May 17, 2021

The Markets & the Economy - What We're Watching

Top Theme of the Month:

- Earnings exceptionally strong – inflation remains questionable

Since our last update companies have reported their first quarter financial results. Those results, along with continued strong economic data points, drove an exceptionally strong month of April for the stock market. The S&P 500 delivered a 5.24% return for the month. This came on top of a 4.24% return for March and brings the year to date return (through 5/14/21) to 11.12% for the S&P 500. The biggest question being asked is the sustainability of this momentum and whether or not increased indications of inflationary pressure are transitory or a larger issue.

Earnings

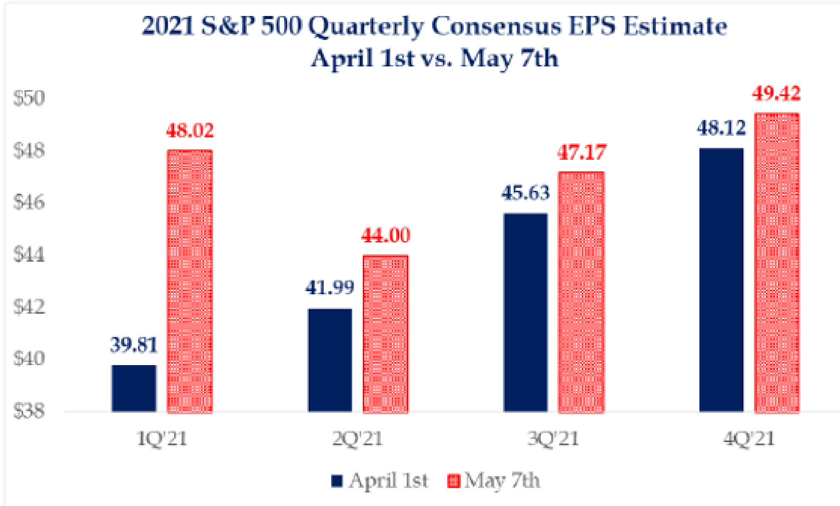
First quarter earnings were robust. As shown in the S&P 500 1st Quarter Earnings Scorecard chart below,[1] both sales and earnings exceeded Wall Street expectations. Earnings were particularly noteworthy given results were better in every sector. On an overall basis, earnings increased 50.4% as compared to last year's first quarter which, of course, was negatively impacted by the start of the pandemic. In terms of revenue, all but two sectors reported better than expected revenue growth and the growth rate overall was 12.9%.

S&P 500 1st Quarter Earnings Scorecard

	Sales Growth (Y/Y%)		Earnings Growth (Y/Y%)		# Reported
	Apr. 30	May 7	Apr. 30	May 7	
S&P 500	11.6%	12.9%	46.3%	50.4%	439/500
Discretionary	16.9%	18.2%	169.6%	188.8%	44/62
Staples	3.4%	3.3%	6.5%	7.0%	25/32
Energy	-3.1%	2.8%	8.0%	23.4%	22/23
Financials	30.9%	33.3%	130.1%	137.8%	64/65
Health Care	9.8%	9.8%	22.6%	26.2%	56/62
Industrials	1.0%	1.7%	-2.4%	0.7%	70/74
Materials	11.4%	12.4%	55.4%	62.2%	26/28
Real Estate	-0.4%	1.2%	2.9%	4.8%	28/29
Technology	21.2%	21.5%	42.5%	43.6%	60/75
Communications	12.2%	12.7%	48.1%	50.1%	19/22
Utilities	7.2%	15.2%	2.5%	6.5%	25/28

[1] Image Source: Strategas

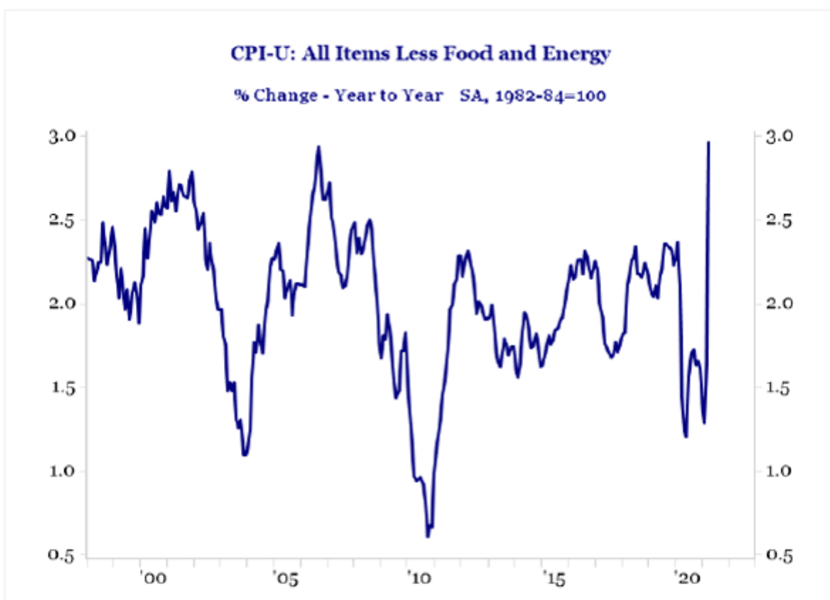
The impact of first quarter earnings was so strong that, as shown in the S&P 500 Quarterly Consensus EPS Estimate chart,[2] each quarter for the remainder of the year has been upwardly revised between April 1st and May 7th. This means that elements of that strength are deemed to be sustainable throughout the year. Stocks have a tendency to follow earnings and this increase in expected earnings drove the aforementioned 5.24% increase in stock prices during the month of April.



Inflation

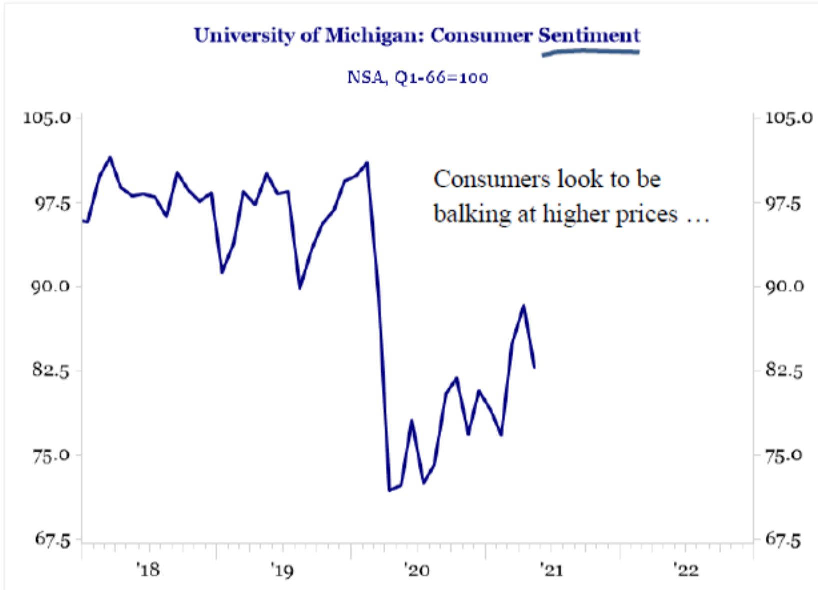
The prospect for inflation given the record amounts of stimulus over the past year, continues to remain a concern for the economy and the stock market. Last week, stocks were very volatile as tangible evidence of inflation appeared. This did not come as a surprise, the Federal Reserve has continuously stated that they expect inflation in the near-term, but that they do not expect it to persist. They maintain their stated goal of a 2% inflation average over time. However, given that some of the recent data looks higher than expected, there is a question of whether or not the Federal Reserve is correct or if they will have to reverse course and raise rates sooner than expected.

Inflation is measured by the CPI (Consumer Price Index). As shown in the chart to the right,[3] Core CPI was +3% from a year ago. Not shown on this chart is the total CPI which includes food and energy that number is +4.2% year over year. These figures are the highest since 1996. Significant attention will be paid to the core CPI number over the next several months to see if it increases, levels off, or declines modestly.



[2] Image Source: Strategas
[3] Image Source: Labor of Bureau Statistics

Lastly, while the inflation dilemma is nuanced and extremely complex, we'd like to narrow it down and focus on two points – interest rates and the economy. The first and most obvious point is that inflation has the potential to make interest rates rise faster than expected (to combat that inflation). Higher interest rates can be seen as a headwind for stock prices, (not always the case) but more importantly, higher interest rates can affect future economic activity. In this chart we see that the most recent consumer sentiment projections declined and were lower than expected. It raises the question of whether or not this reaction was connected to inflation or not – time will tell. We noted above that the market's strong advance in March and April was, in part, the product of robust earnings growth – for that growth to continue consumer sentiment and broad economic activity will have to remain strong.[4]



Click **HERE** to read our latest thought piece on inflation
Rising Inflation: Where Will It Go From Here?

It is important to note how and why a disciplined investment process works in portfolio construction and long-term investing. It is common during such volatile times to find ourselves questioning whether investment changes are required given the fluctuating circumstances. In our disciplined approach, we analyze the data and find that incremental changes based on the facts are often necessary. However, in terms of discipline, it is important to remember that actions such as asset allocation and risk tolerance are long-term decisions and generally speaking, should not change frequently if at all.

Changes in your investment portfolio may be warranted at times, but if you take a long-term investing view, which we recommend, there is proven merit in staying the course. The way we invest and the way we allocate our client's capital is done through a long-term lens that is intended to serve our clients well in good times and bad. It goes without saying that if you're ever wondering about changes or concerned about risk, contact your Relationship Manager and we'll be happy to discuss further your financial matters.

For additional insights from IMG experts,
please visit our website's Insights page and follow us on LinkedIn.

[4] Image Source: University of Michigan