NEVILLE, RODIE & SHAW, Inc. / INVESTMENT COUNSEL
Established 1933
200 MADISON AVENUE, NEW YORK, N.Y. 10016

TELEPHONE: (212) 725-1440
FAX: (212) 689-8746

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Quarterly Review and Outlook

The quarter just ended certainly provided investors with a full agenda of issues to consider and weigh for the balance of 2021. While we, like most long term investors, put primary emphasis on the future, the one-year anniversary of the Covid epidemic's shock to the entire social, business, and financial structure, colors much of our weighing of current policies and their possible outcomes. The memories of the tragic impact on human lives, the disruption of many business sectors, and the fear which gripped world financial markets are accompanied by the heroic actions of the front line health care professionals, the rapid massive responses by world central banks and many countries' legislative bodies to provide unprecedented support and stimulus are capped by the remarkable success of having several effective vaccines developed, accredited, and distributable by year's end which borders on the miraculous.

It is hoped that the trying experiences of the past year can provide a framework for positive policies and actions that will be beneficial to all segments of our populace going forward. Certainly, it seems that the monetary policies of the major central banks are still in an accommodative posture, and many legislative actions are aimed at providing both supportive stimulus and some necessary safety nets through stimulus programs. As history has shown, however, the devil always lurks in the details, and the best intentions can be thwarted by intentions and actions that are counter to the original designs or by changes in priorities and leadership and often by the enticement of overreaching.

In our previous letter, we mentioned the likely emergence and importance of new policies, and we have not been shocked by their appearance in the early weeks. The initial flurry of executive actions has been followed by the proposed two-part bill aimed at renewing or rebuilding important segments of our nation's infrastructure coupled with additional economic stimulus and support for a variety of constituencies. All this short and long-term spending is linked to a significant change in personal and corporate taxation rates. The motto of the new administration and its presumed voting solidarity in Congress seems to be: "Go big or go home!" As this significant program makes its way through individual committee deliberations, flying feathers may darken the skies in Washington and many state legislatures. If a program of this size, scope, and complexity gets enacted, one thing is certain: tax increases hit our economy first and the programs such as infrastructure improvements have a much longer tail to them. While it is clear that many aspects of our infrastructure are dated and not adequate for current or future needs, the complications of coordinating and completing these mega-projects should be concerning.

While much of investor attention has been glued to the changes and proposals in the new administration, the domestic economic fundamentals have been showing important and steady strengthening. As more reopening occurs, stimulus checks are being distributed, and vaccinations are proceeding apace, many businesses are rehiring, and consumers are spending. Many economists are projecting quarterly GDP growth nearing 10% for the second and third calendar periods. The consumer confidence and demand imbedded in such estimates are still subject to changes in Covid rates and the uncertainties associated with the new variants of the virus but demonstrate the pent-up forces that drive the largest portion of our GDP.

The foregoing positive drivers are still being supported and fueled by our Fed's accommodative monetary policies and the seemingly endless commitments of fiscal policies to stimulate employment and restoration of living standards in numerous economic subsectors. This continued expansion of stimulus is now being seen as the cause of the recent rise in short term and intermediate term interest rates from the prolonged historically low levels of the prior two years. These previous benign rate constructs were important factors in many and various economic and financial arenas ranging from housing to reconfiguring corporate and personal balance sheets. Our Federal Reserve and Treasury officials are aware of the current and potential changes if interest rates continue to climb, but for now view these as transitory and not disturbing or distracting.

Our financial markets also did not seem overly concerned by the rise in market interest rates. The recent investor appetite for the economically sensitive cyclical stocks continued to gain believers and were the best performing sector in our equity markets for the quarter, as the reopenings in the U.S. economy strengthened. The prior big winners in the "stay home" sectors had some meaningful cutbacks in their gains of 2020. Not surprising in our view, but not trend changers for the broader growth portions of the equity market, which we believe include many semi cyclical firms whose management teams have been proactive in adopting new production techniques and increasing their potential free cash flow while entering new markets.

Looking ahead for the balance of 2021 and beyond, we believe we must be ever vigilant as the pandemic is not defeated yet and unforeseen changes in the path and types of viruses remain possible. In addition, the domestic political battleground is still contentious and fractured, and the implications are difficult to predict and prepare for. The prospective tax changes are of a type and magnitude that we have not witnessed in several decades. The implications go beyond our borders, because many of our key trading nations/partners are lowering their respective corporate tax rates in the hope of stimulating increased domestic growth and stronger exports. Finally, the international political arena is seemingly becoming a bit more unstable. China has recently shown publicly a more belligerent attitude and Russia and Iran are acting in a more provocative manner. These are not new zones of conflict and tension, and next steps are impossible to predict, but must be watched carefully.

All that said, we remain optimistic about the prospects for the U.S. economy and the domestic equity markets for 2021. The broader participation by various corporate sectors and by the leadership of economically sensitive companies is a sign of confidence by investors that our economic recovery has momentum and sustainability. Bonds are still of minimal interest for new money until we have clearer indications of what monetary and fiscal policy alterations may be employed to successfully meet the challenges ahead.

These are challenging and exciting times which encourage us to keep our guard up and the lines of communication open with our clients. Please stay in touch when there are any questions or concerns. Onward!