August marked the fifth consecutive month in which all three major stock indices, the S&P 500, the Dow Jones Industrial Average and the NASDAQ 100, rose. The S&P 500 returned 7.2% in August and has returned 56.0% since the market's low in March. Year-to-date, the S&P 500 has returned 9.7% and has set twenty record highs this year alone.

The stock market's momentum and prevailing trends continued in August with growth stocks outperforming value stocks and macro cap stocks outperforming mid cap and small cap stocks. Once again, gains were focused in a handful of high profile stocks including Amazon, Facebook, Apple, Alphabet, Microsoft and Netflix.

Concerns over equity valuations and a possible disconnect between the market and the economy persist. The S&P 500 is trading at 23.0 times 2021 earnings forecasts, a level not seen since 2001. While this is above the long term average P/E ratio for the S&P 500, we think it is reasonable given the low level of interest rates; the liquidity pumped into the financial system by the Federal Reserve; and indications that the economy is not at the tail end of an economic cycle, but is entering a robust recovery.

Just as the shut-down-induced drop in economic activity was more pronounced than in prior recessions, the V-shaped recovery has been more rapid than recoveries following past recessions, and more rapid than we had expected.

Unprecedented actions by the Federal Reserve and multiple rounds of fiscal stimulus, with additional aid of $1.5 to $2.5 trillion anticipated in late September, have built a financial bridge that is expected to carry the economy to the post-Covid-19 era. The economic recovery is intact and while the economy will face challenges, these too shall pass in time.

As we often point out, the market is a leading indicator that anticipates the changes to come and moves accordingly. With rapidly increasing economic activity, improved manufacturing results, positive corporate earnings reports and increased earnings forecasts, stocks continue to move higher. Notably, small cap and cyclical stocks are showing increasing strength – which would be indicative of an early-stage economic recovery. Increasing industrial commodity prices – including copper and iron ore, as well as timber and crude oil – are also indicative of an early stage recovery.

Given the economic outlook, we believe that markets are not disconnected from the economy. Rather, markets are pricing in an economic recovery which is supported by economic data.

The Federal Reserve has announced what may prove to be a very significant change in policy. Rather than pursuing an inflation target of 2.0%, the Federal Reserve's goal will now be to achieve an average inflation target (AIT) of 2.0% over time.

This is considered a "dovish" move by the Federal Reserve which many believe may re-ignite inflation. Alternatively, it has been suggested that by adopting ATI the Federal Reserve will avoid the types of deflationary monetary errors it has made in the past decade.

The Federal Reserve has a dual mandate: support conditions that result in full employment and keep inflation under check. The consensus economic thought is that you can have one or the other but never the two shall meet. The Fed will continue to grapple with the challenge of

returning to full employment without triggering an inflationary cycle and is willing to let the economy run a little hot for longer to achieve that goal.

Former Chairman William McChesney Martin, Jr. once described the role of the Federal Reserve as being "to take away the punch bowl just as the party gets going." For decades now, the Fed has targeted an inflation rate of 2.0%, a goal it achieved a handful of times in the post-financial crisis era but has been unable to sustain. This is due in part to the Fed, when the 2.0% target had been reached, prematurely "taking away the punch bowl" by increasing interest rates and shrinking its balance sheet, in order to slow the economy in an effort to contain inflation. In so doing, inflation invariably fell back below the 2.0% target and the U.S. economy softened.

Modifying its approach may improve the Fed's chances of achieving its inflation target and making it stick rather than purposefully slowing economic growth and risking a deflationary recession. The deflationary consequences of globalization and an ageing population in the U.S. are powerful forces which have held inflation in check for the better part of this century and remain an issue the Fed continues to struggle with.

Over the last three months we have seen a stream of incrementally improving economic data which, combined with Federal Reserve support and fiscal policy, provide greater clarity on the economic and market outlook. With this in mind, we anticipate that, where appropriate, we will begin to selectively deploy a portion of the cash on-hand as opportunities present themselves.


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