CBL WEALTH MANAGEMENT
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Market Brief

April 29, 2021

Supplemental Commentary:

Market Snapshot	
Closing Values as of 04/29/2021	
Dow	34,060
S&P 500	4,211
Nasdaq	14,083
Gold	$1,773

Now that the darkest days of the pandemic are behind us, the American economy is at a once-in-a-generation inflection point and operating in unprecedented conditions. Economic activity boomed to start 2021, as widespread vaccinations and more fuel from government stimulus help spur consumers to spend big. Gross domestic Product (GDP) for the first three months of the year jumped 6.4% (annualized), driven by a massive increase in consumer spending and additional government spending. With the recovery just getting started and consumers still flush with cash thanks to the $1400 stimulus checks sent out in April, many expect blowout double-digit GDP and EPS growth through at least the next two quarters. But the path ahead may not be without some potentially serious challenges.

In addition to questions about how sustainable the markets extreme valuations might be, price inflation, persistent difficulties in meeting labor demands, and potential increases in tax rates (corporate, capital gains and estate tax), and continued escalation of COVID cases and related lockdowns globally all present potentially significant headwinds to economic recovery and continued expansion.

With April coming to an end, many investors will be asking if it might be prudent to follow the old Wall Street adage to "Sell in May and stay away [through October]". Some say yes, in anticipation of a long overdue digestion of recent gains triggered by lofty valuations. Others say no, since valuations are justified by a projected second-half surge in GDP and EPS growth, due to pent-up consumer demand, the spending of the recent $1400 stimulus checks, and the anticipated passage of an infrastructure package.

The cost and availability of raw materials used by manufacturers is pushing consumer prices higher, stoking inflation concerns. Compounding inflation fears and a potentially serious bump in the road to recovery is the inability of employers to meet the demand for labor. It is curious (and concerning) that the number of unemployed Americans remains stubbornly high despite the obvious (and growing) need for workers in businesses that are reopening.

Inflation pressures are likely to rise in the coming months as producers struggle to catch up to pent-up demand. However, it is very likely the bulk of the rise in consumer prices are one-time increases in response to temporary surges in demand and disruptions in supply caused by extended COVID lockdowns. It is difficult to know whether inflation rates are simply catching up to a post-pandemic normal or if the rate of inflation will exceed the Fed's 2.0-2.5% expectations, but any increase over pandemic lows is likely to be seen as extreme.

…And suddenly the markets recognize the inevitability of higher corporate, capital gains and estate taxes. It is clear the administration has some very expensive goals and they plan to push for higher taxes on corporations and the wealthy to pay for those goals. It is hard to say whether any of the proposed tax increases will negatively impact the markets or slow the economic recovery, and if so, how significant the impact(s) will be. The markets seem to have accepted the idea there will be a corporate tax increase of some amount, but how much and whether there will be other tax increases with the potential to move the markets remains a big question mark. Should the threat of increased taxes on capital gains tax and/or possible modifications to the estate tax rules cause wealthy investors to sell-off, the impact could be quite significant.

Final thoughts & Recommendations:

Despite the potentially serious headwinds presented by inflation, taxation and the pandemic hangover, I expect economic growth will be the dominant driver of the markets this year. First quarter earnings growth is/has been phenomenal but much of the growth can be explained by a combination of base effect and demand pull-forward caused by pent-up demand and is unlikely to be as strong the remainder of the year. Growth should remain strong the reminder of the year, but will likely moderate significantly by year end.

Given the markets lofty valuations and unique economic conditions, a modest pullback still seems reasonable. I don't believe the markets will simply pause and wait for economic growth to catch-up with valuations, either the markets will continue higher or pullback. The higher the markets climb and more stretched valuations become without a meaningful pullback, the more likely any future correction is to be deeper or more severe. However, there is very little reason to believe the markets will "crash" or experience a correction greater than 20% in the near future.

Given the positive momentum in the markets, increased potential for inflation and rising interest rates, and the very strong possibility that economic growth remains strong through next year, I believe being equal or slightly overweight stocks would be prudent. Fixed income exposure should continue to be limited to shorter duration options. Ideally, large moves into stocks would be done on market weakness or clear pull-back. Absent any evidence of weakness or pullback in the near term (early May?), it may be necessary to begin systematically building exposure.

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