JOHNSON
INVESTMENT COUNSEL

# Quarterly Insight

## MARKET UPDATE

2021:
FIRST
QUARTER

### LIGHT AT THE END OF THE TUNNEL FUELS STOCK MARKET GAINS

Stocks rose in the first quarter, powered mainly by vaccine rollouts and prospects for a resurgence of economic activity. The daily realities of the pandemic carried into the new year, along with political turmoil. Both served as a headwind for stocks in January. But by the end of March the vaccine rollout was in full swing. Positive cases, hospitalization rates, and deaths generally improved around the world (with some exceptions). Millions of people are emerging from their relative isolation with pent-up energy to travel and consume. Thanks to reduced expenses last year and government stimulus, many have extra cash in their pocket to do so.

The Biden administration and Congress showed no signs of slowing the flow of stimulus, and the Federal Reserve communicated similar supportive messages. Several massive pieces of legislation are expected to come later this year on top of the trillions of dollars of spending already signed into law.

The overall gains came amid significant divergence in returns in various sectors of the market, reflecting the different opportunities and challenges industries face in the wake of the pandemic.

Interest rates increased during the quarter, a sign of pending economic strength and potential for rising inflation. This led to slightly negative returns for bonds in the quarter (see the nearby article for more on this topic). Commodity prices rose, particularly oil, as expectation for demand increased.

All this made for an action-packed first quarter and sets the stage for what is sure to be an eventful 2021.

### POCKETS OF FROTH

There were several stories in the quarter that demonstrated there are pockets of froth in certain areas of the market. Shares of GameStop skyrocketed as retail investors piled into the stock in an effort to put a "short squeeze" on large institutional investors betting against it. The idea that a nearly bankrupt video-game rental store could rise to such dizzying heights made it clear that the price increase had nothing to do with fundamental value. Several other companies experienced a similar frenzy. Terms like "blank-check companies" and "non-fungible tokens" were also in the news as massive demand drove up prices in those markets. Cryptocurrencies like Bitcoin experienced massive swings, but ultimately surged higher. As interesting as these stories were, the money involved is still dwarfed by the broader stock market.

### ROTATION TO VALUE

The first-quarter rotation from growth stocks to value stocks was one of the most powerful in years. Growth stocks (many of which are tech companies) have domi-

## FEATURING



## TOTAL RETURNS

| | 1Q 2021 |
|---|---|
| S&P 500 | 6.2% |
| Dow Jones Industrial Average | 8.3% |
| NASDAQ | 3.0% |
| Russell 2000 | 12.7% |
| MSCI EAFE (International) | 3.6% |
| Barclays Aggregate Bond Index | -3.4% |

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» ASSET MANAGEMENT

nated the market for well over a decade. But as optimism about a reopening economy increased, so too did investor interest in beaten-down sectors like energy, industrials, and financials. Several of the stocks that have led the way during the bull market were actually down in the first quarter. The Dow outperformed the NASDAQ by about 5 percent, its largest spread since 2018.

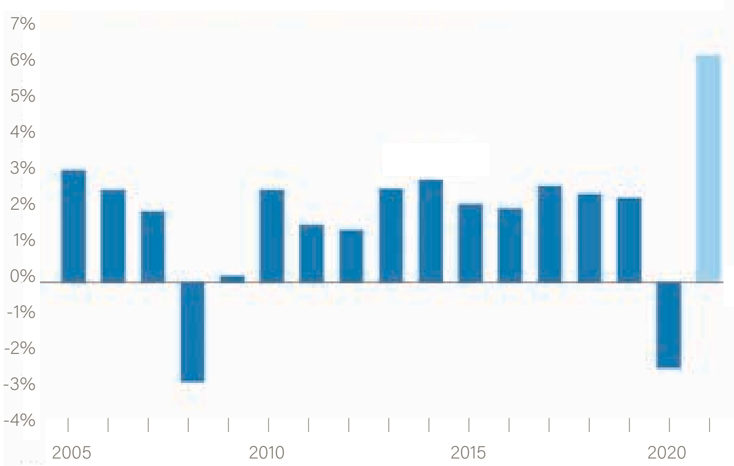
Small cap stocks also performed well relative to large cap. Many of the largest multinational companies were able to navigate the pandemic more successfully than smaller competitors, so their stock prices held up better last year. The strong performance of small cap stocks reflects the expectation that a return to a normal economic environment could be more beneficial for smaller companies.

The first-quarter rotation came nowhere close to erasing the wide gap that exists between growth stocks and value stocks. As a result, there is still value to be found in various sectors and industries.

### ON THE CUSP OF ECONOMIC RECOVERY

A picture is emerging of an economy on the verge of a robust recovery. The economic pain inflicted by the virus and lockdowns was severe. Millions were laid off with no other option but to wait out the lockdowns. But as more are vaccinated and case counts fall, hiring is happening in earnest, and mobility and spending data show people are anxious to get out and spend money. There is certainly a long way to go, and the damage is likely to take years to heal. But the snapback effect coming off the lows of 2020 could lead to record growth numbers in the coming quarters. This is especially true if the pandemic continues to ease. The combination of pent-up demand and record cash on hand for consumers is a powerful one.

### CHANGE IN FOURTH-QUARTER REAL GROSS DOMESTIC PRODUCT FROM A YEAR EARLIER




*Note: 2021 is economist's average forecast*
*Sources: Commerce Department (historical GDP); IHS Markit (2021 forecast)*

### STIMULUS, INFRASTRUCTURE, AND TAX REFORM

Over the past year the government has committed approximately $6 trillion to the crisis, with more potentially on the way. A major feature of the legislation has been direct payments to qualifying individuals and businesses, which has allowed many to survive the pandemic economically. While the amount of forthcoming legislation is being debated, there is no doubt that there is a lot of money flowing in the economy.

The nature and extent of further legislation will continue to influence markets as the year progresses. A $1.9 trillion infrastructure package is in the works that will pump more money into the system. Investors are also keenly interested in the potential for tax reform later this year. The Biden administration has proposed raising the corporate tax rate as well as taxes on the highest-earning taxpayers. The stock market is likely to react to the headlines on this issue throughout the process.

## BONDS, INTEREST RATES, AND INFLATION

### ARE BONDS STILL A RELIABLE HEDGE?

The shock of the global pandemic sent bond prices higher in 2020, driving interest rates to all-time lows. In the later months of 2020 and early months of 2021 yields have increased somewhat, but in general still remain low by historical standards. As a result, we are often asked what role high-quality bonds play within diversified portfolios. With rates so low, some wonder whether high-quality bonds can still provide a reliable hedge against economic and market volatility.

History demonstrates that they can. Yields on short-term bonds remain extremely low, tethered to the Fed's easy monetary policy. However, longer-term bond yields now offer bond investors a reliable cushion against future stock-market volatility. Historical analysis of similar environments provides evidence that even at these levels bonds can deliver positive total returns (price increase plus interest income). This is crucial to cushion the blow of stock market losses in a balanced portfolio. This stability is what allows for liquidity to meet cash flow needs during periods of stock-market declines.

### FASTER INFLATION ON THE WAY?

Investors should take comfort in knowing that the "bond hedge" is still alive and well. Still, we recognize that massive government spending, with prospects for even more later this year, on top of an accelerating vaccine rollout and economic reopening has left some wondering about the prospect of faster inflation and, in turn, higher interest rates.

## BONDS, INTEREST RATES, AND INFLATION

When evaluating the outlook for inflation, it is crucial for investors to separate short-term, cyclical trends from the long-term, secular outlook. There is little question that near-term trends favor a modest acceleration in the official inflation statistics. In fact, even without unleashing pent-up pandemic demand, the year-over-year inflation statistics are likely to rise simply because of the COVID-induced deflation that we experienced last March, April, and May.

Additionally, as the population becomes more broadly vaccinated, demand is likely to accelerate for the nights out at the restaurant, vacations, and concerts people gave up last year. However, as this one-time burst in demand subsides, the long-term secular forces that have driven decades of subdued inflation and sluggish economic growth are likely to regain control once again. An aging population, bloated public and private sector debt, and stubbornly-low productivity all acted as governors against robust growth and higher inflation throughout the prior economic recovery. If anything, these trends not only remain in place, but have worsened in the wake of the pandemic.

### A PATIENT FED

As a result, the Fed is likely to be patient in regard to tightening monetary policy. In fact, it has gone to great lengths to articulate its willingness to look beyond modest, short-term inflation tailwinds. Instead, it has been adamant about prioritizing full employment as a condition for raising interest rates, which may take many years to achieve.

Our base case outlook for monetary policy is that it could be a while before the Fed makes the initial move to raise the benchmark rate above zero. It is also likely to peak at a relatively low rate, possibly in the 2% to 3% range.

There is a great deal of uncertainty with forecasting Fed policy many years in advance. Still, even in a scenario where the Fed tightens much sooner and more aggressively than we believe is likely, bond returns could still be positive.

### DELIVERING STABILITY AND PEACE OF MIND

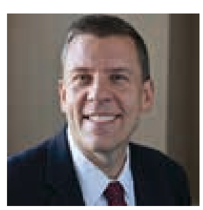
High-quality bonds remain a strong defense against volatility. In recent years low bond yields have tempted investors to reduce or even remove traditional bonds from portfolios in search of higher returns. Unfortunately, for some this has led to unnecessary risk taking and unintended consequences. When constructing portfolios we hold to the philosophy that bonds should behave like bonds, delivering stability, income, and peace of mind in times of turmoil.

*Disclaimer: Any expectations presented should not be taken as a guarantee or other assurance as to future results. Our opinions are a reflection of our best judgment at the time this presentation was created, and we disclaim any obligation to update or alter forward-looking statements as a result of new information, future events or otherwise. The material contained herein is based upon proprietary information and is provided purely for reference and as such is confidential and intended solely for those to whom it was provided by Johnson Investment Counsel.*

## UPCOMING EVENTS


Senior Managing Director Jarett Levitsky, CFP® joins experts from DBL Law and VonLehman CPA & Advisory Firm to discuss President Biden's proposed tax plan. There have been many proposed changes to tax rates (both individual and business), estate planning considerations, and more. While the effective date for these changes remains unknown, being prepared is the best approach.

To register, visit our website JOHNSONINV.COM and click the link in the red bar on the homepage.

JIC Senior Portfolio Manager and Procter and Gamble (P&G) Retirement Plans Director Mike Stanis, CFA, CFP® will guide current and former P&G employees through their Profit Sharing Trust (PST) distribution options. Mike spent 17+ years with P&G and will share what he learned so that you can make the best decisions for your family.

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## PROMOTIONS

We are pleased to announce that these individuals have been promoted to new positions:

> **Joseph R. Abbott**
> Research Analyst

> **Alex J. Bey, CFA**
> Client Portfolio Specialist

> **David A. Christian, CFA, CFP®**
> Associate Portfolio Manager

> **Emilia J. Connor**
> Credit Analyst

> **Rebecca J. Desch**
> Senior Marketing Associate

> **Sandy F. Himmelsbach, CFP®**
> Portfolio Manager

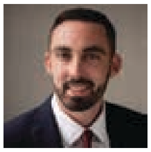
> **Laura, R. Mattern, CFA, CFP®**
> Portfolio Manager

> **Leah B. Quortrup, CTFA**
> Associate Trust Officer

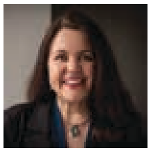
> **David Q. Theobald, CFA**
> Senior Portfolio Manager


Abbott


Bey


Christian

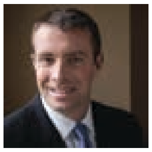

Connor


Desch


Himmelsbach

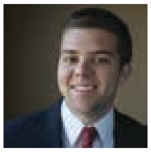

Mattern

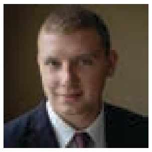

Quortrup


Theobald

## NEW DESIGNATIONS

Johnson Investment Counsel is committed to continuing education to provide personal development for our employees and better service to our clients. Congratulations to Portfolio Manager Assistant Eric Bachus, CFA, and Credit Analyst Brad Morrissey, CFA, on earning Chartered Financial Analyst designations.


Bachus, CFA


Morrissey, CFA

## NEW ADDITIONS TO THE TEAM

> **Michelle L. McGinnis**
> Client Support Assistant

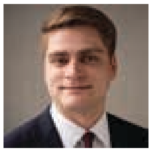
> **Treven A. Mitchell**
> Equity Research Associate

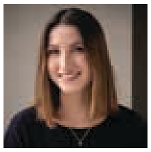
> **Erica M. L. Osborn**
> Portfolio Manager Assistant

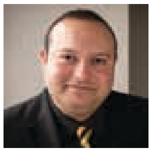
> **Previn C. Pandey, MFE**
> Equity Research Associate

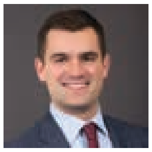
> **Landon J. Peterson**
> Portfolio Manager Assistant


McGinnis


Mitchell


Osborn


Pandey


Peterson

*If you are a client of Johnson Investment Counsel, you should receive account statements on at least a quarterly basis directly from the qualified custodian that holds and maintains your assets. You are urged to carefully review all custodial statements for accuracy. If you are not receiving custodial statements, please contact our Chief Compliance Officer, Scott Bischoff at (513) 661-3100.*

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## ABOUT US

Johnson Investment Counsel, Inc. is one of Ohio's largest independent wealth management firms, managing more than $15 billion in assets for clients in 49 states. Johnson Investment Counsel is an employee-owned firm, offering a full range of fee-based, integrated wealth management services, including: investment portfolios, education and retirement planning, cash management, estate planning, trust services, charitable giving, mutual funds, 401(k) plans, IRAs, and more. Johnson Investment Counsel has built strong, long-term relationships with individuals, families, charitable organizations, foundations, and corporations through four integrated divisions.

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