Looking Forward to Summer

June 2021

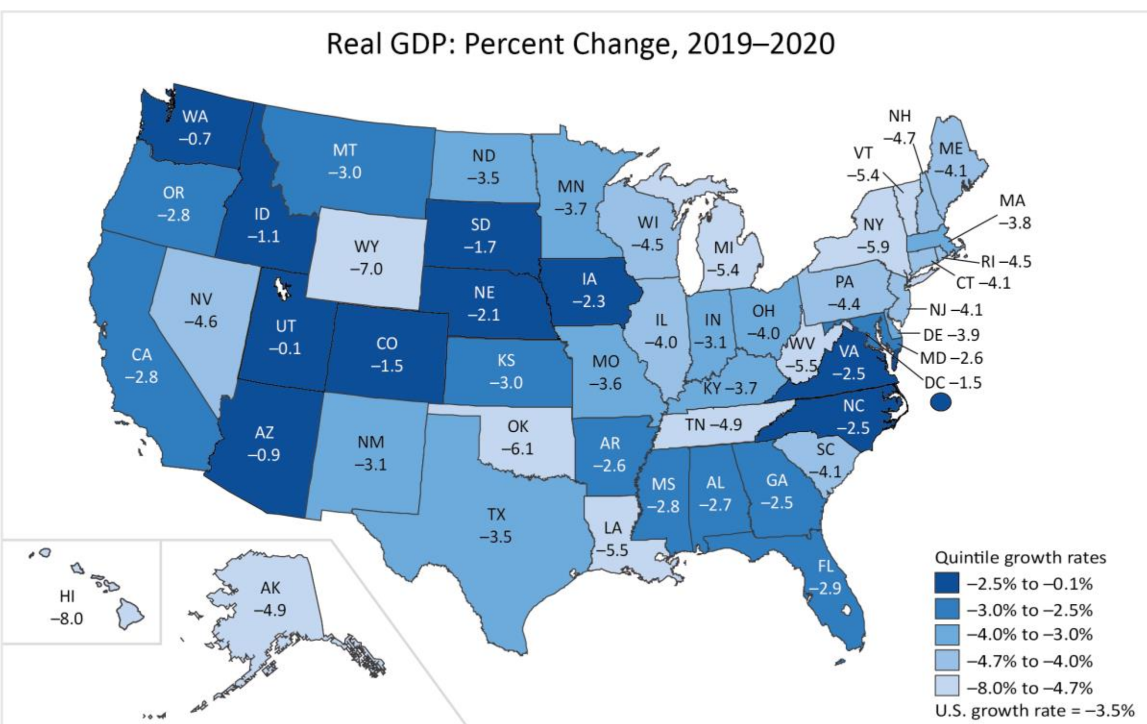
As the summer of 2021 approaches, there is much to look forward to. The world is opening back up after the pandemic and many are looking forward to traveling and spending time with family and friends. But as always, this does not mean complacency is called for in the financial markets.

A look at the recent past

The pandemic from COVID-19 was historic in many ways. With over 164 million cases worldwide and over 32 million in the US alone, the numbers are staggering. Now vaccination rates around the world are increasing and economies are opening. Mask mandates are being lifted and life appears to be slowly returning to normal.

The pandemic had a significant and ongoing impact on both the economy and the equity markets. By late March 2020, the S&P 500 had fallen 34% in just six weeks. The economy entered a recession, and many Americans lost their jobs. For the full year of 2020, the US Gross Domestic Product (GDP) decreased by 3.5% nationally and decreased in all 50 states plus the District of Columbia as shown in Figure 1 below. Thankfully, much has changed. In the first quarter of 2021, the economy grew at an annualized rate of 6.4% nationally[1].

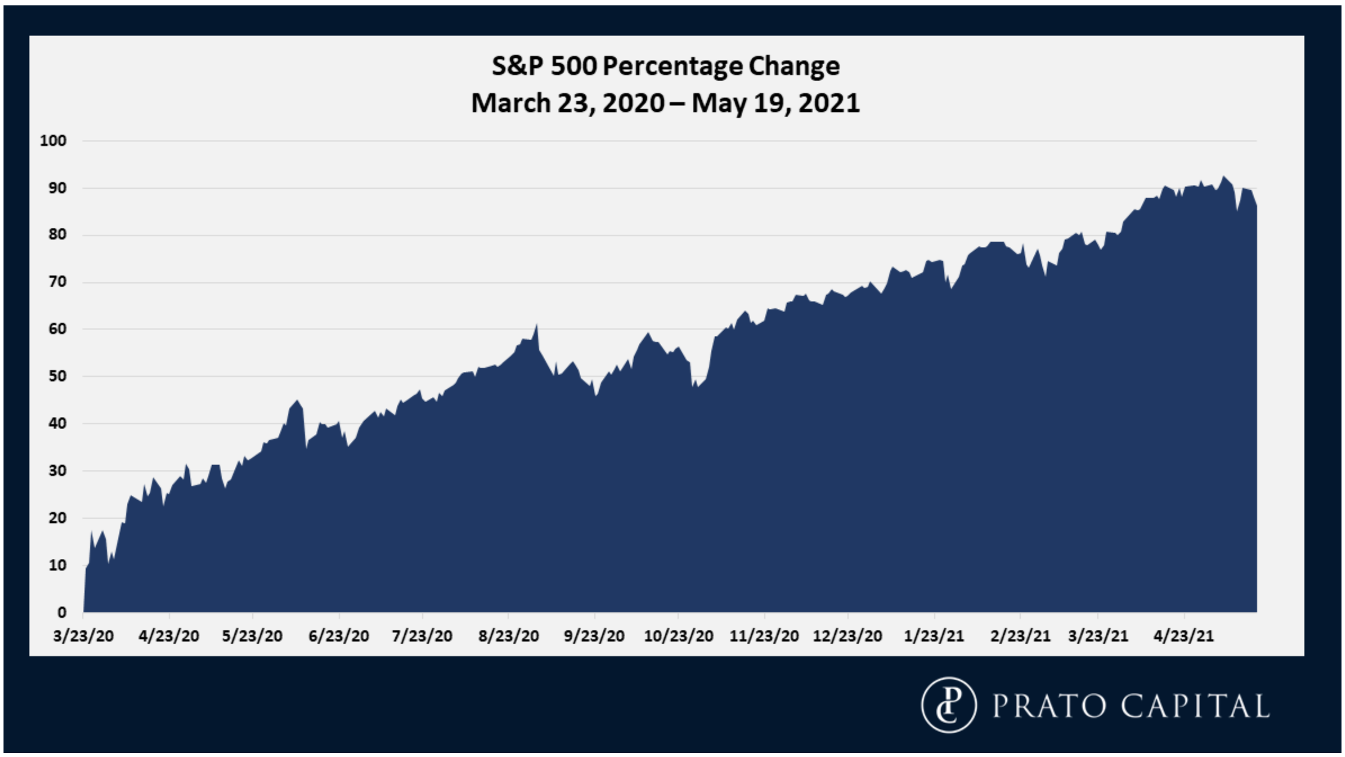
Figure 1: GDP Change by State, 2020



U.S. Bureau of Economic Analysis

As the economy started to contract due to the pandemic last year, the S&P 500 hit its low on March 23. Many in the financial media were predicting the losses to continue, rivaling those of the Great Depression of the 1930s. Instead, in just three days, by March 26 the S&P 500 had gained over 17%. Over the next six months, it rose 60%. It seemed counterintuitive for the stock market to be gaining so much while the US economy was still faltering. In our June 2020 Newsletter, we wrote about how the stock market and the economy can become disconnected, and last year was a perfect example of this. Recently, the S&P 500 has set all-time highs again, rising over 90% in 14 months, as shown in Figure 2 below[2]. The market low in March 2020 was not predicted and could only be seen in hindsight. The gains realized in the stock markets since were captured by investors that remained invested in spite of all the negative predictions. Not an easy thing to do at the time.

Figure 2: S&P 500 Percent Change from March 2020 Lows



Summer Volatility

"Sell in May and go away" may be an often-used proverb on the financial news channels to describe any volatility associated with the summer months. But is there anything to it or is this just a myth? The origin of this saying dates back centuries to when the aristocracy and bankers left London to escape the heat of the summer. Since stocks could not be traded from the English countryside, effectively limiting the liquidity in the markets, this may have been an appropriate description for the times. However, in 2021 the technology that brought us "work from home" also allows fixed income and equity trades to happen from anywhere. The basis of the "Sell in May" statement is no longer applicable. And, changing a portfolio due to the month of the year alone is just another form of market timing that can miss substantial market gains, like last year when the S&P 500 gained over 27% from May 1, 2020 to September 2, 2020. We believe investors would be best served ignoring this 'noise' from the media based on the English aristocracy from several centuries ago.

However, market volatility is a normal part of investing in the stock market. We often do not remember market volatility until it turns into a bear market like we saw in 2008 and again in 2020. But like any other time of the year, equity markets can be volatile during the summer months. A recent example occurred in August 2019 when the S&P 500 dropped almost 7% over six trading days to start the month. By the end of the year, the S&P 500 had gained over 10% from August 1 alone and over 31% for the full year. Having a balanced and diversified portfolio matched to an investor's risk tolerance will make periods of volatility less worrisome for those investors and keep them invested.

What to do?

What should be done about any potential market volatility, not just for this summer but anytime? At Prato Capital, volatility of the stock market is accounted for by the Financial Life Plan (FLP) we offer to our clients. Markets do not rise in a straight linear line and the FLP can account for that in the future growth of their investments. But this does not mean a portfolio is set once and forgotten. Rebalancing a portfolio in times of volatility is a technique we use to keep desired risk levels, maintain a balanced portfolio, and allow gains to be captured as they happen.

Over time we have found our clients become more focused on the FLP and seeing what is possible for their financial future and become less concerned about short-term market volatility. This makes it possible for our clients to tune out the noise of the media when markets turn volatile and continue living their lives.

Our advice to our clients now is to get out and enjoy a summer afternoon with family and friends as our economy continues to open. After the past year and a half, it is well deserved.

"Summer afternoon - summer afternoon; to me those have always been the two most beautiful words in the English language." - Henry James, Author

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[1] Data on GDP from US Department of Commerce, Bureau of Economic Analysis. https://www.bea.gov/news/current-releases.
[2] S&P 500 data from YCharts. S&P 500 returns are total returns and include the reinvestment of dividends.