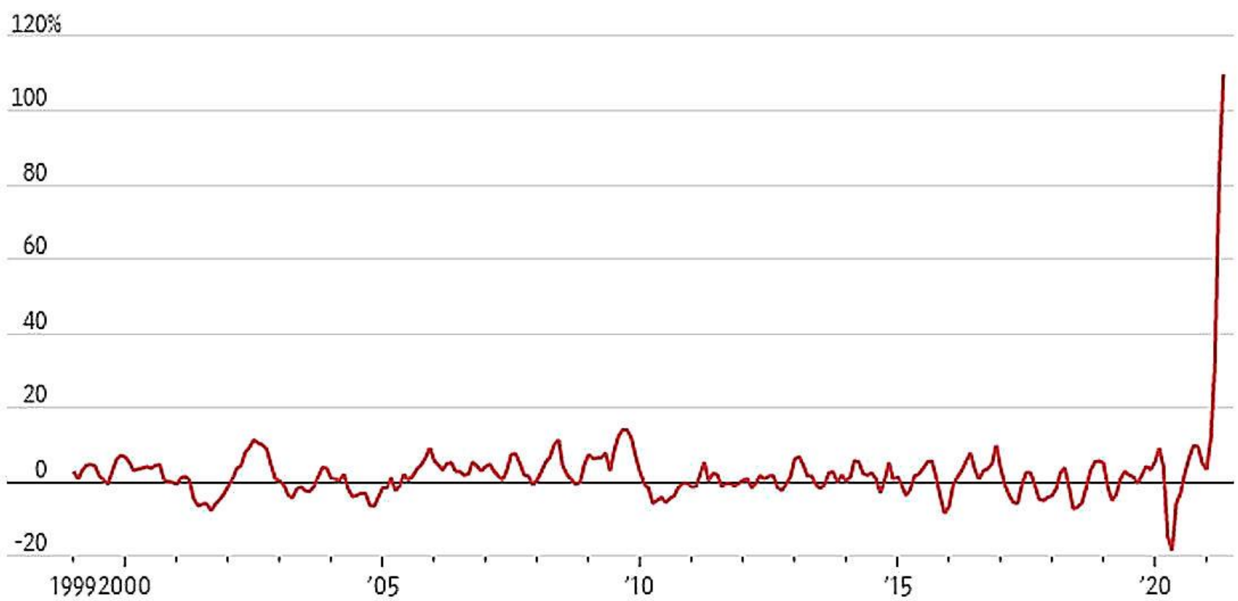
MARKETTREND ADVISORS

July 2021

Dear Clients and Friends,

Markets spent the second quarter of 2021 obsessed by inflation. The past year brought the economy an abrupt shutdown. That shutdown nicked supplies of almost everything – from reductions in the building of homes to occasionally empty grocery shelves. As economies have reopened, consumers have rushed back in forcing businesses to scramble to bring their supplies back online. The surge in demand while supplies struggle to recover has sent prices upward – ergo inflation. Since inflation rates are typically measured as growth in price <u>from the prior year</u>, some inflation statistics are misleading. Prices during the pandemic cratered setting an unusually low bar against which current prices are compared. Have you tried to rent a car this summer? The chart below shows prices have doubled from last summer's level. Of course, last summer rental cars were languishing as travel was way down. Rental prices then were unusually cheap.

Change in rental-car prices from one year earlier



Note: Seasonally adjusted
Source: Labor Department

Free government money lined the pockets of some consumers. Home-bound consumers, largely unable or unwilling to travel, go to restaurants, and pursue their usual discretionary spending habits instead spent money on cars, houses, and everything available online. This spending behavior pushed up the price of houses and cars to record levels. Workers in some industries have been slow to return to work pushing up wages. These factors have sent the inflation rate to its highest level in three decades.

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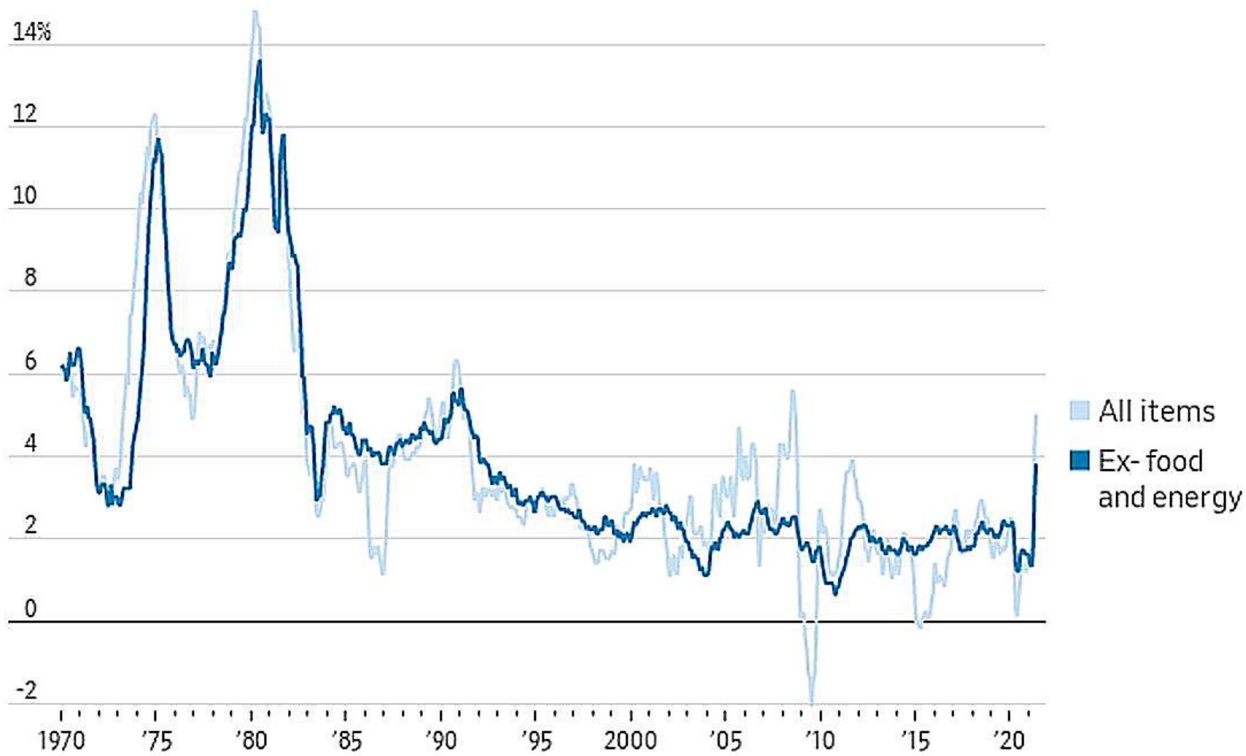
U.S. consumer prices, change from one year earlier



Source: Labor Department

The Federal Reserve's stated view has been that this inflation is temporary and will recede as supplies adjust to support the demand. That seems possible. After peaking in April, prices of lumber and copper have dropped back, in some cases sharply so. Labor trends show initial signs of adjusting as restaurants, movie theaters, and other entertainment options reopen. Come September, universities and schools will broadly be back in person while 'extra' unemployment benefits stop; both factors are expected to generate a dramatic shift in the economy's return to normal.

While the headlines throughout the quarter highlighted inflation, interest rates were believing the Fed. After surging higher in the first quarter, interest rates spent the second quarter easing back below pre-pandemic levels. Some of this decline likely relates to diminished expectations for the size of future government stimulus. However, the downward tilt to rates also tells us that expectations for inflation are diminishing.

The up and down expectations for inflation drove a wildly shifting environment for stock investors. The high growth "FANG" stocks (Apple, Facebook, Amazon, Google, etc.) were all that investors wanted during the pandemic as their businesses are well-known, growth rates stable, and stocks viewed as less risky. Once vaccines became available, however, investors shifted quickly to "re-opening" cyclical stocks in financial, materials, and industrial sectors. As inflation fears abated in the second quarter, markets shifted yet again, rushing back toward the high-growth stocks.

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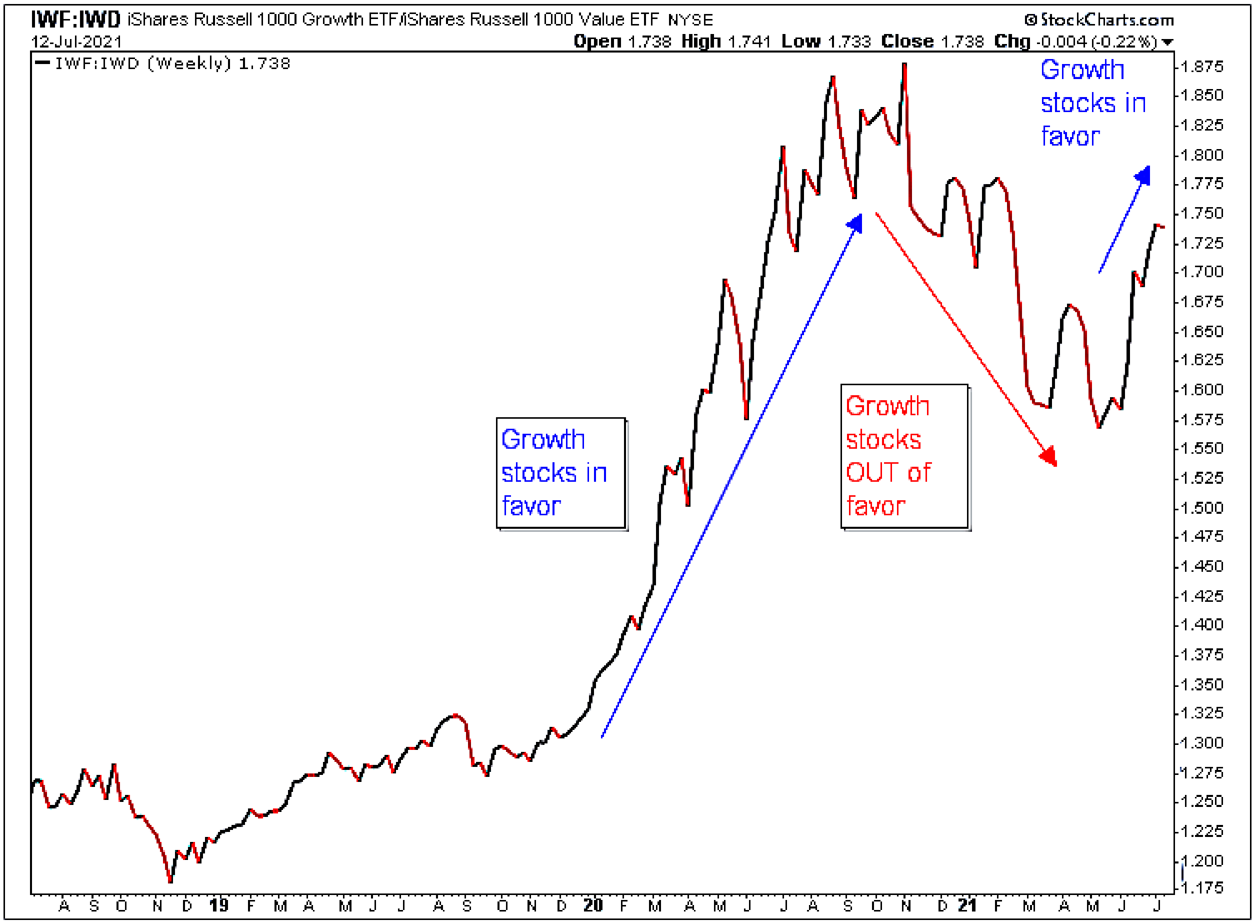

This turbulence among the sectors has not impacted the overall market much, as the broad market indexes have inched upward. The S&P 500 has now gone eight months without a -5% pullback, an exceptional period of calm. That will likely change as the calendar turns to the third quarter. Though July is typically kind to stock investors, August brings a major Fed meeting. The central bank will likely announce reductions in stimulus measures enacted during the pandemic. Then, September is notorious for being the worst month of the year for stocks, on average. We think the stock market environment ahead will bring more turbulence. Our focus on risk helps us during these periods of volatility allowing us to provide your accounts a continued smooth ride.

To future profits,

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