DIXON, HUBARD, FEINOUR & BROWN, INC. investment counsel

Second Quarter 2021 Review & Outlook
by Whitney Brown

Also in This Issue

INVESTMENT OUTLOOK

- Equities move higher in second quarter.
- Market leadership in flux.
- Selling pressure absent so far this year.
- Economy and market will move beyond peak rate of recovery in Q3.

Equities logged another up quarter for the April to June period. Along with almost all other major asset classes stocks continue to benefit from the abundant liquidity supplied by the Federal Reserve and the U. S. Congress. A rapidly recovering economy and a robust rebound in corporate earnings has boosted investor sentiment, especially toward companies in sectors highly leveraged to the economic cycle such as materials, energy, industrials, and financials. Understandably, commodities have surged as growth returns. All major U.S. and international indexes are up for the year so far, and even bond prices have risen as yields have backed down.

Late last year we saw the cyclical stocks take off when we got the good news that effective COVID vaccines would soon be widely available. Stocks of small companies and so-called cyclical value companies surged on hopes for a return to growth and expectations of higher inflation. Meanwhile, growth stocks, predominantly in the technology, consumer discretionary, and communications sectors took a breather after leading the market's explosive launch from the selloff low of March 2020.

Market Measures	2nd QTR	YTD
S & P 500 (price)	8.2%	14.14
Dow Jones Industrial Average	4.6%	12.7%
NASDAQ Composite	9.5%	12.5%
Russell 2000	4.1%	17.0%
MSCI EAFE	4.4%	7.3%
Barclays Capital Inter. Gov't/Credit Bond Index	1.0%	-0.9%
	06/30/21	06/30/20
10-Year U.S. Treasury Bond Yield	1.47%	0.67%
Three-month U.S. Treasury Bill Yield	0.05%	0.14%

In recent weeks, we have seen a rotation back to the growth sectors as small cap and value have given back much of their relative outperformance gained in the first quarter of the year. The switch back to growth can be attributed in some measure to the perception that the Fed is seeing better than expected growth in the economy and, in order to combat inflation, may be inclined to bring forward the timing of much anticipated initial rate hikes. In fact, even as the Fed has restated their commitment to letting growth and inflation run hot for a while in the near term, the yield on the 10-year U.S. Treasury has declined, implying slower growth and inflation in the more intermediate term.

Indeed, one of the distinguishing features of the stock market this year has been the high degree of rotation of investor interest among styles, sectors, and industry groups. We've watched investors push up beaten down old economy energy and materials stocks right along with highly speculative assets like cryptocurrencies (Bitcoin, et al), meme stocks (GameStop and AMC), and special purpose acquisition companies (SPACs). Then, they have moved on from those and back into tech industries like online media and software. Unlike the middle part of last year where the mega-cap tech companies dominated market returns, there has been no dominant, sustained leadership from any single sector or group.

We view this rotation as evidence of a healthy market. It is notable, particularly with the large tech stocks, that even as investor interest shifted to small cap and value, the tech stocks held their gains and did not sell off. We take it as a bullish sign that investors are staying in the market and searching for the right places

(Continued on page 2)

Animal Spirits and Markets by John Hubard

Regarding financial markets, "Animal Spirits" refers to the set of psychological and emotional factors that drive investors to act when faced with high levels of volatility in the markets. The two factors most commonly discussed are fear and greed. Monitoring various measures of market sentiment as proxies for fear and greed can help us understand current levels of risk in the market and how to avoid falling victim to our human nature.

In recent years more attention has been given to understanding the human side of investing, and today "behavioral investing" and "market psychology" are major parts of investment curriculum. In addition to fear and greed, overconfidence or any other "non-economic" motivation to buy or sell are potential pitfalls found in decision making. Because we know humans' investment behavior is influenced by these variables, it is clear that market participants do not necessarily behave rationally when making decisions.

Former Fed Chair Alan Greenspan famously coined the term "irrational exuberance" to refer to unreasonable levels of investor optimism when sentiment had reached an extreme. From studying market history, we know that major market tops and bottoms are associated with excessive levels of either greed or fear. These important turning points follow periods characterized by excessive risk taking or extreme caution. At one extreme everyone is fully invested, stocks are expensive, and there is no one left to buy. At the other extreme everyone is scared, there are no more sellers, and prices are too cheap to ignore.

Another way to contextualize the stock market so that we are making informed decisions not based on emotions is by understanding how markets trend. Financial markets move in three directions: uptrends, downtrends and sideways consolidation. Uptrends are characterized by price patterns of higher highs and higher lows, and downtrends by lower highs and lower lows. Sideways consolidation shows a lack of any real price progress in either direction. Using multiple time frames allows us to get a complete look at a trend which is made up of a *primary trend* (longer term viewed on monthly charts), a *secondary trend* or counter-trend move (intermediate term seen on daily or weekly charts), and *minor trends* which are generally "noise" and largely driven by financial news. Primary trends are usually very durable, lasting multiple years. Understanding this can help the long-term investor tune out short-term noise and work with the primary trend rather than against it.

Following a defined investment process with a long-term view which includes buy/sell rules, the regular monitoring of various sentiment indicators, and adherence to basic tenets of technical analysis including trend studies and relative strength is the best way to ensure that one does not "follow the herd" and end up buying at the top (the point of maximum confidence) and selling at the bottom (the point of maximum fear) – a worst-case scenario.

For most investors, relying on the services of a skilled and experienced investment advisory team may be the most practical way to implement an effective investment process. *(Continued on page 3)*

Second Quarter 2021 Review and Outlook (continued)

(Continued from page 1)

to put money rather than selling out and moving to cash.

Looking ahead to the second half of this year, we are optimistic that the market will avoid a major decline even though a summertime correction would be in order and would help to reset expectations. The shift back to growth stocks and levelling off of bond yields may be signaling that we're near the peak of the recovery in corporate earnings and GDP growth. Certainly, growth will continue, but we've likely completed the steepest part of the climb back from the pandemic-induced lows. As the economy continues to recover, we expect bond yields to rise moderately with the yield on the 10-year Treasury approaching 2%. Given the mixed leadership evident so far this year, active stock selection will be important to preserving portfolio values and sustaining returns. Risks to the market in the second half include a renewed inflation scare where inflation proves to be less than "transitory" and possible missteps or miscommunications from the Fed. An overshoot on bond yields could also cause trouble for stocks. Needless to say, a significant setback in the stellar progress against COVID could also roil markets in the short term.

Investing Tips from the Greats by Jim Hall

During this long-running bull market, we have all become aware of stock market volatility where certain sectors or stocks move in or out of favor. Volatility is just part of the investing process which more often than not, creates buying opportunities for future gains. Technically, the bull market officially ended last March during the pandemic when the market sold off very quickly; however, when viewed against the longer upward trend since 2008-2009, it can be simply viewed as a rather sharp but very temporary downdraft that has completely been erased while new highs have been established.

William Green, an author of many market articles, recently published *Richer, Wiser, Happier: How the World's Greatest Investors Win in Markets and Life*. The book was published after he studied the philosophies and interviewed many famous investors including Sir John Templeton, founder of Templeton Funds; Jack Bogle, founder of Vanguard Funds; Warren Buffett and Charlie Munger, founders of Berkshire Hathaway; and Howard Marks, co-founder of Oaktree Capital Management.

The book is a pretty quick read and also focuses on some life lessons, rather than being solely about markets and investing themes.

Among the nuggets he gleaned, several are common and stand out as themes across each interview:

- When you invest in a stock, you are buying into a business with an underlying value that may or may not be accurately portrayed by the stock price. The market tends to follow a "herd" mentality with certain stocks moving in or out of favor based on an analyst opinion or report. When a stock moves out of favor, it may present a buying opportunity.
- It's always best to reduce or eliminate debt, avoid leverage and excessive expenses. In a debt-free position, it's much easier to ride out any sort of downturn in the market.
- Respect uncertainty. One can never predict the timing or triggers for disorder, chaos, or surprises. Be ready to seize upon an opportunity when the general market seems to be negatively focused on some extrinsic event or occurrence. Most recently we saw this with the pandemic reaction when almost every stock took a very swift dive.
- Avoid getting caught up in fads or investing in a stock that's not understood and may be at the top of a cycle. The recent trades involving "meme" stocks represent a perfect example of this phenomenon. Many of those stocks are trading far beyond their intrinsic business values based on current cash flow or even based on their projected cash flow.
- Avoid trading too often in a taxable account. Own the stocks you like and allow them to work. Many make the mistake of trading often based on market whims and end up with excessive fees and taxes that eat away any profits.

You will notice your accounts with us at DHFB tend not to have a great deal of turnover. We rely on a mix of technical analysis and fundamental analysis in order to understand when particular companies have valuable goods and services that are in demand and are starting to be accumulated by investors and funds. Some of our long-time clients will have stock positions that have enjoyed continuous appreciation over many years.

Rather than doing their own market research and analysis, many of our clients choose to spend their time doing other things and entrust us to assist them with their investment management needs which brings us to one of the final bits of advice from the book: If you have neither the time to devote nor the interest in doing your own research and analysis, find an investment manager you trust and work with that firm.

Animal Spirits and Markets (continued)

(Continued from page 2)

At Dixon, Hubard, Feinour & Brown we follow a collaborative, well-defined, risk-adjusted process which ensures that important decisions are not based on emotion. We believe investing in stocks which are in primary uptrends, supported by bullish trading volume and demonstrating price strength relative to the market index, adds a margin of safety to our investments. Our job is to be sure our clients don't follow the herd off the cliff.

You Probably Need Umbrella Insurance by Bob Martin

We have mentioned to you in previous newsletters our broadening financial planning services. Part of a planning discussion can include your insurance protection. While life and disability insurance and longevity protection are often discussed, a subtler but necessary form of protection is personal liability insurance.

Liability insurance protects you and your family's finances from liability exposures such as lawsuits against you. For example, if you are in an automobile accident which results in bodily injury to others, your liability coverage on your automobile policy can pay for legal defense and any judgements or settlements up to the liability limit. Similarly, homeowner's liability insurance can protect you from various claims for property damage or bodily injury to others. For example, if you have watercraft at Smith Mountain Lake or at the beach, you have more liability exposure.

The safety net of liability insurance, however, only stretches as far as the coverage limit of the underlying insurance policy. If you have significant assets to protect in a lawsuit, you need higher levels of liability protection than usually afforded under the underlying policy--typically $250,000 to $500,000 on most policies. Even if you have more limited assets today, future income streams could be a factor in awards.

This is where umbrella coverage (excess liability insurance) becomes very important. Umbrella policies provide an added layer of liability protection above underlying limits. Additionally, an added benefit of umbrella insurance is that it can provide coverage that is not found in the base auto or homeowner's policy. Do you serve on a charitable board? Do you have a swimming pool, pond, or trampoline? Do you have dogs or other animals? Do you manage a family trust? Do you employ household staff? Do you have a high public profile? These are all questions to consider as you evaluate the relevance of umbrella protection.

The good news is umbrella policies are relatively inexpensive based on added protection. Even if you have coverage, adding additional coverage may be appropriate. Umbrella coverage is readily available from insurers who sell auto, home and watercraft coverage. Please give this consideration and have a conversation with your agent or insurer.