AMI Quarterly Commentary

Growth Through Stability

Q1 ▪ 2021

Capital Market Outlook

"My destination is no longer a place, rather a new way of seeing"– Marcel Proust

Stocks added to the 2020 gains with the S&P 500 up 6.2% in Q1. The Q1 rally was led broadly by cyclical businesses and financials, a departure from market leaders last year. While there were a number of interesting developments in financial markets in Q1, the overarching takeaway is that the incredible speed in the development and production of Covid-19 vaccines is setting up 2021 to be one of the best years for GDP growth on record.

After a spike in Covid-19 cases in Q4, cases declined in Q1, which baffled experts but was likely due to some combination of the vaccine rollout and immunity from prior infection. The vaccine rollout continued to progress as Pfizer and Moderna ramped production and as initial shipments of the recently authorized J&J vaccine were distributed. As of today, approximately 190 million doses have been given in the U.S. and approximately 22% of the U.S. population is fully vaccinated. At the current pace of just over 3 million doses per day, the U.S. should reach herd immunity within the next few months. While we do not know how long the vaccines will protect us, recent data show they are still effective at the 6-month mark.

Perhaps the most important event of the first quarter occurred during the first week of January, with Democratic victories in the Georgia Senate runoff cementing Democratic control of Congress. As a result, another round of fiscal stimulus was passed in the form of a $1.9 trillion relief package in March, with the Biden administration also proposing a $2.2 trillion infrastructure bill at the end of the quarter. The expectation of this stimulus and government spending helped drive a rally in some of the most beaten down sectors of the market, especially energy and cyclical industrial businesses. However, this proposed spending will likely be paid for by increased corporate taxes, which could be a potential offset to stimulus.

This stimulus, as well as vaccine progress and lower case counts, drove expectations for economic growth significantly higher. However, this also resulted in the interest rates moving higher, as concerns over inflation and general growth optimism were priced into longer dated maturities. The 10-year Treasury yield moved from 0.93% to 1.74% over the course of the first quarter, returning to levels seen pre-pandemic. As rates moved higher, the mega cap technology companies and stay-at-home winners that had largely driven last year's rally came under pressure, while financials were the biggest winners of a steepening yield curve, which caused some broader weakness in the market during early March.

Capital Market Outlook (cont'd.)

The Fed gave no indication that its support for the economy would waver in the near future, indicating that inflation was broadly manageable, and that the overall economy remained under strain from the virus. The path forward for inflation, and whether the Fed is forced to make a move to reign in price pressure, will be a key question for equities moving forward. In addition, the expectation for strong economic growth, as well as the impact of the virus and one-time events (the Ever Given container ship stuck in the Suez Canal) has led to significant inflation in key commodities such as oil and lumber. The Fed is watching these developments closely but views current levels of inflation as relatively benign.

The massive fiscal and monetary support has thus far had a positive impact on the economy. Jobs are returning at a faster rate than expected as the unemployment rate dropped to 6.0% in March from 6.7% at the end of 2020. Recently released data showed that service-industry growth in March was the fastest growth on record. More so, many businesses have said that they are having difficulty finding workers to fill open positions in areas that are re-opening while restaurants and hotels are raising wages and offering bonuses to cope with shortages. While the path ahead may be bumpy, U.S. GDP is forecasted to grow at 7% in 2021, the fastest pace since 1984.

There were a number of notable developments in equity markets during Q1 that will be interesting to watch moving forward. "Meme" stocks such as GameStop and the rise of retail traders, Bitcoin and the prevalence of SPACs all made headlines during the quarter. These developments likely suggest a certain level of euphoria in some areas of financial markets; however, we believe these trends will prove to be temporary and remain focused on executing our investment strategy without being distracted by noise.

At AMI, we continue to position ourselves both for the inevitable economic recovery, while also recognizing that some of the underlying digitization trends that accelerated during the pandemic are here to stay. Our focus remains high quality companies that trade at reasonable valuations that should drive positive relative performance over the long-term and in all market cycles.

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