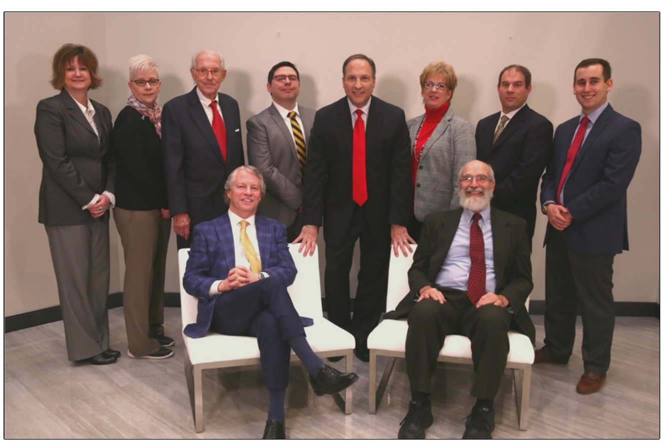
J.W. Burns & Company
Investment Counsel
Quarterly Update - July 2021

Room To Run
But With
Tempered Expectations

"Before anything else, preparation is the key to success." - *Alexander Graham Bell.*

Dear Clients and Friends,

The second quarter of 2021 was, by all accounts, exceptional for stocks. The S&P 500 finished up 8.55%, Dow Jones Industrial Average up 5.08%, and international stocks overall up 5.32%. Bonds recovered from their disappointing start to the year and were up 1.77% for the second quarter. Finally, the Lipper Balanced Index – a mix of stocks, bonds, and cash – was up 3.10%.



Midway through 2021, U.S. stocks, as measured by the Dow Jones Industrial Average, are up a very impressive 13.79% and remain the best place to be, with domestic equities outperforming international stocks by over 5%.

High-quality growth stocks resumed their leadership role in the second quarter, following value's dominance in the first, with the technology sector up 11.5%, and the tech-like communication services sector up 9.2% ("growth stocks" are the more future oriented sectors of the economy, while "value stocks" are considered old economy companies concentrated in the financial, industrial, energy, and material sectors.)

Your portfolio companies performed very well and have reported strong quarterly earnings results as the U.S. economy moved closer to a full re-opening. Indeed, annualized first quarter GDP growth soared 6.4%, and expectations for the second quarter are forecasting over 10% growth as the effect of normalized spending, travel, and consumption rates takes hold.[1]

"Trying to predict the outcome of potential issues in the market, or 'Black Swan' events seems like a very poor investment strategy to me."

Rather than being influenced by short-term trends, our disciplined and appropriately diversified approach to managing your portfolio continues to pay dividends.

There are many challenges facing this bull market, which include stocks selling at record highs, rising inflation concerns, geopolitical conflicts, and staggering levels of government debts and deficits. The spread of the Delta variant is also obviously a real concern. However, trying to predict the outcome of these issues or other "black swan" events seems like a very poor investment strategy to me.

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In fact, overall, there are solid reasons to remain bullish for the second half of the year, despite stocks selling at/near record highs. The first reason comes from history, which shows that when the first six months for the year gain more than 12.5%, stocks are usually higher in the second half as well, with an average return of 7.1%.[2]

First Six Months Indicator

If the S&P 500 is up > 12.5% After Six Months, The Bulls Usually Smile

Year	YTD Return at the end of June	Return The Rest of the Year
1954	17.7%	23.2%
1955	14.0%	10.8%
1958	13.1%	22.0%
1967	12.8%	6.4%
1975	38.8%	-5.3%
1976	15.6%	3.0%
1983	19.5%	-1.9%
1985	14.7%	10.1%
1986	18.7%	-3.5%
1987	25.5%	-18.7%
1989	14.5%	11.1%
1995	18.6%	13.1%
1997	19.5%	9.6%
1998	16.8%	8.4%
2013	12.6%	15.1%
2019	17.3%	9.8%
2021	14.3%	?
Average		7.1%
Median		9.7%
% Positive		75.0%

*Source: LPL Research, Factset 06/29/2021 (1950 to Current)

In other words, strong starts to almost all calendar years lead to even stronger full year returns.

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The direction of stocks in the second half of 2021 will be largely dictated by the usual suspects: the economy, interest rates, and corporate earnings. Here's our view on all three, which on the whole look positive for your portfolio holdings.

The U.S. economy, as we all know, is firing on all cylinders and is, in fact, the strongest we have seen in nearly 40 years.[3] The unemployment rate has fallen to below 6%, and many states are now ending supplemental unemployment benefits, which hopefully will encourage workers to look for jobs and put further downward pressure on the unemployment rate.[1] Measures of CEO confidence are at nearly 50-year highs as businesses look to expand and grow coming out of the pandemic.

It should be noted, however, that the velocity of the economic recovery is likely at its peak, and the momentum effect it has had on markets will likely begin to subside heading into next year.

As has been the case for over a year now, the Federal Reserve remains accommodative and has pledged not to raise interest rates until 2023, which continue to provide a favorable backdrop for stocks heading into the second half of the year. With paltry return opportunities from bonds, CD's, and most other fixed income instruments, investors will likely continue to need both yield and growth and will thus favor stocks to generate any substantive rate of return. This is a significant positive for overall stock values.

Corporate earnings soared 52% in the first quarter of the year compared to 2020, the strongest results since 2010. Second quarter earnings results – which are already underway at the time of this writing – are expected to grow 64% compared to last year. We believe this positive earnings momentum should continue to support equity valuations and some multiple expansion – at least in the second half of this year. It is again worth noting that we are probably approaching peak earnings growth and that a significant portion of the positive news is already baked into stock prices.

On the whole, we remain constructive on the outlook for U.S. stocks heading into the back half of 2021, but we acknowledge that with equities selling at all-time highs, peak levels of economic growth, and the likelihood of an overdue market correction, clients should prepare for more muted returns over the next 12 months.

After all, nothing grows to the sky.

Now, let's get into some of your questions.

Q: What is your take on the recent surge in inflation?

A. The most recent year-over-year inflation number showed a 5% increase, which is the fastest growth rate in over 10 years.[5] Prices for goods are rising quickly which includes cars, gas, raw materials, commodities, even food. Lower-skilled workers, many of which are still collecting pandemic era unemployment benefits, are demanding higher wages to come back to work, further driving up prices in the economy.

It is disconcerting.

However, I believe that a good portion of the inflation we are seeing can be attributed to the rapid surge in economic activity. COVID-19 was a massive negative shock to the economy, and the relatively rapid re-opening we have seen since spring has injected a powerful positive shock to the economy.

In other words, I think much of the recent rise in inflation is a function of the push-pull of supply and demand in the economy and is not necessarily a bad thing. Remember, capitalism requires the ability of businesses to raise prices, at least moderately, in order to succeed over time. In fact, the Federal Reserve and policy makers have been trying to increase inflation rates, unsuccessfully, since the 2007-2009 financial crisis. And while the Federal Reserve does not want to overshoot on inflation, they do see this as an opportunity to create "escape velocity" on inflation.

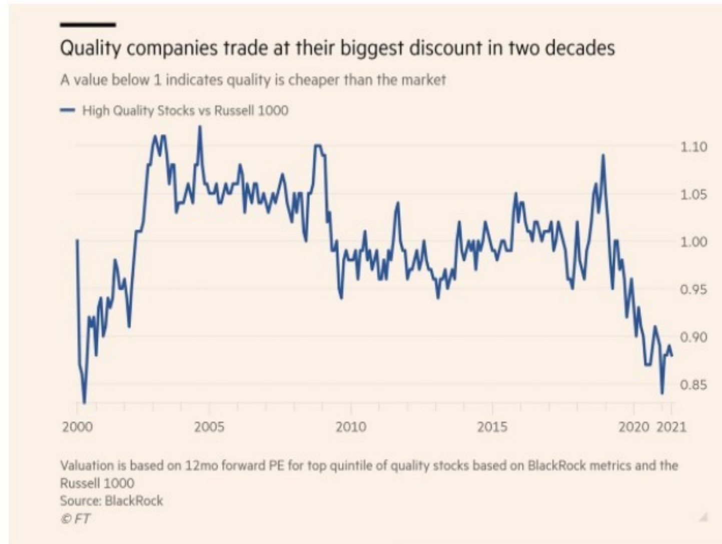
"In the era of cryptocurrencies, 'meme' stocks and unicorn IPOs, ...higher quality companies have become (relatively) cheap."

It should be noted that interest rates have actually declined as of late, so the bond market does not believe that this inflation surge is a longer term issue.

We can only wait and see how this "experiment" will play out.

Q: Where do you see value in the markets with stocks continuing to move to new highs?

A. In the era of cryptocurrencies, Reddit "Meme" stocks, and the deluge of new companies going public via IPO's and SPAC's, many investors have chased higher returns in these speculative investments. These "lower-quality" companies with no earnings are likely in a bubble while "higher-quality" companies, at least on a relative basis, have become cheap. In fact, high-quality stocks are trading at their largest valuation discount to the broader market in 20 years.[3]



Quality stocks are generally defined as companies having consistently profitable business models, stable balance sheets, predictable earnings, growing dividends, and an above-average return on shareholders' equity. ***These are all the specific attributes we target when selecting stocks for your portfolio, and, in fact, make up the overwhelming majority of our valued client portfolios.***

Look, in this market, it is hard to say that any stocks are "cheap." But on a relative basis, we view high-quality stocks as a very good bargain for the long run. Furthermore, as earnings and the economy return to more normalized growth rates and investors begin to focus on the prospect of higher interest rates, inflation, and taxes, we believe investors will return to quality relative to the rest of the market.

Which should bode well for you.

In summary, I believe that the backdrop for stocks remains reasonably healthy heading into the second half of the year and into 2022. That being said, the waters ahead are likely choppier than the smooth waters we have been on, ***and our clients should be prepared for sharp corrections and more muted returns***.

In fact, the last 10% decline we saw in the S&P 500 came almost a year ago, back in September of 2020. So, I would not be surprised – or disappointed – if we see another 10% or so correction before the end of the year.

It should also be pointed out, that a forceful resurgence of COVID-19, particularly the Delta variant, remains a major concern and could be a trigger for a sharp decline. Let's see how it plays out.

As always, the most important thing is to embrace these corrections as being a normal part of the investment process and to not allow them to scare you out of your long-term investment plan. That is, foremost, what we are here for as your investment counselor.

Thank you for your continued confidence and enjoy the rest of the summer!

Best Wishes,

Jim

James C. Burns, CFA
President & Chief Investment Officer

J.W. BURNS & COMPANY, INC.

INVESTMENT COUNSEL
Important Disclosure Information

1 J.P. Morgan, Midyear 2021 Investment Outlook.
2 LPL Financial, 4 Charts To Help You Get Ready For July and Beyond, June 2021.
3 Blackrock, Taking Stock, July 2021.
4 Factset Earnings Insight, June 2021.
5 Ben Carlson, How to Hedge Against Inflation.