

Cherry Bekaert Wealth Management

Market Update: The Quarter in Review

Useful Information for Your Business & Financial Success

Summary

1st Quarter 2021

US. Stocks

The US equity market posted positive returns for the quarter, outperforming non-US developed markets and emerging markets. Value outperformed growth across large and small cap stocks. Small caps outperformed large caps in the US.

International Developed Stocks & Emerging Stocks

In US dollar terms, developed markets stocks outside the US posted positive returns but underperformed the US and outperformed emerging markets equities for the quarter. Small caps outperformed large caps in non-US developed markets. Value outperformed growth across large and small cap stocks.

In US dollar terms, emerging markets posted positive returns for the quarter, underperforming the US and developed ex US equity markets. Value stocks outperformed growth stocks and small caps outperformed large caps.

Fixed Income

Interest rates generally increased in the US Treasury fixed income market in the first quarter. The yield on the 5-year US Treasury note rose 56 basis points (bps), ending at

0.95%. The yield on the 10-year Treasury note increased by 81 bps to 1.74%. The 30-year Treasury bond yield increased 75 bps to finish at 2.39%.

On the short end of the yield curve, the 1-month T-bill yield decreased to 0.05%, while the 1-year T-bill yield fell by 5 bps to 0.08%. The 2-year Treasury note finished at 0.15% after a yield increase of 15 bps.

In terms of total returns, short-term corporate bonds declined 0.59%. Intermediate-term corporate bonds returned 2.19%.

Total returns for short-term municipal bonds was flat, while intermediate munis lost 0.52%. General obligation bonds underperformed revenue bonds.

Global Fixed Income

Government bond interest rates in the global developed markets were increased during the quarter. Longer-term bonds generally underperformed shorter-term bonds. Short- and intermediate-term nominal interest rates were negative in Japan, and Germany.

Source: MSCI. Past Performance is not a guarantee of future results. All non-US equity market returns are in USD, net dividends, unless otherwise noted. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio.

Past performance is no guarantee of future results. This information is provided for educational purposes only and should not be considered investment advice or a solicitation to buy or sell securities. Please see page 4 for additional footnotes and disclosures.

YOLO, Meme, and EMH: What's Your Investment Style?

First Quarter 2021

Marlena Lee, PhD
Global Head of Investment Solutions

You only live once! Social media investors have banded together on unconventional platforms to drive up the prices of a handful of “meme stocks,” seemingly without traditional evaluation of investing risks and rewards. They made headlines with their “short squeeze” of GameStop (GME), and, as they garner media attention, their tactics continue. While it’s not the intended victim of the YOLO traders, will the efficient market hypothesis be a casualty of these events? The answer depends a lot on your definition of efficient markets. Perhaps long-term investors would be better served questioning the potential impact on their investment philosophy.

Professor Fama (1970) defines the efficient market hypothesis (EMH) to be the simple statement that prices reflect all available information. The rub is that it doesn’t say how investors should use this information. EMH is silent on the “correct” ways investors should use information and prices should be set. To be testable, EMH needs a companion model: a hypothesis for how markets and investors should behave. This leaves a lot of room for interpretation. Should asset prices be set by rational investors whose only concerns are systematic risk¹ and expected returns? It seems implausible to link recent meme-stock price movements to economic risks. Rather, they seem fueled by investor demand to be part of a social movement, hopes to strike it rich with a lucky stock pick, or plain old *schadenfreude*.

There is a vast ecosystem of investors, from individuals investing in their own accounts to governments and corporations who invest on behalf of thousands. Ask investors why they invest the way they do, and you’ll likely get a range of goals and approaches just as diverse. It’s this complex system that generates the demand for stocks. Another complex system fuels the supply of stocks. Supply and demand meet at the market price. People may contend that the market is not always efficient, or rational, but the stock market is always in equilibrium. Every trade has two sides, with a seller for every

buyer and a profit for every loss.

There are plenty of well-studied examples that show supply and demand at work. The huge increase in demand for stocks added to a well-tracked index often creates a run-up in the stock price. Some of this price increase can be temporary and reversed once the tremendous liquidity demands at index reconstitution² are met. Index reconstitution is just one example; instances of liquidity-driven price movements happen all the time. It is well documented that liquidity demands can produce temporary price movements.³ Investors may wonder if temporary price dislocations motivated by users of *r/WallStreetBets* differ from those caused by changes to an index. Lots of buying puts temporary upward pressure on prices, which later fall back to “fundamental value”—it sounds familiar. The more relevant observation may be that markets are complex systems well adapted to facilitate the supply and demand of numerous market participants.

There are numerous reasons people may be willing to hold different stocks at different expected returns. Can all those differences be explained by risks? Doubtful. To quote Professor Fama, “The point is not that markets are efficient. They’re not. It’s just a model.”⁴ EMH can be a very useful model to inform how investors should behave. We believe investing as if markets are efficient is a good philosophy for building long-term wealth. Trying to outguess markets might be a quick way to destroy wealth.

It’s true, you only live once. The good news is that investors can look to market prices, not internet fads, to pursue higher expected returns. Theoretical and empirical research indicate higher expected returns come from lower relative prices and higher future cash flows to investors. Long-run investors can be better served by using markets, rather than chatrooms, for information on expected returns

1. Systematic risk is the possibility of an investor experiencing losses due to factors that affect the overall performance of the financial markets in which he or she is involved.

2. Reconstitution involves the re-evaluation of a market index. The process involves sorting, adding, and removing stocks to ensure that the index reflects up-to-date market capitalization and style.

3. For example, see “Tesla’s Charge Reveals Weak Points of Indexing” (Dimensional, 2021)

4. “Are markets efficient?” – Interview between Eugene Fama and Richard Thaler (June 30, 2016)

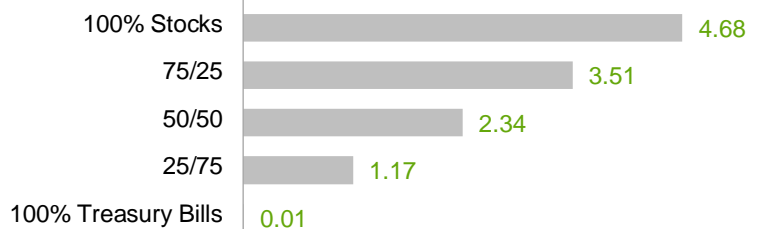
Eugene Fama is a member of the Board of Directors of the general partner of, and provides consulting services to Dimensional Fund Advisors LP.

Impact of Diversification

First Quarter 2021

These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but have higher expected returns over time.

Ranked Returns (%)

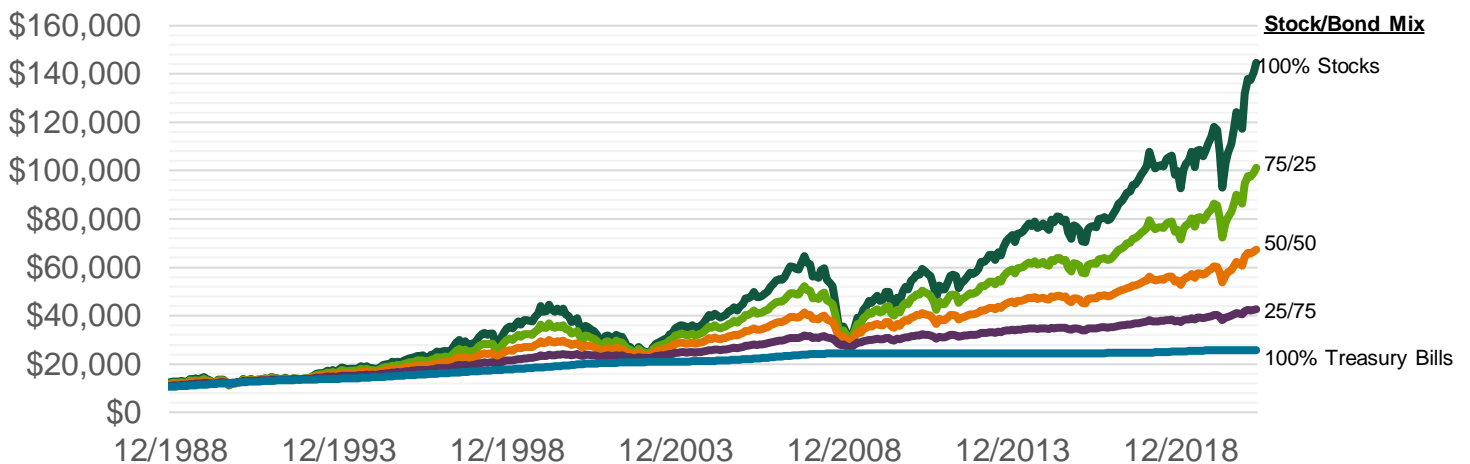


Period Returns (%)

* Annualized

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*	10-Year STDEV ¹
100% Stocks	4.68	55.31	12.66	13.81	9.73	14.07
75/25	3.51	39.64	10.05	10.71	7.57	10.55
50/50	2.34	25.27	7.29	7.55	5.31	7.03
25/75	1.17	12.11	4.38	4.33	2.97	3.51
100% Treasury Bills	0.01	0.08	1.35	1.07	0.55	0.23

Growth of Wealth: The Relationship between Risk and Return









1.STDEV (standard deviation) is a measure of the variation or dispersion of a set of data points. Standard deviations are often used to quantify the historical return volatility of a security or portfolio.

Diversification does not eliminate the risk of market loss. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio.** Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals. Data © MSCI 2021, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld).

Quarterly Market Summary

Index Returns

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
1Q 2021	STOCKS				BONDS	
	6.35%	4.04%	2.29%	6.22%	-3.37%	-1.90%
						
Since Jan. 2001						
Avg. Quarterly Return	2.4%	1.6%	3.0%	2.5%	1.1%	1.1%
Best Quarter	22.0% 2020 Q2	25.9% 2009 Q2	34.7% 2009 Q2	32.3% 2009 Q3	4.6% 2001 Q3	4.6% 2008 Q4
Worst Quarter	-22.8% 2008 Q4	-23.3% 2020 Q1	-27.6% 2008 Q4	-36.1% 2008 Q4	-3.4% 2021 Q1	-2.7% 2015 Q2

Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]). S&P data © 2021 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2021, all rights reserved. Bloomberg Barclays data provided by Bloomberg.

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Investing risks include loss of principal and fluctuating value. Small cap securities are subject to greater volatility than those in other asset categories. International investing involves special risks such as currency fluctuation and political instability. Investing in emerging markets may accentuate these risks. Sector-specific investments can also increase these risks.

Fixed income securities are subject to increased loss of principal during periods of rising interest rates. Fixed income investments are subject to various other risks, including changes in credit quality, liquidity, prepayments, and other factors. REIT risks include changes in real estate values and property taxes, interest rates, cash flow of underlying real estate assets, supply and demand, and the management skill and creditworthiness of the issuer.

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