One year. It seems incredible, but it has been one year since COVID-19 struck our shores. One year since the World Health Organization declared a pandemic. One year since the markets crashed and the schools closed, and we realized just how much we take toilet paper for granted.

Since then, the markets have recovered and risen to new heights. The economy, meanwhile, has recovered more slowly. Now, a quarter of the way through 2021, we have a new president, several new vaccines, and a completely different world than the one we knew before all this started. We have also seen some renewed volatility in recent weeks. This has many of my clients asking, "Where are the markets going next? What should we expect for the rest of 2021?"

We'll address those questions in this letter.

As you know, there are two types of long-term market situations: Bull markets and bear markets. But the whole "bull vs bear" concept can also be used to describe two types of investor sentiment. Bulls are investors who have a positive, or "bullish", view of where the markets are headed. Bears, meanwhile, generally have negative, or "bearish" expectations. So, in this letter, we're going to let both animals debate each other, each presenting their case for why the markets will have a positive year or a negative one. We'll start with the Bull, move onto the Bear, and then give the Bull a chance for a short rebuttal. Finally, as your financial professionals, we'll give you *our* view.

The Bullish View

Last year's market crash was sudden, swift, and deep. But in the grand scheme of things, it didn't last very long. In fact, it took only six months for the markets to recover. (By contrast, it took the markets almost six *years* to recover after the Great Recession.) Since then, the markets have risen to new highs.

Three things propelled the markets to this remarkable turnaround: Low interest rates, federal stimulus, and the expectation of a major economic recovery. Let's start with the first one. To help juice up the economy, the Federal Reserve lowered interest rates to a historic degree. Low interest rates promote more borrowing and spending, two pillars our economy is based on. They also help people buy homes and encourage businesses to invest more in themselves. (Including hiring more workers.)

Congress, meanwhile, has passed three major stimulus packages in the last year. The most recent bill was signed by President Biden on March 11. The **America Rescue Plan Act of 2021,** as it's called, provides $1.9 trillion in aid for both businesses and consumers.[1] Among other things, the Act extends COVID unemployment benefits through Labor Day, provides $1,400 direct payments to individuals, expands certain tax credits, and grants billions to small businesses to help meet payroll and retain workers.[1] The first two stimulus packages had a positive impact on things like retail sales and consumer spending, and it's widely expected that this one will, too.

This combination of low interest rates and government stimulus have helped the economy tread water while we deal with the virus. But much of the market's rise is due to something else: Expectation. Specifically, expectation that the pandemic will end, and the economy will hit the accelerator. As more people are vaccinated and case numbers fall, the thinking goes, more and more of society will re-open, releasing a flood of pent-up demand. Demand to travel, to eat out, to catch a movie in theaters, you name it. Add the latest round of stimulus to the mix, and suddenly Americans have both extra money in their pocket *and* the means to spend it. In other words, all the ingredients are there for a *major* economic comeback, the likes of which we haven't seen in decades.

Now, we seem closer than ever to that expectation becoming reality. As of this writing, there are three approved vaccines in the U.S., with more than 115 million doses administered.[2] (40 million people are currently considered fully vaccinated, approximately 12.3% of the total population.[2]) Currently, our nation is averaging over 2 million shots *each* day.[2] It's no surprise, then, that cases in the U.S. have been falling for weeks. In fact, as of March 19, cases are down over 14% over the last two weeks.[3]

We're not out of the woods yet, not by a long shot. Masks and social distancing will continue to be a part of our lives for some time yet, and of course there are relatively new variants of the coronavirus to deal with. But if we can maintain this trajectory, increasing the number of people vaccinated and reducing the number of people sick, that could do wonders for our economy. It could lead to more of society re-opening, leading in turn to more jobs, more consumer spending, and greater company earnings. Greater earnings, of course, usually lead to higher stock prices.

The Bearish View

So, in light of all this, how can anyone have a negative view of where the markets are headed? It all comes down to a single word: **Inflation.**

Inflation. It's a scary-sounding word that conjures up images of German children stacking useless money in the 1920s, or gas rationing in the 1970s. For decades, economists have monitored it relentlessly. The Federal Reserve considers managing inflation to be a core aspect of its mission. That's partly why our nation's inflation rate has been relatively stable over the last twenty years.

But recently, some analysts and investors have begun stressing over inflation again. They don't deny that the economy is poised to grow. They just worry that it will grow too much, too fast. There's a word for this, too. Economists call it **overheating.**

When an economy overheats, it essentially no longer has the capacity to meet all the demand it faces from consumers. Some producers will simply not be able to supply all the goods their customers want. Other producers, to keep up with that demand, will be forced to raise prices. It's a classic example of the Law of Supply and Demand. (When the demand for something outpaces its supply, the price goes up.) For example, if everyone suddenly decides to fly to that vacation spot they've been putting off for a year, the cost of air travel would skyrocket.

If the economy were to grow too quickly, prices would rise across the board – and the value of our currency would drop. This, essentially, is inflation: When the general price level rises, a dollar simply pays for less than it used to. That makes it much harder for people to buy the goods and services they need. Or to pay off their debts. It makes it harder for businesses to hire new workers or pay the workers they already have. The upshot? When inflation gets too high, consumer spending plummets, unemployment jumps, and economic booms turn into economic busts.

Some experts worry this is what's in store in 2021. They see the economy as a garden hose that's been tied up into a knot. Untie the knot – or re-open the economy too quickly – and the water will burst out with sudden, savage force.

So, here's what this has to do with the stock market. Normally, the Federal Reserve combats inflation by raising interest rates. Higher interest rates tend to cool off the economy, because they prompt people to *save* their money instead of spending or borrowing it. A cooler economy decreases inflation, and gradually things go back to normal. The problem is the stock market has become accustomed to the Fed's low interest, "easy money" policies. Low interest rates mean that many types of investments, most notably bonds, simply don't provide the same return on investment as they would in a high-interest rate environment. That drives more and more investors into the stock market to get the returns they need. But what happens when interest rates go up? Consumers and businesses could cut back on spending, which in turn could cause earnings to fall and stock prices to drop.

Fear of inflation, and fear of higher interest rates. That's the bearish view in a nutshell.

Rebuttal

We promised the Bull would have the opportunity for a short rebuttal, so here it is. There are two main reasons for thinking this fear of high interest rates are overblown. The first is that, even if inflation *does* go up – which it likely will – we have a *lot* of room to work with before it becomes a problem. In 2020, the inflation rate was only 1.2%.[4] That's well below the 2% mark the Fed generally aims for, and nowhere close to the mindboggling numbers we saw in the late 70s and early 80s. (In 1979, for example, the inflation rate was 13.3%.[4])

The other reason is that there's no reason to assume the Federal Reserve will automatically raise interest rates just because inflation goes up. Why? Because the Fed itself has said that it won't![5] Currently, the Fed sees stimulating the economy and boosting employment to be far bigger priorities than tamping down on inflation, and recently, the Fed Chairman suggested interest rates would remain low at least until 2022.

My View

We've told you what the Bulls and Bears think. So, here's what *we* think. Go watch a video on YouTube and then read the comments. Ever notice how many people like to say "First"? In my experience, a lot of investors – be they Bulls or Bears – are like that. They stress over "getting ahead" or "being first", and as a result, they overreact to the slightest provocations.

Here at Hudock Capital Group, we don't worry about being first. We only care about moving forward. That's why we focus on one thing: Investing for the *long* term without trying to guess whether the Bulls or the Bears will dominate. That means positioning ourselves to take advantage of bull markets while being prepared – mentally and financially – for bears.

Historically, an improving economy leads to a stronger stock market. If that happens in 2021, wonderful! But *if* interest rate fears worsen and volatility goes up, experience has taught us not to overreact. Remember, we're not investing for next week, or next month, or next quarter. We're investing for *years.* Any general rise in prices is likely to be temporary, just as any bouts of volatility are temporary, too.

It's been a year since the pandemic began. A year since some of the worst market turmoil in a long time. We got through that by being disciplined and patient, and we've been rewarded. So, that's what we'll continue to do. Other investors can worry about being a Bull, or a Bear, or "first". We'll just continue being disciplined and patient.

If you have any questions or concerns about the market, please feel free to contact me. In the meantime, enjoy the upcoming spring season!

Sincerely,

Barbara B. Hudock CIMA®, CPM®
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