realtors
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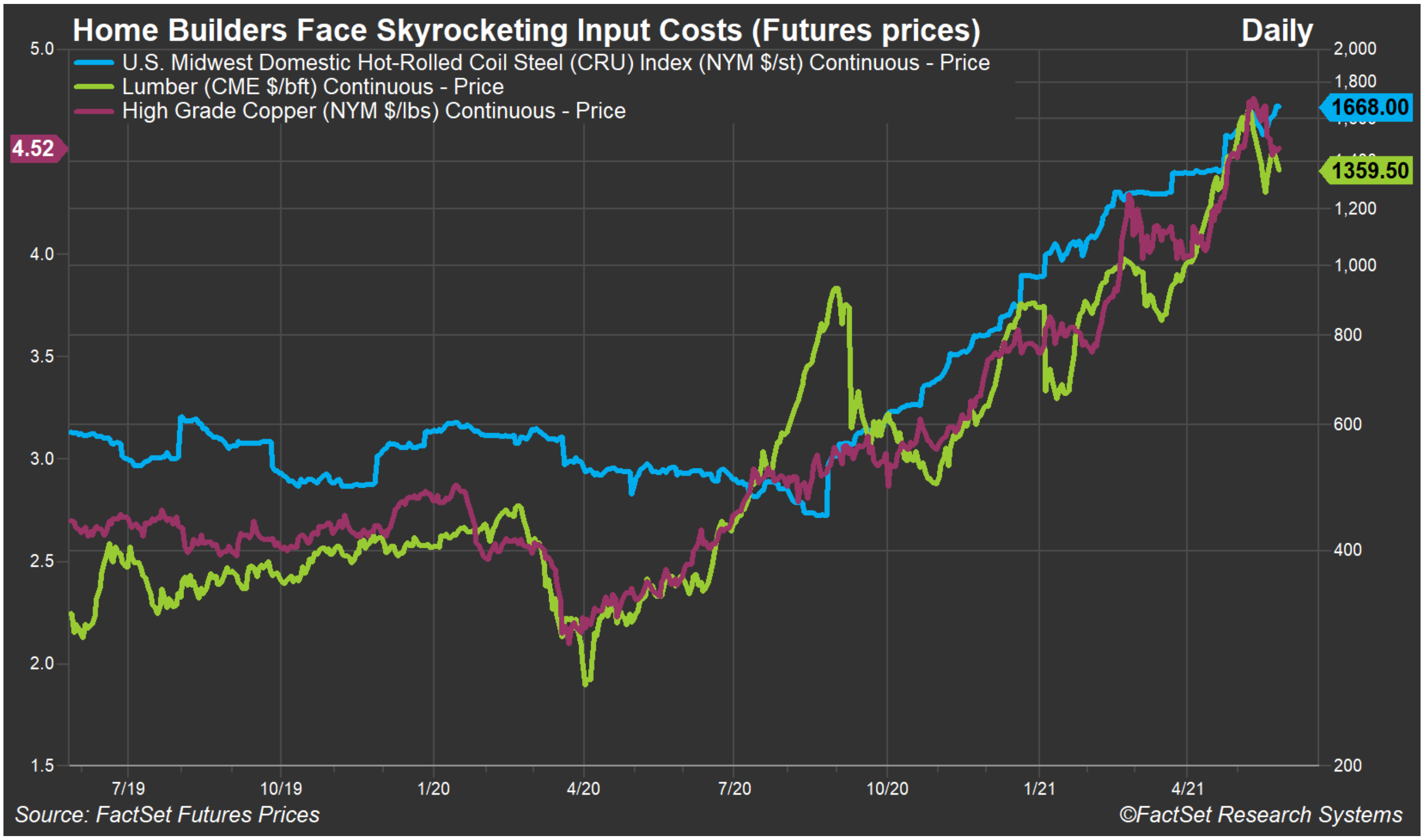

Home Builders Face Skyrocketing Input Costs (Futures prices)
Daily
U.S. Midwest Domestic Hot-Rolled Coil Steel (CRU) Index (NYM $/st) Continuous - Price
Lumber (CME $/bft) Continuous - Price
High Grade Copper (NYM $/lbs) Continuous - Price
4.52
1668.00
1359.50
5.0
4.0
3.5
3.0
2.5
2.0
1.5
2,000
1,800
1,200
1,000
800
600
400
200
7/19 10/19 1/20 4/20 7/20 10/20 1/21 4/21
Source: FactSet Futures Prices
©FactSet Research Systems

Market valuations are still high compared to their historic averages but as companies beat earnings expectations and raise guidance, we are seeing valuation multiples contract. To give an example, if a stock was expected to earn $1 in earnings, and the stock price is $20 per share, that implies a 20x price-to-earnings multiple, but the company really earned $2, so the price-to-earnings multiple contacts to 10x ($20 per share divided by $2 in earnings). This growth in earnings is helping to bring down lofty valuations. This trend should continue with the transportation bill on the horizon injecting more cash into the economy, but investors should brace for volatility as rates fluctuate with upcoming inflation data.

Source: Bloomberg

As the summer months come, will the old market adage, “sell in May, and go away,” hold true?

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