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2021 Second Quarter Review

Greetings Clients, and welcome back from a long holiday weekend!

U.S. stocks appreciated 15.3% in the first half of the year, world stocks were up 12.3%, and bonds declined 1.6%, as represented by the S&P 500 US large company Index, the MSCI All Country World Index of stocks, and the Bloomberg Barclays Aggregate Bond Index.

Over the past twelve months ending on June 30th, most Ridley Cove client accounts increased 25% to 30%. Clients that were fully invested outperformed our simple stock/bond benchmark as US large company stocks underperformed several other asset classes.

Yay, we have made a lot of money, but are we about to lose it? What's going to happen next?

If you have been a Ridley Cove client for a few months or more, you know that Chief Allocation Strategist Steve Bobo and I adhere to a discipline called multiple scenario analysis. This means considering several outcomes when we meet each month to review threats and opportunities. We routinely focus on four distinct scenarios, but let's boil it down to two:

1) Our investments go down: Asset prices are overvalued and unsustainable. Markets are distorted. Stocks have to fall.

2) Our investments keep going up. Our economy came to a screeching halt 15 months ago, but COVID infections and deaths are under control in our country. Consumers are beginning to exercise pent-up demand and recover from supply disruptions.

We believe that the happy scenario is most likely for the foreseeable future thanks to high vaccination rates, the likely passage of some form of a bipartisan infrastructure deal, and continued monetary support from the Federal Reserve. As we have seen more often than not in the past decade, bull markets can persist for a long time, and when bad news spooks investors, the markets usually recover quickly. Yes, all bull markets eventually come to an end, but they need a catalyst.

Current Price to Earnings (P/E) Ratios

Amazon.com, Inc.	67
S&P 500 Index	46
Quality Stocks (VIG)	26
US Value Stocks (VOOV)	20
International Stocks (SPDW)	16
Small US Stocks (SPSM)	17

The S&P 500's P/E ratio of 46 is well above its historical average of 16 since 1929. It is one of the reasons why we have increased our allocations to these other asset classes. In the previous two quarters (4Q20 and 1Q21), US large company stocks underperformed smaller company stocks and value stocks for the first time in several years as investors began to fear that overweighted technology stocks could not maintain their momentum. In the first quarter of this year, inflation fears (real or imagined) pushed up interest rates and encouraged investors to further abandon large growthy companies. Large companies are more reliant on debt financing than small companies, and debt becomes expensive when interest rates rise. In addition, many value-oriented companies like banks and insurance companies benefit from rising interest rates. Last quarter, interest rates drifted back down, and the S&P 500 Index once again outperformed smaller and more value-oriented investments.

We believe that fears of sustained inflation are overblown. Schwab strategist Liz Ann Sonders makes an excellent point about the interplay of economic growth and inflation in the attached article: "At least in the near term, the surge in economic growth expected for the second quarter serves as an offset to the upward pressure on inflation." And the non-partisan Congressional Budget Office just released its Budget and Economic Outlook Update, which projects that inflation will rise by 2.8% this year, but fall back to 2% next year.

The beautiful thing about our investment strategy is that we don't have to perfectly predict the timing of a single outcome in order to protect and grow your assets; there is almost always an outperforming asset class to sell and an underperforming asset class to buy. We review your accounts monthly and rebalance when we see juicy outperformance like we have had over the past few months. So while we cannot tell you what the markets will do next, we can assure you that we are confident in our approach, pleased with your performance, and comforted by the protections that we have put in place.

What makes all of this possible is knowing your cash needs. Please keep us updated so that we can avoid having to raise cash for you at an inopportune time.

We have uploaded your quarterly reports to your portals, and you can access them with the following link:

https://main.yhlsoft.com/auth/users/webportal/ridleycove.

If you just started working with us, you will receive your first performance report next quarter.

Please contact me if you have any trouble accessing your report, or if you have any questions about your investments, our strategy, or your financial goals. Our money is invested right alongside yours.

Sincerely,

John H. Biebel, J.D., CFP®