Intrinsic Investors

Timely Insights into Markets and the Economy

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Equities

- There are multiple ways to explain the equity markets these days. The bears are cautious while the bulls are optimistic. As usual, we here at Intrinsic Investors are *cautiously optimistic.* One really has to admire the resilience of stock investors considering everything that we have witnessed over the past year.

- As COVID-19 continues to give ground to increasing levels of vaccinations, the economy can continue to rebound and expand as we advance into 2021. Of course, now the concern centers on getting people to get their shots!

- Despite brief periods of volatility during the most recent quarter, *equities continue to impress.* It may not necessarily feel that way to large-cap investors. Many of the gains seen in 2020 have eased in recent months as prices in large caps approach full value for the year Relative Value (click link to view).

- Even the red-hot small cap trade has been taking a bit of a breather after exploding upwards this past November. That is not necessarily a bad thing as markets tend to get ahead of themselves as investors throw caution to the wind, which is always a bad idea. While the economy has been doing better (*"V-shaped" recovery*) and the employment situation stabilizes, there are always more than a few clouds on the horizon.

- *A sustainable earnings recovery is critical to a complete snap-back* from last year's drop. We continue to monitor signs of improvement on this front. Against the backdrop of otherwise encouraging news, this one still has my antennas twitching a bit.

Fixed Income

- Fed watchers had more to digest in 1Q21 as analysts ponder a plethora of changes to the monetary and fiscal landscape. Our main focus in this section is on fiscal policy.

- Without discounting the pandemic completely, a fair amount of attention shifted recently onto the rise in the 10-year Treasury Note. *The rate spiked north of 1.70% in March*, which was almost a full point higher than it was six months ago. This triggered inflation concerns and adversely affected equity prices.

- This, combined with rising US government debt has many experts concerned about the longer term implications, if rates continue to rise. *Historically, low interest rates have gone hand-in-hand with low inflation, since the cost of servicing the debt was comparatively low.* That situation changes once rates begin a sustained drive higher. For now, this is not an immediate concern.

- Another source of concern that will affect investors is *the prospect of rising taxes.* Not all of this deficit spending can be kicked down the road for our grandchildren to pay back and a new administration in Washington is proposing raising corporate taxes, as well as individual taxes on certain taxpayers. Some advocate increasing corporate rates to 28% while the compromise number sounds like 25%.

- One thing in particular to keep an eye on is *the fate of capital gains treatment on security transactions.* When Ronald Regan eliminated capital gains in the 1986 tax act, all that happened is that investors moved their assets into tax-free and tax-deferred investments and the deficit continued to grow.

- When Bill Clinton re-instated capital gains in the late 90's, investors returned to stocks in a big way. The main takeaway on this is that individuals always act in their own perceived self-interest. They always have and always will. Just sayin…

- Expect the *Fed to continue its neutral stance* on interest rates for the foreseeable future. Investors need to watch retail and wholesale prices for hints the Fed will eventually move, but for now, it appears that *the Fed wants inflation north of 2% and is finally getting its way*.

Conclusions

- Our managed accounts have done well during the first three months of 2021, averaging in the high single digits. I will take that over the same period a year ago. As I indicated at the beginning of this letter, we are cautiously optimistic but are ready to admit that the current environment could be "masking" future challenges. Sorry, I could not resist getting that one in!

- I did not get around to the *technical picture of the market* due to space constraints but will discuss this in detail in the next missive. In short, large caps are getting more bullish, small-caps are slightly mixed and volatility is bearish, which is bullish! More next time. Stay tuned!

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