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Stocks have rallied broadly heading in to the end of the second quarter in a sharp reversal from the declines earlier in the month. Those declines were driven by comments from the Federal Reserve about the possible need to raise interest rates sooner than expected based on an increase in inflation. The ten-year Treasury briefly touched 1.69% in mid-May as copper and lumber prices soared, but it has now dropped back to 1.46%. The S&P was up 8.55% for the quarter and 15.25% ytd. The Dow is up 13.79% ytd. The Fed's position for most of the year has been that the strong jump in inflation is due to transitory factors caused by strong growth coming off the Covid lockdowns combined with supply chain disruptions leading to an imbalance in supply and demand of goods.

The service sector has also been hit with higher costs as it has tried to lure employees back in to the work force. The jobs report for June is expected to show the unemployment rate at 5.7%, down from the lockdown high of 14.7% in April of last year. However, it has remained stubbornly high due to childcare concerns, the extra $300 a week in unemployment benefits, concerns about Covid, and on-going travel disruptions. The extra $300 a week payment runs out in September, and with schools opening in August, we may see more normal employment trends. Twenty-two states have suspended these payments already, and they are seeing unemployment rates falling faster than before.

We agree with Fed Chair Jerome Powell and strategist Ed Yardeni that supply and demand will come back in to balance as the massive disruptions to the global economy caused by the lockdowns dissipate further. While the Fed expects inflation to hit 3.4% for 2021, it forecasts that it will fall to 2.1% in 2022. At a hearing before Congress on June 22, Fed Chair Powell, stated that "We will not raise interest rates pre-emptively because we fear the possible onset of inflation. We will wait for evidence of actual inflation or other imbalances." Most commodity prices except for energy have fallen from their highs in May, but they are still signaling stronger economic growth. There is plenty of liquidity in the financial system, and banks recently passed their stress tests with flying colors. The Senate and the White House just agreed on an infrastructure package. Consumer spending has been strong, and manufacturing has been rebounding. Even if sales begin to slow as pent-up demand is satisfied, production should get a lift from re-stocking low inventories.

All the factors above combined with low interest rates and tight credit spreads contribute to our positive outlook for continued economic growth in the U.S. While the newest Covid delta variant is cause for concern, the data looks good on the protection provided by the Pfizer and Moderna vaccines. More and more people are getting vaccinated every day, and the U.S. is now sending vaccines to the less developed world that has not done as well as the U.S. and Europe. The loss of life from the pandemic is staggering, and while the economy continues to heal, there are ongoing impacts on families around the world from grief, lingering health issues, and interruptions to children's development and education.

We think that our growth-oriented strategy should continue to work well even if inflation picks up. Companies with unit growth, pricing power, and the ability to increase productivity can buffer the impact of rising input costs. After a strong first half of the year, market volatility as measured by the CBOE Vix index is at its lowest level since February of 2020. This means that we could have more episodes of volatility as the market reacts to new economic and inflation data.

Thank you for your confidence in us, and we look forward to meeting with you in person or by phone.

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