Leigh Baldwin & Co.

Investment Brokerage

Watch the doughnut, and not the hole – English proverb

It is easy to focus on what is missing or what you want, but as this English proverb suggests, we should focus on what we have. Government stimulus, historically low interest rates, and over 37% of US adults with at least one vaccine shot. A delicious donut.

The first quarter of 2021 brought investors a regime change that began at the end of 2020. The rotation from growth to value stocks. Oil and interest rates were the major drivers of the continued rotation. WTI Crude Oil rose by over 20% per barrel and the US 10yr Treasury Note yield rose just under 1% to close the quarter around 1.7%. So, what did that mean for the major indexes, well the Dow Jones Industrial Average with a value tilt led with a return of 7.8%, the S&P 500 returned 5.8%, the NASDAQ with a growth tilt returned 2.8%, and the Bloomberg Barclays Aggregate, a bond index, returned -3.3%.

The donut of the quarter was Energy and Financial companies, as the sectors returned about 29.5% and 15.5% respectively. Energy companies benefitted from the rise in the price of oil, the distribution of vaccines and the reopening of the US, which increased the demand for oil as people began to travel. Financials tend to outperform as interest rates rise through increased profit margins. Simply, if interest rates are higher, a bank can increase profitability through lending at higher interest rates while keeping their annual interest rates on deposits low. Therefore, as interest rates rallied so did the bank stocks.

What about Technology? The darlings of 2020. Well, unfortunately they were the donut hole of the quarter. As interest rates rose, technology companies' future earnings were discounted at a higher rate to value the company today. Therefore, if you are discounting earnings 5 years, 7 years, or 10 years from now at a higher rate, your result is a lower price target today. Furthermore, as the economy recovers there are alternative opportunities away from Technology stocks for investors looking for growth.

Economists may consider our current economic environment as the scarcity principle or in other words high demand for goods that do not equal the supply. We see the scarcity principle exhibited in housing. Today, there are more real estate agents than homes for sale as there are the fewest homes on the market in nearly 40 years. This demand stemmed from the move to the suburbs from urban areas fueled by the pandemic and millennials purchasing their first home. The housing theme has played in our portfolios through companies like Home Depot and is something we will watch to see if the trend continues or if we begin to see an overbought market.

We believe interest rates will continue to rise in 2021, albeit at a slower rate than Q1, thus we will look for opportunities in companies that benefit from increased interest rates in the quarters ahead. President Joe Biden's "American Jobs Plan" is the donut for infrastructure and the economy and may provide a continued tailwind for industrials in 2021.

We thank you for your continued support in our team and our company. We look forward to our next phone call with you and please call us anytime regarding your account. As always, "you do the dreaming, we'll do the math."

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