ANCHOR
CAPITAL ADVISORS LLC

GLOBAL COMMENTARY
SECOND QUARTER 2021

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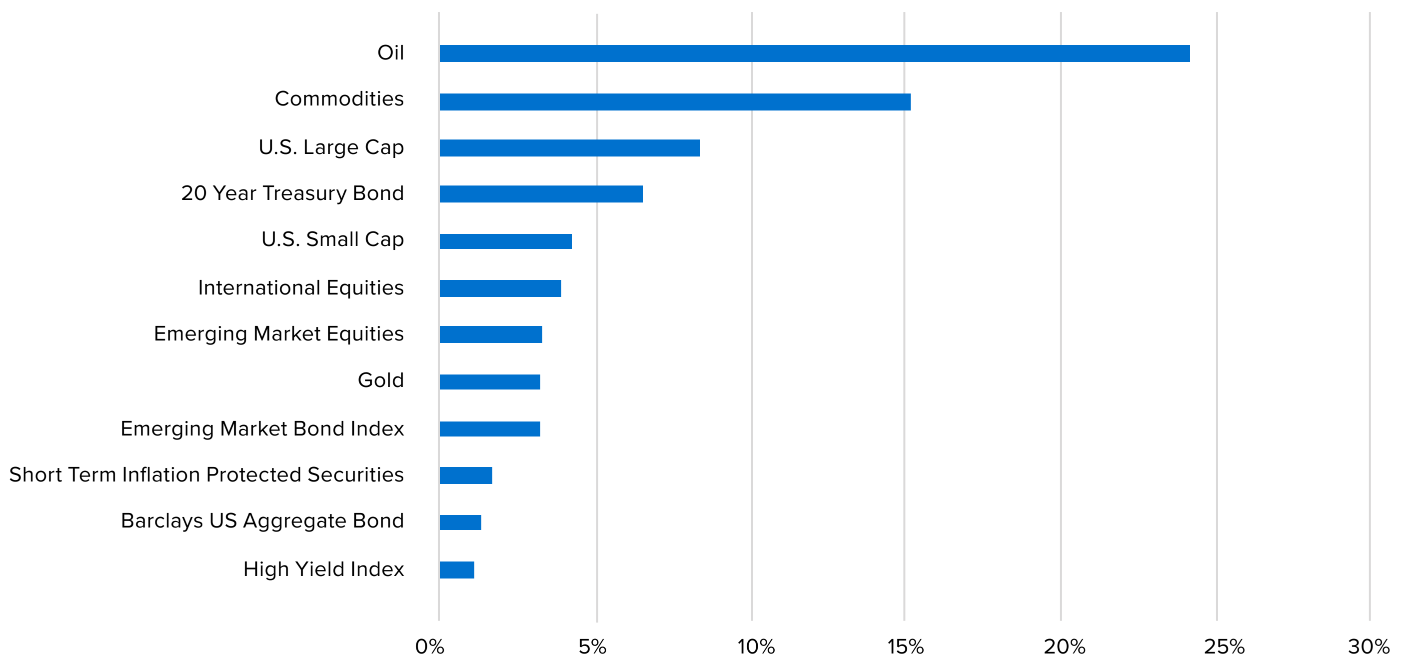
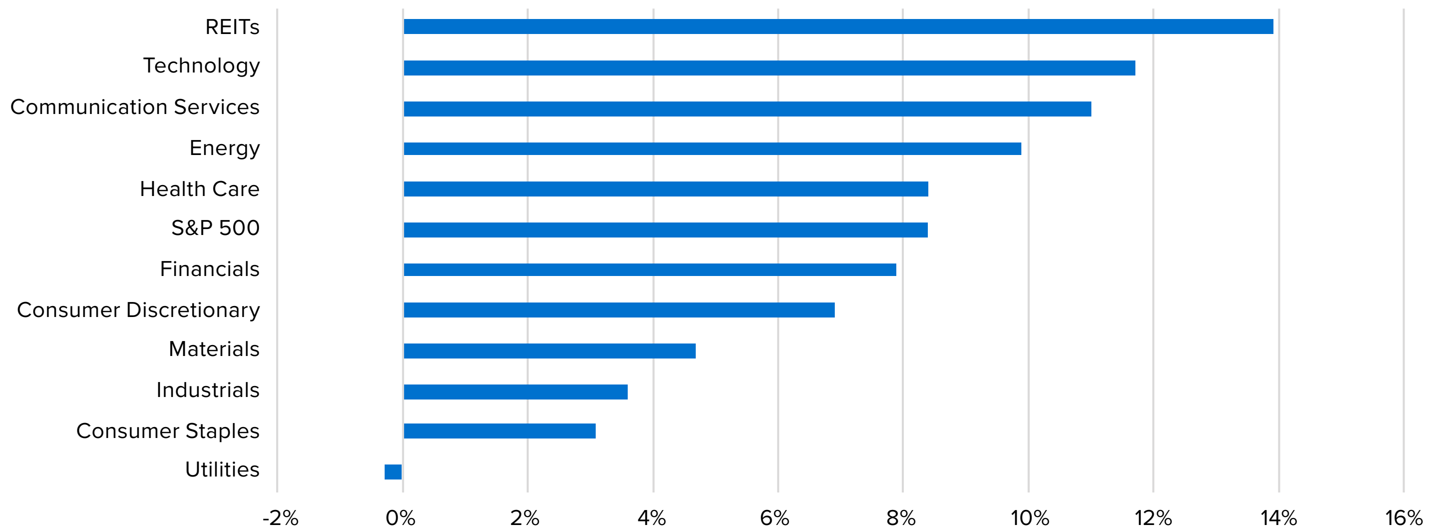
Overview

The equity markets and most asset classes performed well during the second quarter with the global recovery taking shape. While there are still concerns about COVID variants, most countries are moving forward with getting their populations vaccinated and their economies reopened. The U.S. continues to have strong positive performance and the second quarter led with large cap stocks tilting to growth.[1] The S&P 500 was +8.6%, followed by Russell Mid Cap at +7.5% and Russell 2000 at +4.3%.[2] Outside the U.S., the international developed markets were +4.0% and emerging markets +3.4%. The bond and commodity markets were also positive.[3]



U.S.

The U.S. economy has rebounded at a powerful pace with higher than normal manufacturing numbers, a hot real estate market and employment quickly recovering. The first quarter earnings for most companies reflected this strength as we saw the benefits from multiple rounds of stimulus and pent up spending by consumers. The Energy sector continues to perform well with rising oil prices. Technology, Communications Services, and Real Estate were also top performers.[4] Defensive sectors like Consumer Staples and Utilities remain laggards.[5]



Europe

The European economy is slowly recovering, having faced slower vaccination rates and extended lock downs due to COVID variants. We are now seeing improvement and it is expected that the EU's GDP growth will be +4% for 2021, with similar levels for 2022.[6] Much like the U.S., Europeans saved during the pandemic and are now beginning to spend that capital. The EU is coordinating a $5.85 Trillion recovery package to help boost growth coming out of the pandemic and prevent a relapse.[7] The EU is also seeing modestly higher inflation levels, which they have not seen in a long time.[8] Europe could be viewed as an attractive investment opportunity given that stock valuations are lower than what we are seeing in the U.S.

China

The Chinese economy recovered quickly from the COVID shutdown and experienced +18% GDP growth in the first quarter of 2021.[9] Like other central banks, China has provided fiscal and monetary stimulus to help the economy recover and is now pulling back those stimulus measures.[10] In particular, there has been a focus on tightening credit standards and bringing down the debt to GDP levels.[11] With that, the World Bank is forecasting 2021 GDP to be +8.4% and 2022 GDP to be +5.4%.[12] There is risk that the GDP growth could be slower given the restrictions on credit and slower consumer demand.[13] That said, China continues to have one of the highest GDP growth rates in the world.

U.S. Inflation

When the pandemic hit, companies – many of which employ just in time systems – automatically reduced inventories in anticipation of a slow rebound. A hurricane in Louisiana, a deep freeze in Texas and the Suez Canal jam compounded supply chain issues. As the economy has recovered very quickly there have been shortages of a number of goods and freight costs have soared. On top of that, additional stimulus and unemployment benefits appear to have had the unintended consequence of making it less attractive for people receiving those benefits to return to work. Thus, many retailers and restaurants are having to raise wages to attract workers. Many states are suspending the additional unemployment benefits and hopefully the labor situation will improve. We believe that the shortages will be rectified over the next several quarters.

All of these factors combined have translated into a rise in the rate of inflation not seen since August of 2008. In April and May, we saw consumer price index (CPI) 12-month percentage growth of 4.2%[14] and 5%[15], respectively. For context, the Federal Reserve (Fed) has a dual mandate to keep full employment and stable prices – with a current inflation target that averages 2% over time.[16] We suspect that the growth seen in more speculative activities has been fueled in part by liquidity provided by the government.

Federal Reserve and Interest Rates

The Fed is in an interesting spot because they want the economy to fully recover and get to full employment, but they do not want inflation to get out of control.[17] This is controlled by the Fed raising interest rates.[18] If the Fed raises rates too early then the economy could stall out, and if the Fed waits too long then the rampant inflation could impact economic growth.[19] In addition, the Fed is cautious in telegraphing any interest rate increases so the markets do not sell off. The Fed has said that they are happy to let inflation run a little hot, but based on the June Fed meeting they are expecting to have two interest rate increases in 2023.[20] The interest rate increased quickly for the 10 Year Treasury Bond, from 0.90% at the end of 2020 up to 1.7% at one point, and is now hovering around 1.5%.[21] We expect that interest rates will grind higher as the year progresses and the economic recovery takes hold.

Biden's Infrastructure Plan and Taxes

President Biden's proposed infrastructure plan, which is currently being negotiated, is meant to fix aging infrastructure, support the continued build out of electric vehicle charging stations, fund solar and wind projects and build out broadband for rural America.[22] Funding this plan requires an increase in corporate and personal taxes to currently unknown levels. In looking at our holdings, we are monitoring the impact a potential tax increase from 21% to as high as 28% could have on businesses. The proposal also includes an increase in the capital gains tax rate.[23] For many investors that would be a significant and impactful change. Our ability to construct portfolios of securities we can hold over multiple market cycles remains critical.

Commodities

There has been notable attention paid to rising commodity prices this year. Oil, lumber, copper, and aluminum prices spiked.[24] We are also seeing a pullback in what were escalating prices for lumber and copper due to unsustainable input costs. As it relates to copper and aluminum, China recently released reserves to help combat the rising prices and prevent speculators from hoarding.[25] Oil prices have reached over $75/barrel, levels that we have not seen since 2018.[26] We believe as the global recovery continues to take hold there will be continued demand for materials.

Gold as a precious metal and a store of value has been up this year, but not as robust as other commodities. What we have observed is that investors are looking for other places, such as Bitcoin, to store value and benefit from inflation. Younger generations do not place as much value on gold and have allocated towards Bitcoin, which as an asset class has been volatile. Bitcoin has fluctuated in price between $30,000 to more than $60,000 over the last year. More recently, the price has come back down as China has clamped down on Bitcoin mining.[27]

Conclusion

We have seen a strong start to the year across most asset classes as the economic recovery takes place globally. In the equity markets, we are transitioning from early-cycle to mid-cycle and moving from multiple expansion to earnings growth. We believe that central banks will balance inflation and interest rate increases to help contribute to the economic expansion and get to stable ground. Having a diversified portfolio of different asset classes will allow investors to take advantage of the synchronized global recovery.

1. FactSet Data & Analytics, Charting
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For a complete listing of all strategies contact Anchor Capital Advisors LLC (617) 338-3800.

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