Investment and Economic Update
First Quarter 2021

What a difference a year makes! Unlike the situation in the first quarter of 2020, U.S. stocks posted healthy gains since the start of the year, and there is optimism that the recent flurry of government checks to individual consumers, plus the huge infrastructure project on the drawing board, will give the economy a shot in the arm. Other countries are looking at the U.S. bull market with envy, and the American economy seems to have weathered its biggest challenge since at least 2008.

Looking at large cap stocks, the Wilshire U.S. Large Cap index gained 5.80% in the first quarter. The Russell 1000 large-cap index finished the quarter with a similar 5.91% gain, while the widely quoted S&P 500 index of large company stocks has gained 5.77% so far this year.

Meanwhile, the Russell Midcap Index gained 8.14% in the first three months of 2021. The Russell 2000 Small-Cap Index is up 12.70% in the year's first three months. The technology-heavy Nasdaq Composite Index is up 2.78% for the year, as tech stocks finally took a back seat to their peers in other economic sectors.

International investors saw far more modest gains. The broad-based EAFE index of companies in developed foreign economies gained 2.83% in the first quarter. In aggregate, European stocks are up 3.52% so far this year, while EAFE's Far East Index was up just 1.74%. Emerging market stocks of less developed countries, as represented by the EAFE EM index, gained 1.95% in dollar terms in the first quarter.

In the bond markets, the rates on longer-term securities jumped from historically low rates to simply low rates. Coupon rates on 10-year Treasury bonds rose to a 1.67% yield, while 3 month, 6-month and 12-month bonds are now sporting barely positive yields for the first time since this time last year. Five-year municipal bonds are yielding, on average, 0.50% per year, while 30-year munis are yielding 1.79% on average.

This is obviously a big change from this time last year, when stock markets in the U.S. and abroad were reeling from a historically rapid downturn. Today, most analysts believe that the market is overvalued, and many professional investors are cautious. But any move to get out of the markets when this overvaluation became evident would have meant missing huge gains in the markets, proving once again the folly of trying to time the market. And we are looking at a multi-trillion-dollar infrastructure proposal which would inject additional life into the U.S. economy.

Better news: analysts have increased their earnings estimates for S&P 500 companies by 6.0%—which is a record—and unemployment rates have been trending lower since the start of the year. Finally, the progress of vaccination against COVID appears to be picking up, with some estimating that all adult Americans will be vaccinated in the next couple of months. A return to normalcy could be viewed as another positive sign.

The only dark clouds on the horizon—and these are really gray, not black—is the rise in longer-term interest rates. The U.S. Federal Reserve Board continues to hold down short-term rates to essentially zero, which means several things. First, we have a steepening yield curve, which is often an indicator of economic health. Second, people who invest in longer term bonds are finally getting paid something for their trouble. But higher long-term interest rates make bonds competitive with stocks for investor dollars, which could trigger a shift in investment flows which, in turn, could lead to lower stock prices.

All of this is a long-winded way of saying that it is impossible to predict whether the markets will continue the long bullish run or take a break. It is not impossible that stocks will eventually return to more normal valuations—suggesting prices at least 30% lower than they are today—but that could happen gradually, as companies boost their earnings while market returns go back down to single digits. The sudden, unpredicted appearance of the pandemic shows us how little we know about what is to come.

Below, we've summarized some of the widely quoted indexes for your reference. As a reminder the challenge is, the DJIA is not the same as the S&P 500, which is not the same as the NASDAQ – and none of these indexes perfectly match your own distinct mix of assets and their expected returns, especially if you own a globally diversified portfolio with exposure to stocks and bonds, large and small companies, value and growth companies, and U.S. and non-U.S. based companies. The following returns are year-to-date and the rolling 1-year; respectively:

S&P 500: 5.79%, 60.81%
Dow Jones: 7.76, 57.48%%
NASDAQ Composite: 2.78%, 79.97%
Russell 2000 (Small-Cap): 12.70%, 107.14%
MSCI EAFE (International): 2.83%, 41.60%
Barclay's Capital US Aggregate Bond: -3.37%, 0.71%