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PLAN ADVISORS

Quarterly Client Update

What A Difference A Year Makes

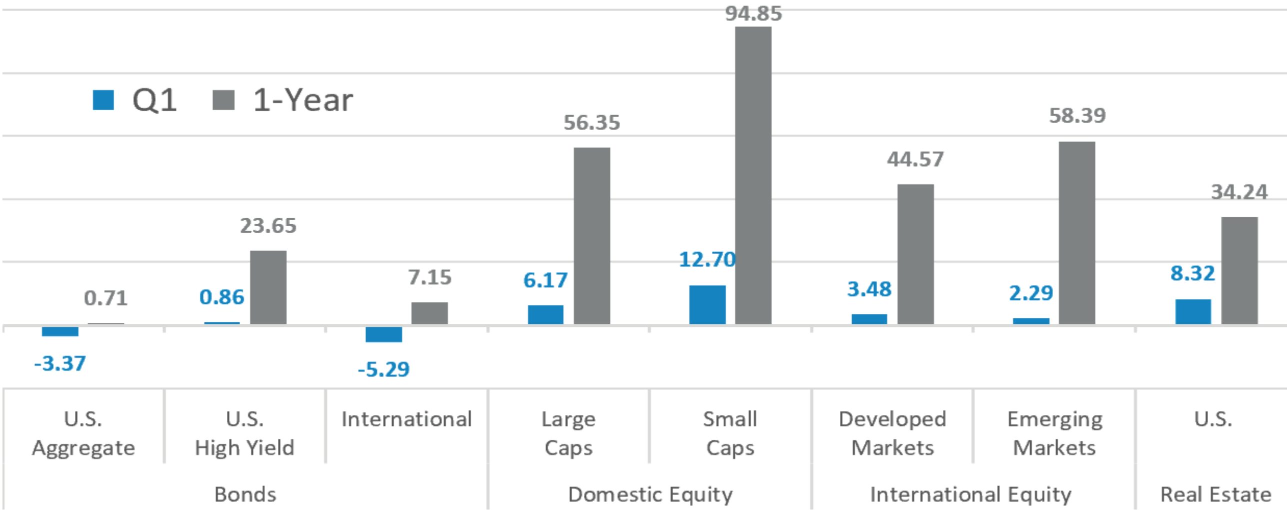
This time last year, we were all forced to make drastic changes to our everyday lives -- working from home, acting as educators to our children and grandchildren, and settling in for the unknown long-term. Fortunately, there is finally optimism and a shred of pre-pandemic normalcy. As the first quarter of 2021 closed, we are just over a year removed from the Federal Reserve's (Fed) announcement of the intent to provide significant liquidity to the markets, restoring confidence, and seeing the market bottom on March 23, 2020. One-year returns from 03/31/2020 to 03/31/2021 are remarkable, led by small- and mid-sized companies, as measured by the Russell 2000 and S&P MidCap 400, gaining +94.85% and +83.46%, respectively. While large company indexes lagged, the +56.35% return on the S&P 500 and +72.04% gain on the tech-heavy NASDAQ over the same period are nothing to sneeze at. Given the global capital market synchronization, factored with a weaker dollar, it should not be surprising that the foreign markets turned in solid gains over the last year of +44.57% and +58.39% on the MSCI EAFE and the MSCI Emerging Market Index, respectively. Though the yield on the 10-Year Treasury has more than tripled since bottoming in 2020 (prices and yields have an inverse relationship; as yields go up, bond prices go down), the Bloomberg Barclays U.S. Aggregate Bond Index still delivered a +0.71% return.

To the Moon?

While equity markets ended the quarter in positive territory, the road to gains was anything but smooth. Late January brought about the 'Reddit Revolution,' whereby hordes of retail investors banded together in taking a fight to Wall Street. Their primary focus was small companies with extreme levels of short interest, such as GameStop (GME) and AMC Entertainment Holdings (AMC), intending to send the stock prices 'to the moon.' What started as a message board for people to invest their stimulus money morphed into a movement, pitting Main Street against Wall Street, albeit short-lived. Investors' attention quickly turned to the spike in longer-dated yields, prompting fears that inflation will exceed the Fed's target of 2%, forcing them to a reduction in their accommodative policy sooner than planned. These fears essentially caused the general market to move in the opposite direction of yields day by day (if yields went up, equities went down, and vice versa). The market's yield sensitivity sent the tech sector reeling, pushing the NASDAQ into correction territory (10% or more contraction). A rotation out of large- and mega-cap companies into smaller companies continued to lead equity markets higher, with S&P MidCap 400 and Russell 2000 generating +13.47% and +12.70%, respectively. While not as impressive, the S&P 500 delivered a solid +6.17% return, and the NASDAQ, even with contraction, brought up the rear gaining 2.78% year-to-date.

Uneven COVID containment across emerging market countries, along with varying degrees of inoculation success and rising US yields, saw the MSCI Emerging Market Index experience increased levels of volatility yet delivered a positive return of +2.29% in the first quarter. Conversely, foreign developed countries (primarily Europe) continue to lag the US in vaccine rollout progress and suffer from tighter mobility restrictions which threaten the near-term recovery. Yet, the MSCI EAFE Index gained +3.48% for the period. A weakening US dollar served as a tailwind for investments outside of the US in 2020, but thus, far in 2021, the dollar has strengthened, thereby dragging down foreign markets' performance.

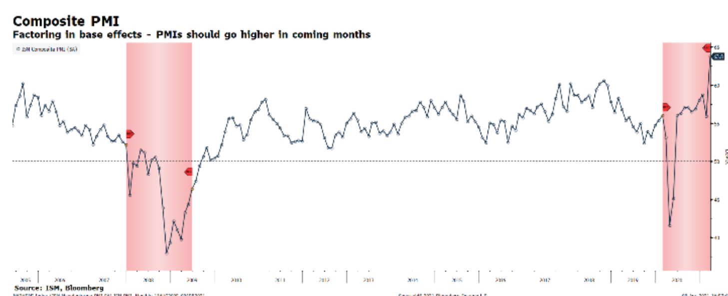
A third major Congressional COVID Relief Package coupled with extraordinary monetary support from the Fed and easing of COVID restrictions caused a lift in growth projections – and higher inflation expectations. Consequently, the bond market, with yields on the 10-Year Treasury up +0.84%, closed the quarter at 1.75% resulting in equity investor anxiety. This inverse relationship bond prices have with yields booked a return on the Bloomberg Barclays U.S. Aggregate Bond Index down -3.37% for the quarter.

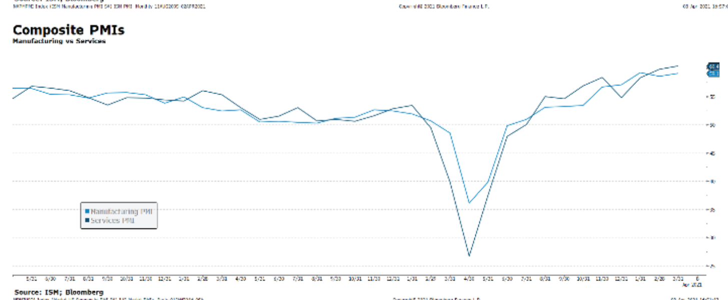


Source: Bloomberg

From Cold to Hot?

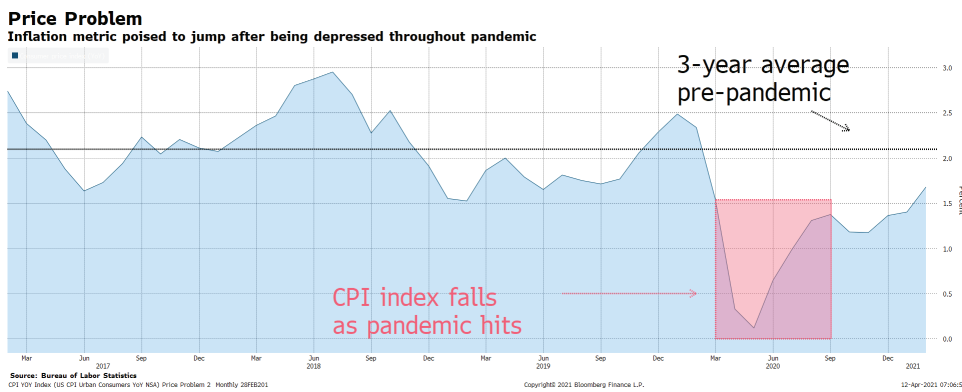
After the February freeze, the economy is heating up. With $600 checks from the late December Congressional stimulus package in hand, consumers started spending, as evidenced by the revised 7.6% jump in Retail Sales experienced in January, the fastest pace in seven months. Retail Sales contracted in February, as did other economic indicators resulting from the Arctic freeze that essentially closed activity for multiple weeks during the month. Strong January sales, along with another round of stimulus checks in mid-March, accelerated reopening, and accumulated savings, should boost spending for March and beyond. Given that the consumer accounts for roughly 70% of our economy's output, spending is a significant driver for economic growth. The composite Purchasing Managers Index (PMI) has accelerated recently, well beyond pre-COVID levels, registering all-time highs of 63.8. A reading above 50 indicates expansion, while a number below 50 indicates contraction; composite PMI comprises Manufacturing and Services PMI. The service-oriented industries sector, including leisure, travel, hospitality, dining, etc., shut down in March of 2020, resulting in a massive contraction in services. Yet, as mandates were lifted or loosened, these sectors' activity picked up significantly, rising to levels we have not seen in nearly two years. Since our economy is primarily services-oriented, it is clear that our services sector's health is essential to a sustainable recovery. Fiscal COVID relief and accelerated economic activity have led many to increase their first quarter and full-year GDP outlooks. Bloomberg forecasts a first quarter acceleration of +6.0% GDP output and 7.7% for the year, with the second and third quarters clocking in at 11% and 10%, respectively. The last time the economy grew at a similar pace was following the 1981-82 recession when growth accelerated at 7.9% in 1983.





One area of the economy still suffering impairments is the labor market. The April 2020 unemployment rate peaked at post-Great Depression highs of 14.7%. While the headline unemployment rate has continued to recover, with March's unemployment rate falling to 6.0%, the bottom line is that while momentum in the labor market is developing, it is still fractured. First-time unemployment filings are averaging more than 700,000 per week and remain elevated over the 2008 Great Financial Crisis's peak. Returning the labor market to pre-pandemic maximum employment levels is one of the Federal Reserve's primary objectives, a requirement before consideration of raising rates. By their admission, a long road ahead remains. The Fed's recent forecasts suggest that hiring will continue to accelerate as vaccines are administered, pushing the unemployment rate down to 4.5% by the end of the year. February gains of 468,000 were restrained by the month's arctic weather, but March saw a spike of 916,000 new jobs added. This trend expects to continue, and we would not be surprised to see more than a million jobs added over each of the next several months. Given the economy needs an average run rate of 400,000-500,000 new jobs per month to approach an unemployment rate near 4% by the end of 2022, the significant, expected gains are undoubtedly welcome.

Economic and market indicators are often presented as year-over-year statistics, so as data releases in the coming months, they may seem extraordinarily large due to the base effect. Essentially many economic indicators were in the basement this time last year which suggests data today may appear inflated from reality over the next several months. Arguably no data point has been more debated and in the spotlight than inflation. Inflation measures the rate of increase in prices of goods over a given period, and high inflation levels can damage productivity and economic growth. Last year prices fell in March and April and remained low in May. As such, the year-over-year increases for March through May will likely appear inordinately high. Since the Fed is targeting an average inflation level of 2%, these reports are critical to monitor and decipher, which may prove more difficult when accounting for the recent $1.9 trillion pandemic relief package. Given significant monetary and fiscal stimulus provided over the last year and supply chain disruptions resulting from the pandemic, it is hard to envision an outcome where inflation does not rise. Some would suggest that we are positioned for hyperinflation. In contrast, others like the Fed and Treasury Secretary, Janet Yellen, believe we will experience higher inflation levels, though the elevated levels will prove transitory and will ultimately normalize. They have been vocal about their expectations and the impact of the base effect over the coming months. While they have communicated their expectations surrounding the illusory readings expected, we would not be surprised if some investors still view elevated readings as confirmation that inflation is surging, which could lead to market volatility in both equities and bonds.



Federal Reserve Update

The Fed continues to provide as much accommodative monetary stimulus as possible through open-ended Quantitative Easing (QE4) and keeping rates historically low. This 'anything it takes' mentality has seen the Fed's balance sheet balloon by approximately $5 trillion over the last year, with no real signs of slowing. The Fed is currently purchasing $120 billion ($80 billion US Treasury securities and $40 billion in mortgage-backed securities) per month and has indicated their intent to maintain this pace through 2021, and possibly into 2022, before beginning to taper their purchases. Taper does not mean halt buying bonds, instead means, slow the pace of their purchases. Tapering could reduce purchases from $120 billion per month to an amount such as $100 billion per month in a transparent and well-communicated manner. The Fed has also indicated short-term interest rates could remain unchanged through

2023. Fed communicated their decisions will hinge on actual data and not forecasted data. While they adjusted the GDP growth forecast upward to 6.5% for 2021 due to the growing optimism and vaccine deployments, they continue to stress that containing the pandemic will be crucial for recovery. Last year the Fed changed their policy framework related to achieving 2% inflation, subsequently tightening to prevent the economy from overheating (see 2018 monetary policy). They have adopted a soft, or flexible, inflation averaging approach, whereby the Fed would hypothetically allow inflation to run above 2% for an undisclosed period, to average 2%. Under this framework, if inflation remains suppressed below 2% for long periods, then when/if inflation rises above 2%, the Fed will allow inflationary pressures for more extended periods before tightening policy (reducing asset purchases, raising rates, or engaging in bond sales). The Fed's forecasts for inflation over the next few years would align with this targeting, as they anticipate inflation at 2.4% in 2021, 2.0% in 2022, and 2.1% in 2023.

Fed policy remains a subject of debate in 2021, mainly as yields on longer-dated bonds have risen sharply in the first three months. A rise in yields resulting from increasing optimism surrounding future economic growth prospects is healthy, yet a sharp rise in yields resulting from inflation expectations causes investor angst. It is conceivable that abnormally high data points resulting from the base effect will likely push yields higher and challenge the Fed's rhetoric. While we do not believe this will impact the Fed's messaging in the immediate term, we would not be surprised if the Fed starts to lighten their tone as they turn more bullish in the latter part of the year, especially if actual data meets or exceeds forecasted expectations.

Congressional Stimulus

President Biden did not waste any time pushing another pandemic fiscal relief package through Congress. This $1.9 trillion package, coined the 'American Rescue Plan,' rounded out the $2,000 Nancy Pelosi sought in the December package and sent $1,400 checks to most Americans, roughly $400 billion. Existing $300 weekly unemployment benefits extend through September 6th and included a tax break on $10,000 in unemployment benefits. The package provided $350 billion for states, cities, and tribal governments, $130 billion to help K-12 schools reopen, and tens of billions to fund coronavirus testing and contract tracing, among other components. Perhaps the most significant Congressional area of contention was excluding a federal minimum wage hike from $7.25 to $15 per hour.

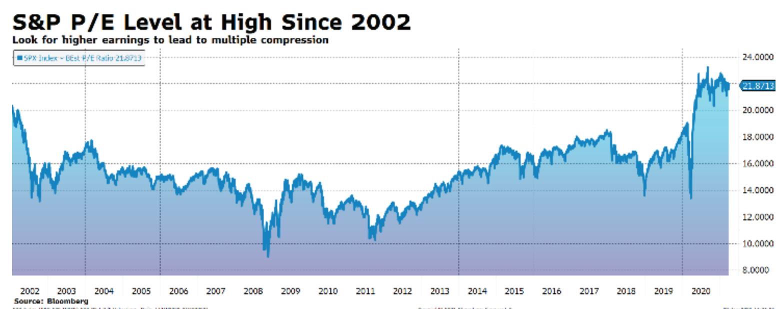
The President then focused on an infrastructure package of nearly $2.3 trillion. The proposal includes traditional forms of infrastructure, including repairing roads and bridges, public transit, rail, airports, clean drinking water, affordable housing, education infrastructure, broadband access, electric vehicle expansion, and several other areas in dire need of upgrades and repair. While most of the items listed in the package are not heavily debated, Democrats and Republicans alike are unsure of the deal's timing. Biden has proposed using taxes as the primary source of funding over the next 15 years. Perhaps the most noteworthy change is increasing the corporate tax rate from 21% to 28% and a pushing for a global minimum tax rate of 21%. The funding details have already been met with opposition from both sides, and while many expect the corporate tax rate to increase, they anticipate the rate will be less than the targeted 28%. Applying a global minimum tax rate, whereby foreign profits earned outside a country's domicile would have a 21% tax applied would require buy-in from several countries worldwide and is no easy task. Given the push back to date, the expected timeline for the passage is estimated in the September/October time frame, with details anticipated to change between now and the final draft.

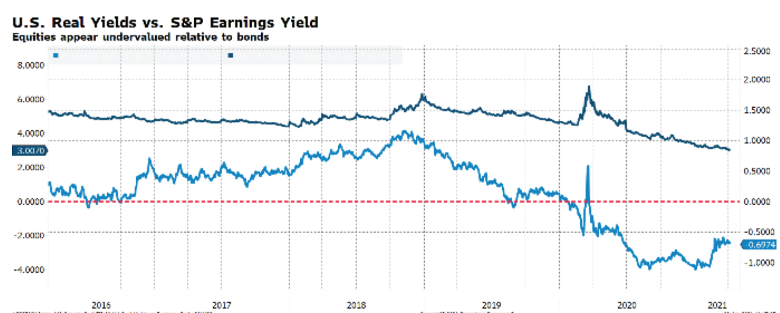
Implications looking forward

With the unprecedented amount of monetary and fiscal stimulus poured into the economy since March of 2020, we are fundamentally bullish long-term on equity markets, particularly in 2021. We have been clear that we believe this recession is a bookend recession: caused by a virus, and as such, should end with a vaccine. To date, vaccination efforts have been largely successful, with shots administered reaching more than three million per day thanks in part to having Moderna, Pfizer, and Johnson & Johnson options. COVID still poses an enormous risk to our recovery, though, as evidenced by the recent upward reversal in cases, death, and hospitalizations in states like Florida and Michigan. Our collective economic recovery is dependent upon vaccination success here and abroad. Developed countries with established vaccination protocols in place should continue to fare well. Still, a complete global economic recovery depends upon successful vaccination campaigns in other developed and emerging markets as well. With this framework in mind, we would not be surprised to witness the US dollar continue to strengthen into the next phase, putting additional downward pressure on foreign investments before starting to weaken again when Europe starts to come back online.

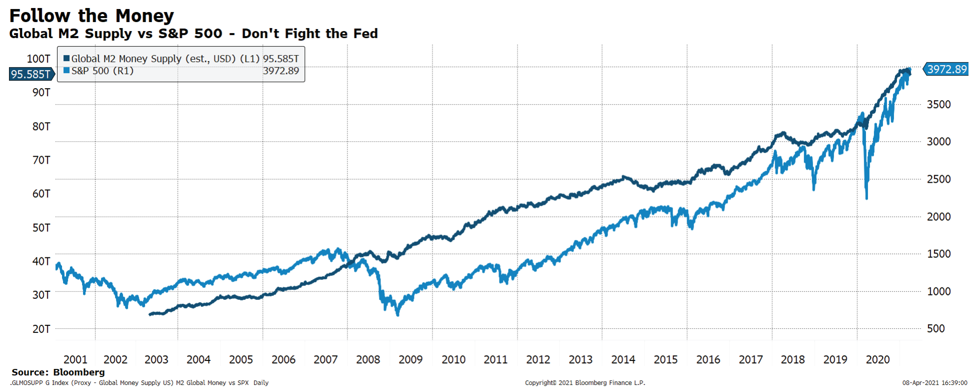
The first earnings season of 2021 has kicked off, with high expectations for all four quarters this year, peaking in the second quarter. As of April 1, 2021, FactSet estimated a first quarter earnings growth rate for the S&P 500 of 23.8%, which would mark the highest year-over-year growth since the third quarter of 2018. Earnings growth of 23.8% is certainly a remarkable number, yet pales in comparison to the second quarter estimate of 52.5%. On the surface 52.5% seems like a monstrous number – and it is –like many of the economic indicators to be reported over the coming months, the second quarter earnings growth will fall victim to the same base effect that saw earnings contract more than 20% in the second quarter of 2020. Accounting for these expected results, we think monitoring companies' performance and messaging as the country continues to come back online, navigating in a new normal, is equally important. Going forward, we will place emphasis on profit margins. Given price increases of many input costs (as evidenced by March's Producers Price Index (CPI for producers) year-over-year gain of 4.2% and expectations of continued upward trends), focus on management's messaging around current and projected profits and perception of a potential tax increase that may impact the ability to generate consistent margins.

Extreme valuations continue to garner headlines and how they indicate whether the S&P 500 is in bubble territory. Valuations, as measured by the Price-to-Earnings ratio, are the collective prices of the companies in the S&P 500, divided by their collective earnings. Generally, the lower the P/E ratio, the more attractive the stocks, as they are considered undervalued. Last year prices rose in the absence of earnings, causing valuations to reach elevated levels. However, vaccine optimism, record low interest rates, non-existent inflation, and unprecedented levels of fiscal and monetary stimulus make a strong foundation for the earnings rebound we previously outlined. As such, we anticipate multiple compressions over the course of the year, resulting from earnings growth rather than price declines, forcing current valuations lower and more in line with their risk premium. Additionally, when looking at valuations, we monitor the earnings yield on equities (the inverse of P/E, or earnings divided by price) relative to the real rates on the 10-Year Treasury. Typically, when the earnings yield is greater than the real yield on 10-Treausry notes, the market is perceived to be undervalued. While the relative spread has compressed over the course of 2021, the current levels suggest that based on this comparison the S&P 500 is still slightly undervalued relative to government securities.





We subscribe to the investing world adage, 'Don't fight the Fed.' It is important to remind investors of the strong correlation between the change in money supply and the path of equity markets as illustrated in the 'Follow the Money' chart. To jumpstart the economy, the Fed grew the M2 money supply by more than 27% year-over-year through February 2021; thus far the market has held up its strong correlation. While solid earnings growth and the Fed are two components driving our preference for equities in 2021, perhaps the most telling signal is the positive vaccine developments and the optimism surrounding vaccine rollouts. Fed-imposed low interest rates, little inflationary pressure, and massive amounts of federal stimulus all provide a positive backdrop in support of risk assets like equities. We have seen cyclical sectors such as energy, financials, industrials, and materials significantly outperform mega-cap tech, especially when optimism led to increased likelihood of reopening. As such, we would expect to see such cyclical, or value-oriented sectors continue to lead the charge over the first half of the year, and perhaps beyond. We are, and will always be, long-term investors. We feel that long-term, companies positioned to capitalize on the strong secular growth trends such as cloud computing, artificial intelligence, machine learning, and e-commerce are all leading the race toward digitization. Those longer-term secular growth trends should persist. The key is identifying those companies that can deliver consistent, stable and predictable earnings. In the short-term, you rent value, but continue to own growth. We are managing portfolios to navigate two regimes, 1) the current economic recovery, and 2) the post pandemic economy.



With short-term interest rates expected to remain low, we anticipate longer-dated bonds to continue to inch higher, putting further downward pressure on the price of traditional government securities, and further promoting the well-known acronym 'TINA', There Is No Alternative, meaning no alternative to equities. Given approximately 41% of equities in the S&P 500 have dividend yields greater than the 10-year US Treasury bond at 1.70%, many investors find themselves weighting equities higher to boost their income production. Turning to equities to make up for lost income, or even incorporating more esoteric credit vehicles like bank loans, structured credit (MBS, CMBS, CLOs, etc...), or high yield bonds to boost yield, often increases the underlying level of risk, leading to unintended consequences. Our focus remains on quality with a commitment to each portfolio's respective risk target. Additionally, with expectations of further yield curve steepening, we think it is important to shorten portfolio duration, which reduces interest rate risk, and helps offset expected losses should yields continue to rise. We have found that COVID-19 has revealed balance sheet weaknesses within companies and believe it will magnify, rewarding quality and strength, during the recovery. For now, equities and bonds appear stuck in a feedback loop, whereby the economy grows, prompting yields to rise, sending interest rate sensitive stocks (i.e., technology stocks) reeling. The Fed confirms their policy, causing yields to compress, the Fed buys more bonds, strengthening the economy, sending yields higher, and so on. For the time being, we anticipate yields and equities will be intertwined. However, as yields continue to approach 2%, we would expect a self-correcting mechanism; returning foreign investors to the bond market to begin purchasing government bonds again; pushing yields lower and limiting equity downside.

The longer-term backdrop for equities appears supportive, but in the short-term we remain cautious. We see several risks that could dampen our outlook. First and foremost is the containment of the COVID-19 virus. Aside from the virus, we see inflation as potentially the largest risk facing markets. Should inflation surprise to the upside of the lofty base effect expectations, market volatility may ensue, and the Fed's rhetoric will continue to come under pressure.

With so many headlines and so much change occurring, it can be easy to become complacent or take the path of least resistance. We continue to stay nimble, maintaining a disciplined and diversified approach in our portfolios, with a continued emphasis on quality. We constantly look for opportunities to ensure the portfolios we manage match the objectives and risk tolerance of the clients we have the privilege to serve. As always, we appreciate your business and ongoing trust. We invite you to reach out to your advisor with any questions or concerns and encourage you to schedule your next review.

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