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asset management

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Living and Investing During Rapid Change

It is hard to believe how much has changed in only one year. The dream of revolutionary science methods creating new approaches to vaccinate against viruses, such as Covid-19, and the Federal Reserve's "dream" of reaching their inflation target have both come true. Fortunately, these dreams have been accomplished on the heels of the first pandemic in one hundred years. The U.S. economy and the country have opened up out of the pandemic as a result of a multitude of factors. Consumer spending on dining and travel is increasing, as people are enthusiastic about returning to normal life. The most recent retail sales data increase of 28.1% compared to the same period last year is evidence of the pent up demand for many goods and services. It is also readily apparent that the stimulus packages provided by the U.S. Treasury have succeeded in igniting the economy.

Over the past 10 years, inflation as measured by the CPI Core Index has never gone above 2.5%, and for the larger part of the decade, had remained below the Fed's target of 2%. The Index, however, rose 3.8% year-over-year in May. The Federal Reserve's perspective on the recent higher inflation rate is that it is "transitory" because of both economic activity accelerating from pent up demand as well as supply bottlenecks due to the workplace challenges of the pandemic. There are other economists, however, who believe that higher inflation will be persistent, especially if the stimulus and easing programs are not tapered. AHB's macroeconomic outlook expects stronger economic growth to bring a return to a more normal, higher inflation rate and in turn, higher interest rates.

Given the signs of accelerating economic growth and higher rates of inflation, the Federal Reserve is beginning to reassess the monetary easing measures that have been in place both prior to and during the pandemic. It will be a delicate balancing act to tighten monetary policy at the same time that the stimulus benefits from the pandemic are expiring. Overall, AHB client portfolios are positioned in sectors and companies that will benefit from the increasing growth, higher interest rates and increasing spending on infrastructure.

The low inflation and low interest rate environment of the past few years has been positive for growth stocks that also have high valuations measured by price-earnings ratios. As the market anticipates changes such as tapering of monetary and fiscal policy, investors will realign the valuation that they will be willing to pay for earnings growth when compared to the anticipation of a higher interest rate environment. Nevertheless, there are many sectors and industries that are poised to benefit from this environment. Financial service companies such as banks, brokerage and insurance are able to garner higher net interest margins and/or higher return on their investment premium portfolios. Price increases in addition to unit growth will drive sales in consumer products higher. Additionally, a potential bipartisan infrastructure bill will benefit industrial companies that will build the proposed projects. Lastly, the energy sector is poised to benefit from higher oil prices as demand rebounds from its artificially low level during the pandemic as well as the increased demand for goods used for building infrastructure that require oil as an input.

AHB client taxable and municipal bond portfolios are invested in laddered maturities at a conservative duration to prepare for the prospect of modestly higher interest rates. Investment grade, intermediate-term maturity, laddered client portfolios provide a prudent approach to insulate bond portfolios from interest and credit risk. Client portfolios will have maturities during the subsequent years that we will be able to reinvest at the higher available future yields. This approach allows client bond portfolios to take advantage of increasing rates in a manner that Bond Mutual or Index Funds are unable to provide.

In such an unprecedented time in history, there are many questions about what the economic recovery and subsequent unwinding of government monetary and fiscal policies will confer upon the capital markets. AHB accepts its role to monitor, assess, evaluate, and analyze the changes and take proactive steps to structure client portfolios accordingly.

Wishing you a Pleasant and Enjoyable summer,

AHB Investment Team

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