April 4, 2021

Overview

In March, equities generally continued their progression but not without several reversals along the way. The S&P's 500 rose a solid **4.38%** on a total return basis. The Nasdaq Composite was up a mere **.48%** as the rotation in favor of "value" stocks continued at the expense of the technology sector. The Russell 2000 (Small US Caps) was up **1.00%.**
Internationally, the EPAC BMI (developed economies) was up **1.84%** and the MSCI EM (emerging markets) sunk **1.51%.** The USD was sharply up during the month as a result of the continued rise of US interest rates (beyond the very short-term interest rates that remain anchored to the Fed fund rate, at close to 0%). That caused non-US equities, particularly emerging market equities, to lose ground over their US brethren. This trend is likely to persist over the foreseeable future.

The continued rise in US interest rates, combined with the rapid economic pick-up in the US, remain the main "explainers" of the ups and downs of the equity markets as market sentiment shifts from one to the other. As far as interest rates are concerned, a bit of perspective is useful. Below is a graph of the yield of the US 10-year note over the past three years. The yellow area covers the "Covid" period, starting in mid-February 2020. At that time, the yield on the 10-year note was around 1.60%-1.75%. It collapsed to well below 1% shortly after that, together with the US economy.

Over the past 6 weeks, that yield has dramatically increased and is now at around 1.75%. That is basically where it was just a few weeks before the beginning of the pandemic. While a lot has been made of this rapid increase, when considered in a historical context, it is far from being particularly worrisome, at this stage anyway.

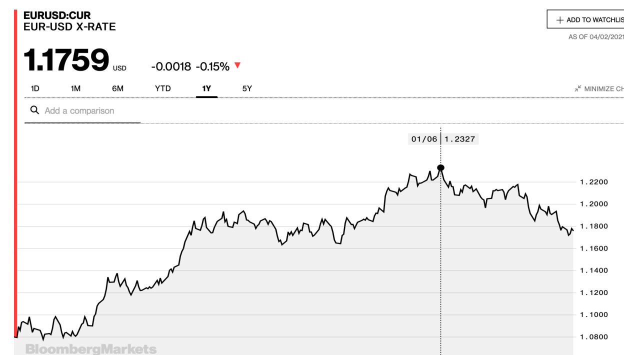
In March, the performance of our clients' portfolios hovered between **1.23%** and **2.58%.** Over the same period, a portfolio consisting of 50% ACWI (World Equity Index ETF) and 50% AGG (US bond aggregate proxy) rose **.85%.** Year-To-Date (YTD), our clients' portfolios are up from **.91%** to **2.89%.** Our benchmark stands at **.76%** on a YTD basis. The equity allocation in our clients' portfolio ranges currently from 40% to 70%, depending on risk profiles.

Market developments

In March, equities progressed in most developed economies, supported by a narrative of economic pick-up, loose monetary policies and a foreseeable end to the pandemic thanks to rapid vaccinations. This positive story had to contend with contradictory currents in the form of renewed health concerns due to new Covid 19 variants, rising interest rates in the US and the rest of the world and high equity valuations overall.

So far, the "positive" narrative has kept the upper hand and markets, with hiccups here and there, continue to subscribe to it. All the more as the Biden Administration keeps on adding fiscal stimulus to an already supportive monetary policy. After securing the $1.9 trillion Coronavirus aid package, it is now pushing for a $3 trillion infrastructure bill. This unprecedented amount of fiscal stimulus cannot be ignored by markets. It is translating into higher interest rates, a stronger USD and generally well supported equity markets in developed economies. The situation is a bit different in most emerging markets as rising US interest rates make it more difficult for these countries to service their debt.

Rising US rates, in an environment of weak economic activity elsewhere in the world, make for a stronger USD, as illustrated below:



The vertical line marks the beginning of 2020 on this chart of the USD/Euro exchange rate. The Euro has gone down about 4.6% since. Specifically, a Euro bought 1.2327 USD at the beginning of the year. It is now buying 1.1759 USD. This is a significant decline. The rise of the USD against emerging market currencies has been even more dramatic and explains in large part why non-US equity markets have struggled to keep pace with US markets so far this year.

Tilts and Allocations

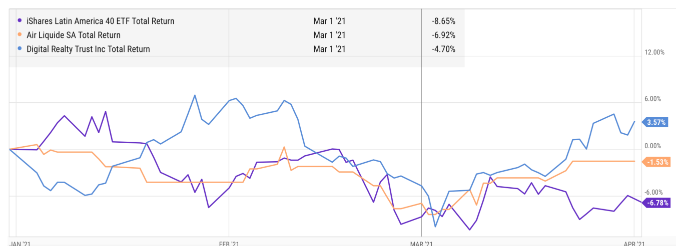
In the US equity markets, the sectorial rotation away from technology and growth equities in general in favor of value stocks continued in March. It explains the relative underperformance of the Nasdaq Composite (up .48%) against the S&P's 500 (up 4.38%) over the same period.

This dichotomy is illustrated by the difference in performance of the two funds that I use to take long-term positions in US equities, PRBLX (Parnassus Core equity) and BUFTX (Buffalo Discovery Fund). PRBLX was up **4.74%** in March while BUFTX was down **.77%**. I have favored PRBLX over BUFTX in almost all portfolios since the end of 2020.

Elsewhere in our portfolios, our relative outperformance this month is mostly due to DLR (Reit) and AIQUF (Air Liquide). Both investments were up more than 5% in March. However, both remain flat or slightly negative on a YTD basis. I think that more positive contributions are to be expected from them in the coming weeks and months as interest rates stabilize and economic activity gathers momentum.

On the other hand, our investment in Latin American equities has been disappointing. While we haven't lost money overall due to our relatively low entry point in November of 2020, the headwinds keep on getting stronger for Latin America and I will reduce our positions in ILF in the coming weeks. I might re-invest once the political and economic situation in Brazil stabilizes somewhat. Brazil accounts for about 40% of ILF.

The YTD performance of these three investments is illustrated below:



In term of overall allocation to equities, I have slowly increased our investments across geographies and sectors as opportunities have materialized. I expect to continue doing so in the coming weeks.

Conclusion

Last month, I argued that remaining under-invested or on the sidelines, although understandable due to high equity valuations, was probably counterproductive. Markets have proved me right since. In an environment characterized by loose fiscal and monetary policy and with economic activity on an upswing, the chances of a significant market corrections are low, if non-existent.

Conditions have not materially changed since. If anything, they have become even more supportive of equities in the US. Accordingly, I remain ready and willing to add to our equity investments.

Thank you for your continued trust.

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