MINK WEALTH MANAGEMENT
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MACRO MUSINGS

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2021 Second Half Outlook

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SUMMARY

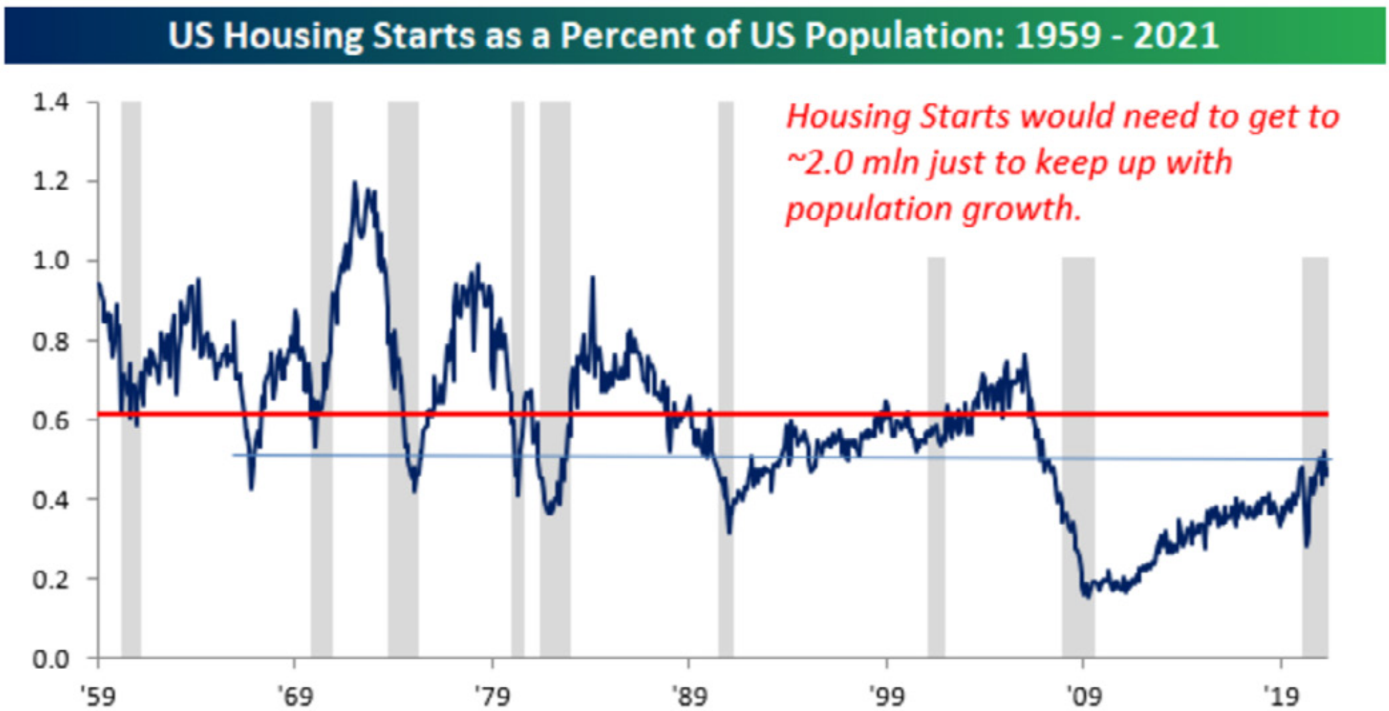
- Economic growth should remain robust for the rest of 2021, albeit at a slower pace. Constraints in both the housing market and auto industry may negatively impact GDP, but these issues should prove temporary and lead to a rebound in 2022, helping extend the recovery.
- The Fed met last week, and their projections for interest rates have shifted to a more hawkish stance since their March meeting. Today, several members expect rates to rise in late 2022, with the potential for multiple rate hikes in 2023. These are simply projections, and the Fed did not change its current policy, nor did it signal that its policy stance will change this year.
- The combination of new highs in the markets, low volatility, and a pullback in long-term rates has historically been a bullish development for stocks. A measure of these factors triggered earlier this month, and in historical instances, the market closed higher six and twelve months later.

GDP GROWTH SHOULD REMAIN STRONG, **WITH A FEW SETBACKS**

Economic growth continues to be robust. The median estimate for GDP growth in the second quarter is 10.5%, after rising 6.4% in Q1. While growth is expected to continue at an above average pace in the second half of the year, constraints in two critical segments of the US economy could weigh on estimates as the year progresses.

Let's start with housing. Both housing starts and building permits—two key leading indicators for housing activity—missed expectations last month. The slowdown in new production has been attributed to several factors, including rising lumber prices, a lack of available lots, and labor shortages in the homebuilding industry.

Longer term, demographics should support strong housing growth over the next decade, as the Millennial generation enters their prime home-buying years. Additionally, after the 2008 housing crisis, the housing market underwent a multi-year period of underbuilding, creating a cumulative deficit of homes relative to population demand. Today, housing starts as a percentage of the population remains at the lower end of its historical range, leaving ample room for growth as homebuilders expand capacity to catch up with demand (chart from Bespoke):



Separately, the auto industry is dealing with its own supply-side issues. The shortage of semiconductors continues to plague the production of new vehicles. New cars are increasingly becoming computers on wheels, with semiconductor technology supporting elements like connectivity, electrification, and autonomous driving aids. While auto sales remain strong, supply is struggling to keep up. Current inventory to sales is at an all-time low:

Although the problems surrounding housing and auto sales may not be fully reflected in current GDP estimates for the second half of the year, these bottlenecks should resolve at some point, and that could lead to better growth next year than is currently projected.

FED MEETING:
A SURPRISE IN RATE EXPECTATIONS

Markets are often volatile around Fed meetings, and last week was no exception. Volatility was likely driven by two changes in the Fed's outlook:

1) Higher inflation expectations for 2021. The Fed now estimates their preferred measure of inflation, the Core Personal Consumption Expenditures (PCE), to be 3.0% in 2021. In March, they estimated Core PCE would be 2.2%. More importantly, in our view, the Fed's expectations did not meaningfully change for 2022. Core PCE estimates for next year rose from 2.0% to 2.1%, suggesting the Fed still views any spike in inflation as temporary.

2) Hawkish shift in the Fed's "dot plot." The dot plot depicts the Fed officials' outlook for interest rates. It is released quarterly, and the shift in the dot plot from March to June was more hawkish, meaning rate hikes are expected to begin sooner than previously projected.

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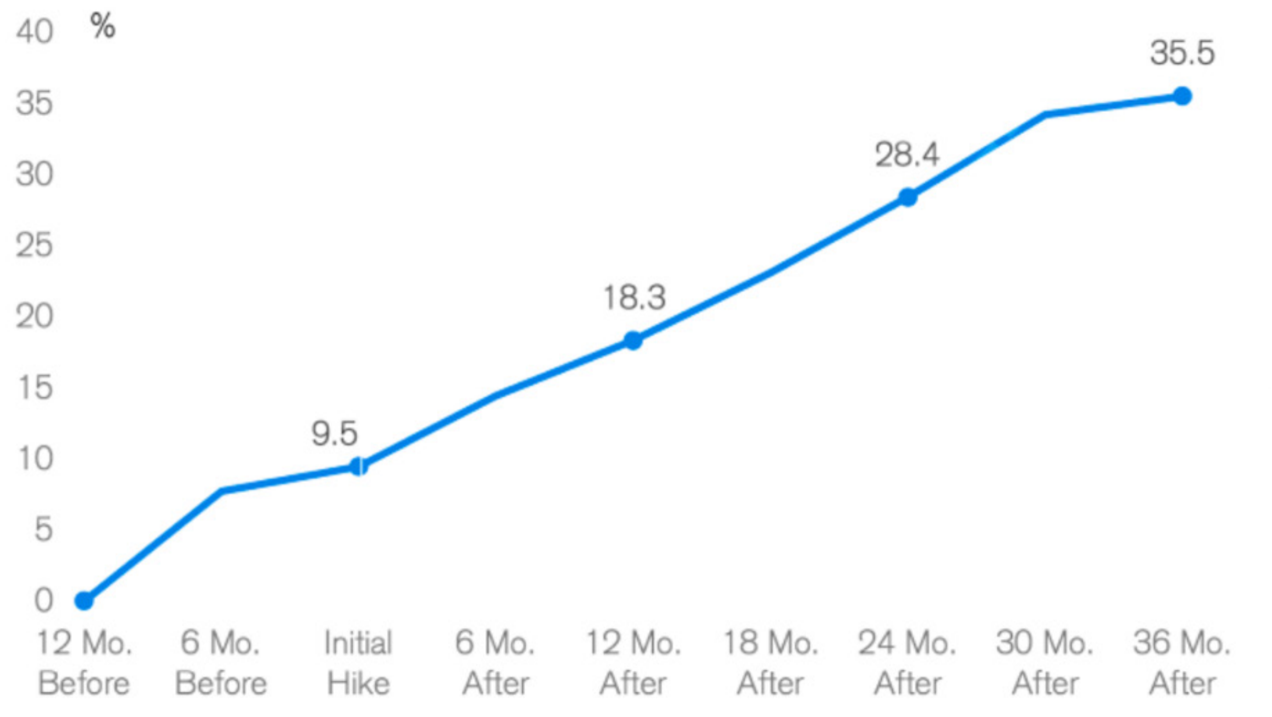
To be clear, the Fed did not change any policy during their meeting. The Fed funds rate is still 0%, and they are still purchasing Treasury bonds as part of their quantitative easing program. Given this reality, we think it was an overreaction to the change in the dot plot. Fed policy is fluid, and members constantly adjust their views and update their outlooks to reflect the latest economic data.

For example, in October 2018, Fed Chairman Jerome Powell said interest rates were "a long way from neutral," signaling potentially many more rate hikes ahead. Although the Fed raised rates in December of that year, they did not raise rates again. In fact, within 13 months of making that statement, the Fed actually cut rates three times.

Even if one assumes a rate hike occurs in late 2022, that does not mean a negative outcome for the stock market. On average, equities have risen 9.5% in the twelve months leading up to the first rate hike (chart from Credit Suisse):

Figure 1: Average S&P 500 Returns Before and After Initial Rate Hike



Note: Average returns based on rate hike cycles beginning in 1994, 1999, 2004, and 2015
Source: Standard & Poor's, FRB, the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Stocks tend to go up. (Credit Suisse)

ALL TIME HIGHS, LESS FEAR, AND LOWER RATES: **BULLISH FOR THE MARKET?**

Despite the increased volatility witnessed late last week, the market was sitting at an all-time high as recently as June 15th. Meanwhile, market volatility, as measured by the VIX (aka the "Fear Index"), had dropped to levels not seen since before the pandemic, and the US 10 Year Treasury yield was sitting at a 3-month low after rising substantially in Q1.

Historically, whenever the three criteria above triggered, it was a bullish development for stocks. While there was some short-term weakness, stocks were higher six and twelve months later each time (table from Bespoke):

S&P 52-Week High, VIX 52-Week Low, 10-Year 3M Low

	S&P 500 Performance (%)				
Date	One Week	One Month	Three Months	Six Months	One Year
8/22/91	1.3	-0.9	-3.9	5.1	6.0
11/12/91	-4.4	-3.8	5.1	4.9	6.6
2/24/95	-0.6	2.6	8.3	14.2	35.0
12/4/95	1.0	0.7	6.1	9.6	21.4
6/2/17	-0.3	-0.6	1.5	8.3	12.1
6/10/21					
Average	**-0.6**	**-0.4**	**3.4**	**8.4**	**16.2**
Median	**-0.3**	**-0.6**	**5.1**	**8.3**	**12.1**

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SUMMARY:
OUTLOOK REMAINS BRIGHT

Economic growth should remain robust through the end of the year. Any production delays resulting from supply issues should be resolved within the next twelve months, potentially setting up stronger than expected growth in 2022. While a correction can happen at any time, the combination of a favorable macro backdrop and accommodative Fed policy remains supportive of risk assets, and we believe any pullback should be temporary.

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