

# July 2021 REVIEW & COMMENTARY

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## Battle between Market Bulls & Bears 2nd Quarter 2021 Wrap Up

In the ongoing battle between market Bulls and Bears, so far in 2021 the Bulls have built a substantial lead. As of June 30th, the S&P 500® Index (“S&P 500”) was up 15.3% on a total return basis while other well-known indices also posted gains – ranging from 13.8% for the venerable Dow Jones Index to 12.5% for the growth- oriented NASDAQ Composite index. Although changing substantially as the second quarter ended, value indices outperformed growth indices by about 200 basis points year-to-date as markets shift between favoring “recovery” stocks versus favoring more all-weather growth companies.

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With the consumer price index up 5.0% in May on an annual basis, inflation has arrived. The question is whether it is “transitory” or ongoing. Time will tell. There are clearly some Covid induced aberrations in recent CPI data. Because of a shortage of computer chips and because people are eschewing public transportation, new car building has slowed causing a 29.7% increase in the used car prices. Gasoline has risen about 56.2% over the past year, mostly because people cut back driving much a year ago. Copper, considered a harbinger of future economic activity, rose from \$2.75 to \$4.30 in the past year.

Some relief in price hikes is inevitable. Lumber is down 57% from its May 2021 peak. The great unknown regarding inflation’s direction is probably closely related to labor costs. In Charlottesville, Virginia at least, the service industry is begging for workers with sign on bonuses being offered for restaurant workers, prison guards and nurses. The key thing to look for is whether labor costs mitigate as Covid-related enhanced unemployment benefits end in many states.

The second “I,” interest rates are closely linked to inflation as well. Ten-year U.S. Treasury yields ended the quarter at 1.47%, versus 0.91% on December 31, 2020. The rate hike hurt fixed income performance year-to-date, but probably helped add fuel to equity market rallies. At least for now, interest rates remain low and are not much competition for equity investors.

The last “I” stands for infrastructure. The Biden administration and a small bi-partisan group of legislators has proposed a \$1.2 trillion spending bill to fix everything from roads and bridges to airports and railroads and to further develop a national broadband internet network. The overall economy and many companies stand to benefit from enhanced infrastructure spending. They include companies that sell construction equipment or materials, companies that design various infrastructure projects and companies that build the projects.

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By most standards of value, the S&P 500 is overvalued compared to historic norms. As of July 1, 2021, analysts were expecting earnings for the S&P 500 of about \$189 in 2021 and \$210 in 2022. Based on the June 30, 2021 value, the S&P 500 sells for 22.7x and 20.5x estimated 2021 and 2022 earnings. This compares to historic norms of about 15x to 17x forward earnings. The second quarter 2021 earnings season will begin in about two weeks. It promises to show great results – but only because Q2 20 was the quarter of 2020 most negatively affected by the Covid economic slowdown.

As with every year, the next two quarters should be interesting. There remains plenty of fuel to further boost equity prices. But growth is bound to slow as we lap Covid-weakened quarters. There also remain long-term issues, such as repaying the massive amount of debt created over the past two years, that could worry investors.

As always, we are here to help.