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First Quarter 2021

"The road goes on forever and the party never ends"

Robert Earl Keen

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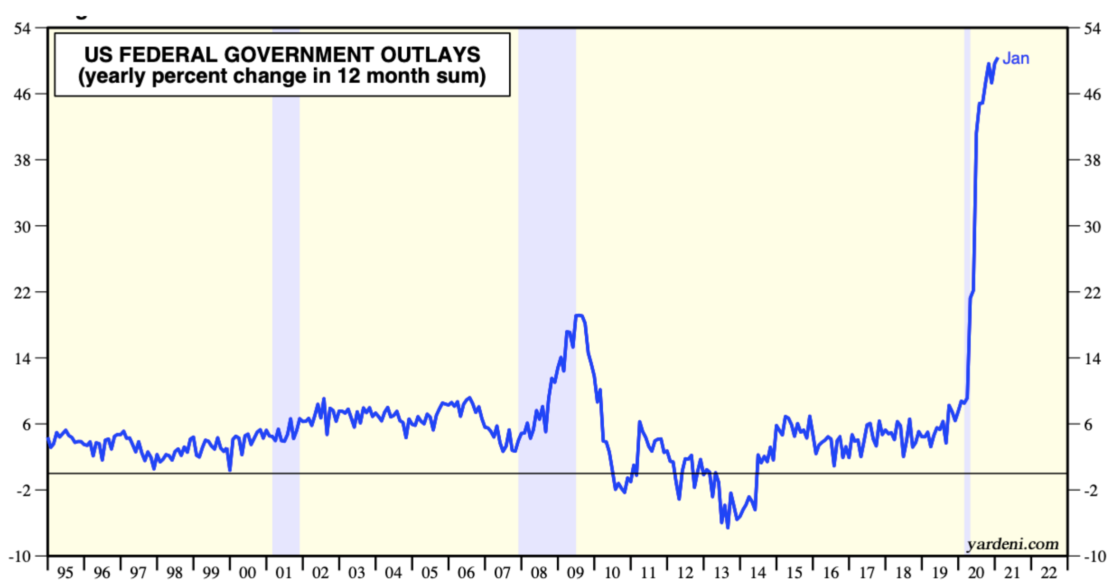
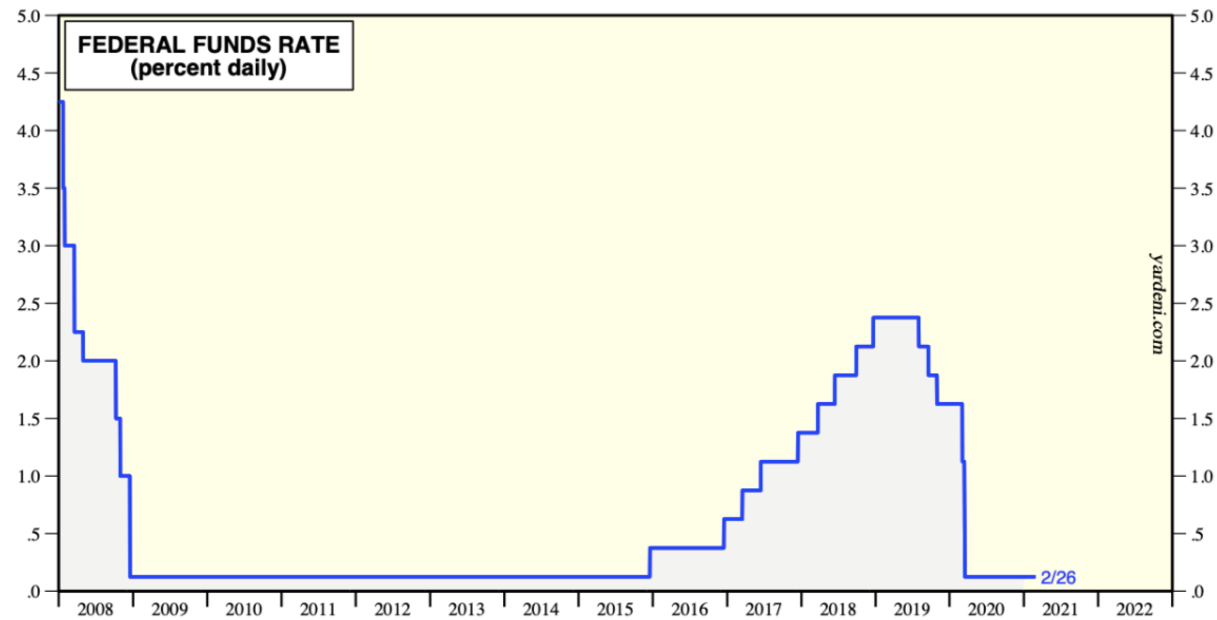
Robert Earl Keen's signature song is considered an anthem within the genre called *outlaw country*. It tells the love story of Sonny and Sherry and their delinquent behavior. They live life in the fast lane with no worries about tomorrow or the consequences today's behavior may bring. Their outlaw behavior escalates with each verse of the song. Just like Bonnie and Clyde, they keep escaping the consequences. They start believing they are invincible. The refrain at the end of each verse is; *the road goes on forever and the party never ends*. Sonny and Sherry eventually find out, just like Bonnie and Clyde, not only does the party end, but it ends violently.

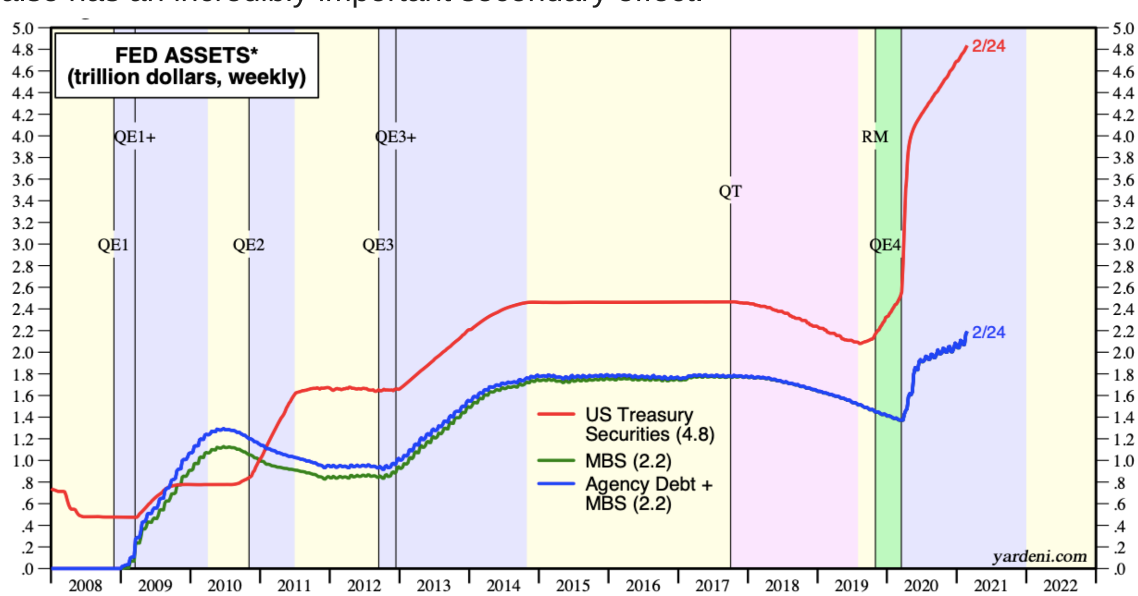
We often refer to the U.S. Federal Reserve as our *Crazy Uncle Fed* and its current monetary policies as a liquidity party. Uncle Fed is behaving as if the liquidity road goes on forever and the party will never end. The liquidity party will end someday, and we expect the economic reaction will be violent.



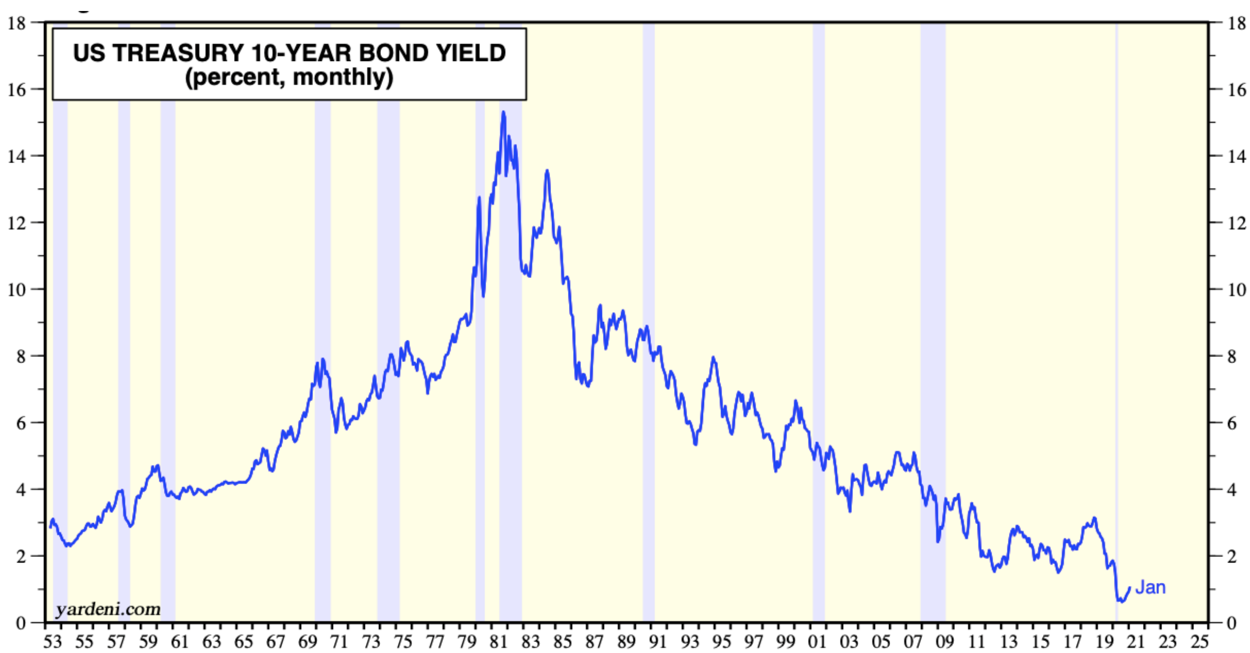
Prior to the credit crisis of 2008, the Fed fulfilled its dual mandate of stable prices and full employment by adjusting short-term interest rates (Federal Funds Rate). This increased/decreased money supply by adjusting short-term interest rates lower/higher. When the economy was becoming overheated, higher rates slowed the economy (decreased money supply) and kept inflation in check. When the economy was sputtering, lower rates provided liquidity (increased money supply) and gave the economy a booster shot. This is considered traditional Keynesian economics.



Since 2008, the Fed has added many new tools to their Keynesian toolbox. Primary among these tools is *quantitative easing.* Quantitative easing is the practice of the Fed directly buying longer-term Treasury and Mortgage Bonds in order to inject liquidity into the economy. Quantitative easing also has an incredibly important secondary effect.

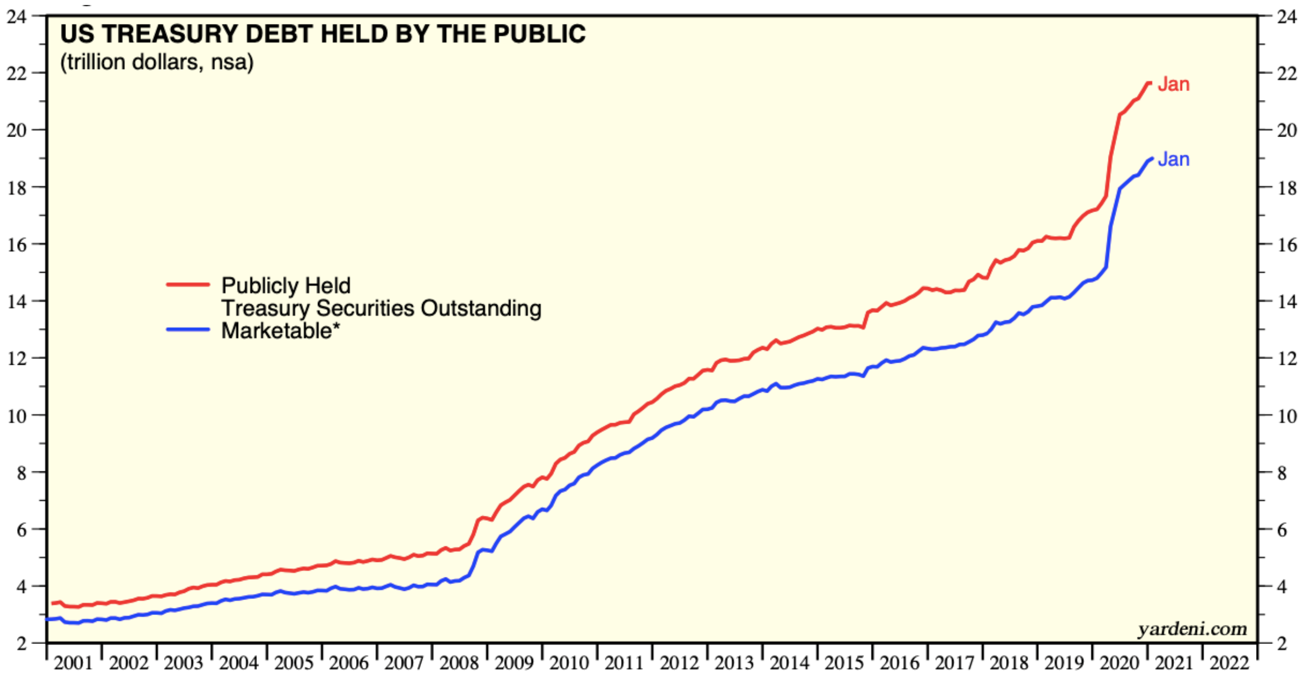


Historically, bond investors have acted as enforcers against too much deficit spending. Bond investors would stop buying, and start selling bonds when they deemed government deficits as excessive. This would push interest rates higher, increasing the debt service cost of the government's debt. This helped to contain growing government deficits. Quantitative easing is allowing the Fed to control not just short-term rates, but also long-term interest rates. This protects them from the wrath of bond investors. As deficits grow and bond investors sell bonds, the Fed offsets the selling by purchasing billions of dollars of 10 Year Treasury Bonds. This pushes longer-term interest rates lower than they otherwise would be, keeping the debt servicing cost of funding our deficits lower. It’s estimated that 10 Year Treasury Bonds yields would likely be 3% higher without the Fed’s purchases. This is becoming an increasingly dangerous game.

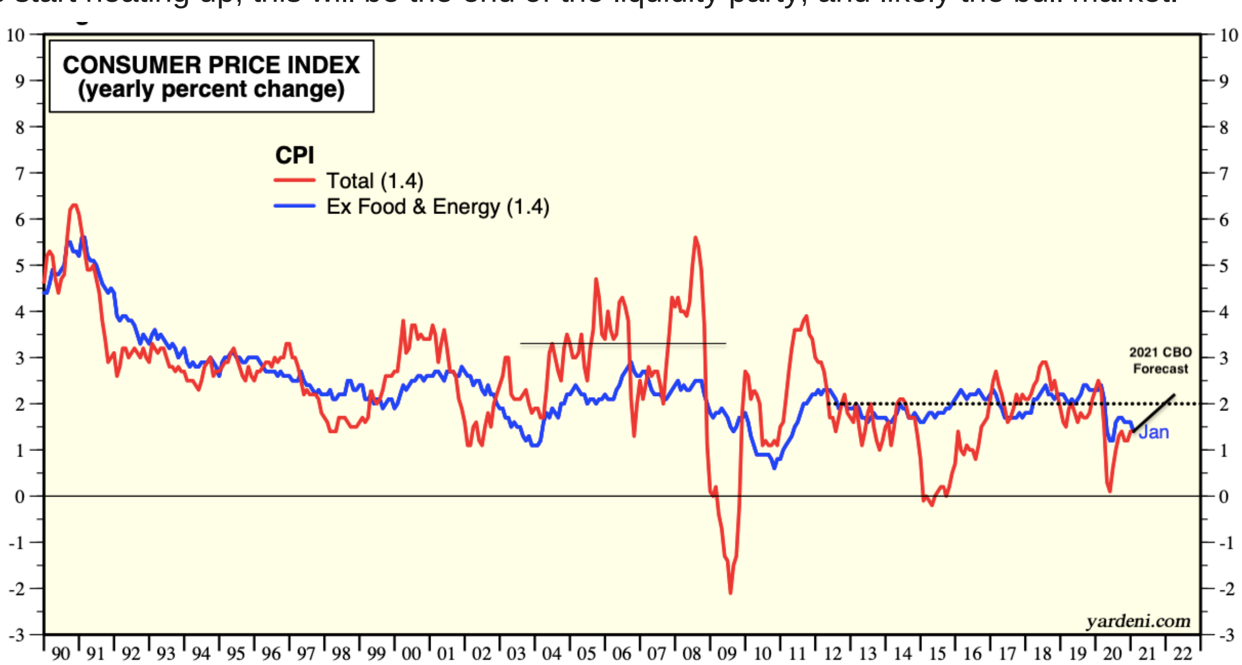


We have and continue to be overweight stocks despite our concerns about current monetary policy. We are not foolish enough to fight the Fed. We are also not foolish enough to fight the U.S. Treasury. Former Federal Reserve Chair Janet Yellen is now the U.S. Treasury Secretary and has formed a close alliance with current Fed Chairman Jerome Powell. They are society's newest power couple. Together, they are vowing to “act big”.

The Treasury Secretary is urging Congress to pass the American Rescue Plan, a Covid relief bill totaling $1.9 trillion in new stimulus money. This plan includes $1,400 stimulus checks to most Americans. $600 checks were already sent out during January and $1,200 checks were sent out last April. This helped to drive the 2020 federal budget deficit to a record $3.1 trillion and our federal debt to a record $21.0 trillion.



The Congressional Budget Office (CBO) projects that the U.S. deficit will average $1.5 trillion per year over the next 10 years. Lest we forget, the Treasury Secretary is also endorsing the Green New Deal. Should that pass, that would be another $2 trillion in deficit spending. Inflation is forecasted to rise 2.2% in 2021 and close to 3% in 2022. This would be the highest level in many years. We believe the long-anticipated return of inflation may finally be arriving. If inflation does start heating up, this will be the end of the liquidity party, and likely the bull market.



10-year Treasury bond yields have risen significantly in 2021 despite massive government purchases of their own bonds. Bonds investors are becoming increasingly concerned about deficit spending and its inflationary consequences. Investors are selling their treasury bonds faster than the Fed can offset the sales with bond purchases. There are two ways to solve the deficit issue and higher rates; less government spending (shut off the stimulus spigot) or collect more revenue (raise taxes). Either solution would likely be the end of this bull market.

It's important to recognize that we have not yet seen *the whites of inflation's eyes.* We've consistently argued against traditional Keynesians that have been warning about inflation for many years. We believe that globalization and technology have dramatically increased labor supply and productivity. Traditionally, the price pressures of an increasing money supply have led to higher wages, which is ground zero for inflation. That has not been a problem over the last couple of decades. Corporations are avoiding paying higher wages through the use of technology and utilizing the global labor supply. The magnitude of the current stimulus along with sending this stimulus directly to the consumer may finally break this decades-old pattern of disinflation.

In the meantime, we will not fire until we see the whites of inflation's eyes. Stimulus spending benefits stock prices, until it doesn't. 2021 is off to a very strong start.

Asset Class	Feb	YTD
Small Cap Value	10.83	17.83
Small Cap Growth	4.34	10.80
Mid Cap Value	7.51	7.23
Large Cap Value	5.97	4.33
Mid Cap Growth	3.47	2.40
Asian Equity	2.67	2.25
European Equity	2.84	1.85
Cash	-0.12	-0.08
High Yield	0.12	-0.10
Large Cap Growth	-0.04	-0.49
Gov't Bond	-1.16	-1.44
Investment Grade	-1.08	-1.59

We are closely monitoring the economic stress levels of higher interest rates and inflation. We remain uncomfortably overweight stocks. As we've seen over the last several weeks, we will likely get some significant pullbacks in stock markets due to justifiable fears over inflation and higher interest rates. However, until stress levels reach a breaking point history tells us stocks should continue to move higher as asset prices reflate.

We are keeping a very close watch,

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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Mommaerts Mahaney Financial Services, Inc. provides advisory services through ERTS Wealth Advisors, LLC, a registered investment advisor.
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