Strategy Newsletter – 2nd Quarter 2021

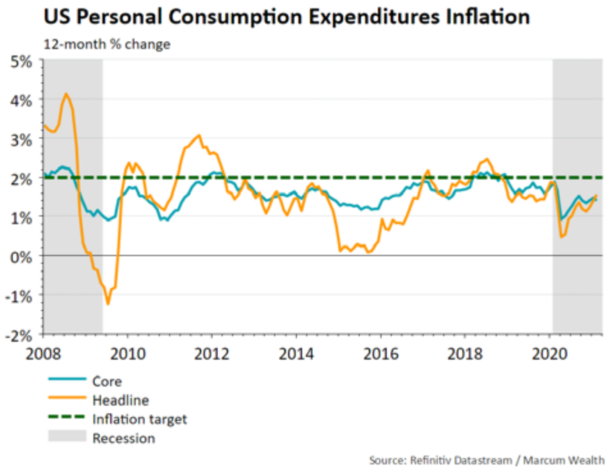
- There is more to inflation than just government spending.
- Small caps continued the winning streak.
- Treasuries had the worst quarter in decades.
- Housing markets remain scorching hot, is it a bubble?

## Economy

In March, the $1.9 trillion American Rescue Plan Act of 2021 was signed into law. This bill sent direct payments to households increased unemployment benefits and support to businesses and municipalities. Economic forecasters raised GDP growth estimates for the year, some above 8%.

The size of the spending and a possible infrastructure bill on the way has many concerned about inflation.

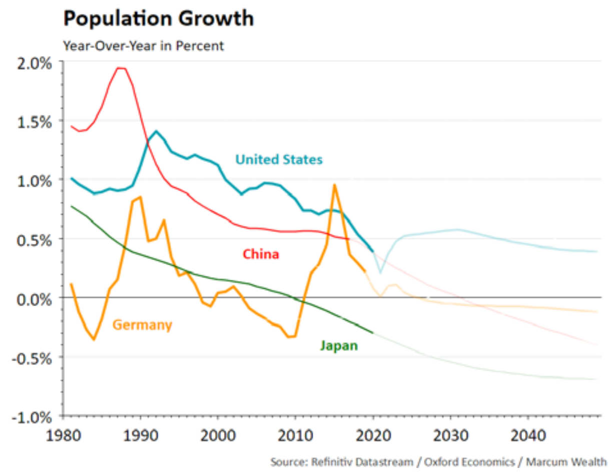
The data point that matters is Core Personal Consumption Expenditures (PCE) Inflation. This is what the Federal Reserve Open Market Committee monitors the most for setting interest rates. It is shown in the teal below. The data has rarely reached above the 2% target over the last 13 years. Even after large spending following the 2008 recession, it only bumped above the target for a few months.




There are still 9 million people unemployed who had jobs prior to the pandemic. The lack of spending from so many unemployed people is likely to keep a lid on inflation. In addition, the Fed stated its willingness to let inflation run above its target to make up for missing it the last several years.

The lack of inflation the last decade baffled economists. The pace at which technological innovation lowered costs is one factor. Another is the already large debt burdens keeping a lid on spending.

Finally, another long-term trend keeping prices down is lower productivity and slowing population growth around the world.



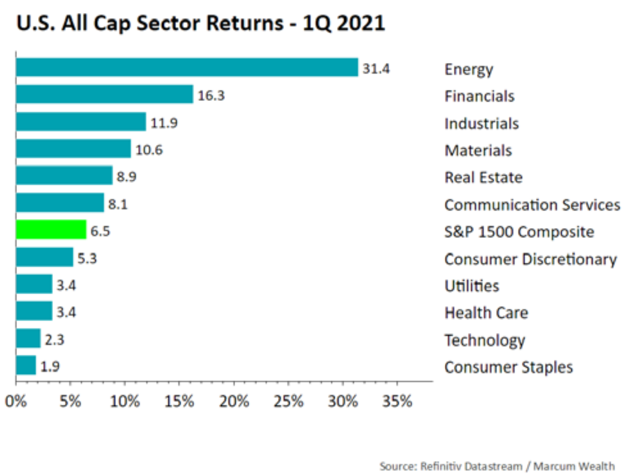

Three of the other largest economies are forecast to have negative population growth in the 2030s. Japan is already there. This means less working age population coming into the labor force over the long-term.

## Equity

The upward trajectory for equity markets continued during the last quarter. Small caps led the way and value outperformed for the second consecutive quarter.

| US Equity | 1Q 2021 |
|---|---|
| **Large Cap Stock** | |
| S&P 500 | 5.8% |
| **Small & Mid Cap Stock** | |
| S&P 400 Mid Cap | 13.5% |
| S&P 600 Small Cap | 18.2% |
| **All Cap Style Indices** | |
| S&P 1500 Value | 11.6% |
| S&P 1500 Growth | 2.7% |
| **International Equity** | **1Q 2021** |
| MSCI EAFE | 3.6% |
| MSCI EAFE Value | 7.6% |
| MSCI EAFE Growth | -0.5% |
| MSCI Europe | 4.2% |
| MSCI Japan | 1.7% |
| MSCI Emerging Markets | 2.3% |

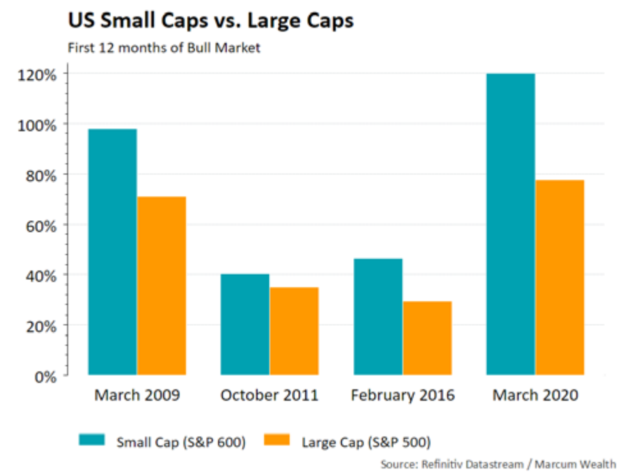
Under the surface, there was a change in leadership. Energy and financials, two of the worst performing sectors in 2020, came out on top during the first quarter of 2021. Technology led the way in 2020, yet was the second worst performer so far this year.




Small caps historically outperform following bear markets (defined as price declines of greater than 20%). Following the bear market is when small caps shine, winning the bulk of excess returns against large caps.

Over the past 13 years, there were 4 small cap bear markets. Many people forget about the bear markets in 2011 and 2016.

Since the lows of March 2020, small caps trounced large cap returns by over 40%.




After the first year of a bull market, returns for small caps relative to large caps are more muted.

The vaccine rollout and normalization of economic activity across the world varies. Because of the different speeds of economic recoveries in different nations, equity markets are also recovering at different paces. We still see value and diversification benefits from owning companies around the world.

International and emerging markets posted positive returns during the quarter. Due to the currency influence, the stronger U.S. dollar detracted from relative results.

If the dollar were to turn negative as a counter-weight to all of the fiscal stimulus, this would provide a strong tailwind for U.S. investors in global equity markets.

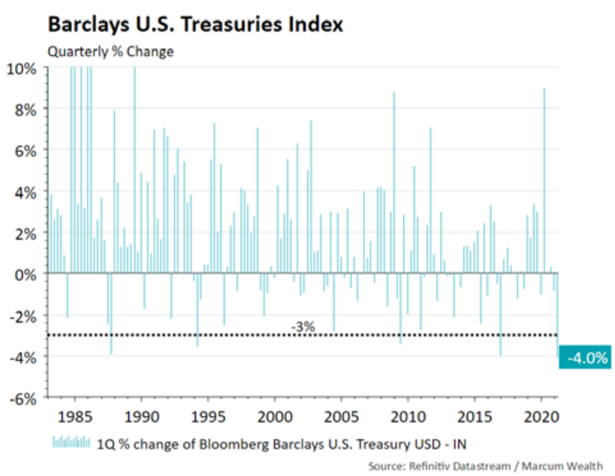
Equities remain at the strategic target weight within the Marcum Wealth Asset Allocation Frameworks.

## Fixed Income

The 10-year Treasury rose during the first quarter from 0.91% to 1.75%. The rise in yields across maturities led to negative results for bonds.

| Fixed Income | 1Q 2021 |
|---|---|
| Barclays U.S. Aggregate Bond | -3.5% |
| Barclays Corporate Inv. Grade | -4.8% |
| Barclays High Yield Bond | 1.0% |
| Barclays Global ex. U.S. Treas. | -6.5% |
| Barclays Municipal Bond | -0.4% |
| Barclays TIPS | -2.0% |

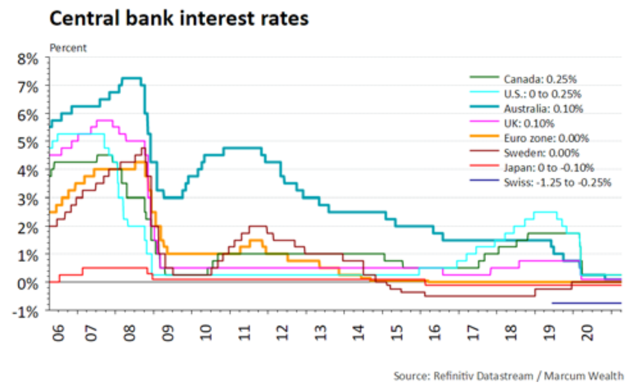
It was the worst quarter in 38 years for Barclays Treasuries Index, which saw a 4% drop. The silver lining is that when returns were -3% or worse, the index historically followed up with positive returns in the quarters ahead.




Credit spreads tightening provided a positive return source for bond portfolios during the quarter. Corporate high yield bonds were up 1%. Still, with credit spreads near historic lows and bond prices well above par, the strong returns over the last year are not available in the current setup.

Investors around the world are struggling with the low yield environment. Negative yields in Europe are being driven partially by regulations, requiring banks to own the high quality government bonds as collateral. With the back up in U.S. yields, investors from abroad will likely look to lock in yields that are more attractive than their home markets.

Central banks all have the same playbook. Different countries had varying levels of policy interest rates over the last 15 years. Now nearly every country is pinned at zero percent.




We still see bonds having a place in portfolios. First, the backup provides a greater yield than before, which increases the expected return. Bonds also tend to offset equity risk in portfolios, allowing a source of funds for rebalancing during price corrections.

The Asset Allocation Frameworks continue to maintain the exposure within fixed income.

## Real Estate

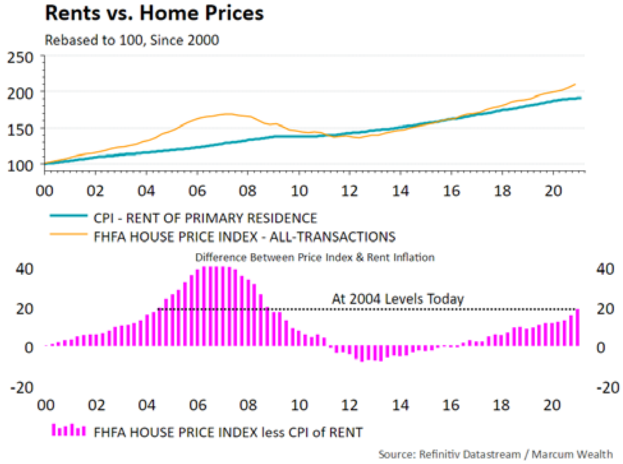
REITs in the U.S. outperformed the broad market index during the last quarter.

| Real Estate | 1Q 2021 |
|---|---|
| Wilshire U.S. REIT | 8.8% |
| Wilshire Int'l REIT | 2.6% |

There is no shortage of topics around real estate. One is how work-from-home will affect the office sector over the long-term. Greater demand for industrial space is pushing up prices as e-commerce companies look for closer exposure to last-mile delivery.

Finally, the red hot housing market has many wondering how far it can go. The inventory is at such low levels historically that prices are adjusting higher, resulting in bidding wars.

Looking at rent inflation versus home prices gives us a clue as to how prices compare to the past. Compared to the cycle in the 2000s, these data are at roughly 2004 levels. Home prices went on to rise for the following three years.

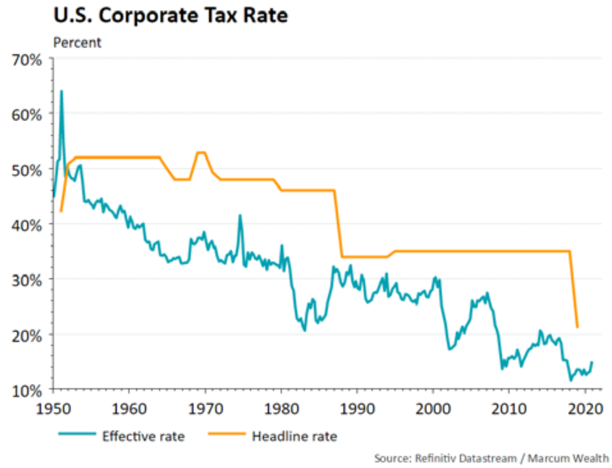



The major data providers in the housing space forecasted double digit price gains for 2021. The supply / demand imbalance on the inventory side looks likely to stay for the foreseeable futures.

The Asset Allocation Frameworks continue to maintain equal weight exposure to REITs.

## Summary

The changes in taxes are on market participant's minds. So far, the market has shrugged this off. Perhaps it does not think the 28% corporate tax rate proposed will have much legs. Or the top line growth from greater government spending will offset the tax expense. Either way, more clarity on corporate and personal income tax changes are likely in the quarters ahead. This could affect positioning, rotation of portfolios, and markets.




## Marcum Wealth Asset Allocation Frameworks

| | Income | Conservative | Balanced | Moderate | Growth |
|---|---|---|---|---|---|
| **Asset Class** | Strategic | Strategic | Strategic | Strategic | Strategic |
| **Equity** | **20%** | **35%** | **50%** | **65%** | **80%** |
| U.S. Equity | 12% | 21% | 30% | 39% | 48% |
| International Equity | 6% | 11% | 15% | 20% | 24% |
| Emerging Markets Equity | 2% | 4% | 5% | 7% | 8% |
| **Fixed Income** | **77%** | **62%** | **47%** | **32%** | **17%** |
| US Fixed Income | 69% | 56% | 42% | 29% | 15% |
| Global Bonds | 8% | 6% | 5% | 3% | 2% |
| **Real Estate / REITs** | **3%** | **3%** | **3%** | **3%** | **3%** |

The risk designations are relative only to the five Strategic Allocation targets and do not represent comparisons with any other investment or risk of the overall strategies.

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