ANCHOR
CAPITAL ADVISORS LLC

GLOBAL COMMENTARY
FIRST QUARTER 2021

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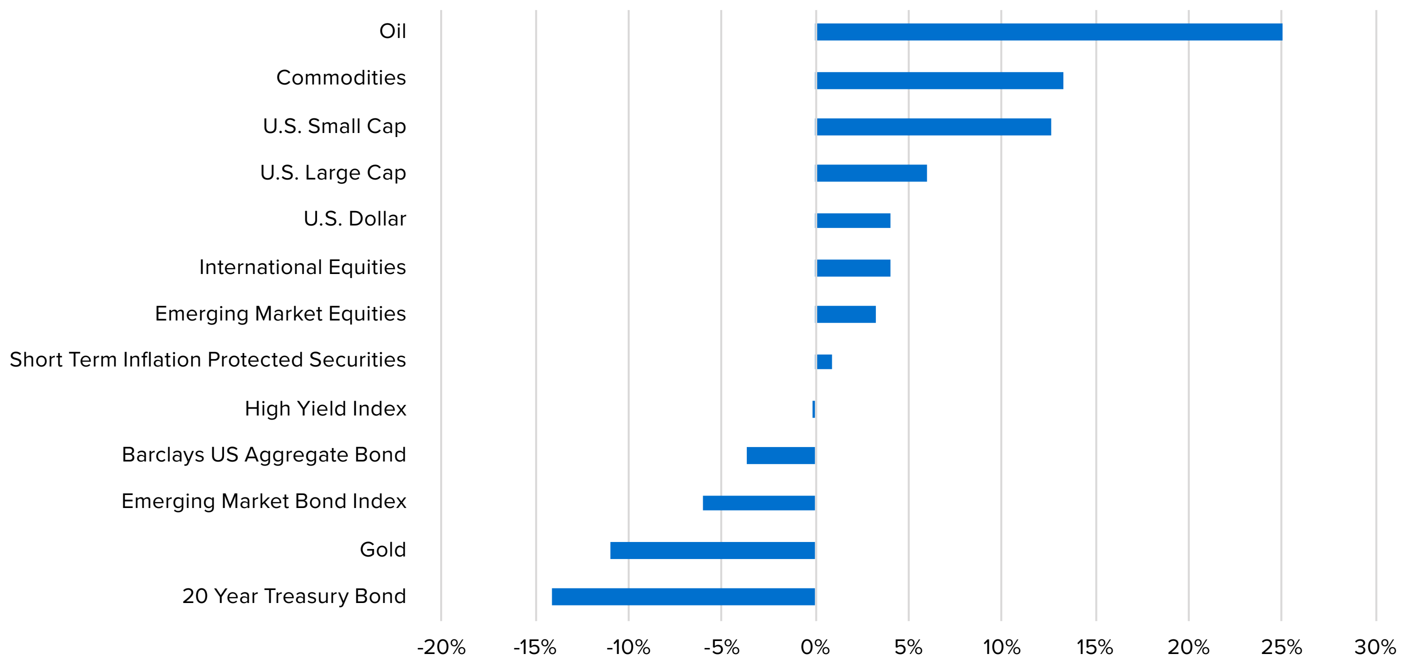
Overview

We have now passed the one-year mark since the pandemic started and it was certainly a challenging year on many fronts. However, we at Anchor are encouraged that with the vaccine rollout now in full swing, it seems that a full economic recovery is not far off. We are also very much looking forward to having the opportunity one day soon to return to face-to-face interactions with friends, colleagues and our clients.

The global equity markets have responded positively to the emergence of an economic recovery along with additional government stimulus that is providing liquidity to the markets. The U.S. has led the global markets this year, followed by Europe and then emerging markets. China has had a relatively muted return this year after a very strong 2020. Globally we are also seeing value outperform growth, and small caps outperform large caps, as you would expect in the early stages of an economic recovery.

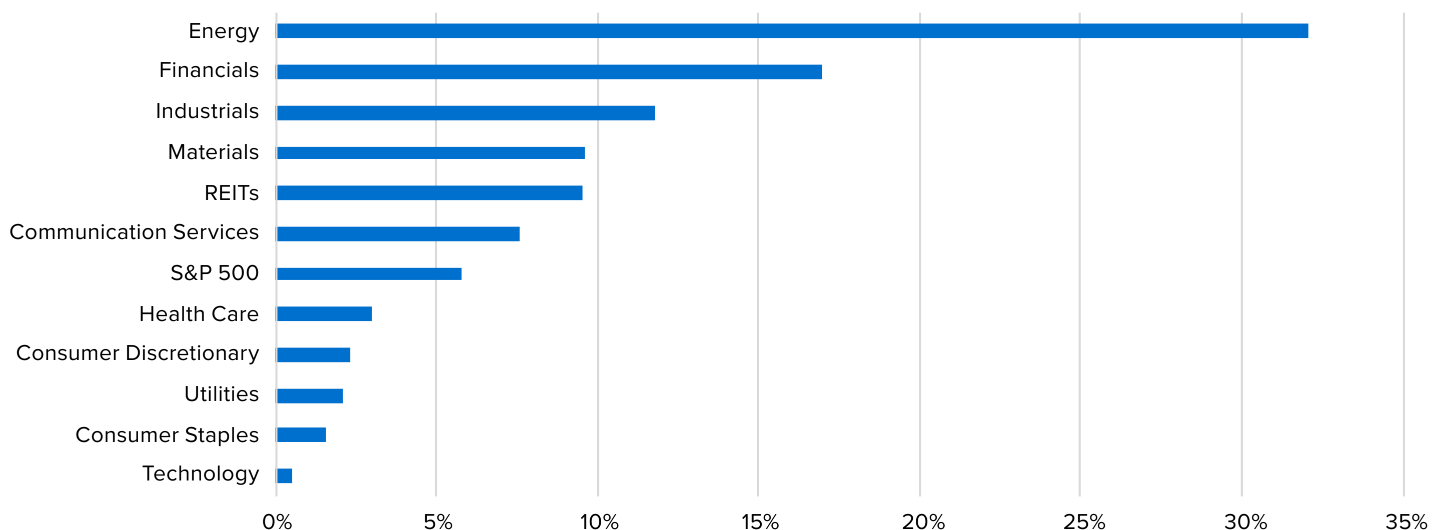


U.S. Markets

While on the surface it appears that we are experiencing a positive swing for equities across the board, in reality the equity markets have been in transition since last fall. For several years, growth had been outperforming value and large cap returns had led mid and small cap equities.[1] Technology, which had already been the highest performing sector prior to the pandemic[2], received a further boost from the sudden spike in people working from home and the Federal Reserve's zero interest rate policies.[3] However, with the announcement of vaccine approvals last November, the equity market shifted its outlook to economic recovery. In the first quarter, value cut last year's record gap between growth and value by a third and small caps have significantly outperformed large.[4]

It is estimated that consumers held on to over $1.7 trillion last year, leading to significant pent-up consumer demand.[5] Forecasters are expecting that by 4Q2021 annualized GDP growth will exceed 7%.[6] As a result, many parts of the economy that were the most battered last year have already shown signs of explosive recovery. After declining the most during the March 2020 market sell-off, energy and financial sectors have rebounded significantly in the fourth quarter of 2020 and first quarter of 2021.[7] A number of cyclical sectors, such as airlines and commercial aerospace, cruise lines, department stores, and auto manufacturers, have also rallied.[8] The resurgence in small-cap and cyclical stocks is not unusual as they historically bounce most off the market and economic bottoms.[9] What has been different this time is the faster than usual speed of the recovery.[10]

First Quarter 2021 S&P 500 GICS Sector Returns



U.S. Economy

As more people are vaccinated and the number of Covid infections decrease, we are seeing a gradual reopening of the economy, with people going back to work and kids going back to school. March showed strong jobs growth with unemployment down to 6%.[11] Other economic indicators are also positive with the U.S. Purchasing Managers' Index in solid expansion mode.[12] Housing sales have increased almost 19% year over year[13] and retail sales continue to increase.[14] In addition, Congress passed a $1.9 trillion stimulus package that provided cash for individuals and families, as well as money to help cities and states with the reopening process. We fully expect that much of this additional liquidity will reach the equity markets.

Federal Reserve/Interest Rates

Due to the economic recovery and additional stimulus, the bond markets are reacting to better economic times but also to the potential for much higher inflation. We have seen the yield curve steepen and the 10-year Treasury bond yield go from 0.92% at the beginning of the year to over 1.7% by the end of March.[15] As a result, bond prices were impacted and we had negative performance in most bond asset classes for the quarter.[16] The exception was Treasury Inflation Protected Securities (TIPS), which were positive for the quarter.[17] The Fed Reserve has remained dovish, stating at the March Fed meeting that it will not start raising interest rates until 2023 and that it is ok with letting inflation rise above the 2% level.[18] Furthermore, the Fed is continuing its bond-buying program of $120 billion per month.[19] The fed balance sheet is around $7.7 billion at the end of the first quarter.[20]

China

China has quickly recovered since the pandemic and is expected to have first quarter GDP growth of 18% or more, which should carry through for the year to generate over 6% GDP growth for the year.[21] Manufacturing and exporting goods has returned to prior levels, but domestic consumption continues to be weaker.[22] We have seen several companies that sell into China report much stronger sales, so we believe there is a divergence between income levels and spending. The Chinese A share stock market had a big year in 2020, up 29%, and is lagging a bit this year.[23]

Europe

Europe struggles with repeated shutdowns due to resurgence of Covid rates and difficulty getting the vaccine rolled out across the continent.[24] The European Union implemented some stimulus programs, but not to the same extent as the U.S., because Europe has more embedded social welfare programs that have helped prevent the level of unemployment that U.S. faced last April.[25] However, many of the structural issues in Europe still exist and the economy is not projected to have the same level of rebound growth as the U.S.[26] Despite these challenges the markets are responding to the potential for a recovery.[27]

Oil/Natural Resources

With global economies rebounding, the demand for oil has increased and we have seen oil prices increase from $48/barrel at the end of 2020 to $61/barrel at the end of March, a 25% increase.[28] Energy producers have indicated they are opening up wells but not driving for new wells at this point until oil prices stay at these levels. OPEC has said it will keep output stable.[29] Other natural resources like aluminum, lithium, and lumber continue to rally.

Other areas of the market we are watching

We are keeping an eye on several speculative and potentially harmful trends that began gaining momentum last year. First, in the latest quarter, there was a record number Special Purpose Acquisition Company (SPAC) new equity issuances, with over $166 billion raised.[30] A SPAC, by raising equity, becomes effectively a blank check company, which then finds a company to acquire. SPACs avoid many of Securities and Exchange Commission (SEC) regulations imposed on traditional IPOs, including being allowed to market aggressively and to make growth projections that typically are prohibited. We expect that the SEC will put more restrictions on SPACs in the future.[31] While the pool of public companies was shrinking for many years, it is finally growing again with these new SPAC and IPO issuances.

Another area of concern is the surge of short-term trading by individual investors as platforms like Robinhood and the largest discount brokerage firms allow the regular retail investor to trade with ease with zero commissions. Many investors have been following the guidance of a blog called Wall Street Bets, buying into speculative companies with high short interest, such as Game Stop and AMC Theatres, causing historic swings in share prices.[32] Individuals with limited investing experience are potentially going to get hurt.

Finally, bitcoin, cryptocurrencies, and non-fungible tokens (NFTs) may be bubbles waiting to be burst. These assets have quickly climbed in value without real fundamental support. Bitcoin is trading at over $55,000, up from roughly $30,000 at the beginning of the year.[33] Investors may claim there is limited supply, and they may believe that something is a store of value, but price volatility makes holding any asset more risky. In addition, there is concern that governments can ban Bitcoin. NFTs are currency related to blockchain with artists or athletes providing a stamp authenticating a trading card, music, piece of art.[34] Some NFTs have sold for millions of dollars.[35] We suspect that part of the growth of these more speculative activities have been fueled in part by liquidity provided by the government.

Outlook

There are several tailwinds in the equity market as the economy continues to open and recover, vaccine rollouts expand, more people return to work in person and seek out travel and experiences. We are expecting strong GDP growth later in 2021 and into 2022. GDP growth across the globe should recover, but we expect it will be uneven depending on additional lockdowns and vaccine distribution.

Given the potential for higher interest rates and muted opportunity in the fixed income markets, we believe that investors continue to be driven toward equities. We remain diligent as valuations of the stock markets are clearly above historic averages. We have seen several examples of extreme speculation and potential "bubbles". Yet, unlike the dot.com bubble period 20 years ago, the absolute level, quality, and outlook for corporate earnings growth should continue to provide the underpinning for positive equity returns.

1. FactSet, Data & Analytics, Charting
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26. Ibid.
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34. https://www.theverge.com/22310188/nft-explainer-what-is-blockchain-crypto-a
35. Ibid.

For a complete listing of all strategies contact Anchor Capital Advisors LLC (617) 338-3800.

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