



Potential For Inflation Is Taking Center Stage

It was a good quarter for all asset classes. Unlike the previous two quarters, small and value stocks trailed the S&P 500. Foreign stocks had a good quarter, but fell short of U.S. large stocks. Although the Value Strategy outperformed small and value stock benchmarks, it trailed the S&P 500 significantly. The Select 25 Strategy also trailed the S&P 500 but by a smaller margin than the Value Strategy. The Foreign Value Strategy trailed its benchmark slightly. Bonds had a respectable quarter with a slight positive return.

Inflation is still my biggest concern, and I'm seeing more news articles relating to inflation in both the U.S. and European press. It is widely accepted that the current rate of inflation is higher than we can accept long term. What is up for debate is if this inflation rate will continue after the economy "re-opens", or if we'll return to a more reasonable rate of inflation. There are good arguments on both sides but I am concerned by anecdotes I see in company communications, the labor shortages we've been hearing about (and the increase in wages that will result), and the extreme price rises in most real estate markets. Wages in particular do not generally go down, so wage increases over the next few months are likely to be permanent.

I will keep a potential rise in inflation, and a corresponding rise in interest rates, in mind as I make stock selections. It's important to avoid the temptation to predict inflation, but instead to choose stocks that may be less susceptible to rising interest rates. However, inflation and interest rates have the potential to cause a sharp drop in the markets that leaves very few stocks untouched.

<u>Market Sector</u>	<u>Return</u>	<u>Benchmark</u>
Total U.S. Stocks	8.5%	SPY (S&P 500)
Small U.S. Stocks	4.1%	IWM
U.S. Value Stocks	3.7%	IJJ
Foreign Stocks	5.3%	VEU
Bonds	1.8%	AGG

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