Legacy Trust

Investment Perspectives

Economic Recovery Taking Hold

April 2021

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Key Takeaways

- Optimism about the vaccine rollout has helped build confidence that reopenings and lifting of restrictions will be sustainable
- Economic activity has risen sharply as Covid-19 cases are on the decline in the U.S.
- Equity markets have continued to rise as earnings are rebounding significantly, helping to justify higher valuations
- Interest rates are still expected to remain lower for longer as equities continue to appear relatively more attractive than fixed income

On the heels of tremendous upheaval and uncertainty for much of last year, 2021 finds investors feeling optimistic about the future as the pandemic is on the decline. Increased confidence around the vaccine rollouts and gradual economic reopenings has helped to push investor sentiment higher, and markets have continued the rally they began last year.

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So far, the story for 2021 has been one of an economic recovery that is gaining momentum. Even though uncertainty surrounding Covid-19 remains high and many countries around the world are still under significant economic restrictions, vaccine rollouts in the U.S., the U.K., and other developed countries have helped to maintain optimism that reopenings will be sustainable.

Economic data in the U.S. shows a rapidly improving situation, with unemployment dropping, consumer spending rising, and a very tight housing market. Many businesses are reporting challenges with finding new employees to fill open positions, and wages are likely to be on the rise as a result.

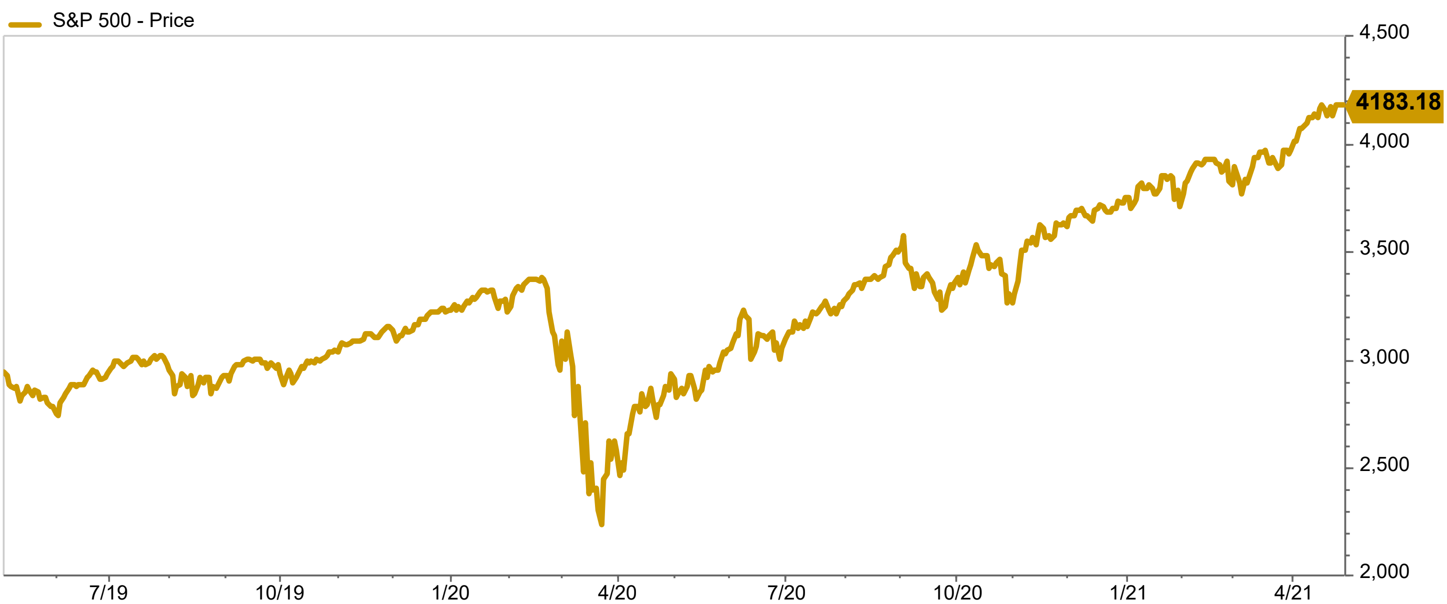
The Organization for Economic Cooperation and Development (OECD) has upgraded its forecast for global growth for 2021 significantly based on these indications of a faster than expected recovery, but progress remains very uneven by country. The U.S. held up relatively well last year and is leading the recovery, but other developed markets slowed significantly in Q4 2020 and many developing economies including India and Brazil are still battling active outbreaks of the coronavirus.

Valuations remain stretched for most asset classes after a year of unprecedented policy stimulus from central banks and governments across the globe. Fortunately, company earnings announcements have largely proven out expectations of a strong recovery, helping to justify higher stock prices. At the time of this writing, with 60% of the S&P 500 companies having reported actual results for Q1, the blended earnings growth rate for the index is +45.8% year-over-year – the highest rate since 2010 when the economy was in recovery from the Great Recession. Stock prices have continued to rise, with the S&P 500 up more than 10% year-to-date.

As markets continued to price in the solidified case for economic reopening, value stocks have been outperforming growth stocks by wide margins as these stocks are more cyclical and are expected to benefit more from a return to normal social interactions. Emerging market stocks got a strong start to the year but have fallen back since February on continued tensions between the U.S. and China and ongoing pandemic outbreaks in many EM countries. U.S. small caps are the best performing market segment year-to-date, up more than 15%.

Optimism over the unfolding recovery has been tempered a bit by the continued rise in longer dated bond yields and associated fear of tightening in financial conditions. Markets are pricing in higher inflation risk, as well as the possibility that the Fed may have to tighten monetary policy sooner than they have planned. Higher yields are making U.S. fixed income more attractive for international investors, a factor that will likely help to keep a cap on rates from moving much higher.

While equity markets appear somewhat pricey today, we continue to feel that we are in the early stages of the economic rebound and believe there is strong potential for growth going forward. Bond yields are likely to remain lower for longer and investors will need to be sure that their portfolio is well-positioned for growth in excess of inflation, meaning that equity allocations will be critical. We continue to seek active investment opportunities that we feel are best positioned to take advantage of the changing investment landscape and the fundamental recovery underway.



Source: FactSet Research Systems