The Cautious Optimism of Life Resuming after a Lost Year

April 20, 2021

What a quarter it has been to cap off a year-long recovery from the lows we saw in March of 2020. Honestly, we've never seen anything like this before and it's probably pretty unlikely that we'll ever see single-year returns this strong again.
Tilts toward small companies and lower relative price companies (value) continued to deliver tremendous excess return compared to the broad market. This rotation into small and value began in the fourth quarter of 2020 and continued this past quarter.

Asset Class	Q1 2021 Total Return
US Large Cap Growth	– 0.1%
US Large Cap Value	+ 11.1%
US Small Cap Growth	+ 8.8%
US Small Cap Value	+ 22.9%
Source: Dimensional as of 3/31/2021. See footnote[1] below for explanation of asset class definitions.	

At work and play, who isn't eager for this summer to be the most awesome one ever? It's impossible not to trip over market-related news suggesting overwhelming optimism for the rest of the year.

- "Open the Door to Optimism for 2021" — BlackRock
- "U.S. Will Be Ready for Liftoff After Mass Vaccination" — Morningstar
- "2021 Global Outlook: The Second Coming" — Russell Investments

Now, think back to April 2020. A year ago, fear was the only thing you could find in financial media, even as most markets staged remarkably strong and surprising recoveries. Cable financial news paraded an endless supply of hedge fund and investment managers across your television to warn of cataclysmic loss. This year, we're seeing many of those same market players chasing all kinds of hot holdings, as they now succumb to the *absence* of fear.

There is a tremendous expectation for travel, events, and really all out-of-the-house leisure to surge later this year as people are able to get their COVID vaccines. I'm sure you all feel it, too. "Pent up demand" is the phrase being tossed around everywhere. It seems likely that there will be a wave of spending as Americans try to enjoy themselves for the first time since this nightmare began.

So then, what does this all mean for your investments? Well, it's hard to say. While we certainly have positive expectations for the economy, we need to remember that the economy and the stock market are not the same thing. Expectations around a "re-opening" aren't novel. Everyone has built their market forecasts knowing that we'd be able to go outside again, at some point. Did those expectations result in pulling forward investment returns ahead of re-opening actually happening? Perhaps. If so, does that then mean the well is drying up? Not necessarily.

All I mean to say is that we need to temper both our fears and our exuberance. Sometimes, an extra shot of bravery is just what the doctor ordered. "No fear," you tell yourself, as you enter your first marathon, or launch a new business, or hug your college-bound child farewell. That said, in all things, we need balance. *No* fear can be at least as damaging as an excess dose. That's often true in life. It's also true in investing, where it's always best to maintain an accurate assessment of the potential risks and realistic rewards involved in any given approach. Your portfolio is allocated in line with your personal goals and your ability to take risk, where appropriate.

We hope favorable markets continue, but investing is no game of chance. If you were a client of ours last April, we were honored to be by your side, to remind you that your disciplined investment strategy was already in place. Your globally diversified portfolio was already structured to help you maximize expected returns while minimizing the risks involved.

At the time, we encouraged you to stick to plan. Today, we encourage you to do exactly the same. Markets may run hot or cold. The scenery may be different, but your financial journey remains the same.

Technical Investment Related Updates

Many of our clients hold various Dimensional mutual funds in the portfolios that we manage. We have a couple of positive updates that we wanted to make you aware of that will be occurring over the next quarter.

First, over half of the funds offered by Dimensional are reducing their expense ratios by a modest amount. One of the primary factors that has influenced our recommendation of these funds has been their low expense relative to the fund industry's averages. So, a further reduction in fees, which at the end of the day allows investors to capture more of the return for themselves, is certainly welcome.

Second, all of the tax-managed funds which we employ in some of our clients' taxable investment accounts will be converting to an exchange-traded fund (ETF) format in June. The overall investment strategy of the holding is not expected to change. Generally, an ETF allows for increased tax-efficiency compared to a mutual fund, all else equal. We see this as a positive change as it will provide for increased predictability in annual taxable distributions as well as a lower expected overall tax burden.

In the coming weeks you may receive a statement in the mail from Fidelity notifying you of this change and providing additional information about the conversion. This conversion will happen automatically and there is no action required on your part. Obviously, we are happy to discuss this if you have any questions at all.