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Sound Investments Inc.

1st Quarter 2021

DJIA 32981 S&P 500 3972 Nasdaq 13246

Summary

Most of the time, a strong economic recovery produces an upward sloping market but we are in strange times and the market has already made a big move.

A major concern is inflation. The chart on the back of this page shows the consumer price index increasing .6% (.6 x 12 = 7.2% per annum). Digging deeper, energy increased 5% in March and basic food items like corn and soy beans have increased over 50% in the last 4 months. Higher inflation normally leads to higher interest rates,

As I write this in April, first quarter earnings are being released and investors are looking for signs of confidence, from executives, that customer demand will keep rising and cost can be managed. Recently, the S&P 500 traded at 22.6 times earnings compared to the 5 year average of 18.1. So the question to ask is, Has All the Good News been Priced In? Our sense is earnings will continue to grow but at an uneven rate as businesses reopen. The case for equities is sound but some caution is warranted.

This investment letter is mailed quarterly to our clients and friends.

What a Difference a Year Makes!

One year ago, we were writing about the fastest bear market ever amid an economic shutdown that was compared to the Great Depression of the 1930's. The future looked grim, yet stocks soared off their Mar 23rd, 2020 lows. After such a dramatic move, it is interesting to go back to the client letter I wrote on the 4th quarter of 2019 and the 1st quarter of 2020 which are posted on my website, (www.soundinvestments4.com). At the end of 2019, I quoted Abbey Joseph Cohen, Jim Crammer and Charles Akre who all thought there was more that could go wrong than right ... which proved to be right in March as the market dropped over 30% in 10 days. In the next quarter ending in Mar 31st, 2020 after the market had suffered a major downtrend I made the case for equities, stating equities were relatively cheap. A chart showing the bottoming action, starting on Mar 23rd was presented. While I did not sell at the top in Jan, but did have a healthy cash position going into the pandemic and was decidedly on the buy-side after March 2020, and we were rewarded.

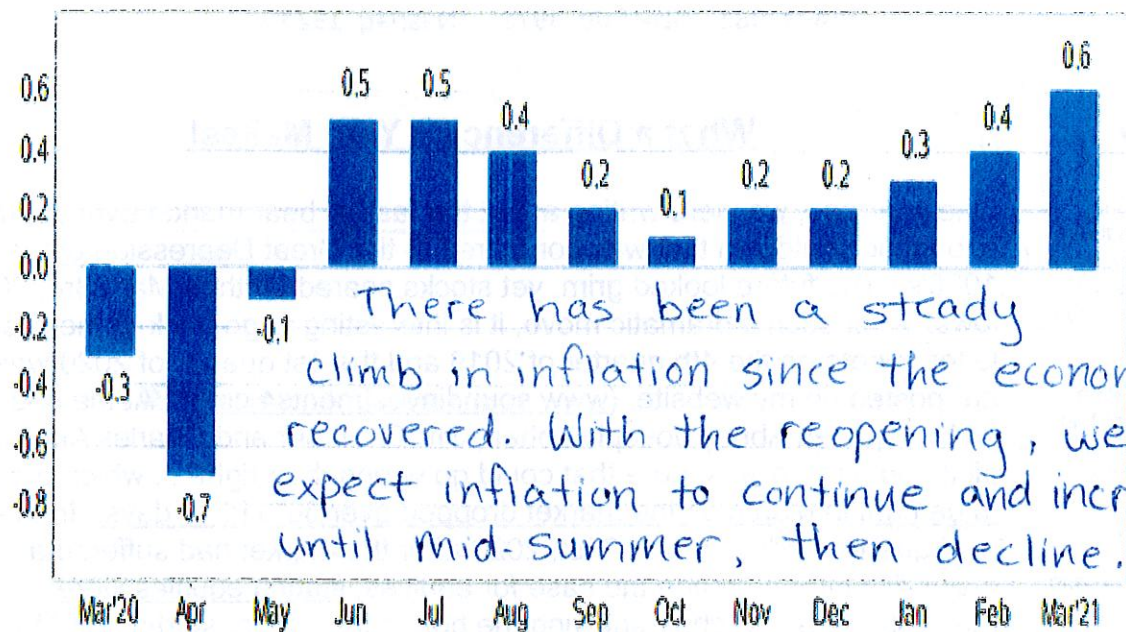
For the first quarter of 2021, the S&P 500 gained 6.4%, the NASDAQ 100 growth stocks were flat and the small-cap Russell 2000 index gained a strong 12.9%. It's clear that market leadership has shifted significantly as outlined in the last client letter under stock rotation. Large-cap growth, particularly technology stocks, led by huge amounts until 6 months ago. Small companies, value and energy, had underperformed for most of the last decade, but are now the leaders.

I hope no one thinks I am bragging as I am not an investment guru or genius, I honestly follow a number of investment research letters and stay at it. If anything, after 30 plus years, the stock market has made me very humble. In the balance, of the letter I want to talk about heightened valuations, inflation concerns and rising interest rates.

Forecasters Brace for Uncharted Liftoff

The 1982 recession was particularly severe with interest rates peaking at 16%+ and unemployment in the 10% range. However, by 1983 things turned around and the growth rate hit an astonishing 7.9%, the highest it's ever been. With the increased Covid-19 vaccinations, economists are

Chart 1. One-month percent change in CPI for All Urban Consumers (CPI-U), seasonally adjusted, Mar. 2020 - Mar. 2021
Percent change



Interest rates are increasing with the reopening of the economy but are still very low.



upping their forecasts for the following reasons:

- We are in round 3 of the Helicopter Money with an additional \$1400 disbursed to the vast majority of Americans. Also, the Federal Unemployment Supplement of \$300 per week helps. Earlier rounds of payments went to savings and investments. Personal savings in 2020 soared to 2.85 Trillion up from 1.23 Trillion in 2019, (a 131% increase). Bottom line people have money to spend!
- An infrastructure package is expected to be passed this year which is another strong positive.
- The Federal Reserve Bank is doing its best to keep interest rates low, (See enclosed excellent article by Jeremy Siegel of the Wharton School of Business).
- We expect the housing sector to do well going forward based on housing starts and building permits issued. Demand is strong even in the face of rising input costs, supplier shortages and longer delivery times. The median price of a new home rose 7% over the past year while an existing home increased 16.2%.
- The conference board of Leading Economic Indicators rose 0.2% in February as 6 of the 10 indexes increased. This marks the 10th consecutive monthly gain even before the \$1.9 trillion in stimulus takes hold.

Does a Rosy Economy Mean an Uptick in Stocks?

Most of the time, a strong economic recovery produces an upward sloping market but we are in strange times and the market has already made a big move, (See Chart on the back of this page).

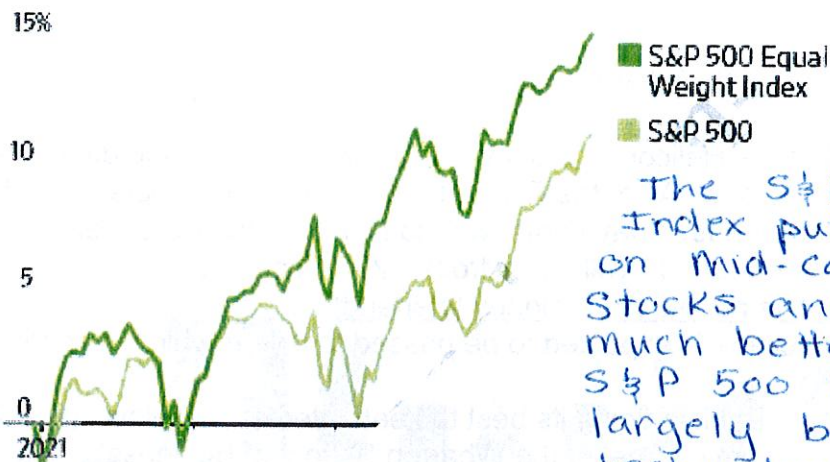
A major concern is inflation. The chart on page 2 shows the consumer price index increasing .6% (.6 x 12 = 7.2% per annum). Digging deeper, energy increased 5% in March and basic food items like corn and soy beans have increased over 50% in the last 4 months. Higher inflation normally leads to higher interest rates, (see chart on back of this page). We feel interest rates will go higher into summer and then recede. At this point, these numbers are not significant, but bear watching.

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Conclusion

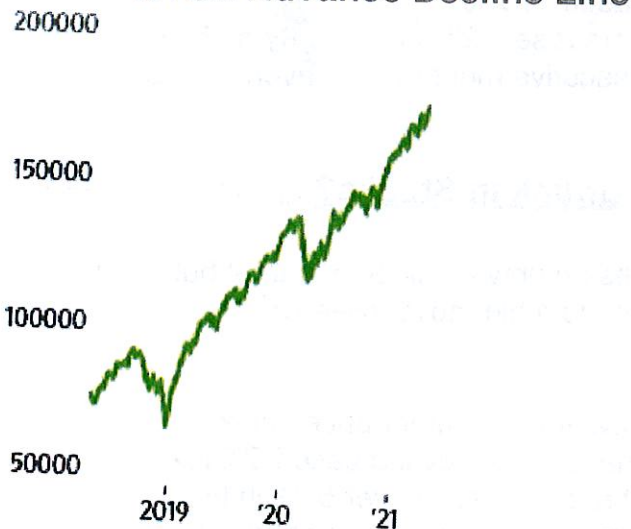
We feel, that there will be some bottle necks as the economy reopens and there will be some stumbling along the way, but it is reasonable to expect an upslope or an increase in business activity over the balance of 2021. We think that the market will be higher a year from now as we move into 2022. We welcome your calls

Index performance, year to date



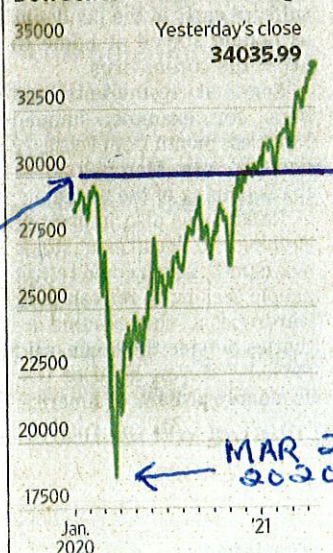
The S&P 500 Equal Weight Index puts more emphasis on mid-cap and small-cap stocks and has performed much better than the S&P 500 which is driven largely by large technology stocks.

NYSE Advance Decline Line



This index shows a greater number of stocks have been propelling the market higher. This shows a widening of the bull market, indicating more gains could be ahead.

Dow Jones Industrial Average



Dow Jones prior to pandemic

The Dow Jones Industrial Average was up over 13% prior to the pandemic. The S&P 500 is also up a similar amount since the beginning of the crisis. This may make the market more volatile going forward.