

July 31, 2021

**BLUME CAPITAL MANAGEMENT**  
**Third Quarter Newsletter**

The vaccine rollout progressed across the world in the second quarter of 2021, the global economy continued to recover, and equity markets delivered their fifth consecutive quarter of gains. The S&P 500 returned 8.5% and, once again, set a record high. Economically sensitive, cyclical stocks led the rally as real estate, energy, and technology outperformed, while utilities and consumer staples lagged.

Foreign equity markets, as measured by the broader MSCI All-Country World Index Ex-U.S.<sup>1,2</sup>, gained 5.5%. The underperformance relative to the U.S. was primarily attributable to Asia, as both Chinese and Japanese shares were roughly flat in the quarter.

Bonds delivered modest returns as yields declined (bond prices move inversely to yields). The 10-year Treasury yield surprisingly dropped from 1.74% to 1.47%, and U.S. bonds, as measured by the Bloomberg Barclays Intermediate U.S. Aggregate Index, returned 0.8%.

INDEX	Second Quarter 03/31/21 – 6/30/21	Six Months YTD 12/31/20 – 6/30/21	Twelve Months 6/30/20 – 6/30/21
S&P 500 Total Return <sup>1</sup>	8.5%	15.2%	40.8%
DJIA Total Return <sup>1</sup>	5.1%	13.8%	36.3%
MSCI All-Country World Index Ex-U.S. <sup>1,2</sup>	5.5%	9.2%	35.7%
Barclays Int Agg. Bond Index	0.8%	-0.8%	0.0%

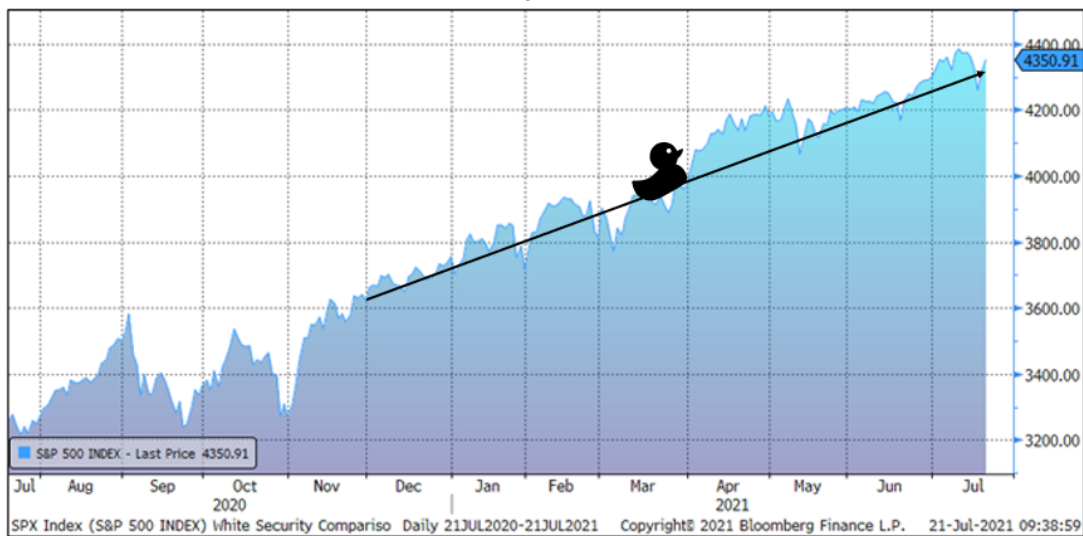
**Market Perspective**

To the casual observer, the S&P 500's ascent in 2021 might be analogous to a duck smoothly gliding across a mildly rippling and gradually ascending river (if such a thing existed). Indeed, during this period, the broader U.S. market experienced minimal volatility and avoided even a 5% decline. Not surprisingly, this unusual calm has many clients wondering if we are overdue for a correction?

<sup>1</sup> Includes dividends in addition to index price appreciation

<sup>2</sup> The MSCI AC World Ex-U.S. index measures equity market performance in foreign developed and emerging markets excluding U.S.

### S&P 500: July 2020 - Present



Source: Bloomberg

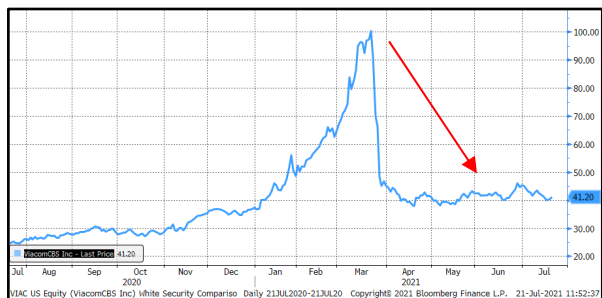
The short answer, of course, is we don't know, and corrections can, and often do, occur at unexpected times. However, for those concerned that investors have grown complacent, we believe it is important to note that many sectors of the market (including most of the "hottest" areas) have experienced significant drawdowns this year. To return to the duck analogy, the calm surface belies notable cross currents below the surface, out of the sight of the broad index, that have produced a series of rolling, sector-specific corrections.

As shown in the one-year price charts below, some of the most popular investment areas that generated headlines and notable gains in 2020 and early 2021 all experienced sizable pullbacks at varying points this year. Bitcoin, and other cryptocurrencies, have declined more than 50% from their peaks. "Meme" stocks, popularized by the Reddit crowd, have all endured substantial volatility with many being cut in half. The enthusiasm around clean energy and Chinese internet stocks has faded as both categories have slid ~40% from their highs. Even Tesla and the favorite stay-at-home stock, Zoom Communications, are down this year.

#### Bitcoin



#### "Meme" Stock VIAC



### Clean Energy ETF (“ICLN”)



### Chinese Internet Stocks



### Zoom Communications (“ZM”)



### Tesla (“TSLA”)



Source: Bloomberg

In more mainstream areas of the market, premier, mega-cap technology companies experienced weakness early in the year, and, more recently, the post-Covid recovery stocks (travel, retail, etc.) as well as cyclically exposed companies endured pullbacks of 10% or more.

Needless to say, these rolling corrections do not preclude the possibility of a larger, broad-based market decline. However, we do believe that these sell-offs and rotations within the market have helped to keep sentiment in check, while also offering select opportunities. As long as this dynamic persists, it will likely continue to provide an attractive environment for nimble, active managers grounded to a valuation framework.

### **Outlook**

The official arbiter of recessions, the National Bureau of Economic Research (“NBER”), recently told us what we mostly already knew. The recession caused by lockdowns in response to Covid-19 was one of the deepest, but also the shortest, in U.S. history, and it ended in April 2020. Now 15 months removed from the nadir, the economy is transitioning from the sharp rebound phase into a more gradual and sustained recovery.

As is often seen at this phase of an expansion, the decelerating rate of growth can cause confusion and concerns over peak activity. These worries were manifest in the movement of the 10-year U.S. Treasury yield during the second quarter. After climbing from 0.9% at the start of the year to finish the first quarter at 1.74%, the yield has fallen in nearly a straight line to ~1.25% as of mid-July. Higher yields are generally considered a signal of economic strength, and vice versa.

These are dramatic moves for one of the most stable and liquid assets in the world, and the decline in yields cascaded across markets as investors sold assets sensitive to economic activity (cyclical stocks, commodities, etc.) and once again crowded into pricier, defensive areas of the market including mega-cap technology during the second quarter.

In our view, this is mostly noise and characteristic of the short-term mindset driving markets today. Our bigger picture view has not changed. The U.S. economy is in the early stages of an economic recovery with likely years before a recession, and the rest of the developed world is trailing a few months behind. With markets anticipating somewhat higher inflation in coming years, the real return (after inflation) on U.S. Treasuries is near the lowest level in history and bonds remain highly unattractive.

Moreover, corporate earnings have far exceeded expectations, and, as measured versus their expected next 12 months earnings, equities look less pricey than they did to start the year. While expensive relative to history, stocks' prospective returns remain superior to bonds, and economically sensitive, or cyclical, stocks continue to offer the most attractive risk-reward, even if they are more volatile when markets turn fearful.

### Closing Thoughts

In the absence of an unforeseen development, there are times when there is nothing original to add about the economy or markets. Hence, this is one of our briefest quarterly letters. However, please do reach out if you have any questions or would like to discuss any of the myriad concerns pervading the world. In the meantime, we hope everyone is enjoying a wonderful summer.

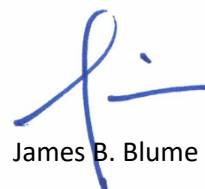
Sincerely,



Peter B. Reidenbach



Jeffrey V. St. Claire



James B. Blume

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