RBC Wealth Management
The Crescent Group
Carsten Frederiksen, CFP®
Senior Vice President
Financial Advisor
Senior Portfolio Manager
Portfolio Focus
Direct: 214-775-6401
NMLS#: 1321563 City National Bank
The Crescent Group website

Paul Hendershot
Senior Vice President
Financial Advisor
Senior Portfolio Manager
Portfolio Focus
NMLS # 1370978 City National Bank

Nick Weege, CPFA
Financial Advisor
214-775-6408

Lindsey Vickers, MBA
Client Service Associate
214-775-6458

Andrew Ielmini
Investment Associate
214-775-6448

March 2021 Crescent Commentary

As the world begins to move past the coronavirus crisis and enter an accelerated period of economic recovery, many investors find themselves asking "now what?" As recession yields to recovery, how should you position your investments for success going forward? In this commentary, we'll discuss some of the financial market dynamics playing out as economies recover from last year's damage. We'll explain why investments that provided a haven during lockdowns won't necessarily drive investment gains moving forward, and describe how our Group has positioned our clients to benefit from social reopening and beyond to long-term success.

During the pandemic panic last March, the Federal Reserve cut its benchmark interest rate to zero. They did this in an effort to limit the damage of coronavirus lockdowns to the U.S. economy. Lower interest rates encourage borrowing and therefore spending, which helps support the economy. Although the U.S. economy has shown positive momentum recently, the Fed publicly stated that it won't raise its key interest rate until 2024. Despite this public statement, interest rates have started increasing, with the key 10-year U.S. Treasury bond yield rising to its highest level in more than a year. This has happened because market participants see the economy recovering in real time and have conducted their own reassessment of the U.S. economy's prospects, without waiting for the Fed. These market makers now expect inflation to pick up as the economy recovers, and therefore demand a higher yield on the bonds they hold to account for their loss of purchasing power from inflation[1][2].

What does the increase in bond yields and interest rates mean for you as an investor? As mentioned above, their increase reflects current signs of economic recovery, as well as expectations of further recovery. This has led to a large market movement towards companies expected to benefit from the economic recovery and social reopening. Last year, our Group anticipated this time would come, so during the depths of the coronavirus pandemic, we increased our client allocations towards high quality industries hit hard by the pandemic, such as industrial companies, banks, and companies tied to restaurants, bars, and travel. Now that investors have begun to anticipate economic recovery and reopening, major investment funds have started moving to those industries, providing them with a

justified price recovery. We believe this recovery has room to run as economic and social reopening have a long way to go[3].

The large market movement towards industries expected to benefit from economic reopening and recovery has come at the expense of industries that investors flocked to as a pandemic safe haven. The long-term success of many of these industries remains in question, yet speculators moved into them last year mainly because digital businesses were viewed as resistant to lockdown pressures and because speculators saw their stock prices going up. The value of these types of businesses has fallen substantially this year as interest rates have increased. Without getting too technical, interest rates act like gravity in that increased interest rates pull down asset prices. Asset prices most impacted are those whose current value depends upon perceived growth and profits far into the future. For this reason, the value of speculative investments has fallen the most this year. Conversely, staid businesses with solid long-term but more stable growth, which pay substantial dividends in cash, are less impacted by interest rate increases due to the cash dividends investors receive up front. This unique combination of last year's speculation and increasing interest rates means that a strongly recovering economy could act as a negative for certain segments of the stock market[3][4].

So what now? In a world of global economic recovery with the potential for increasing interest rates and inflation, investors must strike a careful balance between investing for growth to achieve their financial goals while shielding their assets from investment segments most vulnerable to a negative impact from the recovery. What does our Group do to strike this balance? For starters, we assume an average of long-term interest rates over the past several decades when evaluating investments, rather than simply assuming the historically low interest rates of the past twelve years. That way our analysis accounts for a potential rise in interest rates. Second, we invest in industries and companies with a demonstrated track record of raising prices during inflationary periods over the past several decades. Third, we over allocate to industries and companies providing brands and products beloved and enjoyed by consumers all over the world, and which are resistant to technological obsolescence. Such companies and industries will benefit from increased consumer spending while also providing defensive protection from future economic turbulence. Investment returns over the past twelve years have misled many investors into thinking that asset prices only go up. In reality, financial assets have experienced prolonged periods of no return in the U.S. Whether you look at the Dow's period of no return for the seventeen years through 1981, or the S&P 500's nearly thirteen-year period of no return through 2013, or real estate's crash and burn during the financial crisis. Our Group never loses sight of the long-term realities of investing. We do not get caught up in momentary excitement. And we have designed our investment process to allow our clients to survive and thrive over the next several decades[5][6].

The Crescent Group
Carsten Frederiksen, CFP® | Paul Hendershot | Nick Weege, CPFA | Andrew Ielmini | Lindsey Vickers, MBA

Sources:

(1) The Financial Times
(2) CNBC
(3) The Wall Street Journal
(4) Morningstar
(5) Fortune
(6) S&P Dow Jones Indices LLC

The views presented herein are solely those of **The Crescent Group**, and do not necessarily represent the views of RBC Wealth Management. Current status of issues discussed in this letter is subject to change based upon market conditions and industry fundamentals. Clients should work with their Financial Advisor to develop investment strategies tailored to their own financial circumstances. Past performance is no guarantee of future results.

RBC Wealth Management, a division of RBC Capital Markets, LLC Member NYSE/FINRA/SIPC.