

Nauset Market Commentary Second Quarter 2021

Market Performance Recap: Stock Gains Continue

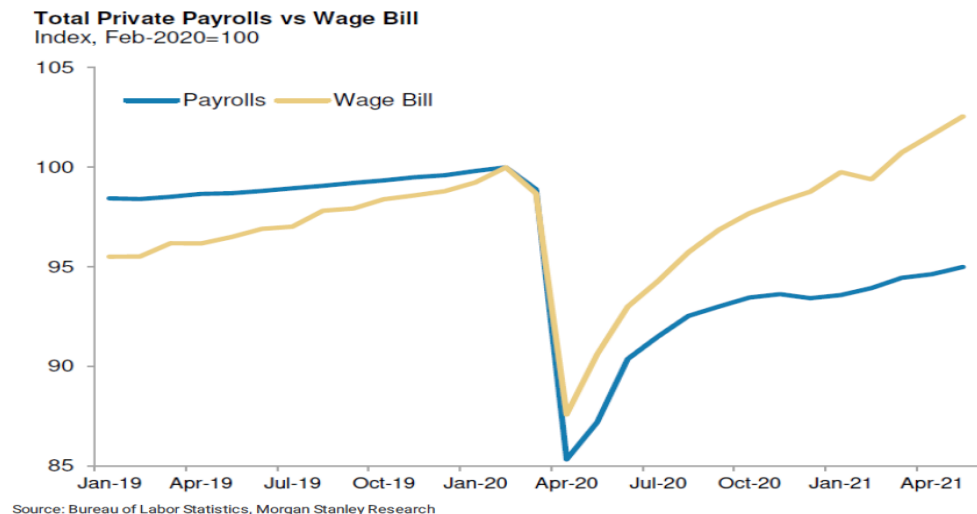
The recovering US economy boosted stocks once again in the second quarter. Investors were buoyed by the reopening of local economies across the US as the pandemic ebbs. The Russell 1000 ended the second quarter on a fresh high, up +8.5%, led by tech, energy, and health care sectors. The tech-heavy NASDAQ was the best performing major index for Q2, gaining +11.7%. International stocks posted solid gains as well with EAFE up +5.2% and Emerging Markets index climbing +5.0%. After a down first quarter, fixed income rebounded to post a gain of +1.0% per the Barclays Intermediate Gov't/Credit bond index.

Economic & Market Discussion: Surprise! Labor is Front & Center

A fascinating aspect of the pandemic recovery economy is the change in labor market dynamics from pre-pandemic times. The continued rebound in new jobs has seen significant wage growth along with other changes. What does this mean for companies, earnings and the stock market now and going forward?

- Jobs Rebound, But Still Lag – The US job market lost over 20 million jobs in April/May of 2020. The job recovery has strengthened recently as employers have enticed workers back with higher wages and other perks. However, the economy is still down 6.5 million jobs from pre-pandemic levels and the unemployment rate stands at 5.9% vs. 3.5% pre-pandemic.
- Wage Gains: Good or Bad? – Compared with February 2020, the month before the pandemic plunged the U.S. into recession, average hourly earnings among private-sector workers have risen +6.6%. The chart below shows how wages have outpaced the job recovery. The consensus opinion is that workers finally have some wage power and ability to demand better work conditions. The other side of this is that higher wages and benefits can negatively impact company profits and drive inflation. Will this development hurt earnings growth or will worker productivity and efficiency gains offset higher wages? We believe the latter outcome will play out, but this is a market risk we will monitor going forward.

Exhibit 1: The aggregate wage bill has recovered more fully than jobs



- New Work World – While recent wage gains are a key new labor development, the pandemic has also caused other changes – increased work-from-home, different office configurations, reduced travel and a more flexible work force. We believe that many of these changes will become a permanent part of US and global work conditions. Along with increased tech-enabled productivity, we are positive on how workers will benefit and companies can profit from this changed work environment. All of this bears watching as we move through the end stages of the pandemic into a new normal for work.

Portfolio Strategy: Diversification is Risk Management

The recent record highs in US stock market indices have created some nervousness among investors. Are US equity markets overextended and too risky? Is a major correction around the corner? In this environment, it makes sense to quickly review how our active asset allocation portfolio management strategy works to manage risk.

- Seven Asset Classes – We segment portfolios into seven asset classes, each with different return/risk profiles: Growth, Emerging Growth, Real Assets, High Yield, Income, Alternatives and Cash. For each client portfolio, we manage to specific weights for each of the seven asset classes. We continually set and manage overweights and underweights to each class and subsector to manage and reduce risk of any single asset class or subclass, while creating differentiated sources of return.
- US Equity is only One Allocation – US equity is one allocation within the Growth asset class. For our clients, the portfolio allocation to US equity ranges roughly from 20-50% of total portfolio assets, depending on risk profile. In no case is US equity ever a 100% allocation. Investment news flow creates the perception that US large cap stocks are the only investment held by investors, and thereby overemphasizes the general risk of investing. The reality is diversified portfolios, like those we manage, carry less risk than a 100% US large cap stock portfolio.
- International Equity, Real Estate and Bank Loans – Demonstrating diversification in our portfolios, we recently added exposure in these three very different areas -- real estate, international equity, and floating rate bank loans -- to most portfolios. These elements provide differing return potential at different risk levels. Together with other portfolio elements, we continue to seek attractive long-term returns with appropriate levels of risk.

Market Index	Market Performance					% Change for Periods Ended 6/30/2021				
	Second Quarter	2021 YTD	1-Year	3-Year Annual.	5-Year Annual.					
Russell 1000	8.54	14.95	43.07	19.16	17.99					
MSCI EAFE – Non-US	5.17	8.83	32.35	8.27	10.28					
Russell 2000	4.29	17.54	62.03	13.52	16.47					
MSCI Emerging Markets Equity	5.05	7.45	40.90	11.27	13.03					
DJ US Real Estate	11.68	20.28	32.26	11.60	8.20					
NASDAQ Composite	9.68	12.92	45.23	25.72	25.80					
Barclays Gov't/Credit Intern. Bond	0.98	-0.90	0.19	4.70	2.63					
Wilshire Liquid Alternative	2.22	4.44	11.56	3.79	3.25					
3-Month T-Bill	0.01	0.02	0.08	1.31	1.14					