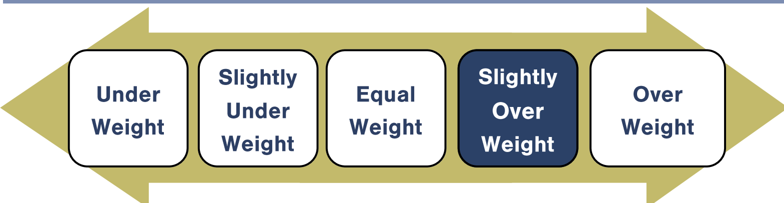
ECONOMIC & MARKET UPDATE—APRIL 2021 (as of 4/29/21)

SFMG MARKET RISK SIGNAL—STOCK ALLOCATION



CURRENT ASSET CLASS ALLOCATIONS

The long-term uptrend in markets was broken, but has recovered. Following the strength in our risk signals, we have maintained our stock exposure of **Slightly Overweight.** This allocation of stocks vs. bonds depends on our risk signals that shift our weightings accordingly.

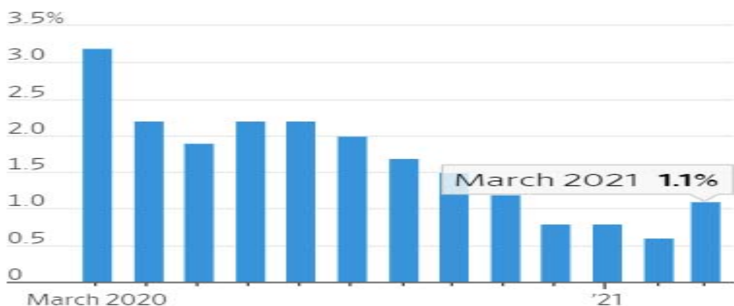
ECONOMIC NEWS

- The Biden administration has unveiled tax proposals to pay for a $1.8 trillion spending package. This includes raising the top individual income tax rate, corporate taxes, and the capital-gains rate to 43.4% from 23.8% for households earning over $1 million. It's likely these initial proposals will meet opposition in Congress.
- First quarter U.S. economic growth increased 6.4% led by fiscal stimulus and strong consumer spending. This growth rate is high by historical standards, but the economy still has further to go in reaching pre-pandemic conditions.
- A shortage of semiconductor chips vital for building new cars is forcing auto factories to curtail production. The lower supply of new cars is boosting sales of used cars, where prices are up 26% compared to last year.

MARKET NEWS

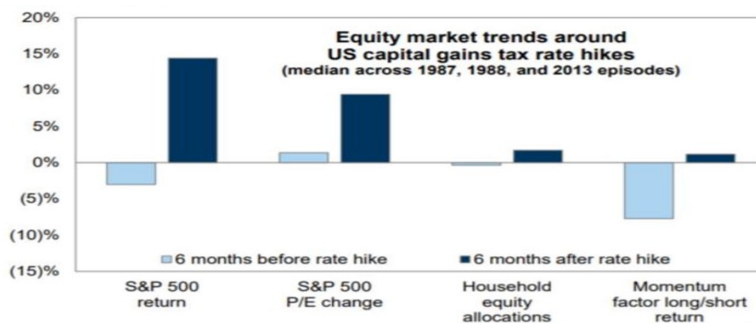
- The market's expectation for inflation over the next five years, as measured by the yield difference between nominal U.S. Treasuries and inflation-protected Treasuries, has continued to rebound to ~2.5%, the highest level since 2008.
- Bank earnings have been strong, driven by improvements in loss reserves set aside for delinquent loans. However, new loan growth has been meager. This could be due to consumers & businesses utilizing the government's fiscal stimulus. Positive growth in new loans will be imperative for the long-term health of banks.
- Some of the hotter areas of the market over the past 12 months such as cannabis, clean energy, 3D printing, and SPACS (special purpose acquisition vehicles), on average have declined between −18% and −42% from their 52-week highs. Higher interest rates are one component putting pressure on these riskier companies.

RISING RENTS COULD SUPPORT INFLATION



Rental rates picked up in March after declining through 2020 as a result of the pandemic. Rent accounts for roughly 1/3 of the Consumer Price Index (CPI), a popular measure of inflation. CPI is expected to rise in the coming months, driven by stimulus and the economic reopening. Using rents instead of home prices as the input for shelter inflation is a drawback of CPI and is dampening the inflation data, as housing prices have soared.

IMPACT OF CAPITAL GAINS HIKES ON STOCKS



Source: FactSet, Federal Reserve Board, and Goldman Sachs Global Investment Research

Historically, increases in capital gains tax rates haven't resulted in a net decrease in household allocations to stocks or negative market returns. The chart above shows declines have on average been minor in the 6 months prior to the hike and began increasing again 6 months after the hike. Although the latest proposed tax rates are higher than in previous years, investors must weigh the returns they will earn when having to reallocate capital to other asset classes.

CURRENT THOUGHTS

Leading economic indicators in the U.S. continue to increase, pointing to an ongoing recovery that is exceeding expectations. Earnings data for the first quarter is also overwhelmingly exceeding expectations, leading analysts to revise their full-year earnings targets higher. In general, market and economic trends look strong. However, Federal Reserve Chairman Jerome Powell has been firm in his stance in not reducing the pace of the Central Bank's asset purchases and becoming less accommodative in their monetary policies until they see further improvement in the labor market. These factors allowed treasury yields to stabilize and helped stock prices move higher through most of April. Headlines on taxes have come to the forefront and so far the market's reaction to proposed legislation on tax increases has been limited since negotiations in Congress may result in tax levels that may be more digestible to investors. Still, tax-related volatility would likely be short-lived. Globally, economic recoveries are looking to be less synchronized than previously hoped with various regions still experiencing major COVID case spikes and less successful vaccine rollouts. But equity markets remain consistent in looking past COVID related struggles, anticipating the post-pandemic rebounds. European markets, despite more stringent lockdowns, have marched higher with U.S. indices. Even areas like India, experiencing some of the largest case spikes more recently, are seeing minimal impacts to stock prices. It seems for now, the more likely catalysts for broader market volatility are still higher, sustained inflation and interest rates rising too far, too fast. Either of which could also precipitate a policy mistake by the Fed. Mindful of those risks and prepared for higher volatility, we remain constructive on the equity bull market.

Contact one of our Wealth Management professionals today at **972.960.6460** or visit us online at **www.SFMG.com**

The purpose of the update is to share some of our current views and research. Although we make every effort to be accurate in our content, the datum is derived from other sources. While we believe these sources to be reliable, we cannot guarantee their validity. Charts and tables shown above are for informational purposes, and are not recommendations for investment in any specific security.