Investment Tally & Perspective

MAJOR ASSET CLASS RETURNS				
	2nd Qtr. 2021	1-Year	3-Year	5-Year
Equities				
S&P 500	8.5%	40.8%	18.7%	17.6%
MSCI EAFE	5.2%	32.4%	8.3%	10.3%
MSCI Emerging Markets	5.0%	40.9%	11.3%	13.0%
Fixed Income				
Barclays Capital US Aggregate	1.8%	-0.3%	5.3%	3.0%
Barclays Capital US Corp. Inv. Grade	3.6%	3.3%	7.8%	4.9%
Barclays Capital Emerging Market	3.0%	6.3%	6.7%	4.9%
Other Assets				
MSCI US Reit Index	12.0%	38.1%	10.1%	6.3%
S&P GSCI	15.7%	57.4%	-2.7%	1.7%
ICE WTI Crude Oil	24.2%	86.8%	-0.3%	8.7%
Comex Gold	3.3%	-1.6%	12.3%	5.9%

Source: Capital IQ — All returns greater than one year are annualized

Market Activity -

Describing the market's most recent twists and turns has morphed into a practice of cutting and pasting from the prior quarter – another quarter closed, another strong period for equities. Bonds were also able to post decent returns for the quarter, curbing their year-to-date losses. Interest rates fell during the second quarter, contrary to our expectation, despite continued signs of growth and inflation.

Economic Activity & Monetary Policy –

The economic rebound that began in earnest early this year continues to gain momentum globally. Highly vaccinated economies are seeing strong growth, while less vaccinated countries are either dealing with widespread infections, or quickly implementing restrictions at the slightest sign of an outbreak. It will take time to get the world vaccinated, but we expect this current dynamic to fade.

In the U.S., manufacturing is showing extreme strength while services have just begun what is likely to be a robust recovery over the summer. Bottlenecks in supply chains, difficulty in hiring, and commodity costs are fueling inflation. While it is obvious that inflation is moving higher, the pace of increase may not be as extreme as headlines suggest. The trimmed mean CPI, which excludes the 16% of categories that are the largest outliers, was up 2.6% in May from last year, up from 2.1% growth seen in December. Core CPI (excludes food and energy) was up 3.8% from the prior year in May, up from 1.6% in December. One of the main drivers of this difference is the semiconductor shortage which is partly responsible for surges in prices of rental cars and used cars and trucks.

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Ronald E. Albert, CFP

Brittany A. Moran, CFP

Sean McGuirk, CFA

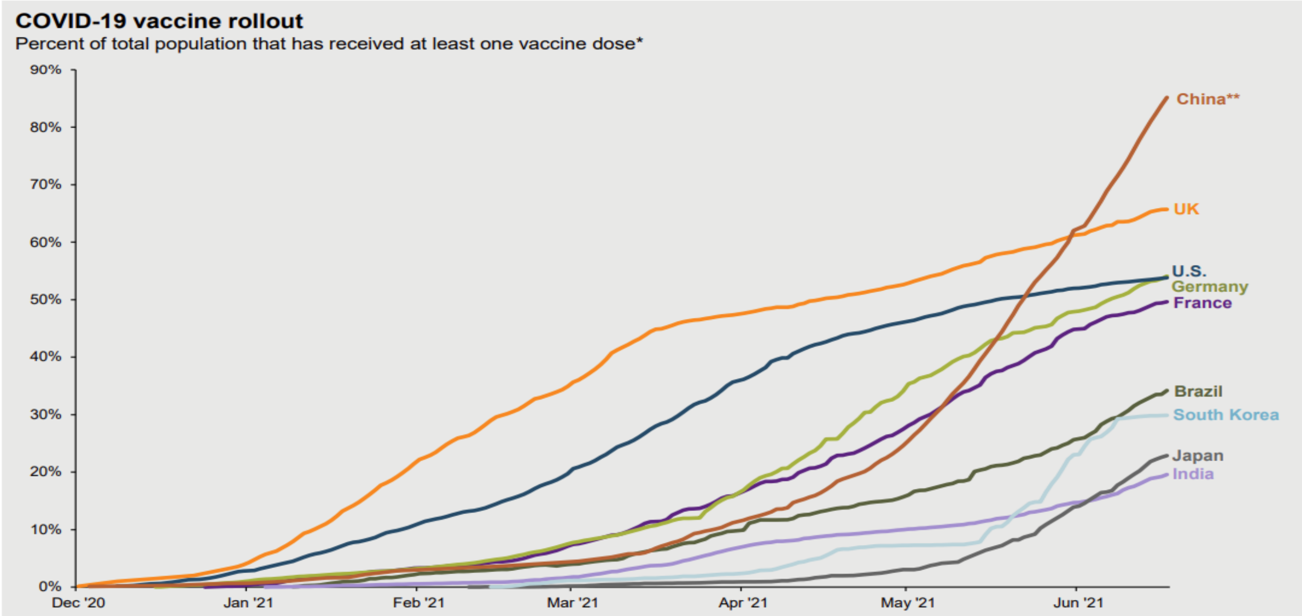
Alexander Albert, CFP

Nina Walsh

Karen Jones Ariosta

40 Westminster St., Ste. 202
Providence, RI 02903

401.454.3040 (phone)
855.768.3040 (toll-free)
401.453.0678 (fax)
info@lincolncapitalcorp.com
www.lincolncapitalcorp.com



Source: Our World in Data, J.P. Morgan Asset Management.
*This metric represents the share of the total population that has received at least one vaccine dose. If a person receives the second dose of a 2-dose vaccine, the metric stays the same. Share of total population may not equal the share that is fully vaccinated if the vaccine requires two doses.
**Data for China represents cumulative doses administered per 100 people, as China does not report the breakdown of doses administered by first and second doses.
Guide to the Markets – U.S. Data are as of June 30, 2021.

J.P.Morgan
Asset Management

The U.S. labor market is behaving oddly with some head-scratching events. Consider this – while 9.5 million people are unemployed, there are 9.2 million job openings and the national quit rate has hit a record high (data from the Jobs Openings and Labor Turnover Survey). What gives? What is behind these anomalies?

Childcare, health concerns and extended unemployment benefits are the most cited causes. Though difficult to know with certainty, Governors that have refused to extend the $300 Federal unemployment supplement have seen a marked decline in their unemployment rolls compared to states that are leaving extended benefits in place through September (Wall Street Journal). If true, then the passage of time combined with the loss of benefits may play significant roles in getting “workers back to work”.

The Fed has been clear that the labor market is a critical variable for U.S. monetary policy. Until the target level of employment is reached, the Fed is not expected to hike rates. Yet another major variable is current and expected inflation. The Fed is not looking to lift interest rates until inflation is above, and expected to stay at or above, their target range. Inflation is currently above target with expectations for it moving higher. At its most recent meeting, the Federal Open Market Committee released their expectation for two rate hikes by the end of 2022, while also beginning to discuss when to end their quantitative easing campaign (which should begin well before the first-rate hike). Globally, there have been more interest rate hikes than cuts this year, however, none of the hikes have been from major central banks. While still accommodative, we expect central banks will begin to gradually tighten policy this year.

Valuation and Sentiment –
Fund flows and individual investor behavior point to positive sentiment towards equities. This year has seen strong and steady inflows into global equities, with modest increases in bonds and outflows from money markets. Inflows to Schwab, TD Ameritrade, E-Trade and Robinhood have continued to outpace pre-pandemic rates – suggesting strong non-institutional participation. Valuations continue to be stretched in our opinion, once again looking cheap only in relation to bonds. Valuations on forecasted multiples are likely not as extended as they appear. With the release of pending second quarter reports, it is very likely consensus expectations for future sales and earnings will be heading higher.

Investment Outlook and Strategy

When trying to divine the future, and for proper context, it pays to review the relevant past. As an example, consider the fact that, in the past two decades, we have experienced three bear markets:

- The Tech Bubble from 2000 to 2003
- The Great Recession from 2007 to 2009
- The Pandemic Recession and Bear Market 2020

A relevant question is "What do the most recent recessions and bear markets have in common?"

Prior to reaching the tipping point in the Tech Bubble and Great Recession, the Fed had kept monetary policy too loose. For example, near the peak of the tech bubble there was global concern that older computer systems may not be able to digitally handle the change in centuries (Y2K), fanning fears that trains and airplanes may stop functioning. With concern for the negative impact that Y2K and the tech bust may bring, the Fed pumped liquidity into the economy for insurance and to protect the overall economy.

In a similar manner, a case can be made that the seeds of the Great Recession can be traced to large amounts of Fed stimulus following the tech bust. Easy credit and rising asset values produced a real estate bubble which burst when real estate prices began declining.

Will time show that the Fed is, once again, putting too much fuel in the system? Will every such action result in a negative reaction? While no one, including our firm, can accurately predict with confidence, precision, and integrity where prices will be at the end of 2021 and in future years, Fed policy and interest rates may be approaching an inflection point with significant ramifications for the financial markets. While the Fed wants to avoid negative interest rates, if a growing economy is running short of human and material resources while inflation expectations rise, the Fed may find themselves in a box, as lowering interest rates that are near zero is not a viable option.

We continue to expect equity returns to exceed returns from fixed income securities as we move through the second half of the year, yet we anticipate more volatility and periods of market turbulence in the months ahead. While our accounts have participated in recent market returns, given the investment background we are managing accounts in a more defensive manner.

Lastly, we found the following historical market data in the latest issue of Barron's of interest and thought you may as well (figures refer to the S&P 500 Stock Index (SPX)).

Quarterly - The SPX return for the quarter ending June 30, 2021, was 8.2%; this was the 5th consecutive quarter with a rate of return above 5%. This is only the second time since 1954 this has occurred and, worth noting, 1954 was also a period of ultra-low interest rates. After five consecutive quarters of greater than 5% growth in 1954, the SPX return for the following quarter was 1.7% and the 12-month return was 26%.

Monthly - The SPX return for June was the fifth consecutive month of positive returns with the index ending the month at an all-time high; this has occurred 17 times since 1961 and the index was higher one year later all 17 times.

As always, please contact us with any questions or to discuss your account management.

PROTECTING HARD-EARNED ASSETS

When we give thought to our personal wealth, we naturally think about how to spend and grow our money, but neglect protecting our assets from lawsuits, creditors, and in certain situations, family members. Doctors, corporate executives, and those in other litigation-prone professions are not the only ones who need to be on guard, as there are many circumstances in which assets can be attached or garnished - bankruptcy, divorce, or lose a civil lawsuit.

We often advise clients to take advantage of their retirement plans and IRAs, as they allow you to exclude contributions from taxable income and provide tax sheltered growth. Another benefit is the legal protection they provide. The Bankruptcy Abuse Prevention and Consumer Protection Act, passed in 2005, allows Roth and Traditional IRAs to have an inflation adjusted protection cap of more than $1 million (currently more than $1.3 million) against bankruptcy proceedings. Other types of retirement plans - SEP, SIMPLE, and assets rolled over from qualified plans to IRA's - have an unlimited cap on the amount of the protection. ERISA plans, such as employer sponsored 401(k) and 403(b) plans, have had this protection in place for years prior, and may also provide an additional layer of protection against other court cases with two notable exceptions – Divorce, where a qualified domestic relations order (QDRO) can award retirement assets to your former spouse, and tax levies from the IRS.

Some states provide a homestead exemption, which allows homeowners to declare a certain amount of equity in their home as exempt from creditors. These exemptions are not available in every state, and the amount in each state also differs. Rhode Island currently provides a generous exemption of $500,000, so paying your mortgage balance down sooner to build equity not only eliminates debt but can provide further asset protection.

While a revocable living trust allows the grantor (the owner of the assets) to designate the terms of how their assets will flow to the trust beneficiaries and avoids probate court, it does not provide protection from creditors or lawsuits against your estate. An asset protection trust, which is not available in all states, is an irrevocable trust that allows the grantor to name themselves the beneficiary. Even though the grantor no longer owns the trust assets they may, at the discretion of an independent trustee, provide distributions to the grantor and, given that these assets are no longer owned by the grantor, they are out of reach by creditors. Whether the asset protection trust is a Domestic or Foreign (offshore) trust, the services of an experienced estate planning attorney is highly recommended.

Other considerations include purchasing an umbrella insurance policy which is a type of personal liability insurance that can help protect your assets in excess of what your homeowners, auto, or other insurance policies cover. Business owners are often advised to separate personal assets from business assets by establishing the business as a corporation, a limited liability corporation (LLC), or limited partnership which, if a lawsuit goes against you personally or the business, the assets of the other will be excluded from liability.

It is important to plan ahead, as these asset protection measures do not work if you are already in trouble. Please view Lincoln Capital as a resource if you have any questions and, as always, please contact us if we may be of assistance in any financial manner.