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Second Quarter 2021

# De-Risking of the Core Portfolios

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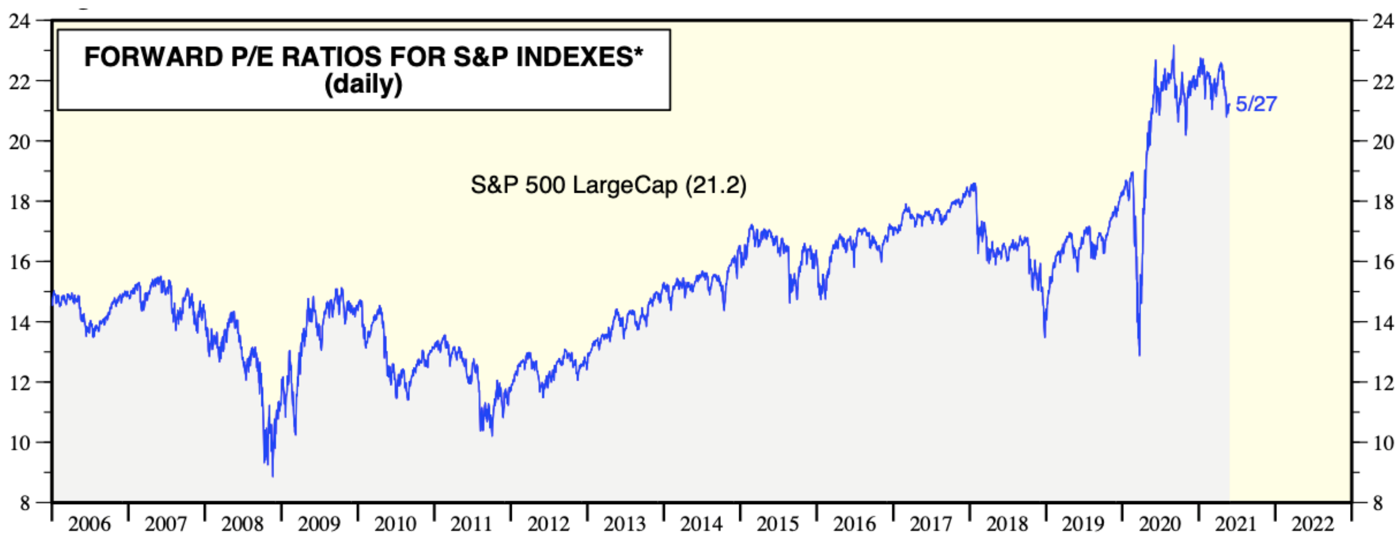
Michigan has dropped many of its Covid restrictions and hopefully more to come. Life is getting back to normal for almost everyone. Our regional sports teams are filling stadiums once again and reservations are hard to come by at our favorite restaurants. Great job everyone. Investment portfolios also weathered this pandemic quite well. Here's the strange part. As quantitively oriented investment managers we found it far easier to manage money during the pandemic than we do now.

Our investment frameworks forecast market returns based on current index levels in relation to multiple economic variables. Valuation is the cornerstone of this process. Valuation simply measures whether stock and bond prices are too high or too low relative to the economic backdrop. Last spring our frameworks were giving us a clear indication that stock markets were materially oversold. As of this May's month-end (we run the frameworks each month-end), our frameworks are forecasting domestic stocks will be about 2% higher over the rest of 2021 and 8% higher in 2022. These forecasts are called point estimates. Our frameworks also provide us the distribution (confidence interval) for each point estimate. This is referred to as the potential error of the forecast. The potential error of our forecasts has increased significantly since last spring. More specifically, the possibility of a major pullback in the stock markets has increased significantly. This leaves us facing quite the conundrum. We believe stocks are going higher but also recognize the increased risk of equity exposure.

We believe the best way to position portfolios for this environment is to continue de-risking the portfolios, without going underweight stocks. Last month we sold much riskier Small-Cap Stocks for less risky Large-Cap Stocks. This month we are selling riskier Mid-Cap Stocks for less risky Large-Cap Stocks. We are also shifting some Large-Cap Growth stock exposure into more stable Large-Cap Value exposure. Additionally, we have decreased credit exposure and increased Duration (gov't bond) exposure. Gov't Bonds are the only negatively correlated asset to stocks. It is the only asset likely to rise in value in the event of a stock market correction.

We are certainly not trying to alarm anyone. To be clear, we remain bullish but far less so than before. We also recognize there are always potential market shocks. Pandemics and inflation scares come to mind. Even when justified, high market multiples increase the intensity of market shocks. It is easier for market multiples to compress when they are high than when they are low. P/E's are very high as of month-end.




As we discussed at April month-end, at a minimum we expect volatility is likely to be higher going forward. From May 7 to May 12th the S&P 500 sold off 4.01%. That's a solid pullback. Currently, stocks are flat for the month. May is a pretty good example of what we expect for a little while. Lots of volatility and ultimately a small move higher.

As always, we are available to discuss your portfolios on an individual basis if you would prefer.

On to June,

The Mommaerts Mahaney Financial Team

**Jon C Mommaerts, CFP®:** Jon is a Principal of Mommaerts Mahaney Financial Services, Inc. He has over 30 years of experience working with professionals and those about to retire. He is a member of the Financial Planning Association, as well as a member of the Preferred Financial Advisors.

**J. Matthew Tuccini, CFP®:** Matt has over 17 years of experience working in the financial services industry with vast experience in retirement planning, tax strategies, and financial planning.

**Robert Kea, CFA:** Bob has over 30 years of experience in portfolio management. He was a founding member and Co-Head on Putnam's Asset Allocation Group, which managed $12Bn in both retail and institutional assets.

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