

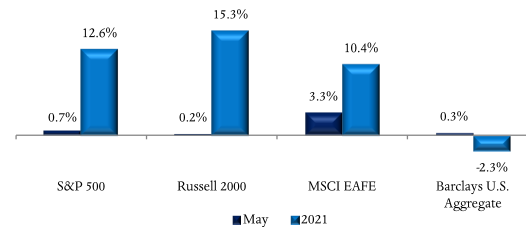


## MARKETS

Global economies continued to recover in May, yet investors fretted over the prospects of inflation, higher US taxation and tapering of monetary stimulus by central banks. The ongoing vaccine rollout has led to greater consumer and business mobility, which, coupled with sizeable fiscal and monetary support, turbo-charged economic activity. US corporate earnings for the first quarter were much stronger than expected (+47% year-over-year versus expectations of +20%). Nevertheless, US equity indexes were constrained, with the S&P 500 and Russell 2000 rising +0.7% (+12.6% ytd) and +0.2% (+15.3% ytd), respectively. Expectations of stronger economic output and inflation once again favored value stocks over growth oriented ones (the tech-heavy Nasdaq declined -1.4%). Overseas, the MSCI EAFE index added a solid +3.3% (+10.4% ytd), while emerging (+2.3%; +7.3% ytd) and Asian (Shanghai +5.0%; +4.3% ytd) markets played catch-up.

Fixed income appreciated slightly in May, a reversion from recent losses, despite monthly core CPI rising by nearly 1%, ushering in higher inflation expectations. Volatility in interest-rate markets was modest throughout the month. The US Treasury benchmark 10-year note traded within a 15 basis point (bp) range, ending May just 4 bps lower, at 1.60%. This drove the Barclays US Aggregate index higher by +0.3% (-2.3% ytd). High yield bonds also registered gains of +0.3% in May (+2.2% ytd), as accelerating growth and better than expected earnings appeared to outweigh concerns over rising inflation (global inflation-protected bonds gained +3.0% on the back of strong capital inflows).

Commodities had a strong May (+2.5% mtd; +26.0% ytd) with the index now having risen 11 out of the last 13 months. Led by inflation expectations and the reopening of the world economy, WTI crude oil rallied



+4.3% during the month (+36.7% ytd). AAA estimated that 37 million Americans travelled over 50 miles over Memorial Day weekend, 60% more than a year ago. It was also a terrific month for gold and silver, which have been in consolidations since last August, both rising circa +7.5% in May.

## GEOPOLITICS

The Biden administration recently released its \$6.0 trillion spending budget for fiscal year 2022, commencing in October, which aims to bolster infrastructure as well as the country's social safety net by expanding education, health care and more. Such a large budget (37% higher than pre-pandemic levels) is likely to result in a \$1.8 trillion budget deficit, even assuming a large increase in revenues from higher taxation on corporations and high earners, and would be nearly double the fiscal year 2019 deficit. Thereafter, spending is set to increase with budget deficits well in excess of \$1 trillion per year, indicating an increasingly progressive agenda.

On the coronavirus front, real world data on vaccine efficacy continues to be largely positive, with hospitalizations low in those countries where the vaccine rollout has progressed sufficiently. In the United States, an estimated 51.1% of the population has received at least one vaccine dose. That figure is 56.6% for New York State, and New York City is currently showing a 7-day average Covid-19 positivity rate of 0.75%, down from 6.70% three months ago. Europe continues to lag in its vaccine rollout, but is making good progress, with 33.5% of the population having received at least one dose of the vac-

chine, a figure that is growing by 0.5% per day on average. Sadly, the tragic health crisis in India has underscored the need for a rapid rollout of vaccines. With 190 million doses administered thus far in the country, progress is being made, which, combined with a relatively young population, brings hope that the worst of the health crisis could be over within a few months.

### UNITED STATES

Investors remain keenly focused on the tradeoff between growth and inflation, both of which are exceeding expectations as the economy emerges from the pandemic. The US Purchasing Managers' Indices (PMIs) for manufacturing and services both reached record levels in May. The details of the PMIs not only showed that consumer demand remains buoyant but that businesses are facing rising input costs.

The US Federal Reserve acknowledged that it will need to think about tapering its monetary stimulus at some point, though it is likely to be a gradual process to avoid spooking financial markets. Central bankers will be sharply focused on rising inflation and whether there are temporary factors at play. There continue to be signs of upward pressure on wages, with a record 44% of small business owners unable to fill roles. This has been partly attributed to enhanced unemployment benefits – which are set to expire in early September (though some states will end them earlier). The sectors competing most with unemployment benefits recorded strong wage growth. In the May jobs report, 559,000 jobs were added, with the unemployment rate dropping to 5.8%. There are still, however, 7.6 million fewer people employed than pre-pandemic.

### EUROPE

After a relatively slow start, vaccination rates in Europe have picked up such that as of end-May, 43% of the German population had received at least one vaccine dose with France and Italy at the 38% level. The EU will soon have provided at least one dose to residents over 50. This trend reinforces the prospects for a strong growth rebound during the second half of the year and

**May 2021 Economic Statistics**

	May-21	Dec-19	Dec-18
Federal Funds Target Rate	0 - 0.25%	1.50-1.75%	2.25-2.50%
Consumer Confidence Index	117.2	126.5	128.1
Manufacturing PMI Index	61.2%	47.2%	54.1%
Unemployment Rate	5.8%	3.5%	3.9%
JPY/USD	109.54	108.61	109.56
USD/EUR	1.2225	1.1210	1.1469
Gold/oz.	\$1,906.36	\$1,517.01	\$1,282.73
Oil (WTI)/bbl	\$66.32	\$61.06	\$45.41

beyond. Notably, eurozone manufacturing data for May reached a record high. While factory activity has been recovering since last year, the rebound in the services sector had been delayed by ongoing restrictions, but is now gaining steam to an expansionary PMI level above 55.0% thanks to improved consumer confidence. Despite the improving economic outlook, European Central Bank (ECB) policymakers signaled that it is too soon to withdraw stimulus measures. Annual inflation rose to 2.0% for May, up from 1.6% in April.

The gradual opening of the UK economy continued in May, with indoor hospitality once-again permissible. A build-up of household savings alongside fiscal stimulus has created an impetus to boost spending, as shown by a 9% month-on-month rise in retail sales in April, with clothing sales growing by an astonishing 70% over the prior month. Due to supply bottlenecks, UK businesses have been struggling to meet demand in a timely manner, with delivery times growing in May. Price pressures facing businesses also grew, with the input price component of the manufacturing business surveys hitting record highs, leading to robust sequential inflation of 0.6%. As such, The Bank England announced plans to slow its quantitative easing program.

### ASIA

China's manufacturing sector outlook remains supported by the reopening of economies in the US and Europe; the latest PMI reading ticked-up to 52.0% in May. However, there were soft spots mainly from supply constraints as well as higher commodity and shipping costs which led to declines in new export orders.

Downward pressure on economic growth is expected to increase during the second half of the year, as pent-up demand subsides, developed markets shift back to services consumption, property tightening measures take effect, and surging raw material prices suppress real demand.

## OUTLOOK

The inflation outlook has not changed much since we wrote about the wide variety of drivers last month. Materials prices remain elevated, labor cost pressures have intensified, shortages persist and transportation has become costlier. As Costco's (the giant 'big box' club retailer) CEO described, "inflationary factors abound."

As economies reopen, the global economic outlook for the second half of the year looks bright, particularly for those countries which are far along in their vaccine rollouts. To the extent emerging markets are able to vaccinate their populations, the economic recovery should broaden out. Unanswered questions include what will be the magnitude of economic growth, how persistent will it (and inflation) be, and how will central banks react to surprises, from a monetary policy perspective? The main risk is that the Fed and their global colleagues might have to raise interest rates sooner than expected to slow down an economy that is running too hot. As a reminder, in 2020, the four largest global central banks injected \$7.8 trillion of liquidity into the financial system. In addition, governments of the top 61 major economies expanded debt to 105% of gross domestic product (from 88% in 2019) an increase of \$12 trillion, in response to the Covid-19 pandemic. The same governments appear ready to add a further \$10 trillion in sovereign debt (to finance fiscal stimulus) in 2021 and the leading central banks are still reluctant to talk about tapering their monetary policies.

Our research indicates that equities should fare well in an environment of modestly rising inflation, as increased revenues would offset higher input prices, which can be passed onto customers when demand is strong. Corporate earnings reflected the economic vigor, with Q1 earnings tracking to be the strongest in over a decade. Performance was led by sectors closely tied to economic growth such as energy and materials, while consumer discretionary

lagged, partly as a shortage of semiconductors has caused shutdowns in auto production. With taxation of concern to investors, it is interesting to note that President Biden's proposal to raise US corporate tax to the 28% level has met with resistance from the Republicans. There is compromise in the air, with negotiations revolving around instituting a minimum tax rate of 15%, which would penalize corporations with low effective tax rates. Looking ahead, we continue to believe that, given valuations at the upper end of historical averages (the S&P 500 is 20.0x 2022 earnings), stock picking is likely to be a significant driver of investor returns, a tailwind for our active managers. Further, given the inflationary tendencies, our favored large capitalization global multinational companies are in a good position to flex their strong pricing power and balance sheets to emerge stronger post-pandemic. Finally, seeking areas within equity markets that stand to benefit both from the cyclical economic rebound as well as rising bond yields, leads us towards value oriented as well as international stocks, with the added benefit of lower valuations.

World debt, according to the IIF, reached \$281 trillion or 355% of GDP at the end of last year, rising from \$142 trillion in 2007, just prior to the 2008 global financial crisis which started the significant upward trend. Low interest rates have made high indebtedness more stable, because it becomes easier to borrow more to pay off old loans. At the present point of the cycle, with near record low interest rates, debtors are benefitting to the detriment of creditors, resulting in an unappealing environment for fixed income investors. As such, we continue to urge the avoidance of long-dated bonds.

Given percolating economies and the potential for inflation surprises, we remain optimistic for equities, both domestic as well as European, and foresee significant merger activity on the horizon. We also maintain a positive view of hedged credit, as well as inflation protected investments including distressed real estate, and water infrastructure. As long-term investors, with the belief that technology will be a dynamic growth sector for decades to come, we are excited about the strong launch of our proprietary Nordic Technology and Innovation Fund.

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Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.