NOTTINGHAM ADVISORS
ASSET MANAGEMENT

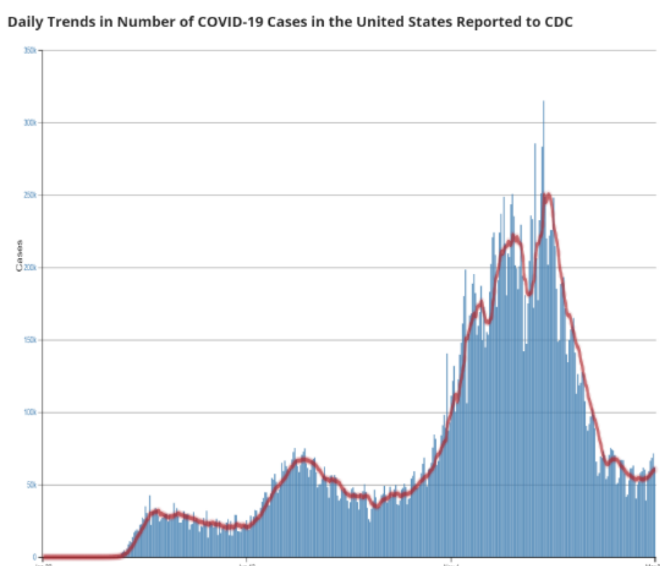
2021 Q1 RECAP AND A LOOK AHEAD

SPRING HAS SPRUNG!

Approximately one year ago, COVID-19 was spreading throughout the world, and the daily news was consumed by the number of hospitalizations and deaths that were occurring here in the U.S. The stock market had fallen 35% from its recent high, and the Federal Reserve was forced into enacting emergency monetary measures to stabilize markets, while Congress rapidly put together and passed the $1.2 trillion CARES Act. Although the death toll continued to rise, markets were able to swiftly rebound thanks to the extraordinary fiscal and monetary stimulus, as well as rumors of progress on a vaccine.

Fast forward to today, and although the infection rate is higher than last spring, the death toll has measurably declined, and indeed, multiple vaccines are in the process of being administered around the world. U.S. equities recently marked an all-time high, while bond yields, which plummeted as the economy went on pause, have now recovered nearly back to pre-pandemic levels. U.S. GDP, which collapsed at a -31.4% annualized rate in Q2 of 2020, now stands poised to possibly accelerate by 6% to 10% here in 2021 on the heels of the $1.9 trillion American Rescue Plan recently passed by Congress.

To put it bluntly, after having had the world turned on its head for the better part of the past year, there is at last some bright light at the end of the tunnel, with stocks tied to a re-opening of the economy performing extraordinarily well and higher interest rates suggesting surging economic momentum.

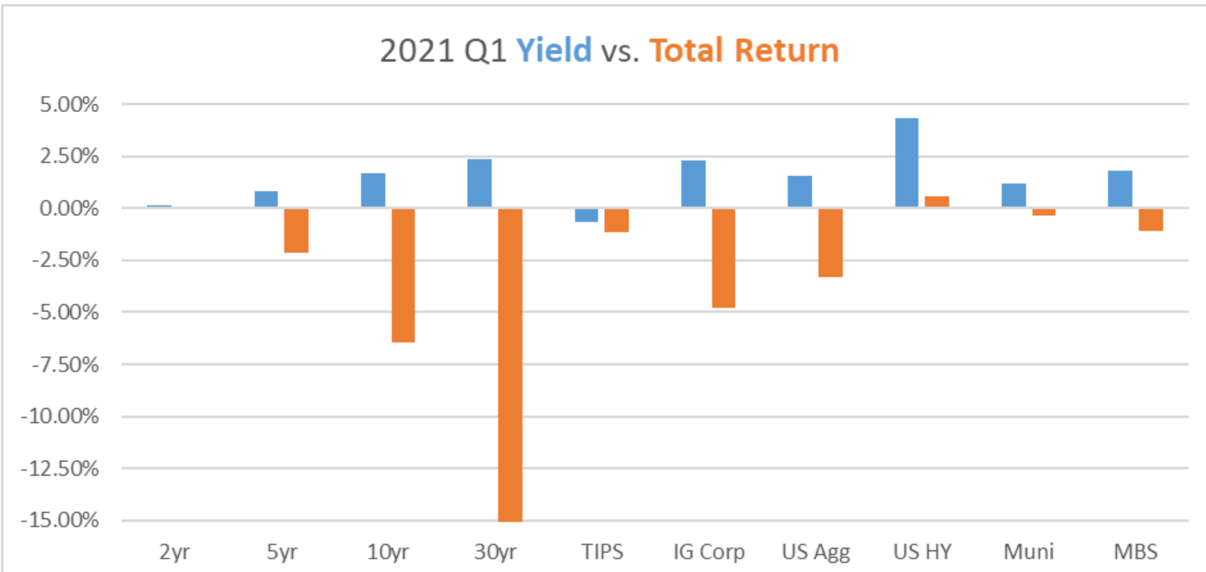


This chart from the CDC website shows the daily cases (blue bars) and the 7-day moving average in red. Despite the increasing pace of vaccinations, we're seeing an uptick in new cases as various state economies begin to more fully re-open. Still, it's estimated that given the current vaccine trajectory, we may see "herd immunity" some time before summer.

The main theme for the second quarter of 2021 will be the continued effort to get as many people as possible fully vaccinated. This would allow for a more widely open economy, give a boost to air travel and offer hope to much of the restaurant and travel and leisure industries.

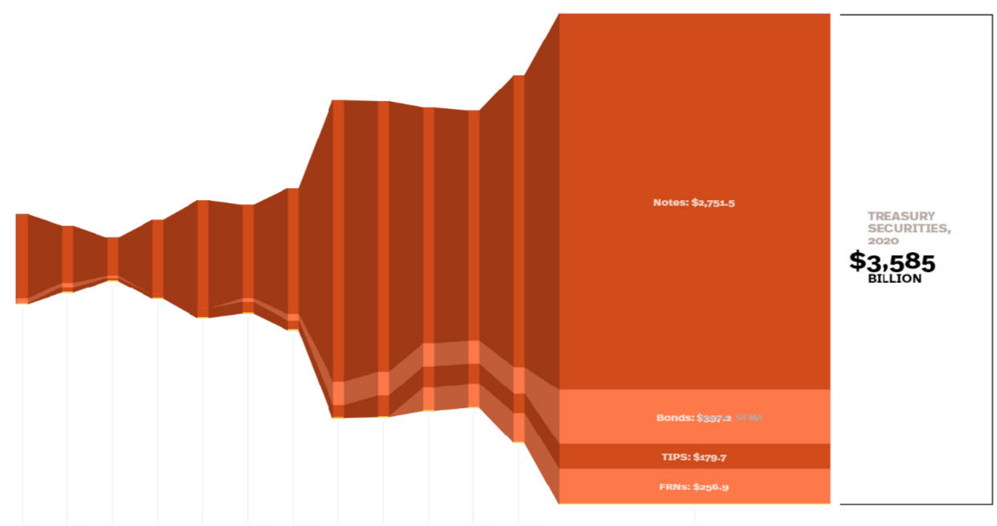
Fixed Income

The real story over the first quarter of 2021 centers on the continued backup in interest rates. After bottoming out at a yield of .50% in August of 2020, the 10-year Treasury note now yields 1.70%, just shy of the 1.80% level we saw before the economic shutdowns a year ago due to Covid. We have talked in the past about the "return-free risk" many investors are exposed to by virtue of longer-dated bonds in a low interest rate regime. In this instance, we feel the price declines merely reflect the re-opening of the global economy following the pandemic induced slowdown, and should be viewed more as a reversal of the 2020 move lower in yield and less as something more nefarious.



Source: Nottingham Advisors; Bloomberg

As the US Treasury is borrowing more than at any other time in history (see chart below), one might expect upward pressure on yields. However, the Federal Reserve is buying $120 billion per month of Treasury and mortgage-backed securities and that may put a ceiling on rates in the near-term.

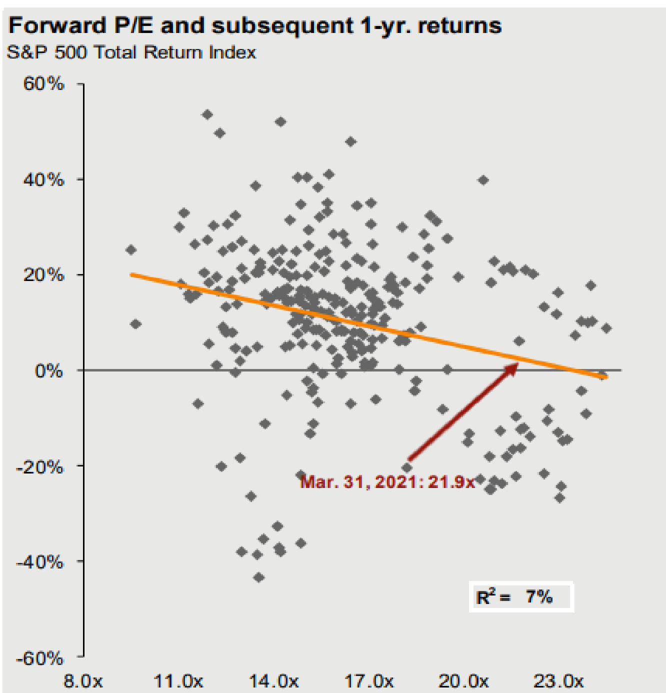


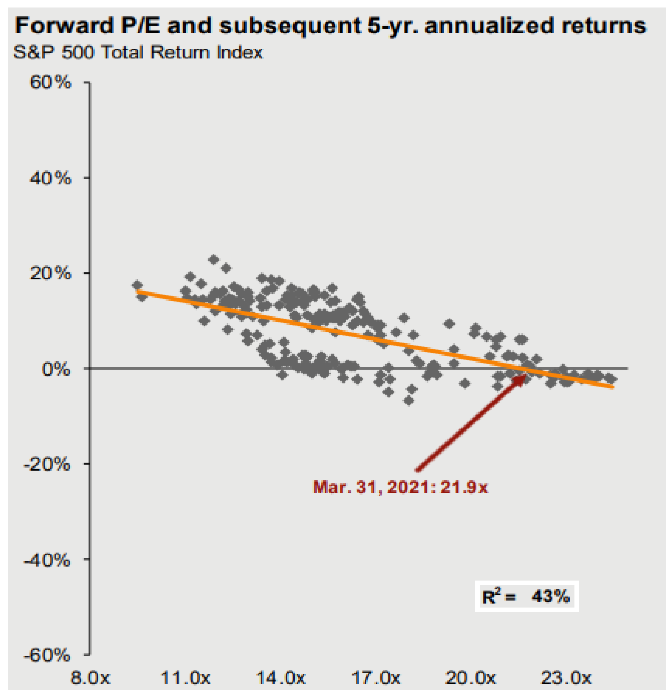
When thinking about risks to the current bull market, a material rise in interest rates would seem obvious, however unlikely. There have been periods of time when markets have pushed back against excessive government borrowing and spending, sending rates higher and currencies lower, but the firepower being brandished about by the Fed and other central banks today seems unparalleled. This type of policy error – believing debt levels don't quite matter anymore – remains one of our bigger concerns going forward.

Domestic Equity

The first quarter saw the continued rise of small-cap equities as the S&P 600 composite rallied 18% and is now up 125% from the March 2020 lows. Close behind were midcaps with the S&P 400 index returning 13% (+117% from the '20 lows), followed by large-caps, which gained 6%. In a reversal from last year, Value outdistanced Growth by a wide margin with the S&P 500 Value index returning 11% relative to the S&P 500 Growth index return of 2%. The tech-heavy NASDAQ, 2020's frontrunner, struggled as interest rates rose and only returned 3% in Q1.

With P/E multiples stretched, the hope is that US corporations can generate significant earnings growth this year and next in order to justify current valuations. Although history would suggest forward equity returns should be somewhat muted over the coming 5+ years (see chart below), there are few analogues involving extended periods of quantitative easing resulting in near-zero (and in some places negative) interest rates. The case certainly could be made that dividend-oriented blue chip equities represent a better bet than 5yr Treasury notes yielding 0.89%.





Source: JP Morgan Guide to the Markets

International Equities

Coming into 2021, Nottingham felt the international sector, and especially emerging markets, were poised to perform well. A combination of lackluster results over the past decade, along with more reasonable valuations when compared with US stocks, a weaker US dollar and rising commodiy prices could set the stage for a meaningful rebound. In Q1, these markets largely tracked their domestic counterparts, with both the developed and emerging markets returning around 5%. The broad themes we saw playing out near the end 2020 still hold and we remain optimistic around the prospects for steady gains here going forward. The negative interest rate experiment in Japan and the Euro area is being tested and any move toward higher rates (i.e. greater than zero) would likely be welcomed by equity investors.

Summary

The first quarter may prove to be the inflection point for the global economy as Covid vaccinations gain momentum, despite regional surges in infection rates. For equity markets, the "re-opening" trade is largely priced in, as is much of the economic stimuli put forth by Congress. What may not be priced in is the possibility of materially higher taxes, not just on corporations but on many higher income individuals. As President Biden's tax reform package moves closer to becoming law, we may see investors adjust portfolios ahead of higher income and capital gains rates. It's likely analysts will lower corporate earnings expectations as well.

Assuming the global economy comes back online throughout 2021, we're likely to see compelling data around GDP growth. As mentioned, much of that is priced into markets already. It may take some surprise to the upside in order to keep this bull moving forward. While Nottingham debates internally whether the U.S. is poised for a "roaring '20's" style decade ahead, or whether the disinflationary forces weighing on growth pre-Covid will resurface, the outcomes couldn't be more stark. Either way, we will endeavour to manage your assets diligently and thoughfully through the process, as always remaining intellectually flexible.

Happy Spring,

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President/Chief Investment Officer
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