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Stocks returns were mixed in July. Large cap stocks in the S&P 500 index were up 2.4% in the month, bringing their year-to-date gains to 18.0%. However, small cap stocks in the Russell 2000 were down -3.6% for the month reducing their year-to-date gains to 13.3%. International stocks in the MSCI EAFE index were mostly flat with just a 0.8% gain for the month and 9.7% year-to-date. Emerging market stocks, though, fell -6.7% in July thereby mostly eliminating their previous gains and registering only a 0.2% return for 2021. Yields fell more sharply this month so the Barclays US Aggregate Bond Index was up 1.1% in July but is still down -0.5% so far this year. The 10-year treasury yield was at 1.26% at the end of July compared to 1.44% at the end of June.

The economy continues to re-open and we have seen a surge in demand for travel and other activities as restrictions have eased. Initial estimates show that GDP growth was 6.5% in the second quarter. However, this is less than the 8.4% which was expected. It appears that the lower figure is due to supply chain bottlenecks and shortages of workers as businesses have not been able to fill open job positions. Additional unemployment benefits are set to expire in September which will hopefully resolve at least some of the labor shortage problems in the coming months. Also, inventory levels are currently low so GDP growth should benefit in coming quarters as companies rebuild their inventories once the bottlenecks and labor shortages are worked out.

New fears over the Delta variant are creating worry that we may be headed for a reinstatement of restrictions. The vaccination rates are not as high as the Biden administration had hoped but about 75% of the population has some immunity either through vaccination or from contracting COVID and 80% of the most vulnerable group is vaccinated. Great Britain saw their cases increase as the Delta variant made its way through their country, but it has already peaked there and cases are declining again so it is possible the US will see a similar pattern. Unfortunately, the uncertainty may weigh on investors minds for a while.

Inflation and taxes are also creating some uncertainty. Prices have gone up on finished goods and the country has been debating whether the resulting inflation is transitory as the Fed believes or whether it has staying power. The infrastructure bill is likely to be passed so the reconciliation process should begin soon and shine more light as to what kind of tax hikes we should expect.

Second quarter earnings reports have been overwhelmingly positive. Of the S&P 500 companies that have reported, 91% have exceeded earnings expectations and 86% have exceed their revenue projections. Earnings are up 105% from second quarter 2020. Once all the companies in the index have reported, earnings are expected to still be up 84%. These high growth rates are to be expected since we are comparing to a year ago when the economy was shut down. Even so, earnings are at their highest dollar level surpassing the highs from 2019.

We are beginning to see improvements globally in terms of vaccinations and re-eopenings. Although international stocks have underperformed US stocks for more than a decade, they may be at the cusp of a period of outperformance. David Kelly of JPMorgan notes that they are currently selling at a 32% discount to US stocks and could benefit from favorable cyclical factors. A weaker US dollar would also enhance international returns for American investors.

With yields low, bonds will likely struggle. If yields rise, bond prices will decline. Although cash and short-term bonds earn low-to-no interest, they may perform better than longer-term bonds.

As always, we are available to discuss any questions or concerns you may have. Please do not hesitate to contact us.

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