mABC LLC
Investment Advisors

INVESTMENT OUTLOOK

Investment Advisors

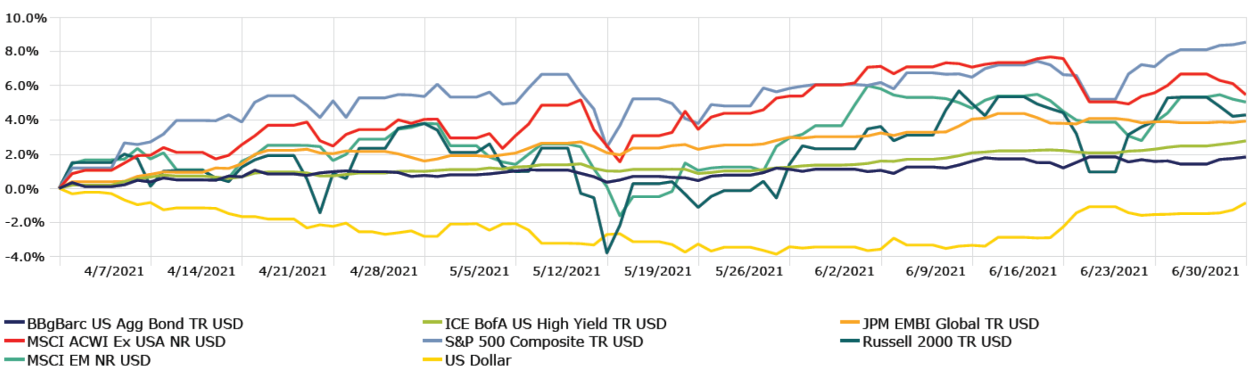
Q2 2021 Market Commentary

Global vaccinations have continued to accelerate with nearly 25% of the world population at least partially vaccinated against COVID-19. Much of that progress has been driven by the developed world, but as further efforts in low-income countries pick up steam the global economy has the potential for a record recovery.

Global Markets Performance

Per Morningstar, the US stock market, as represented by the S&P 500, finished up 8.55% on the quarter, adding to last quarter's return and appreciating 15.25% year to date. Smaller US stocks[1] rose but slowed relative to larger peers, up 4.29% for the quarter following a nearly 13% return in the first quarter. International stock markets[2] and emerging markets[3] rose but underperformed large-cap domestic equities during the quarter, finishing up 5.48% and 5.05%, respectively. On the credit side, core bonds[4] rose 1.83% and high yield bonds[5] posted positive returns, up 2.77% for the quarter, impacted by both lower risk-free rates and narrowed spreads[a]. Emerging market (EM) bonds[6] rose as well and ended the quarter up 3.93%, buoyed by lower rates and a weaker dollar.

Historical Performance



Calendar Year Returns

	YTD	2020	2019	2018	2017	2016
BBgBarc US Agg Bond TR USD	-1.60	7.51	8.72	0.01	3.54	2.65
ICE BofA US High Yield TR USD	3.70	6.17	14.41	-2.26	7.48	17.49
JPM EMBI Global TR USD	-1.00	5.88	14.42	-4.61	9.32	10.19
MSCI ACWI Ex USA NR USD	9.16	10.65	21.51	-14.20	27.19	4.50
S&P 500 Composite TR USD	15.25	18.40	31.49	-4.38	21.83	11.96
Russell 2000 TR USD	17.54	19.96	25.52	-11.01	14.65	21.31
MSCI EM NR USD	7.45	18.31	18.44	-14.58	37.28	11.19
US Dollar	2.78	-6.69	0.22	4.40	-9.87	3.63

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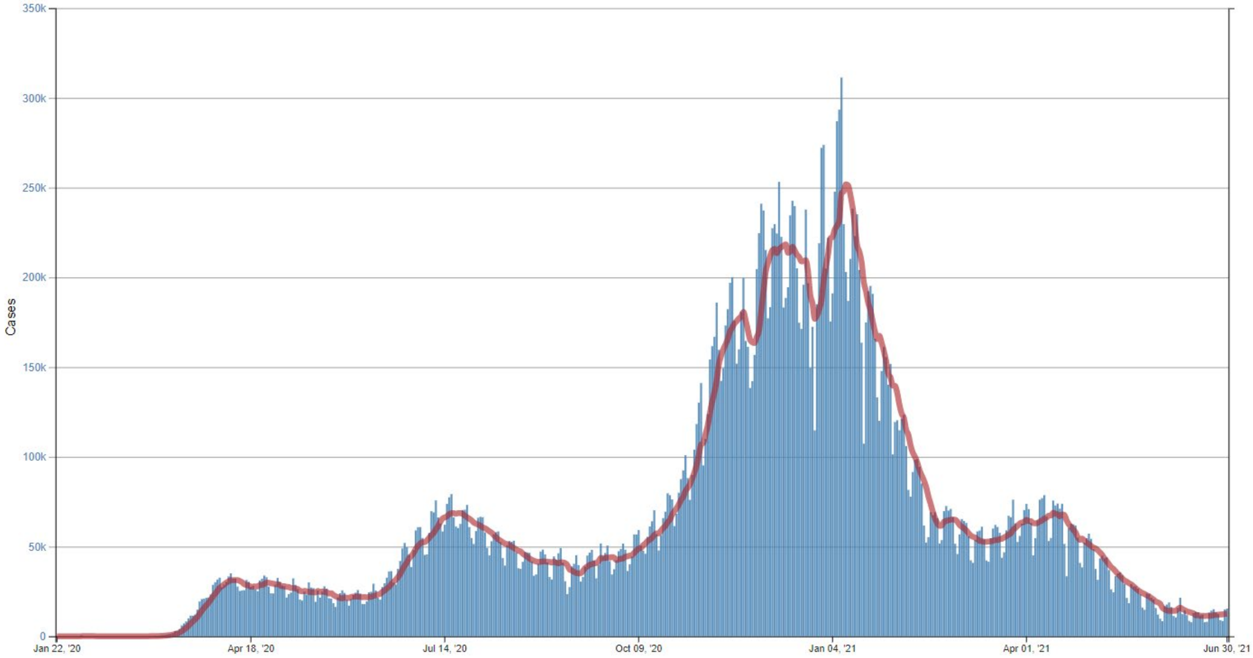
COVID-19 Pandemic Update

As we roll into the second half of the year the COVID-19 pandemic situation in the US has improved drastically from three months earlier. As of June 30th, the seven-day average of new cases in the US hovered around 12.7k, while that same number as of March 31st was approximately 63.5k[8]. Additionally, as of early July more than 47% of the US population has been fully vaccinated and over 55% have received at least one dose of a vaccine[9].

Daily Trends in Number of COVID-19 Cases in US



Source: Centers for Disease Control and Prevention[8].

While the US and other developed nations are making tremendous progress in vaccinating their populations and seeing a resultant decrease in case counts and deaths, much of the developing world is moving slower and continues to see rising or high case counts. Countries like Brazil and Argentina in South America as well as Iraq and Iran in the Middle East continue to see elevated case counts relative to the global average. India, on the other hand, has witnessed a dramatic drop-off in both cases and deaths since the end of last quarter that cannot be fully explained by vaccinations as only approximately 20% of its population has received shots[10].

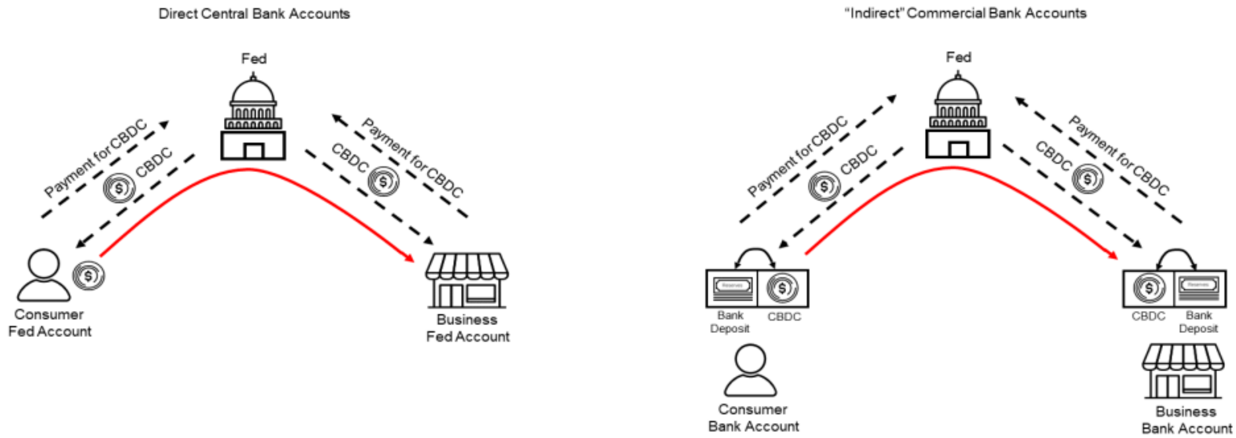
Much of the focus on COVID-19 towards the end of the quarter focused on the Delta variant of the coronavirus that is spreading around the globe and has been linked to higher transmission. According to data from the CDC compiled by the New York Times, this strain now accounts for almost 52% of US cases. However, much research to date suggests that currently approved vaccines in the US continue to offer substantial protection against this and other variants of the virus[11].

DeFi'ing Expectations?

Since the early days of the pandemic, digital currencies have experienced a tsunami of attention and volatility largely driven by individual investors. But the overwhelming majority of that attention has focused on decentralized currencies (or DeFi for Decentralized Finance), the most prominent of which has been Bitcoin, that do not rely on intermediaries or administrators in order to function.

However, a newer class of digital currencies is starting to gain more attention and they have the potential to dramatically transform the financial landscape. These are typically known as Central Bank Digital Currencies (CBDCs) and could be considered more along the lines of centralized currencies. In effect, these digital tokens would give each country's central bank control over distribution, maintenance, and monitoring, which have been up till now managed to some degree by the private financial system[12].

Two Possible Forms of CBDCs: Direct Central Bank Accounts & Indirect Accounts



Source: Goldman Sachs[13].

There are both pros and cons to the idea of digital government currencies. Proponents point to three major advantages: 1) elimination of the shadow economy, 2) costs to transfer digital money are nil, and 3) anyone with a cell phone could have a digital currency account. This latter advantage is powerful as it could give more financial control to the currently under or unbanked[12].

Arguments against centralized digital currencies typically center on increased government oversight, with China as a prime example of such. A pilot program involving about 500,000 people is already running in China to test out the idea of digital yuan, which gives the government real-time access to these citizens' spending habits. A secondary but important implication of increased centralized currency adoption could be the decline and possible elimination of the banking industry[12].

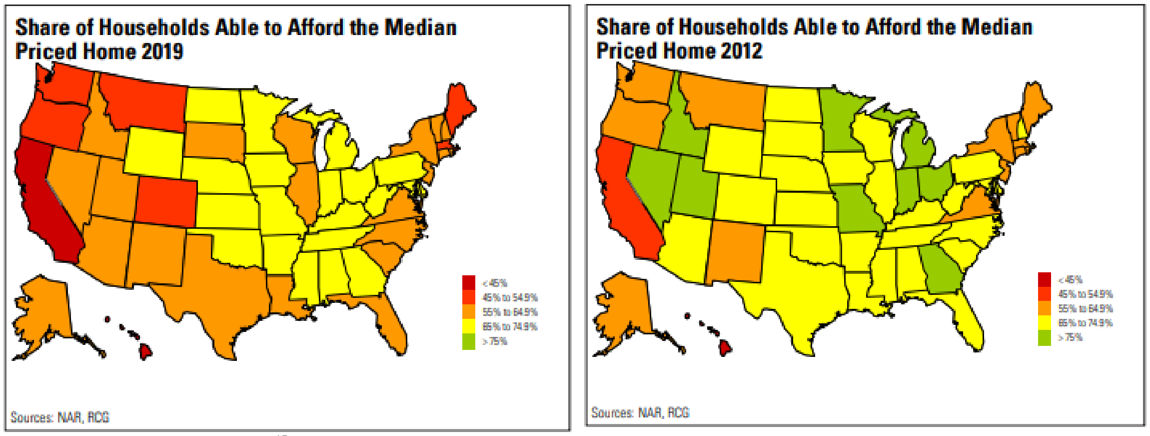
Get Real (Estate)

The onset of the pandemic in early 2020 led to an urban exodus in the US as demand for housing shifted from cities towards suburbs and more living space. By June of 2021, single-family home prices had risen 10% nationally on average and are now at a level higher than their 2006 peak[14]. In many areas of the country, this had led to a deepening affordability crisis as home price appreciation has outpaced income growth[15].

A recent report commissioned by the National Association of Realtors analyzed the history of the US housing market and concluded that the US has underbuilt at least 5.5 million homes over the last twenty years. That number includes both single-family and multi-family homes and is likely a major factor in the supply-demand gap that has built up during the pandemic. In fact, the authors estimate that production of two-to-four-unit homes fell by nearly three quarters since 2000[15].

So, what does all of this imply? At the most basic level it means that the US housing supply has been dramatically underbuilt to keep pace with population growth and demographics. In order to rectify this supply issue in the next ten years, housing production would need to increase by approximately 60% per year based on 2020 numbers[15].

US Housing Affordability: 2019 vs 2012



Source: Rosen Consulting Group[15].

Without efforts to close this gap, there are two immense demographic issues that may continue to get worse: 1) affordability, and 2) household formation. From 1999 to 2019, housing prices outpaced wage growth nationally by about 19% on average, making it more difficult for those on the lower end of the income spectrum to afford property. Closely related is the idea of household formation, where younger generations may not be able to afford to buy a home and begin a family. While not directly correlated, it is interesting to note that the number of adults aged 25-34 living with their parents has doubled since 2000[15].

Looking Forward

Rounding the midway point of the year, 2021 is starting to look and feel drastically different from the same point in 2020. According to economists at Goldman Sachs measuring the recovery, the US economy is now at its highest point since early March of last year[16]. Labor market indicators and unemployment claims similarly point to substantial improvements in the US.

However, the pandemic continues to rage on in certain pockets of the US and around the world. As such, we must recognize that the world is volatile, and markets will continue to reflect the volatility that we see and perceive around us. Markets have soared since bottoming in early 2020, and that performance has led many to believe making money in markets is easy. But the most important lessons are learned on the way down, and we have yet to experience a sustained market drawdown. As always, if your investment situation has changed or you'd like to discuss the current state of the markets, I encourage you to engage your financial advisor and develop a comprehensive strategy for your goals.

As of June 30th, 2021.

References:

Smaller US stocks[1] – as represented by the Russell 2000 TR Index

International stock markets[2] – as represented by the MSCI All Country World ex-USA Index

Emerging markets[3] – as represented by the MSCI Emerging Markets TR Index

Core intermediate bonds[4] – as represented by the Bloomberg Barclays US Aggregate Bond Index

High yield bonds[5] – as represented by the ICE BofAML US High Yield Index

Emerging market bonds[6] – as represented by JPM Emerging Market Bond (EMB) Global Index.

Morningstar performance data[7] – sourced from Morningstar Direct, 2021.

Coronavirus data[8] – sourced from CDC, "Trends in Number of COVID-19 Cases and Deaths in the US Reported to CDC, by State/Territory," 7 July 2021.. https://covid.cdc.gov/covid-data-tracker/#trends_dailytrendscases.

US vaccination progress[9] – sourced from CDC, "COVID-19 Vaccinations in the United States," 7 July 2021. https://covid.cdc.gov/covid-data-tracker/#vaccinations.

Developing world COVID-19[10] – sourced from Our World In Data, "Coronavirus (COVID-19) Vaccinations" 7 July 2021. https://ourworldindata.org/covid-vaccinations.

Variants and vaccines[11] – sourced from The New York Times, "Delta, as expected, is now the dominant virus variant in the U.S., the C.D.C. estimates, " by Emily Anthes, 7 July 2021. https://www.nytimes.com/live/2021/07/07/world/covid-19-vaccine-coronavirus-updates-.

CBDCs, DeFi and digital currencies[12] – sourced from The Absolute Return Letter, "Govcoin – The first proper digital currency has arrived," by Niels Jensen, 1 July 2021. https://www.arpinvestments.com/arl/govcoin.

Forms of CBDCs[13] – sourced from Goldman Sachs Global Investment Research, "Central Bank Digital Currencies: Implications for the US Financial System and Fiscal and Monetary Policy," 20 December 2020.

Single-family home prices[14] – sourced from JPMorgan Chase Bank NA, "US Mid-year economic outlook: After the gold rush, " 25 June 2021.

Real estate demand-supply and affordability[15] – sourced from Rosen Consulting Group, "Housing is Critical Infrastructure: Social and Economic Benefits of Building More Housing," June 2021.

US economy[16] – sourced from Goldman Sachs, "The GS US Reopening Scale: Measuring the Reopening of America: Week of July 7th: Remain at '7' as underlying changes remain minimal; Box office implications," 6 July 2021.

Glossary:

Spreads[a] – the difference in bond yields of the same maturity but differing qualities, e.g. corporate bonds vs. US government bonds.

Average inflation targeting (AIT) – targeting a specific level of inflation that averages an annual % over time; for example, the Fed's 2%.

Short and long-end interest rates – as represented by the 1-month and 10-year US Treasury rates.

Blue wave – refers to the US Democratic party possessing a majority in the House of Representatives and Senate and controlling the White House.

G4 non-financial corporate debt – debt issued by corporations not operating within the financial sector, e.g. banks. G4 refers to the US, the Euro area, the UK, and Japan.

Phase Three trials – per the CDC, in Phase 3 the vaccines are "given to thousands of people and tested for efficacy and safety." After Phase Three trials are approved, vaccines can be issued to the general public.

Options – a contract that gives the buyer the right, but not the obligation, to buy or sell the underlying asset at a specified price prior to a specified date

Blue chip – typically large capitalization, well-known brands.

Fiscal spending & budget deficits – fiscal spending relates to all government expenses, and a budget deficit implies a government is spending more than it is receiving from taxes, interest, etc.

Liquidity vs Solvency – liquidity relates to having enough cash on hand to continue operating in the short term, while solvency relates to the long-term and whether or not equity is sufficient to continue operating.

Repos (repurchase agreements) – in repurchase markets, borrowers needing cash offer lenders collateral, generally in the form of safe bonds (such as US Government bonds), and in return receive a short-term loan. Repo agreements can be as long as one year, but are generally three months or less, and the most popular tenure is an overnight loan.

Federal funds rate – the interest rate that banks charge other banks for lending them money from their reserve balances (held at the Federal Reserve) on an overnight basis.

Agency mortgage bonds – mortgage securities that are issued by government-sponsored entities (GSEs) like Fannie Mae or Freddie Mac, or guaranteed by a government agency like Ginnie Mae.

Strategic asset allocation – the long-term asset class goals for an investor which specify on average, how much of your money should be invested into stocks, bonds, etc.

Goldilocks – describes an economy that's neither too hot as to spur rapid inflation or too cold to cause a recession; it characterizes an economy operating in an optimal state from a macroeconomic standpoint.

Yield curve – the graphic representation of US Treasury securities as defined by their yield and time to maturity.

One-month & ten-year rates – on the US government yield curve, the securities issued with maturities of one month and ten years, respectively. The US Treasury also issues securities between one month and ten years, and longer than ten years.

Asset location – the tax-arbitrage strategy of placing high-tax exposure assets in low tax-paying accounts, and vice versa. The theoretical benefit is to lower taxes from investments and compound higher long-term capital.