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PWM Weekly Observations

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Philip G. Palumbo, CFP®
Chief Investment Officer

Doug Augenthaler, CFA® CFP®
Chief Portfolio Strategist

Cross-Currents

- **The post-pandemic world will be different. Cross-currents are everywhere and how this settles is anything but clear, but ultimately everything resolves and typically not at the extremes.**
- **The economy is recovering, but persistent government intervention continues to cause market distortions. This has led to excesses in markets and very high asset valuations.**
- **As portfolio managers, we need to adapt to these issues and our intention is to increase portfolio diversification by adding uncorrelated asset classes. The goal is to reduce portfolio volatility and allow compounding to better work in our favor.**

It seems that investors are being pulled in opposite directions with greater regularity these days. Confusing cross currents are not unusual, but the sheer number of them hitting at the same time makes today a more confusing time than usual. Here are a few examples:

- **Is the pandemic getting better or worse?**
- **Are chip shortages going to linger or resolve quickly?**
- **Will unemployment remain elevated or correct when extra benefits end?**
- **Will the current inflation prove to be transitory or persistent?**

We suspect that the answer to all of the above questions is – Yes.

There are no easy answers here. Depending on where you are, the pandemic could be getting better or worse, and that has implications for global growth prospects. Some industries will recover from the chip shortage quickly while others will continue to have problems. The pandemic relief for the unemployed has apparently provided a one-time opportunity for lower wage workers to start new careers and unemployment is elevated despite millions of job openings. Some inflationary price increases are clearly unsustainable, like used car prices equaling new car prices, but many others are not so clear cut. Some inflation will likely be persistent.

The world is changing quickly. Shopping habits are moving online at a faster rate than ever before. Work habits are changing the places where we choose to live. **In sum, we are cramming what would normally be years of supply and demand changes into months and that is not likely to progress smoothly. We need to navigate these cross-currents, both personally and professionally.**

The important thing to remember is that all of these things eventually resolve and they usually resolve 'in the middle'. By that, we mean that the changes that come are unlikely to be as extreme as we might fear, but are equally unlikely to return to the way things were. It's time to adapt.

Valuations Also Suggest It's Time to Adapt

The Fed continues to employ extraordinary measures to 'stabilize' the economy. Specifically, the Fed continues to buy about $40 billion of mortgage-backed securities each month, which helps to keep mortgage financing costs down for consumers. In addition, the Fed is purchasing about $80 billion of Treasury securities each month. This keeps a lid on Treasury interest rates and is designed to further stimulate the economy as it recovers from the effects of the pandemic. Lower interest rates are generally good for promoting economic growth. However, this market intervention has been on-going since late 2008 at the depths of the Housing Crisis, and that's a problem.

These purchases artificially increase demand and that tends to increase asset prices – stocks, bonds, real estate, commodities, everything. Precisely how that happens is unimportant here, but the result is that valuations can get too high. We have been beneficiaries of that, but once again, it puts us in a cross-current. This has gone on for a long time and it can't go on forever.

Diversification Is More Important Than Ever

Portfolios have long been structured with stocks and bonds because these are uncorrelated assets, which simply means that most of the time, when one goes up in value, the other goes down. This reduces the volatility (variability) of the total portfolio. This is desirable because we believe the way to grow wealth is to allow your investments to compound returns for as long as possible.

Investment losses interrupt compounding. Logically, the smaller the interim loss you incur, the easier and faster you can get back to compounding your wealth. Thus, improved diversification may help achieve your long-term investment goals.

At PWM, we take the diversification approach to another level by having consistent allocations to both gold and commodities. These are also uncorrelated assets. In the near term **our intention is to take that a step further by adding more uncorrelated assets in particular, hedge funds and real estate.** Our hope and desire is that by adding these assets, we can reduce portfolio volatility further, which is a primary portfolio goal especially when asset prices are very high. Expect us to be calling soon to discuss these additions to the portfolio.

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What We're Reading

Don’t Depend on Stocks and Bonds to Hedge Each Other

Moderna’s Next Act Is Using mRNA vs. Flu, Zika, HIV, and Cancer

CPI Will Be Driven Higher By Rents

Power Shift: Biden's Executive Order On Healthcare Competition

Why the bond market shouldn’t be used to gauge inflation expectations

The Car Market Is Insane. It Might Stay That Way for a While.

Breakthrough may lead to most energy-efficient seawater desalination ever

What Is Happening in Germany? Flooding and a Death Toll Not Seen This Century

There is concern that 10-year yield shows slowing economy ***(2 min. video)***

Wholesale Used Car Prices Drop in June

Markets This Week

After a long winning streak, stocks took a breather this week with small and mid cap stocks the biggest losers among the broad indexes. Bonds rallied despite higher than expected inflation data, led by long Treasuries up over 1%. Commodities took a breather as well while gold had a modest gain for the week. Among the equity sectors, Utilites, REITs and Consumer staples, all dividend paying sectors, were solidly in the green. Energy took a hit this week as OPEC concerns and rising U.S. production put the brakes on this leading sector of 2021.

US Equities	1 week	YTD	Fixed Income	1 week	YTD	Sector Breakdown	1 week	YTD
S&P 500 (SPY)	-0.96%	15.75%	20+ Yr. Treasuries (TLT)	1.15%	-5.29%	Consumer Disc. (XLY)	-2.45%	11.05%
Dow (DIA)	-0.57%	14.16%	Barclays US Aggregate (AGG)	0.19%	-1.04%	Info. Technology (XLK)	-0.60%	16.13%
NASDAQ (QQQ)	-0.94%	14.26%	Intermediate Municipal (MUB)	0.12%	1.42%	Financials (XLF)	-1.61%	23.57%
Russell 1000 Growth (IWF)	-1.10%	14.36%	US Corporate Bonds (LQD)	0.11%	-1.14%	Health Care (XLV)	-0.07%	14.22%
Russell 1000 Value (IWD)	-1.38%	16.07%	Barclays US High Yield (HYG)	-0.38%	2.51%	Utilities (XLU)	2.59%	7.30%
Vanguard Mid-Cap (VO)	-2.50%	13.53%	Dollar Index (DXY)			Industrials (XLI)	-1.53%	15.81%
Vanguard Small-Cap (VB)	-4.16%	11.17%				Energy (XLE)	-7.89%	31.14%
						Materials (XLB)	-2.28%	12.99%
International Equities	**1 week**	**YTD**	**Commodities**	**1 week**	**YTD**	Consumer Staples (XLP)	1.27%	6.59%
MSCI EAFE (EFA)	-1.56%	8.81%	Commodities (PDBC)	-0.65%	29.88%	Comm. Services (XLC)	-0.96%	20.26%
MSCI Emerging (EEM)	0.07%	4.18%	Gold (GLD)	0.12%	-5.02%	REITS (VNQ)	0.24%	25.61%
						Homebuilders (XHB)	-3.11%	23.44%

The table above is an analysis of the weekly and year to date returns of various markets/sectors that we follow (More RED = worse performing markets/sectors; More GREEN = best performing markets/sectors). Source: IEX Trading & PWM Research.

Retirement Planning:

[Inflation could prompt largest Social Security cost-of-living adjustment in decades.]

Seniors could see a much bigger bump to their Social Security benefits next year. However, a bill that has been reintroduced in Congress proposes changing how those annual increases are calculated.

Estate Planning:

[Have you had the 'money talk' with your family yet? Don't put it off]

These conversations will differ depending on your relationship and what stage you are in life, but a common theme involves coming to an understanding of what you and your loved ones value.

Tax Planning:

[Are you prepared for tax impact of the $68 trillion great wealth transfer?]

To lessen the tax bite, families may consider Roth IRA conversions, life insurance, gifting and other strategies.

Health:

[Medicare would cover dental, vision and hearing under Dems $3.5 trillion plan]

It's uncertain exactly what would be covered and to what degree.