Perspectives

Newsletter I Quarter Ending March 31, 2021

Benefit Financial Services Group I 2040 Main Street, Suite 720, Irvine CA 92614 I Phone: 714.282.1566 I www.bfsg.com

Inside This Issue

Market Recap

In last quarter's Newsletter, we mentioned that the see-saw battle between value and growth stocks continued in the fourth quarter of 2020. It seemed that one day growth stocks would do well and the next day value stocks. That theme certainly continued in the first quarter of 2021.

However, in the 4th quarter of last year, growth stocks generally went up more than value stocks on up days and down less than value stocks on down days. It was definitely a "growth" year in 2020 (really decade!). In the 1st quarter of this year, this pattern totally reversed.

In the 1st quarter, the Russell 1000 Value index was up 11.26%, while the Russell 1000 Growth index was up 0.94%.[1] In fact, the technology heavy NASDAQ was up only 2.78% during the 1st quarter.[2] A tech surge on the last day, more than doubled the NASDAQ's returns for the quarter – yet value still significantly outperformed growth!

Investor confidence rose during the quarter, as the national vaccination program took off and a new round of stimulus checks hit bank accounts. The recent stimulus package and the infrastructure package that is now on the table are sure to boost our ecomony over the months and years to come (but at what cost?). Investors were also encouraged by the March jobs report, which showed 916,000 jobs created and the unemployment rate falling to 6.0%.[3]

On the other hand, bonds had a real tough quarter, as yields rose significantly. For example, the yield on the 10-yr. U.S. Treasury bond rose from .93% at the end of December to 1.74% at the end of March. That is a very large move for that short a period of time. Higher yields result in lower bond prices and that was reflected in the Barclays Aggregate Bond Index, which fell -3.37% during the quarter.[4]

International markets generally fared well, in spite of growing concerns about the possibility of a 4th Covid wave in Europe and signicant challeges regarding getting the population vaccinated. The MSCI EAFE index[5] (developed international markets) rose 2.83% and the MSCI Emerging Markets index[6] rose 1.95% during the 1st quarter.

- **Patrick Powers, CFA®, CPA, CFP®**
  Partner/Managing Principal

Forecast

The United States Federal Debt is now topping 28 trillion dollars which represents 108% of gross domestic product (GDP).[7] The late Senator Everett Dirksen once said, “a billion here and a billion there, pretty soon you’re talking real money.” Today, we are not talking about billions but trillions. Is all of this debt accumulated by the Federal Government sustainable? Some politicians, and a very small handful of economists, think so.

Many politicians have embraced Modern Monetary Theory (“MMT”) as a way to increase social spending without having to greatly increase taxes. The proponents of MMT believe that budget deficits don’t matter and that governments can always finance themselves by printing money (tell that to the people of Germany who experienced hyperinflation during the 1920s or Argentina during the Peron years). The key to making MMT work is that interest rates need to be lower than Gross Domestic Product (“GDP”), which is the case right now. However, when interest rates climb above GDP, which would be the case in a normalized economy, the debt dynamics change quickly and become unsustainable.

The main prescription of MMT is to have deficits be of sufficient size to maintain full employment. In theory, large deficits crowd out private investment and crowd in public spending and this is what MMT theorists believe will push the economy into full employment. However, investment in the private sector declines as the government becomes a larger part of the economic pie and that can’t be good. This role reversal puts Congress in charge of stabilizing the economy rather than the Federal Reserve.[8] Such politically-influenced policy would likely increase uncertainty, cause the economy to go through fits and starts, and in general be destabilizing and corrosive.[9]

Another problem with MMT is that large increases in government spending, without raising taxes much higher, should lead to an overheating of the economy. Then the government would have to rapidly tighten fiscal spending and the Federal Reserve would aggressively raise interest rates or face hyperinflation and a plunging U.S. Dollar, all of which defeat the purpose of MMT in the first place.

As the recent stimulus packages have demonstrated, deficit fiscal spending can be helpful when the nation is in a liquidity trap but could prove to be inflationary once full employment is reached. Famed economist, Milton Friedman said it best that “there are no free lunches.”

- **Steven Yamshon, Ph.D.**
  Partner/Managing Principal

Portfolio Management

The Baylor Bears were just crowned the national champions of the 2021 NCAA Division I Men's Basketball Tournament. My alma mater, UCLA, made a Cinderella run but fell short after a Gonzanga game winning shot in overtime. Each year, during “March Madness”, millions of Americans try to predict the outcomes of each game by participating in a bracket pool contest. Nobody has ever had a perfect bracket (correctly picking the winner of all 63 games). If we treat the odds for each game as a coin flip, this will make the odds of picking all 63 games correctly, 1 in 9.2 quintillion (=2^{63}).[10] You may have a better chance of winning the Mega Millions lottery jackpot (1 in 302,575,350)[11] than correctly picking all the games. The only certainty during March Madness is uncertainty.

Chaos theory[12] reigns supreme during March Madness. The most basic tenant of chaos theory is that a small change in initial conditions produces a large and unexpected divergence in outcomes. Chaos theory applies to systems in which each of two properties hold:

1) The systems are dynamic, meaning that the behavior of the system at one point in time influences its behavior in the future;

2) And they are nonlinear, meaning they abide by exponential rather than additive relationships.

The stock market is another system in which chaos theory applies. The fact that the American economy is continually evolving in a chain reaction of events is one reason why it is very difficult to predict.[13] No one expected that a global pandemic would cause the S&P 500 to fall 33.9% in just 32 days, and then rally 67.9% from the bottom, to end up 18.4% for 2020. This turnaround would have likely never happened unless there was tremendous support from Congress and the U.S. Federal Reserve Bank. The movement of the stock market is unpredictable and trying to predict the direction in any shape or form is a fool’s game.

How do we deal with this chaos and the unpredictability of the markets? What we need to do is concentrate our efforts on setting realistic long-term goals, creating sound investment policies, constantly evaluating the right mix of stocks and bonds, assessing your risk tolerance, and properly executing (i.e., rebalancing portfolios when deviations to target allocations occur). This takes fortitude to stay the course and keep on track. Please talk with us if there are any changes in your personal/financial situation, risk tolerance, or investment objectives for the purpose of evaluating our previous recommendations.

- **Michael Allbee, CFP®**
  Partner/Senior Portfolio Manager

Talk With Us!

The University of Chicago economist and Nobel laureate, Milton Friedman, famously said in the 1970's that the only group to which a company is socially responsible to is the shareholders and the goal of the company is to maximize returns to shareholders. The "Friedman Doctrine" became very controversial and it has been fiercely debated over decades.

Many of today's investors are expecting more than just shareholder returns from the public companies in which they invest. They want these companies to have management and leadership in place that are mindful of the footprint that they leave in the world. Some investors are interested in environmentally friendly companies, while others are looking to companies that are making decisions that benefit the social challenges that our country is facing. This has led to a new trend of investing known as Environmental, Social, and Corporate Governance ("ESG") investing.

Here at BFSG, we recognized this new trend early on and we understood that our clients have different needs and visions when it comes to their investing impact on the world. Over the past year, we carefully analyzed and researched various strategies to best meet our clients' needs. This initiative was spearheaded by our Managing Principal, Dr. Steven Yamshon, who has 35 years of investment experience and degrees in environmental resources and advanced certifications in sustainability and climate change. We are now proud to say that we have a number of different strategies to meet our clients' investing goals and objectives. Whether you are passionate about environmental opportunities that will reduce greenhouse gasses or are looking to invest broadly in companies that meet the ESG criteria, we have a portfolio strategy for you.

If you'd like to learn more about our "BFSG Climate Change & Green Portfolio Investment" or our "ESG" portfolios, please feel free to **Talk With Us**!

- **Arash Navi, CFP®, CPA**
  Controller/Financial Planner

BFSG - In The News

March 18, 2021 – [BFSG listed among Top DC Advisor Teams]

Meet the BFSG Team

Please welcome the newest addition to our team, Andrew Donahue, CFP®, MHA.

Andrew joins BFSG as a Wealth Manager and Financial Planner. Prior to a career in portfolio and wealth management, Andrew served as a congressional aide on Capitol Hill and held various senior roles as a health care administrator (hospitals and physician practices). Andrew has a B.S. in Finance from Virginia Tech, a Master of Health Administration from Virginia Commonwealth University, and a Master's Degree in Strategic Security Studies from the National Defense University in Washington, D.C. In his free time, Andrew enjoys sailing and he has earned his bareboat cruising certification from the American Sailing Association.

The Score Board

	03/31/2021	YTD Change
Dow Jones Industrial Average	32,981.55	8.29%
S&P 500*	3,972.89	5.77%
NASDAQ Composite*	13,246.87	2.78%
MSCI EAFE (USD)*	2,208.32	2.83%
Bloomberg Commodity Index	83.44	6.90%
Barclays Aggregate Bond Index	2,311.35	-3.37%
10 Yr U.S. Treasury Bond Yield	1.74%	83 bps
30 Yr Fixed Mortgage Rate	3.26%	39 bps
Prime Rate	3.25%	UNCH
Crude Oil ($ / Barrel)	$59.16	21.93%
Gold ($ / Oz.)	$1,707.71	-10.04%
U.S. $ / Euro €	$1.17	-3.98%
Core Inflation (excluding food / energy)		1.7%**
Inflation (including food / energy)		1.3%**

**Without Dividends; **Unadjusted 12-Months ended February 2021; bps (1 Basis Point = 1/100%); UNCH (Unchanged)*
Sources for Score Board and quoted statistics: WSJ, US Dept. of Labor, Federal Reserve

Sources:

1. The Russell 1000 Index is a stock market index that tracks the highest-ranking 1,000 stocks in the Russell 3000 Index, which consists of approximately 92% of the total market capitalization of all listed stocks in the U.S. equity market. The Russell 1000 Growth index is composed of large- and mid-capitalization U.S. companies whose earnings are expected to grow at an above-average rate relative to the market.The Russell 1000 Value index is composed of large- and mid-capalization U.S. companies that are thought to be undervalued by the market relative to comparable companies. Total returned quoted.
2. The Nasdaq Composite is a stock market index that includes almost all stocks listed on the Nasdaq stock market and is heavily weighted towards companies in the information technology sector. Price return quoted.
3. Source: U.S. Bureau of Labor Statistics (https://www.bls.gov/)
4. The Barclays Aggregate Bond Index is a broad-based index used as a proxy for the U.S. bond market.. Total return quoted.
5. The MSCI EAFE Index captures large and mid-cap segments in 21 developed markets around the world, excluding the US and Canada. Price return quoted (USD).
6. The MSCI Emerging Markets Index captures large and mid-cap segments in 26 emerging markets. Price return quoted (USD).
7. Source: Trading Economics (https://tradingeconomics.com/united-states/government-debt-to-gdp)
8. The Federal Reserve has a dual mandate of price stability and maximum sustainable employment.
9. Alesina, A. and Summers, L. "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence." *Journal of Money, Credit and Banking*, Volume 25, Issue 2 (May, 1993).
10. According to DePaul professor Jeff Bergen, if you know something about basketball, the odds are closer to 1 in 128 billion if every person in the U.S. filled out a bracket.
11. Source: https://www.megamillions.com/How-to-Play.aspx
12. Lorenz, E. "The Essence of Chaos", 1995
13. Silver, N. "The Signal and the Noise", 2012

To unsubscribe from this newsletter, please send an email to Unsubscribe@BFSG.com.