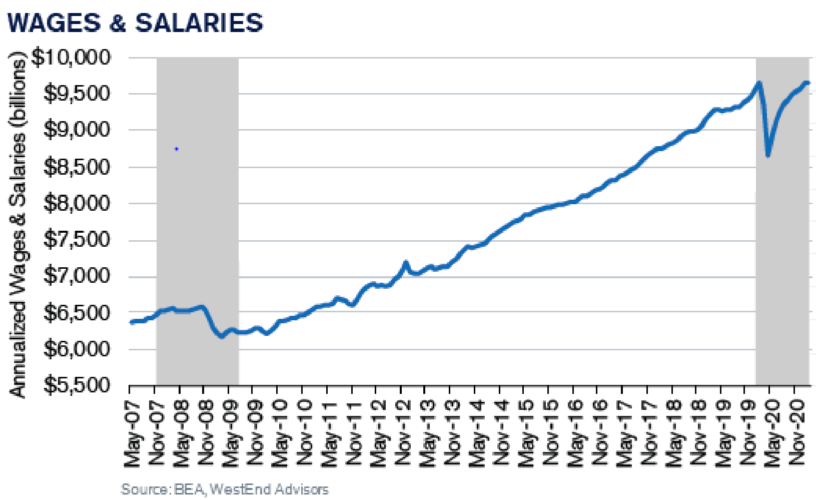
PARAGON
PRIVATE WEALTH GROUP

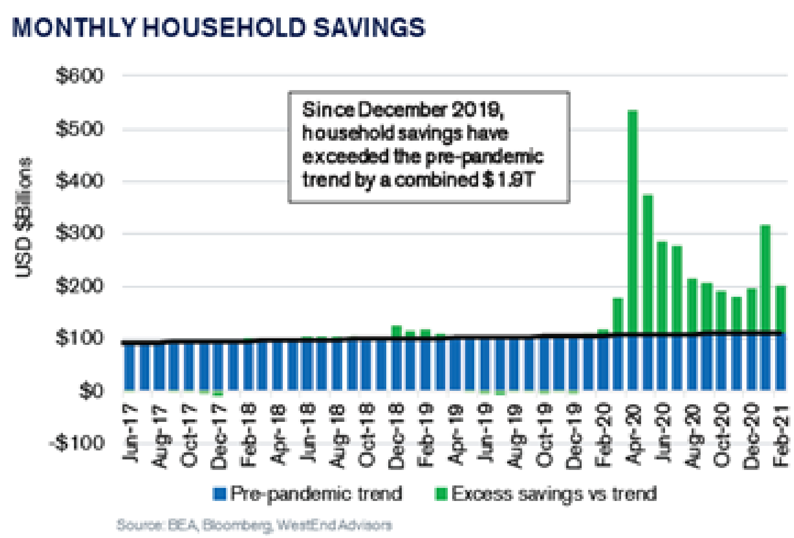
Market and Economic Commentary

Second Quarter, 2021

Economic Outlook- Behind the Curtain

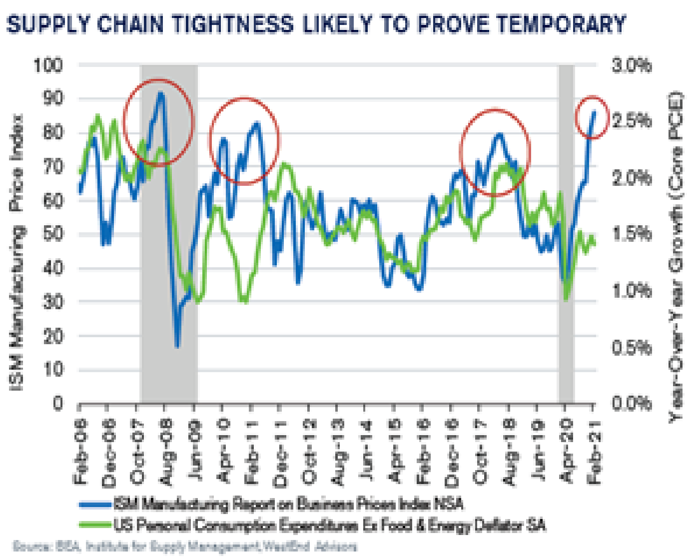
With the Pandemic Recession nearing its final chapter, the swiftness of government response to mitigate the dangers of COVID-19 through vaccine rollout and fiscal stimulus remains center stage but the economic response from the private sector has been just as swift. Consensus estimates put 2021 at a 5% Real GDP (Gross Domestic Product less inflation) which is the highest number in over 40 years. Wage gains have already recovered to pre-pandemic levels and household savings (illustrated on the right) have surged to unprecedented levels since the beginning of 2020 due to fiscal stimulus and reduced spending opportunities. Despite market risks inclusive of higher rates, taxes, and inflation, we believe the economic recovery will continue to progress. This especially bodes well for the consumer discretionary sector.





Inflation- Long Term Outlook

With major government spending comes inflation. We expect a spike in Q2 while normalizing to the 3% range at year end. The Fed has signaled through several press conferences that inflation is a key metric in their planning and intend to respond in kind with interest rate hikes in 2022. As consumers, we are beginning to experience an increase in supply chain tightness, a byproduct of an inflationary environment (more consumer money equals greater spending). An example of this can be seen in the lumber market: prices of raw timber have nearly doubled as timber companies add jobs and increase production to match supply. From a goals and planning perspective, we will maintain our long-term inflation assumption of 2.25% while highlighting the importance of separating out expense types. For example, a fixed mortgage should be set at 0% inflation while healthcare costs assume a 6.5% increase. We look forward to simulating a high inflation “what if” scenario on our reviews this quarter.



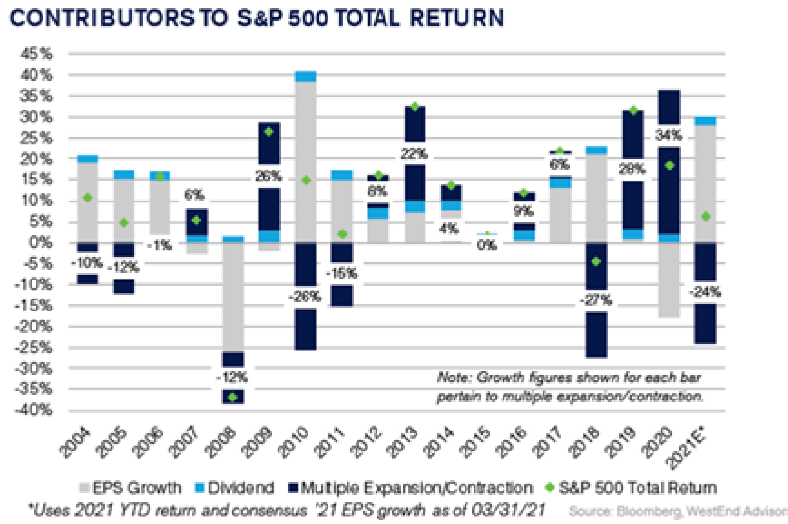
10 Year Treasury Yield 2001-2021

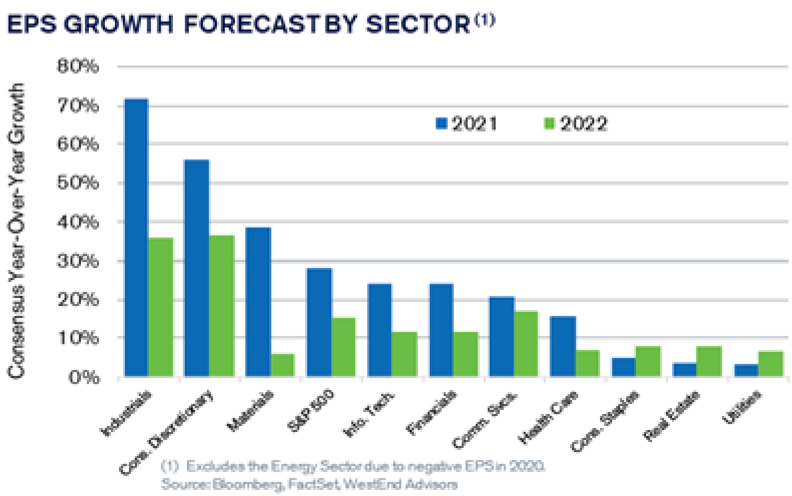
Interest Rates- Spike in Yields vs. Fed Rates

Over the course of this year, we have seen interest rates on 10 year treasuries spike (Righthand Chart Above)   Corporate bonds, meanwhile, have now become more attractive with spreads narrowing. In layman terms, the difference between a corporate yield and 10 year treasury yield has lowered do to higher rises in treasury rates as compared to corporate issuers. In contrast, the Fed has continued to maintain a 0% Fed Funds Rate with chances of an increase drawn out late 2021 early 2022. From a lending perspective, we have seen LIBOR, which is correlated to the Fed Funds Rate, remain low equating to a decrease in pledged asset line rates while seeing mortgages jump as they are tied to 10 year rates.

Valuations- Is the S&P 500 as Overpriced as it Appears to Be?

The trailing price-to-earnings multiple for S&P 500 expanded over 30% in 2020. Meanwhile we saw earnings drop by over 15%. These moves, along with dividend yield, translated into an 18.39% return for the S&P 500 last year. We expect more modest returns in 2021 as robust earnings growth is partially offset by multiple contraction events. Again, these are normal market dynamics at the start of a new cycle – we saw similar earnings and valuation moves from 2009 to 2011.

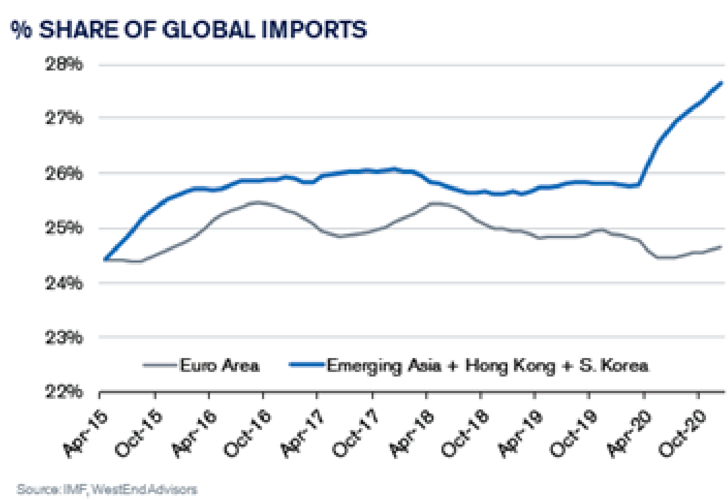




Although our 2021 outlook for mid-to-high single digit returns for the S&P 500, we believe sector dispersion can offer ample alpha generating opportunities. We also believe we are well positioned to take advantage of this performance dispersion. This is evident in the vastly differing earnings forecasts when broken down by sector.

Pandemic Recovery- What We are Seeing Overseas

European economic growth is likely to be materially lower than that of the U.S. in Q1 due to renewed lockdown measures. In our view, activity in the region is unlikely to recover as quickly as it will in the U.S., due in part to a slower vaccine rollout. In contrast, Emerging Asia has been a leader in the global economic recovery, as evidenced by China's participation in global trade which accelerated in 2020. We see the effects of this trade advantage lasting beyond the pandemic, making EM Asia an even larger global trade hub.



Portfolio Management- Translating the Outlook Into Action

US- Continued Value Overweight

As the recovery advances, we believe the Industrials and Materials sector's earnings prospects will improve significantly, in part due to cost savings measures implemented during the pandemic recession. U.S. financial institutions are well capitalized and as a result, the pandemic-induced recession fallout has proved manageable for major banks, and systemic risk has remained low. We see upside to current consumer spending estimates as consumers in aggregate have significant spending power, given both income growth and fiscal support from the government, and there is strong pent-up demand for the services and certain goods. We have additionally become more tactical in defensive sectors. An example of this is medical devices. While healthcare faces potential headwinds, COVID-19 eliminated most elective surgeries. As this trend reverses, we see upside potential.

International Shifts-

As we have seen our international growth provide strong performance, we will be trimming our exposure. In addition to our base case Macro View, EM Asia valuations appear attractive, relative to US, in our view and will shift where appropriate.

Fixed Income-

From a taxable bond perspective, we have shortened our duration of bond maturities across all classes to lower interest rate sensitivity. Inflation protected notes continue to bode well and should continue over the next 12-18 months. Finally, we will look to floating rate opportunity as the space remains undervalued. On the municipal side, strength of municipalities continues with attractive spreads on higher yield while shortening duration. The higher taxes we are likely to see in 2022 also favors this attractiveness with tax equivalent yields becoming more desirable.

Disclosures