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2021 Second Half Outlook

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Economy: Expect continued growth in the US as the economy normalizes and absorbs pent up demand post-pandemic, although the rate of growth should be slower as the supply chain continues to struggle in delivering goods for consumption due to input and labor inefficiencies.

- Total GDP growth should end up around 6.5% to 7% for the year.
- Inflation has become a newsworthy topic after data reported for the months composing Q2 showed high readings people were not used to seeing after a decade plus of little inflation. We believe a productivity-led economic growth scenario will prevail with GDP growth outpacing inflationary pressures, making current concerns "transitory" in nature. Pent up demand will abate and supply side inefficiencies, including broken supply chains and a mismatch of job openings and available workers at the lower end of the pay scale, will correct over time, rebalancing equilibrium prices. The "4 Ds" deflationary forces including Disruption (Technology), Détente (Globalization), Debt and Demographics are all working to overcome these inflationary pressures, and there is a powerful bond market force that can control interest rates on the long end (known as bond vigilantes, or Desperados – our 5th "D").
- The successful removal of stimulus programs as well as the beginnings of more hawkish Fed policy will be an important step for the US economy. Although this should mean growth rates and inflation may have peaked, it will be a healthy development for the economy long-term.
- We may see volatility globally with some economies unable to recover as quickly as others. The depth of these struggles must be monitored spillover effects from foreign producers could prove problematic for US growth and inflation. Other economies' peak economic growth readings will likely come later than those of the US.

Stocks: Our base-case S&P target for the end of 2021 is 4,300. However, despite the S&P closing Q2 at 4,297, we do not expect sideways action for the next six months.

- As we enter Q3 2021, our indicators, especially those focused on momentum, are lockstep in pointing towards a continuing rally in the short term.
- We are keenly aware that there are numerous signs in financial markets of excessively optimistic sentiment and speculative behavior, as well as general overvaluation. These are great pillars of a bearish argument, but history shows they are unsatisfactory timing indicators in calling when the market will turn. These conditions can persist for quarters or years and can move to even more extreme levels, meaning investors who want to fight the trend may miss out on a large portion of a bull market. Early can be a close relative of wrong.

- We continue to consider the expected return on other assets when evaluating the stock market. Stocks with strong fundamentals and growth potential can still look very attractive to other assets on a relative basis.

- We do see the risk of a significant pullback in stocks, possibly sometime in the second half of 2021. We are monitoring for the start of what we call an "Echo Bear" market – a drop in stocks correcting overextended gains that have occurred coming out of a recessionary bear market's low. The Echo Bear usually begins from a point of excessive optimism and overboughtness and is triggered by the market's realization that bullish macro conditions and growth rates experienced immediately after the recession are not repeatable, causing a readjustment in prices.

- Some take the view that the pandemic-driven pullback in March of 2020 was not a true bear market and was instead just an extreme, panic-induced correction. This would leave us at a very advanced stage of the bull market that began in March 2009.

- Hollencrest continues to monitor sector, style, and thematic rotation in the stock market closely. As we move into Q3, market leadership has changed on a weekly, and sometimes daily, basis. We still believe cyclical value sectors such as financials, industrials, and materials, along with small cap, all have some relative value. However, growth in the form of mega-cap tech has re-entered the contest for market leadership of late.

Bonds and Rates: Rates will continue to be anchored at the short end of the yield curve for the forecastable future, and we expect some moderate curve steepening to occur from where longer-term yields sit at the end of Q2.

- We do not expect the Fed to begin raising short term rates until 2023, but they will begin to tighten their policy in other ways much sooner.

- We see an appropriate yield for the 10-year of 1.75% exiting 2021. The Fed will have some influence with how they go about reducing asset purchases and withdrawing liquidity. The global economy and its ability to grow with stability during the second half of 2021 will also have an effect. The recent pullback in longer-term yields indicates the bond market sees continued Fed accommodation and less economic growth than previously expected.

- Very low expected returns in fixed income make it a challenging asset class, leaving few investments with worthwhile return prospects that do not exhibit a consequential perceived credit risk. Private markets continue to provide some excess return with illiquidity discounts, but the overall rate and spread environment would have to change significantly before considering a meaningful increase in allocation.

- Other asset classes that generate stable income with growth potential in a tax efficient manner, such as real estate, continue to be the focus.