HIGHTOWER
The Otto Group

Q2, 2021: Economic Recap | Inflation | Timing | Positioning

July 2021

With our second quarter performance reports, we are glad to provide the following economic recap with associated segments on inflation, market timing and positioning. We hope this stimulates some questions surrounding your own portfolio(s), or answers a few questions you may have. Please do not hesitate to reach out to either of us should you wish to discuss further.

With all our best,

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Economic Recap

Prepared by Michael C. Wood, Investment Operations Analyst

The second half of 2021 has begun with summer in full swing. Markets abroad were impacted by a flurry of factors, and the United States economy is roaring back from pandemic struggles. US Current-dollar GDP increased 11.0 percent at an annual rate, or $566.3 billion, in the first quarter to a level of $22.06 trillion[1]. Despite a global pandemic, United States GDP reached $20.94 trillion in 2020, with China coming in second at $14.72 trillion, and Japan third at $5.06 trillion[2]. With a 40% difference between first and second, the United States continues its dominance as the world's largest economy.

As of June 30, the three main U.S. equity indices have seen gains, with the S&P 500 rising 14.41%, the Dow Jones Industrial Average returning 12.73 %, and the NASDAQ following close behind with a gain of 12.54 %[3]. There was a strong push near the end, with the S&P 500 closing at a record high of 4,297. The second quarter charge was led by the real estate sector, which gained 13.17%[4]. The energy sector has outpaced all others, advancing 42.37%[5] year-to-date (YTD), due to surging demand for travel. A year ago, oil production came to a worldwide halt, with one barrel lowering to a price of $11.26, while surging to a high of $77.84 per barrel in 2021[6].

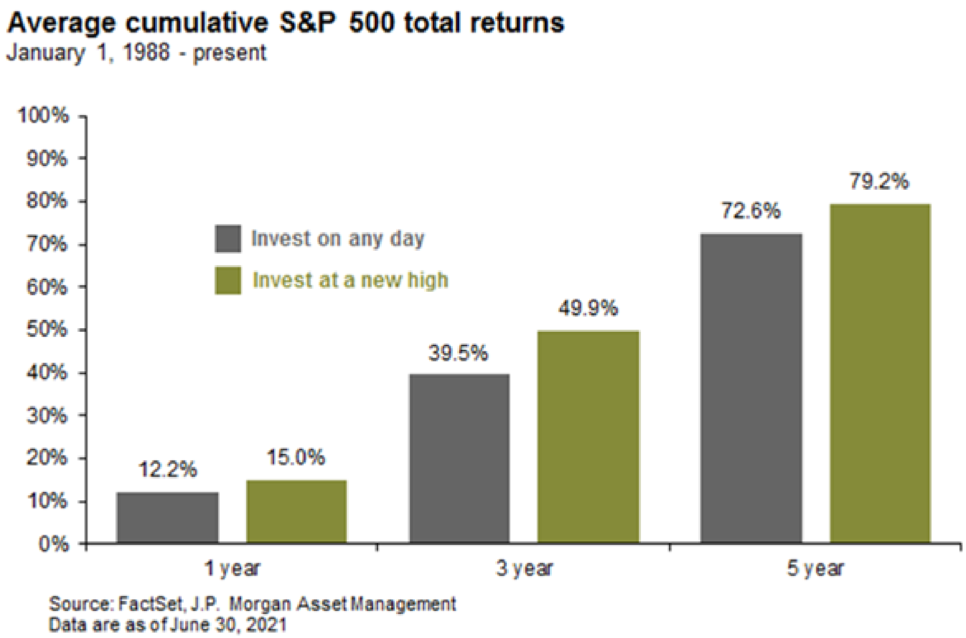
Focus Point: Inflation

The Federal Reserve has argued inflation is only transitory, however recent data is making it difficult to establish any sense of certainty about the long-term implications of the unprecedented amount of stimulus. Merriam-Webster defines inflation as – "a continuing rise in the general price level usually attributed to an increase in the volume of money and credit relative to available goods and services". Simply, inflation is the increase in price of goods and services due to the availability of more money. It is the result of large-scale economic policies, with global impacts. In the past year, trillions of U.S. dollars were injected into the economy to stimulate growth and prevent extended economic disaster. In turn, a vast amount of "new money" entered the system, and as a result prices have steadily risen in multiple sectors, in some cases violently upward. Only time will tell if this inflation is transitory.

The Federal Reserve is hopeful for strong output and consumer spending growth in the coming months and years, which appears to be happening. The Fed has been communicative and transparent about its policies on inflation. If the economy remains too hot too long, a more hawkish Fed tone should begin to present itself. Hightower's own Stephanie Link and Joe Klein shared ideas on the Fed's inflation policy in a market note released July 5, 2021. Link and Klein wrote, "After undershooting their 2% inflation target, the Fed is attempting to course-correct by allowing inflation to exceed 2% temporarily and focusing on average inflation in an effort to promote growth. We're skeptical of the suggestion that inflation is transitory, and, believe that wage increases in particular may be sticky. That said, once pent-up demand lowers and disrupted supply chains are restored, inflation may decrease."

Market Timing

Stock prices are driven by emotions and fundamentals, with the former often leading to irrational investment decisions and poor market timing. Being fearful and waiting for an impending downturn may not be practical. J.P. Morgan Asset Management[7] has conducted research regarding investing at all-time highs, producing interesting statistics. Since 1988, investing in the S&P 500 when an all-time high was reached has outperformed investments made on any random day. The chart below outlines the difference in returns:



A more pragmatic approach involves analysis of fundamentals, where strong earnings and growth drive rational valuation. Analyst consensus shows that the S&P 500 is poised to benefit from consumer demand and earn an estimated $191.65 per share in 2021[8], with earnings expected to grow 37.1%.

Market Positioning

Ultimately, proper asset allocation is the most critical portfolio tool in determining successful long-term outcomes. At The Otto Group we consider this the most vital component in determining allocations of capital. As we move into Q3, we're continuing to position portfolio's for asymmetrical outcomes, while tailoring customized strategies and solutions for each client. Some of these solutions, which we've talked about with many of you, continue to include investments in Transformational Growth, Disruptive and Innovative companies enhancing the future for us all. We barbell this exciting growth with more traditional value-style allocations that tend to have more established business models and higher free cash flow.

As the Financial Media likes to create a narrative around the battle between 'Growth vs. Value', we continue to believe investing in high quality businesses, rather than speculation, is the most prudent approach. In addition, we've started to position ourselves toward a potentially inflationary environment by increasing allocations to institutional grade cash flow producing Real Estate, Farmland, Infrastructure, and Middle Market Lending solutions.

As always, we're here should you have any questions or would like to review anything related to your specific portfolio and financial objectives.

Citations and Disclaimers

[1]Source: Bureau of Economic Analysis, Gross Domestic Product, 1st Quarter 2021, et. al., May 27, 2021

[2]Japan GDP as of 2019; 2020 numbers have not been calculated. Source: World Bank

[3]Figures are year-to-date; source: Hightower Capital Markets Dashboard, July 1, 2021

[4] Source: Hightower Capital Markets Dashboard, June 30, 2021

[5]Figures are year-to-date; source: Hightower Capital Markets Dashboard, July 1, 2021

[6]Source: Business Insider, Commodities, Oil WTI

[7]Redistributed with permission from J.P. Morgan Asset Management, Market Insights, data as of June 30, 2021

[8]For reference, the S&P 500 posted earnings per share of $162.97 and $139.76 in 2019 and 2020 respectively. Source: Yardeni Research Inc., YRI S&P 500 Earnings Forecast, July 12, 2021

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