CAPSTONE
WEALTH ADVISORS

Outlook on the Markets

MID-YEAR SUMMER 2021 ISSUE

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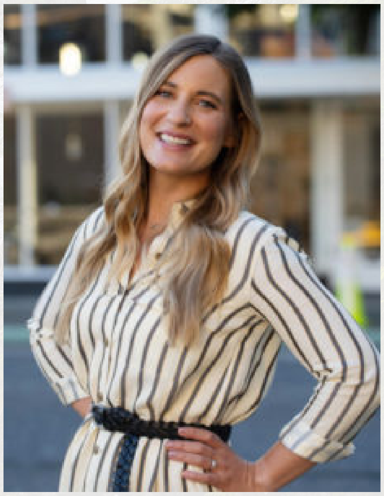
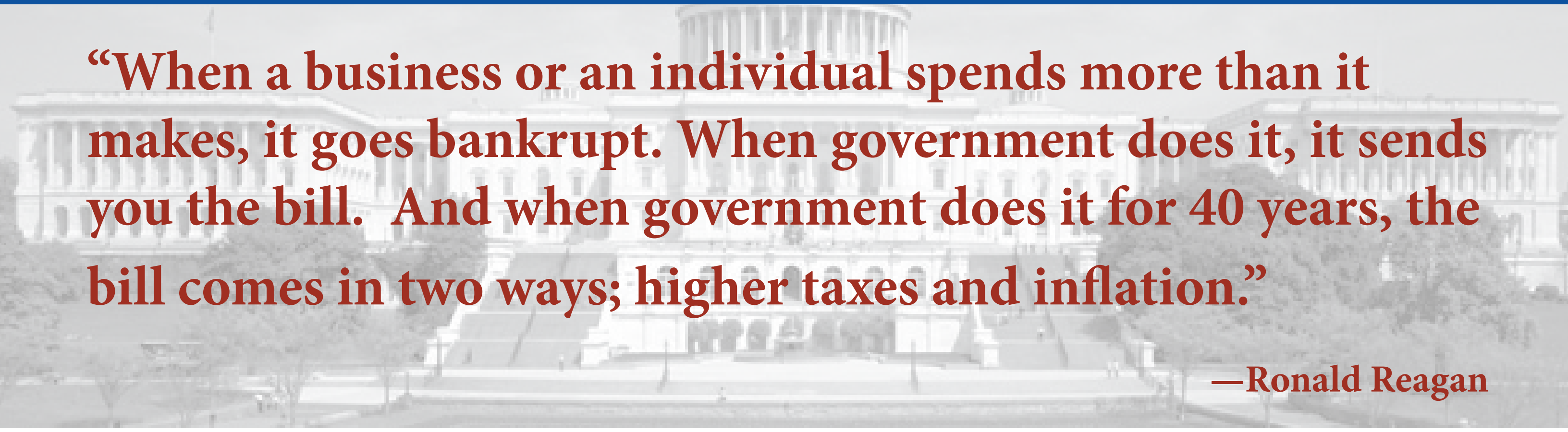


Capstone Wealth Advisors is pleased to release our Mid-Year Outlook on the Markets written entirely by our advisory team. Our outlook is based on our views and philosophies as we see them impacting financial markets, and your money. Current trends, economic indicators and in-depth analysis is at the core of what we do. We monitor and analyze economic trends to help our clients have a clear understanding of the direction the economy is headed and how that impacts your portfolio strategies.

We have six offices throughout the Pacific Northwest, utilizing a team approach to provide continuity for your asset planning needs. Our investment committee meets weekly to discuss current economic events, market trends, asset allocations and more. By using a disciplined and methodical approach to investing, we remove the noise and emotion from your investment portfolio and allow you to focus on the things you love and enjoy most.



“When a business or an individual spends more than it makes, it goes bankrupt. When government does it, it sends you the bill. And when government does it for 40 years, the bill comes in two ways; higher taxes and inflation.”

—Ronald Reagan

Ronald Reagan was a man known for his uncanny ability to make a complicated issue seem simple. In this case, his words have an even more profound meaning as here we are, 40 years later, confronted by the real possibility of both higher taxes and inflation. His words ring true today just as they did decades ago.

It’s no secret our economy is still in the process of recovering from COVID’s devastating effects, but how does that translate to the stock market and how should investors proceed when it comes to their investment portfolios? For starters, the current economic situation in the US is strong and will likely continue to gain momentum as COVID restrictions are further relaxed and businesses are able to operate in a more traditional fashion. This, along with consumers who are flush with cash, sets the stage for continued positive economic activity well into the end of 2021.

Recently, there has been attention focused on whether our red-hot economy will become overheated and produce hyperinflation. We believe some of the current inflation concerns, while on an absolute basis are real, are also being overstated by media outlets at this time. Distinguishing the difference between hyperinflation (aka, runaway inflation) and manageable inflation is the key. Right now, most economists agree with the Federal Reserve’s position that current levels of inflation are “transitory,” meaning they are temporary. This is an important distinction of inflation because mild levels of inflation are healthy and necessary for an economy to grow, while hyperinflation causes significant imbalances in trade and prices of goods & services – almost inevitably ending poorly.

While we do believe hyperinflation concerns at this point are premature, they are not without merit. In April, the US Bureau of Labor Statistics reported that core inflation rose by 4.2% over the past 12 months, a rate not seen since 2008 and well above the 3.6% estimate. The never-before-seen levels of fiscal stimulus, government spending, Fed asset purchases and easy monetary policy certainly present the possibility of creating inflation that, if left unchecked, could create an environment for hyperinflation. However, we believe those worried about inflation becoming uncontrollable are greatly underestimating the ability the US Federal Reserve Bank has to keep our economy running at appropriate levels. Should we begin to see inflation running at elevated levels, the Fed has a significant number of tools at their fingertips which can be deployed quickly to help combat hyperinflation from occurring.

One area of particular concern is that of the labor market. Current imbalances of people willing to accept jobs versus the number of jobs available is cause for caution. This labor supply imbalance has caused many employers to offer financial incentives to applicants to overcome the amount of increased unemployment benefits people receive. If those efforts are not widely accepted, it will likely lead to an increased cost of labor to businesses and thus put pressure on companies to either tolerate some erosion in their margins or pass along the increased cost to consumers, i.e. price inflation. The difference between labor driven inflation and input cost inflation is input cost inflation regularly changes as supply chains are restored to more normal levels, whereas labor inflation more permanently increases a business’s costs because they are not able to easily adjust employee pay downward once an employee is hired.

Corporate earnings, the ultimate driver of stock prices, were nothing short of blockbuster in the first quarter of 2021 with 86% of companies beating analysts already lofty estimates. This suggests continued economic growth is very likely especially as the country continues to reopen and more businesses can get back to how they operated pre-pandemic. It should be noted that despite strong corporate earnings, we have still seen high levels of market volatility at times causing short-term corrections in the market. Investors should always keep in mind that market corrections are part of the process of investing and can happen suddenly, without warning and often without a rational justification for why they occur.

Facts to Consider

- **The S&P/Case-Shiller Index** reported that national home prices increased at the fastest rate since December 2005, growing by 13.2% over the past 12 months. The index currently sits at 252.14 for March 2021. The median home price of a new home sold in April 2021 was $372,000, up 20% from a year earlier and the strongest reading since 1988[1].

- **The Conference Board Consumer Confidence Index®** holds steadily and was virtually unchanged as consumer expectations weakened in May, following a gain in April. The index now stands at 117.2, down marginally from 117.5 in April[2].

- **The Institute for Supply Management's Manufacturing PMI ® Index** reported the manufacturing sector grew in April, with the overall economy notching an 11th consecutive month of growth. The April Manufacturing PMI® registered 60.7%, a decrease of 4 percentage points from the March reading of 64.7%. Survey Committee Members reported their companies and suppliers continue to struggle to meet increasing rates of demand due to corona virus impacts limiting availability of parts and materials[3].

- **The National Federation of Independent Business** reported small businesses reported job openings reaching record high for the third straight month. The jobs report for April shows a record 44% of all small business owners report having job openings they could not fill, 22 points higher than the 48-year historical average, and two points higher than the 42% figure from March. April is the third consecutive month with a record-high reading of unfilled job openings[4].

- The March estimate for personal income and outlays was impacted by the continued government response to COVID-19. **The Commerce Department** reported personal income increased $4.21 trillion (21.1%) in March according to estimates released by the Bureau of Economic Analysis. Disposable personal income increased $4.18 trillion (23.6%) and personal consumption expenditures increased by $616.0 billion (4.2%). The increase in personal income in March largely reflected an increase in government social benefits. Within government social benefits, "other" social benefits increased. The American Rescue Plan Act established an additional round of direct economic impact payments to households[5].

- **The Bureau of Labor Statistics** reports that the official unemployment rate (U-3) seasonally adjusted in April was 6.1%. The U-6 unemployment rate, a more comprehensive measure of unemployment, was at 10.4% in April which is a drastic improvement from the April 2020 rate of 22.4%[6].

- According to the "second" estimate, the **U.S. Census Bureau and the U.S. Bureau of Economic Analysis** announced that real gross domestic product (GDP) increased at an annual rate of 6.4%in the first quarter of 2021. In the fourth quarter of 2020, real GDP increased 4.3% [7].

- **CBOE Volatility Index (VIX)** has experienced a significant decline from it is 52-week high of 40.79 in June 2020 and has experienced short periods of significant volatility since. The index sits at 16.74 as of the end of May[8].

Cryptocurrencies are all over the news. Recently, several of the digital currencies displayed massive initial gains only to subsequently plunge in price due to international government regulation – namely China's ban on them. While cryptos are not currently regulated in the US, we anticipate this changing sometime in the not-too-distant future. Average investors should understand that engaging in the cryptocurrency phenomenon is not investing, it is outright speculation and should only be done with money you do not need to rely on. Risk levels for cryptos are "very high" to "extreme" and one only needs to look back to early May of this year when Bitcoin's price dropped by 40% in just two weeks. Regular and massive price swings should be expected for anyone engaging in cryptocurrencies and they are only appropriate for investors with the highest risk tolerance.

On the international front, the US Dollar has been under pressure recently as global investors see opportunities in other currencies whose economies are beginning to recover more quickly from the pandemic. Corporate earnings globally are recovering rapidly around the world led by the US and China. Stock in companies outside the US may pose a unique opportunity for investors with the appropriate risk tolerances. Despite a brief pullback earlier this year, we anticipate this segment will perform well but with a higher degree of risk than US based companies.

What does all this mean to you and your portfolio? Our team believes an environment of continued economic growth will sustain into the end of 2021 and possibly carry over into 2022, but it will likely be accompanied with episodes of heightened volatility along the way. Long-term investors should remain vigilant during these "episodes" and keep in mind that disciplined investing is a marathon, not a sprint. Keeping the "big picture" in mind is key to a successful outcome for long-term investors. We believe maintaining a core position of large US companies as the foundation of your portfolio strategy provides the most attractive risk vs return tradeoff. Smaller positions in International and Emerging Markets also appear attractive at this time. Bonds with longer maturities are difficult to justify in this rising interest rate environment and we would encourage investors to look to bonds with shorter maturity periods or funds that are actively managed. Bond alternatives are likely to outperform traditional bonds in this environment, however investors should be aware they do carry varying levels of higher risk.

To our valued clients, your investment portfolios already reflect our investment philosophy. As market conditions change, we will continue to proactively implement portfolio adjustments as part of our investment process. For those of you who are not currently a client, we invite you to schedule a complimentary consultation with our team. We can discuss the current economic outlook in greater detail and specifically how it might affect your existing portfolio. If you would like to schedule, please call our office directly at (877) 739-6007 or email us at info@capstonewealthadvisors.com.

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