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Dear Client:

Bad news doesn't seem to bother Wall Street these days. Covid-related hospitalizations and fatalities are soaring once again, while staffing shortages and supply-chain bottlenecks linger, consumer confidence falls, and large businesses shelve plans to return to the office. And yet, the stock market continued its remarkable year-to-date climb in August, posting its seventh straight monthly advance. The S&P 500 index is +21.6% for 2021 -- setting new highs 53 times -- on its way to doubling in value since it hit bottom in March 2020. We may be struggling as a society to eradicate this virus, but the market certainly has adapted, climbing an impressive wall of worry that includes sharp downward revisions to 3Q GDP growth expectations, three months of disappointing retail sales, delays on the infrastructure bill, a chronic chip shortage, relentless inflation hype, weeks of "taper" chatter, and the looming threat of the "debt ceiling".

It's an ascent that looks out of step with the reality of the virus in many parts of the country, but most investors are confident of two things, 1) the Federal Reserve will keep interest rates at rock-bottom levels, possibly for years to come, and 2) the federal government won't be shy about spending heavily to keep the recovery going. One would think this decade's-long largesse would have a greater impact on the bottom line in corporate America, yet according to estimates from the Brooking's Institute, this doubling of the S&P 500 off the lows consists of 75% P/E multiple expansion and just 25% earnings growth. And remarkably, just 3 of 11 sectors are actually at new highs, confined to technology (28% of the index), communication services (11.5%), and real estate (2.6%). At the stock level, just 30% of the index is at a new highs (dominated by the six "FAANGM" constituents); meaning that 70% of the market cap is not.

This bifurcation makes it clear that the continued reach of Covid is exerting a negative impact on domestic demand and the industries involved -- restaurants, hotels, and airlines. The high frequency spending data paints a fairly grim picture for the consumer sector as air-traffic sags, cancellations are on the rise, and new bookings for travel have declined precipitously. The delta variant may not be denting investor sentiment but it sure is affecting the consumer sector, as the August consumer sentiment survey showed buying plans for big-ticket consumer durables fell to the lowest level since April 2020 pandemic lows, putting the pullback in retail sales and housing starts into focus.

It is becoming increasingly clear that the day in which we can declare "victory" over the pandemic is being pushed further and further out. This prospect, and the new surge in cases among the unvaccinated, is creating frictions for the economic recovery, and shows in the data. But unlike early on in the pandemic, the government fiscal spigots are running dry; extended benefits are expiring, a moratorium on evictions lifted, and vaccines, though widely available, has run up against new variants (South Africa's "Mu") and sadly, resolute levels of hesitancy.

As you know, we don't make predictions but prepare for those moments if and when consensus fails to live up to expectation. This historically shows up in the form of volatility and a rush to higher-quality, and the stocks currently in the portfolio, as well as the up/down market structure of the portfolio, reflects this and continues to provide upside participation and downside protection.

Regards,

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U.S. Large Cap Equity Strategy