First Quarter Review

April 22, 2021

By: John D. O'Malley Jr.

Discipline. The market rewards **discipline**. It hurts, it's supposed to. In the end it's worth it. With all the torture of the last 12 months and the wondering if we should "all get out before its too late"-we now have our answer. As difficult as it may have been – discipline paid off.

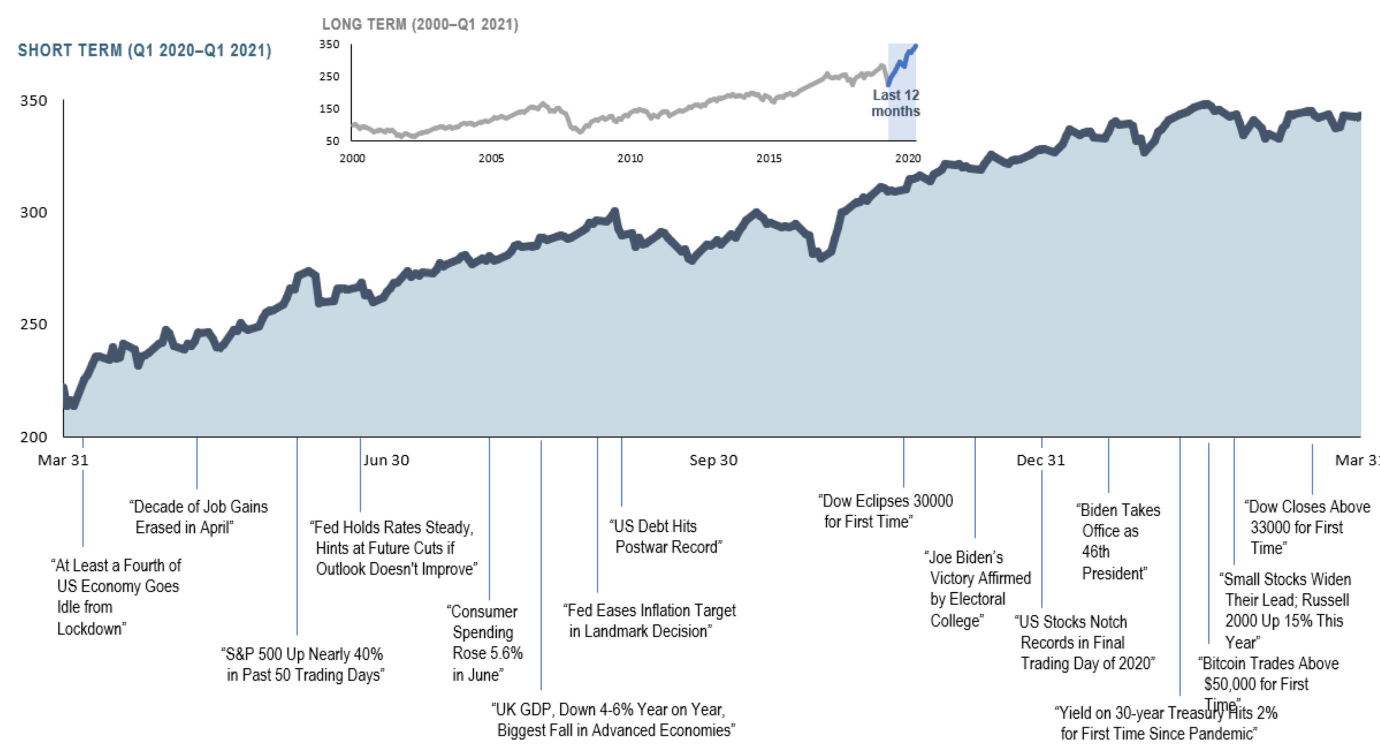
Both the stock market and the economy have rebounded sharply since the lows in March 2020. In the last letter I noted that 2020 ended with strong market performance despite the shocking group of events that occurred: pandemic, wide-spread civil unrest, stimulus packages, and national election turmoil. As this year started US stocks were hitting record levels, Biden took office, yields on the 30-year Treasury bonds rose to 2% for the first time since the pandemic. On top of all that, there was a stock performance flip where small and value stocks outperformed growth stocks.

The end of the first quarter of 2021 finds us 12 months from the US stock market low of March 23, 2020. Long term investors that stayed invested through the market turmoil were very much rewarded for their **discipline**.

Many investors are optimistic about the future growth of the market. The rebound continues strongly with the COVID vaccines rollout and stimulus packages. David Booth, Founder of Dimensional Fund Advisors and University of Chicago Booth School of Business namesake said, "A year ago, at the end of March 2020, the S&P 500 was down nearly 20% and the world was scrambling into lockdown. Many experts wrote articles telling us where we would be in a year. I don't remember reading any that said the S&P 500 Index would be up 56% over the next 12 months. But that is what happened."[1] And that is just the beginning of the story.

World Stock Market Performance

MSCI All Country World Index with selected headlines from past 12 months



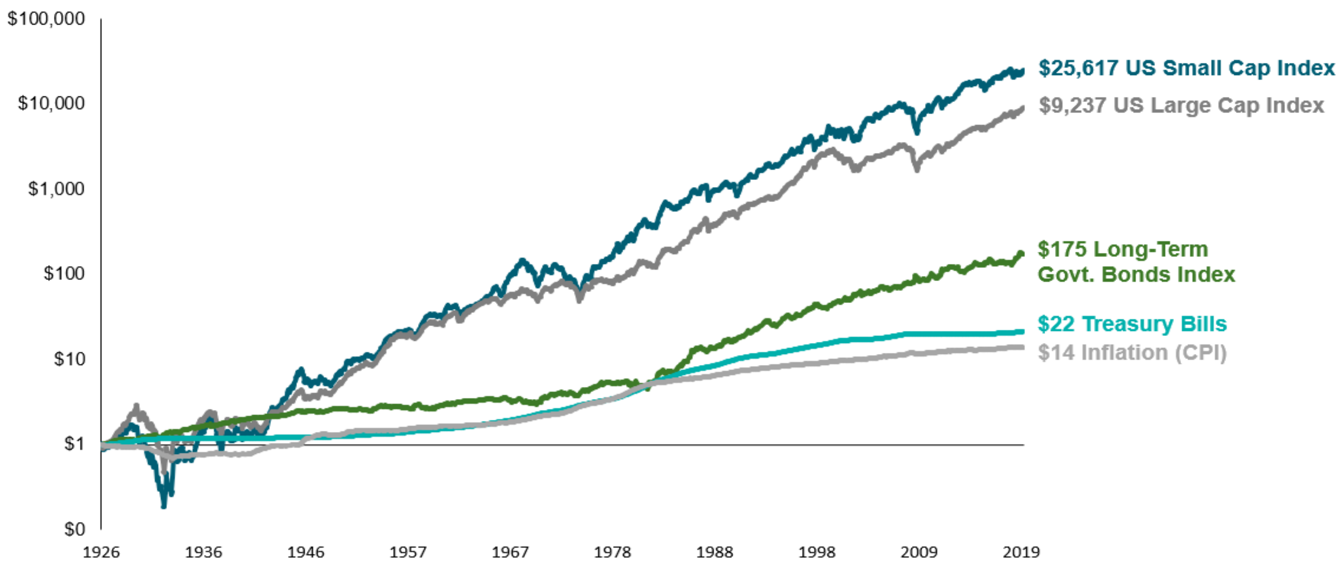
These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index [net div.]. MSCI data © MSCI 2021, all rights reserved.
It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. **Past performance is not a guarantee of future results.**

Stocks continued to reward investors with staying power, the really interesting story is what happened behind the indexes. Recall a hot story in 2020 was that the 5 largest stocks were far out-performing the other 495 stocks in the S&P 500. According to Schwab's chief economist Liz Ann Sonders "…what was brewing as a risk last year-the strong performance of the "big 5"s stocks in the S&P 500 relative to the other 495 stocks-has fizzed out."[2] That storyline has now shifted with the market leaders currently being small cap stocks. Small cap stocks have historically outperformed large cap stocks in the long term. Yet they have previously underperformed for roughly a decade. Many investors had given up hope. Those with **discipline** were recently rewarded.

The Capital Markets Have Rewarded Long-Term Investors

Monthly growth of wealth ($1), 1926–2019



In US dollars.
US Small Cap Index is the CRSP 6–10 Index; US Large Cap Index is the S&P 500 Index; Long-Term Government Bonds Index is 20-year US government bonds; Treasury Bills are One-Month US Treasury bills; 1-Month Treasury Bills Index is the IA SBBI US 30 Day TBill TR USD. Treasury Index data sourced from Ibbotson Associates, via Morningstar. Direct Inflation is the Consumer Price Index. CRSP data provided by the Center for Research in Security Prices, S&P data © 2020 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Bonds, T-bills, and inflation data provided by Morningstar.
Past performance is no guarantee of future results. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio.

Individual speculators were also big news in 2020. Often referred to as "newly minted day traders," trading volume from individual investors started strong at the beginning of the year but is now slowing. Some reports suggest that many of those newly minted day traders have learned painful lessons as the markets gyrate. A *Wall Street Journal* article noted "On March 26, individual investors purchased about $772 million of U.S. equities on a net basis, a 60% decline from the almost $2 billion reached in just one day on Jan. 29, at the height of the meme stock craze."[3] Many expect this trend to continue as vaccines roll out and workers are back in person and the newly minted day traders go back to their regular office jobs-to the extent that people do go back to offices.

We see headlines often, yet we all know the headlines often don't tell the whole story. In March, Federal Reserve Chairman Jerome Powell and Treasury Secretary Janet Yellen both opined that they expect a strong economic rebound this year but feel the recovery is far from complete.[4] Fed Reserve Chair Jay Powell described the US economy as at an "inflection point" and cautioned that new surges of Covid-19 could stall the recovery.[6] The Fed signaled that it does not expect to raise interest rates until 2024, it adopted a new strategy last year for accepting temporary increased inflation above its 2 percent target." The take-away is that the Fed will hold steady with policy until after inflation is apparent.

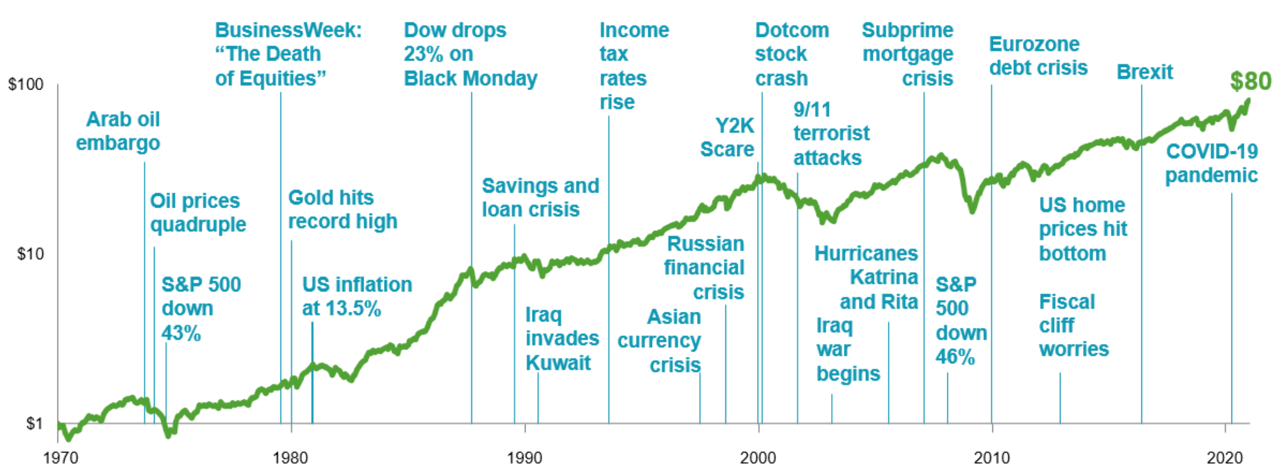
Reading between the lines, we believe that inflation will indeed come on soon and in amounts higher than targeted. The messaging supports the notion that inflation is welcomed at this point. We have had many years of low to near no inflation. Cumulatively we believe the headlines and words are markers. But we pay more attention to the story and thoughts that are unspoken.

According to Ned Davis Research, The Consumer Price Index (CPI) increased 0.6% in March, the most since August 2012 and above the consensus of 0.5%. Notable it was led by a 5.0% jump in energy prices.

Booth's article concludes "As I've said before, every crisis is different, but I think the best way to deal with them is always the same. We can't control crises, but we can control our response to them. You want to be prepared to deal with the unexpected before it happens. Not when you're stuck in the middle of it."[7]

Markets Have Rewarded Discipline

Growth of a dollar—MSCI World Index (net dividends), 1970–2020



A disciplined investor looks beyond the concerns of today to the long-term growth potential of markets.

In US dollars. MSCI data © MSCI 2021, all rights reserved. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results.

The one and only approach we believe that has the highest probability of succeeding in achieving life's financial goals requires **discipline** through all the market cycles and gyrations, both the painful and the pleasing. The equity market has trended up over time and rewarded long term disciplined investors. A globally diversified portfolio built with an appropriate asset allocation tailored to investors risk tolerance and goals is well positioned to deal with the unexpected.

Notes

1. Article *The Next Normal* dated April 1,2021 by David Booth
2. Article *Hit me with your best shot* by Charles Schwab's Liz Ann Sonders
3. Wall Street Journal April 4, 2021 *Individual Investors Retreat from Markets After Show-Stopping Start to 2021*
4. Wall Street Journal March 24, 2021 *Powell Says Stimulus Isn't Inflation Threat*
5. Financial Times April 14, 2012 *The day in markets*
6. Financial Times April 14, 2012 *The day in markets*
7. Article *The Next Normal* dated April 1,2021 by David Booth

Market Summary

Index Returns as of March 31, 2021

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
1Q 2021	STOCKS				BONDS	
	6.35%	4.04%	2.29%	6.22%	-3.37%	-1.90%
1 Year	STOCKS				BONDS	
	62.53%	45.86%	58.39%	36.05%	0.71%	1.45%
5 Years						
	16.64%	8.92%	12.07%	3.52%	3.10%	3.28%
10 Years						
	13.79%	5.21%	3.65%	6.23%	3.44%	4.22%

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]).

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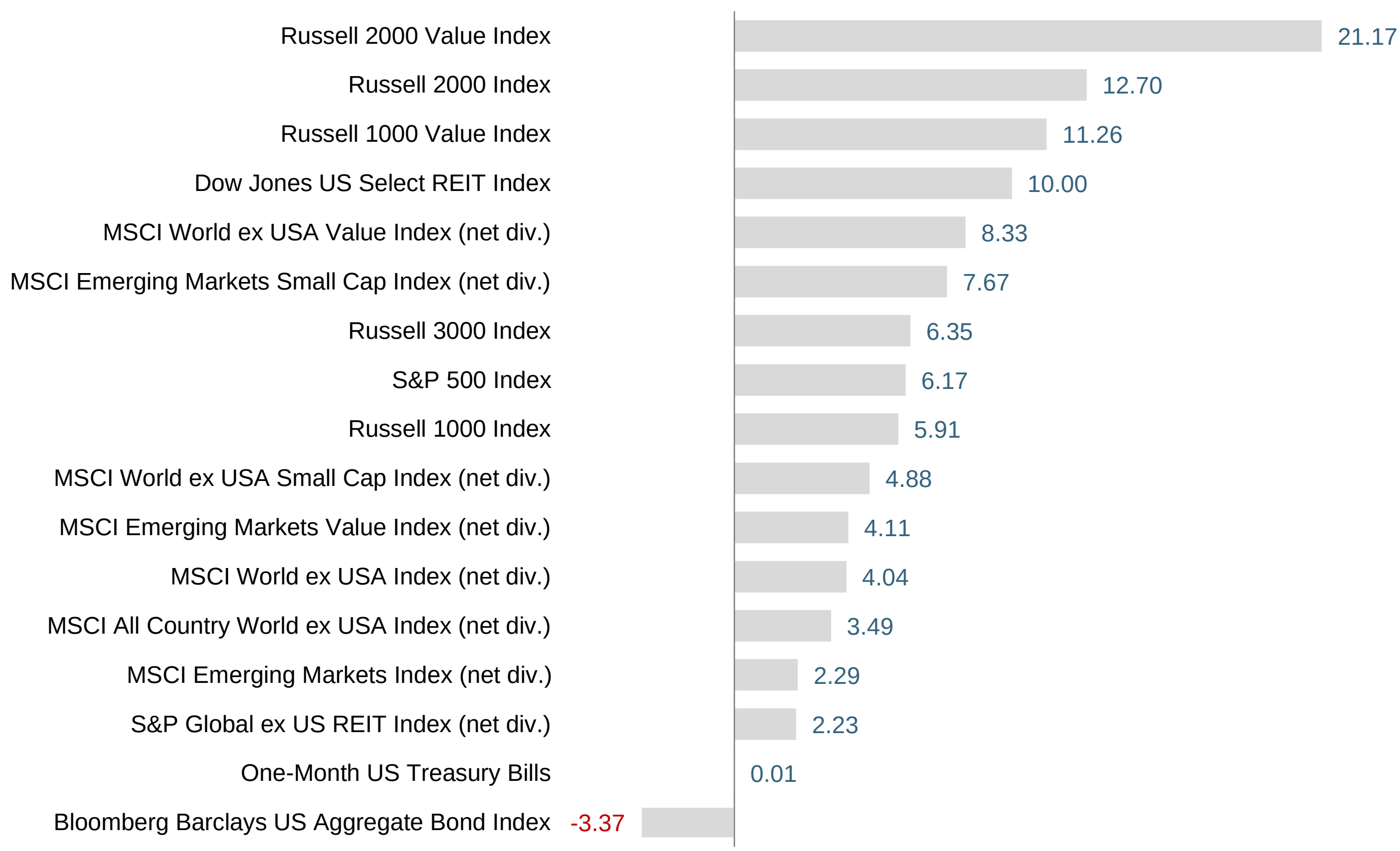
World Asset Classes

First Quarter 2021 Index Returns (%)

Equity markets around the globe posted positive returns in the first quarter. Looking at broad market indices, US and non-US developed markets outperformed emerging markets.

Value outperformed growth across regions. Small caps outperformed large caps across regions as well.

REIT indices outperformed equity market indices in the US and underperformed in non-US developed markets.



US Stocks

First Quarter 2021 Index Returns

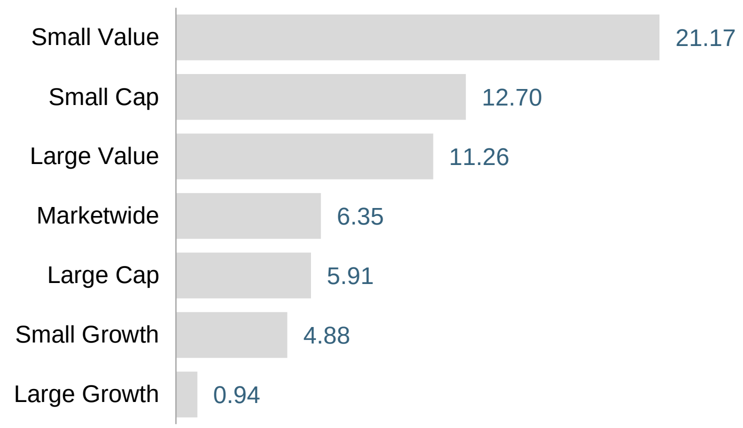
The US equity market posted positive returns for the quarter and outperformed non-US developed markets and emerging markets.

Value outperformed growth across large and small cap stocks.

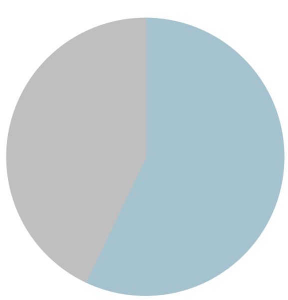
Small caps outperformed large caps.

REIT indices outperformed equity market indices.

Ranked Returns (%)



World Market Capitalization—US



57%
US Market
$40.3 trillion

Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Small Value	21.17	97.05	11.57	13.56	10.06
Small Cap	12.70	94.85	14.76	16.35	11.68
Large Value	11.26	56.09	10.96	11.74	10.99
Marketwide	6.35	62.53	17.12	16.64	13.79
Large Cap	5.91	60.59	17.31	16.66	13.97
Small Growth	4.88	90.20	17.16	18.61	13.02
Large Growth	0.94	62.74	22.80	21.05	16.63

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International Developed Stocks

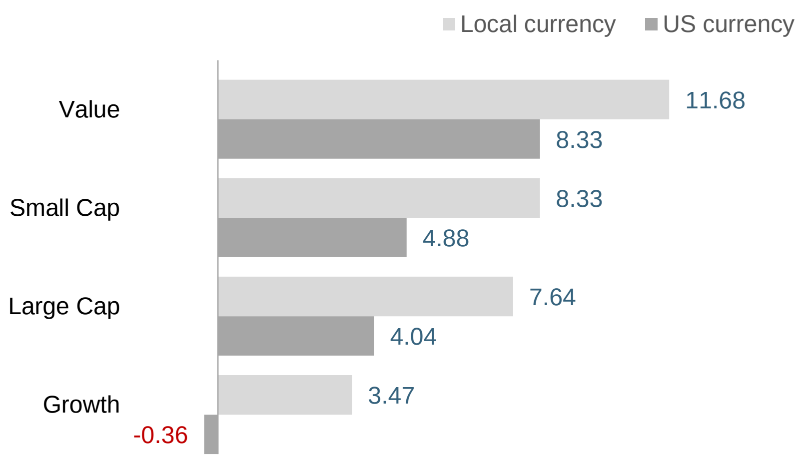
First Quarter 2021 Index Returns

Developed markets outside the US posted positive returns for the quarter, underperforming US equities but outperforming emerging markets.

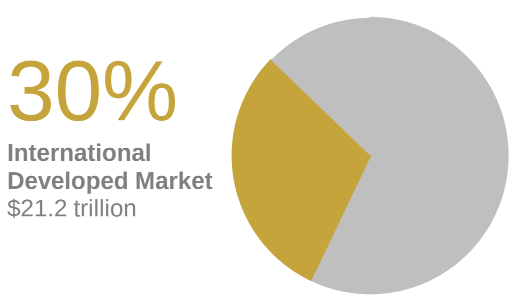
Value outperformed growth.

Small caps outperformed large caps.

Ranked Returns (%)



World Market Capitalization—International Developed



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Value	8.33	47.17	2.25	6.81	3.54
Small Cap	4.88	65.17	6.89	10.55	7.14
Large Cap	4.04	45.86	6.34	8.92	5.21
Growth	-0.36	43.55	10.02	10.72	6.69

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Emerging Markets Stocks

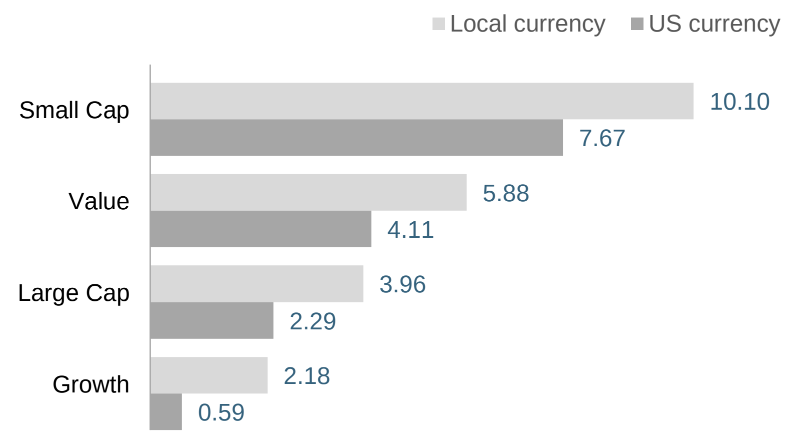
First Quarter 2021 Index Returns

Emerging markets posted positive returns for the quarter, underperforming the US and developed ex US equity markets.

Value outperformed growth.

Small caps outperformed large caps.

Ranked Returns (%)

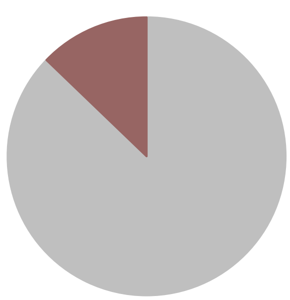


World Market Capitalization—Emerging Markets

13%

Emerging Markets

$9.0 trillion



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Small Cap	7.67	87.13	5.19	9.59	3.33
Value	4.11	52.53	2.60	8.42	1.03
Large Cap	2.29	58.39	6.48	12.07	3.65
Growth	0.59	63.78	10.10	15.53	6.15

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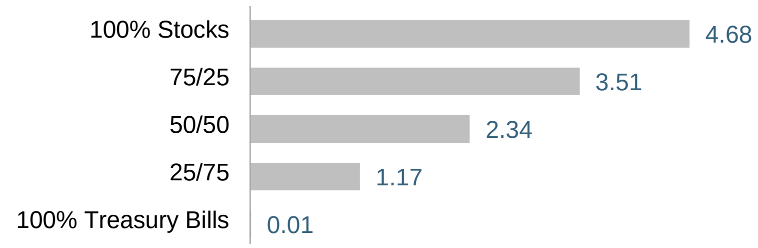
Impact of Diversification

First Quarter 2021

These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but have higher expected returns over time.

Ranked Returns (%)

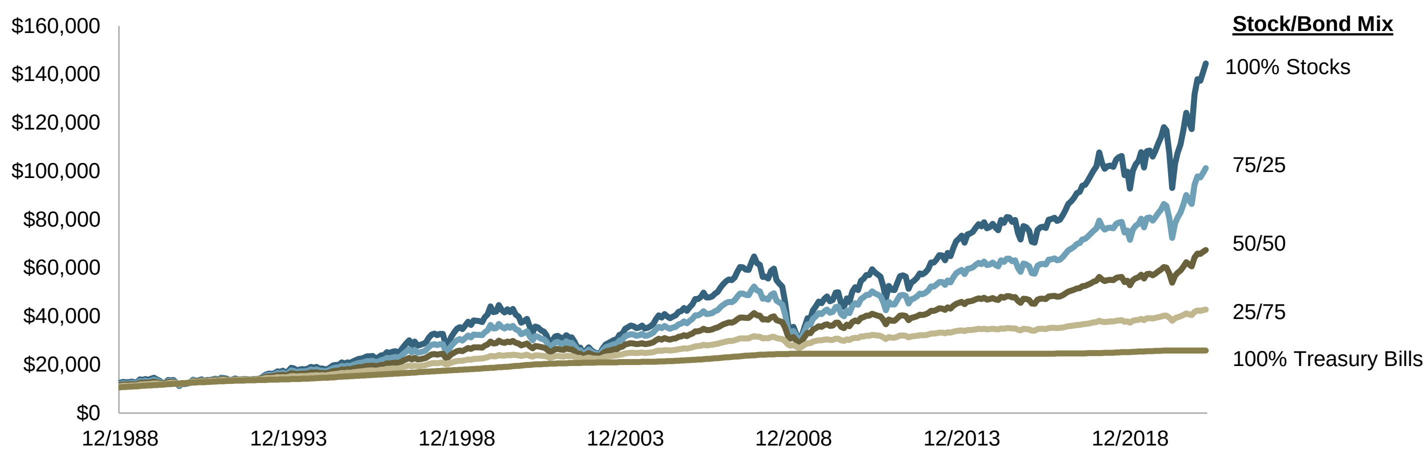


Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*	10-Year STDEV[1]
100% Stocks	4.68	55.31	12.66	13.81	9.73	14.07
75/25	3.51	39.64	10.05	10.71	7.57	10.55
50/50	2.34	25.27	7.29	7.55	5.31	7.03
25/75	1.17	12.11	4.38	4.33	2.97	3.51
100% Treasury Bills	0.01	0.08	1.35	1.07	0.55	0.23

Growth of Wealth: The Relationship between Risk and Return



1.STDEV (standard deviation) is a measure of the variation or dispersion of a set of data points. Standard deviations are often used to quantify the historical return volatility of a security or portfolio.

Diversification does not eliminate the risk of market loss. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio.** Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals. Data © MSCI 2021, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).