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Quarterly Economic Review

July

2021

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39 S. 4th Street,
Warrenton, VA 20186
(540) 878.5416

info@meridianfinancialpartners.com

Mailing Address:

P.O. Box 879
Warrenton, VA 20188







Economic Review

Equities around the globe continued to surge in the second quarter. The U.S. and developed international markets led the way, with the S&P 500 Index gaining 8.5% and developed international stocks rising 5.7%. Emerging-market stocks trailed in terms of progress on the COVID-19 front and in turn rose by a more modest 4.9%.

Within the U.S. stock market, the rotation from growth to value stocks took a pause, with the Russell 1000 Growth Index gaining 11.9% versus a 5.1% rise for the Value index. Smaller-cap value stocks slightly outperformed their growth counterparts and have been the top-performing segment of the U.S. market this year.

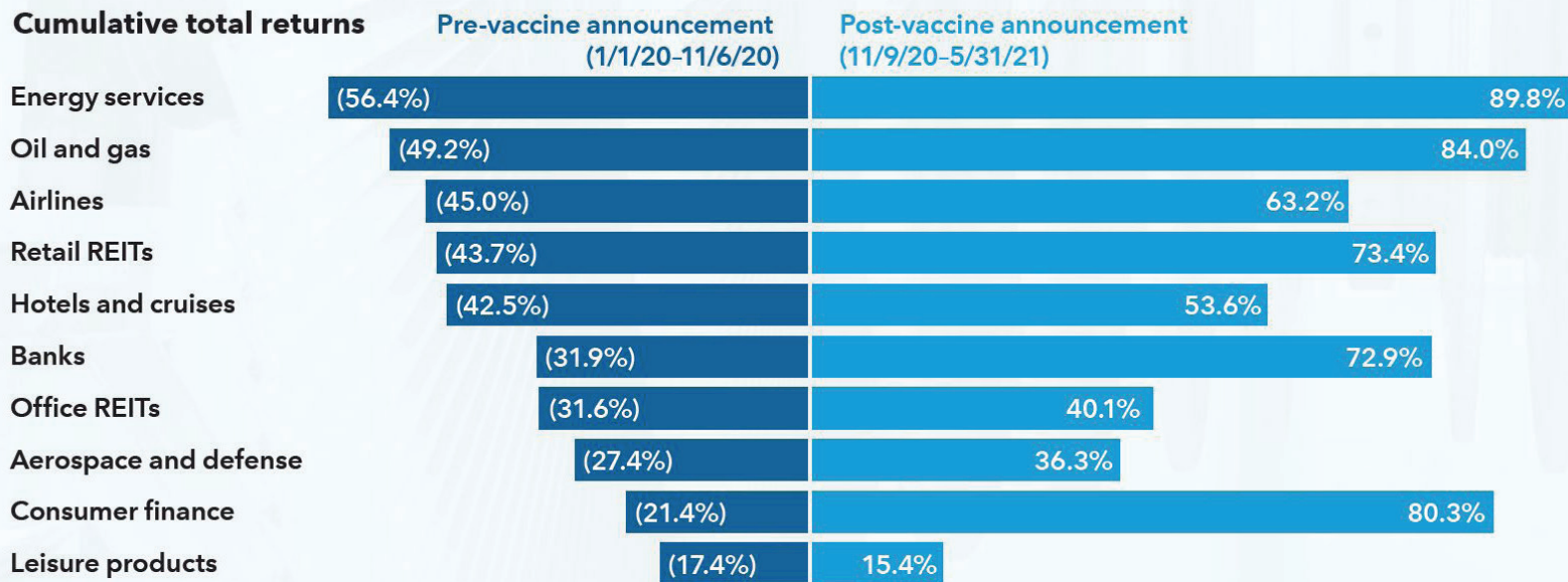
In fixed-income markets, the 10-year Treasury rose as yields dipped below 1.50% in June, ending the quarter at 1.45%, down from 1.75% at the end of March, despite higher inflation readings during the quarter. This contributed to a solid 2.0% return for the core bond index. In fact, inflation fears were felt more strongly last quarter, and core bonds remain down 1.6% for the year as a result of the first quarter selloff. Flexible actively managed bond funds also posted solid gains for the quarter in the 1.5% to 4.1% range.

The second quarter of 2021 was a good one across all asset classes...

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
2Q 2021	STOCKS				BONDS	
	8.24%	5.65%	5.05%	10.17%	1.83%	0.35%
						
Since Jan. 2001						
Avg. Quarterly Return	2.4%	1.7%	3.1%	2.6%	1.2%	1.1%
Best Quarter	22.0%	25.9%	34.7%	32.3%	4.6%	4.6%
	2020 Q2	2009 Q2	2009 Q2	2009 Q3	2001 Q3	2008 Q4
Worst Quarter	-22.8%	-23.3%	-27.6%	-36.1%	-3.4%	-2.7%
	2008 Q4	2020 Q1	2008 Q4	2008 Q4	2021 Q1	2015 Q2

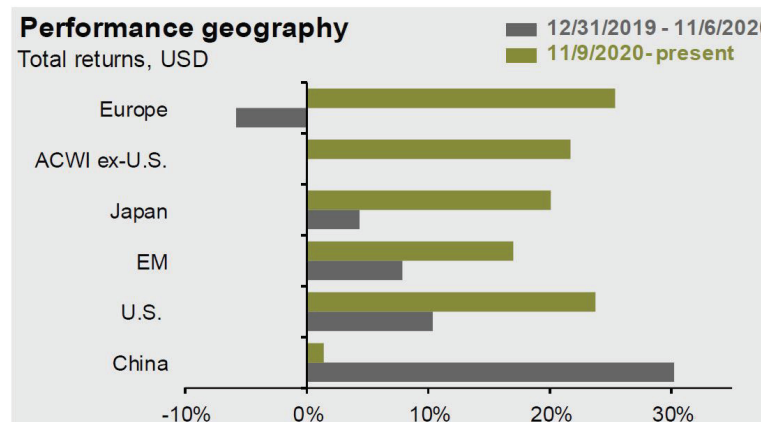
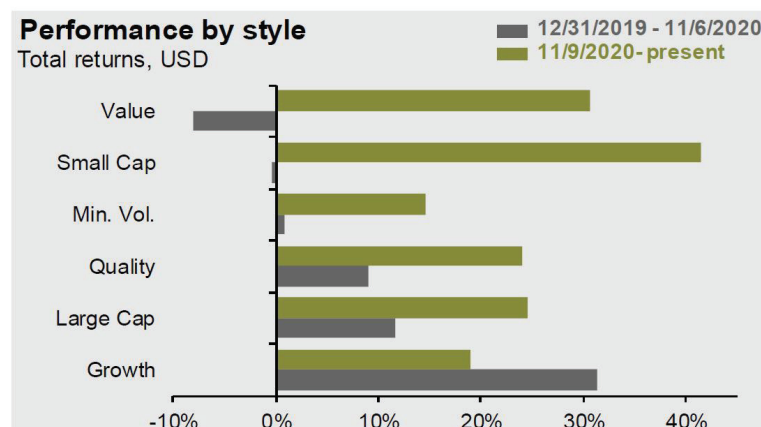
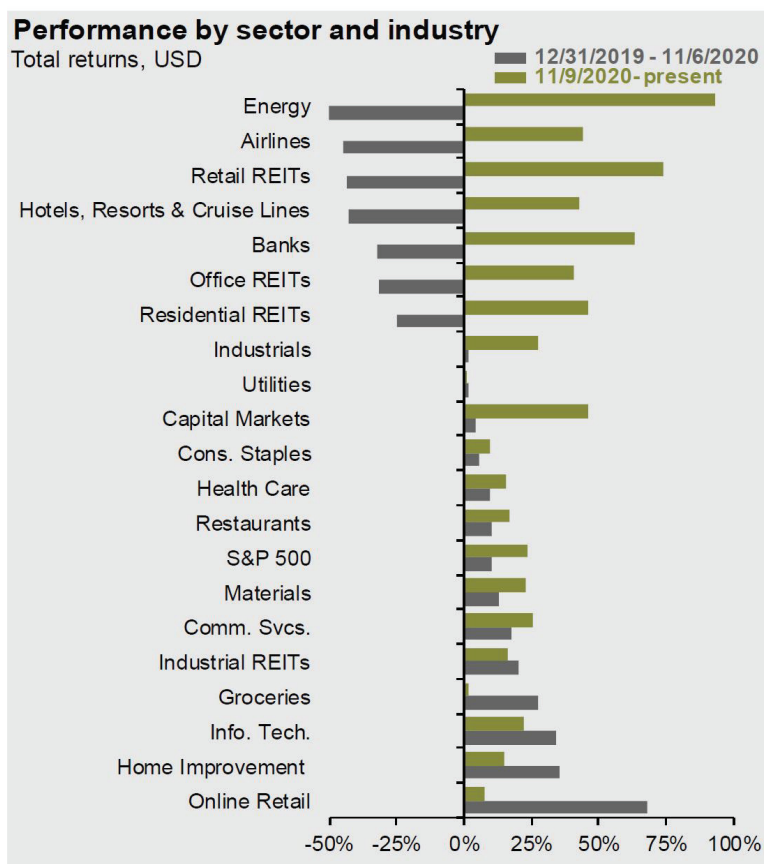
... continuing the rotation seen since “vaccine day” of November 9th.

A rotation to cyclical companies began on November 9, or “vaccine day”



Sources: RIMES, Standard & Poor’s. Industries listed are the 10 worst performing industries within the S&P 500 Index from 1/1/20-11/6/20. Returns are in USD. 11/6/20 was the last business day before the Pfizer-BioNTech COVID-19 vaccine was revealed to have more than 90% efficacy in global trials.

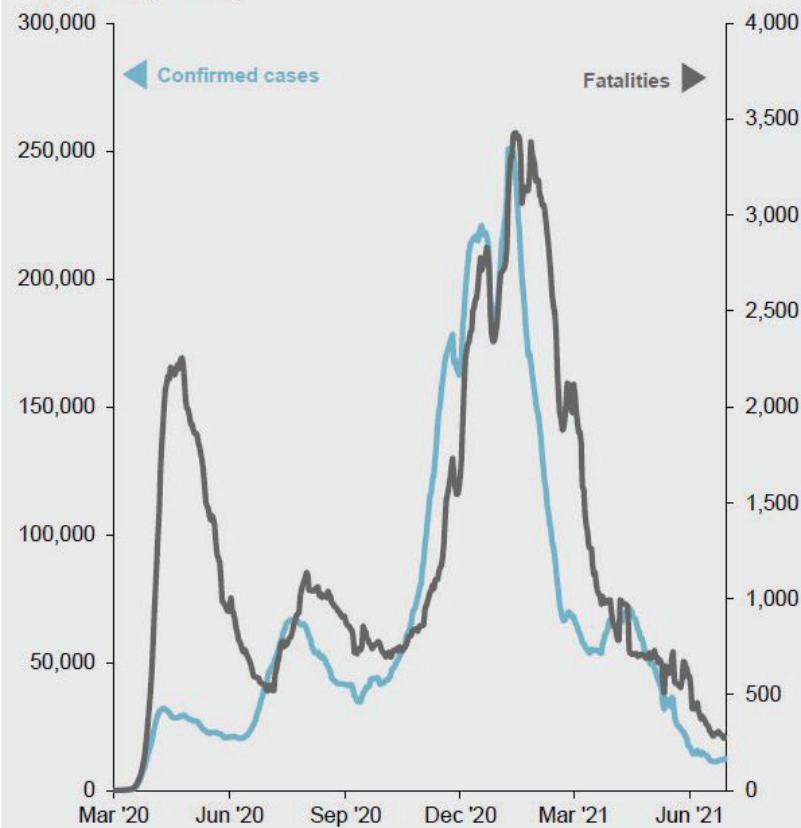
Since a successful vaccine was announced in November, sensitive asset classes have rebounded sharply.



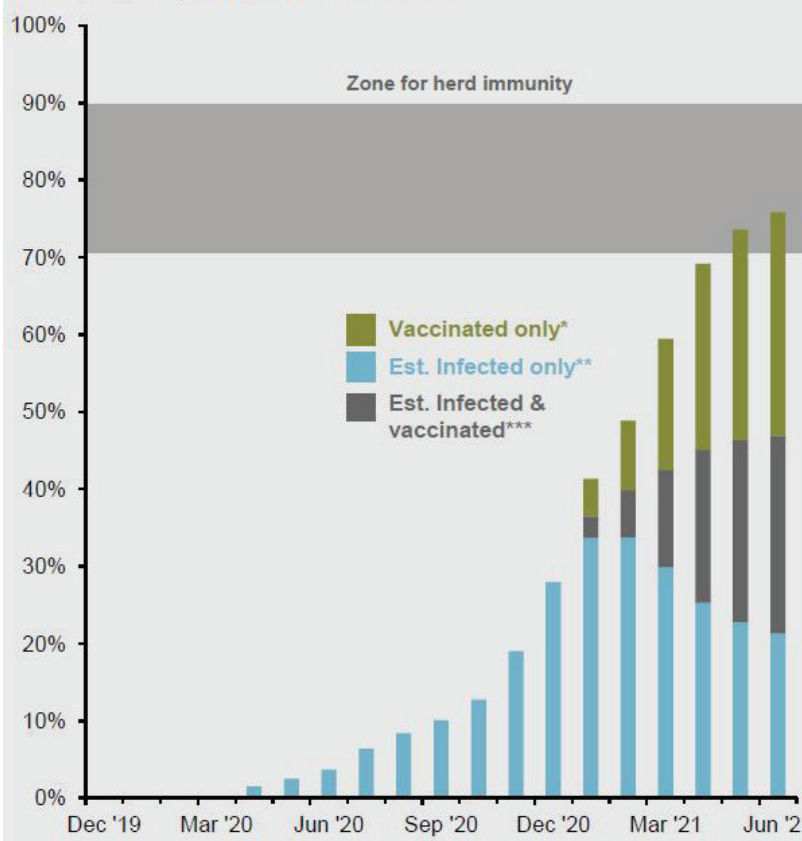
Source: J.P. Morgan Asset Management

COVID deaths continuing to decline and herd immunity is insight.

Change in confirmed cases and fatalities in the U.S. 7-day moving average

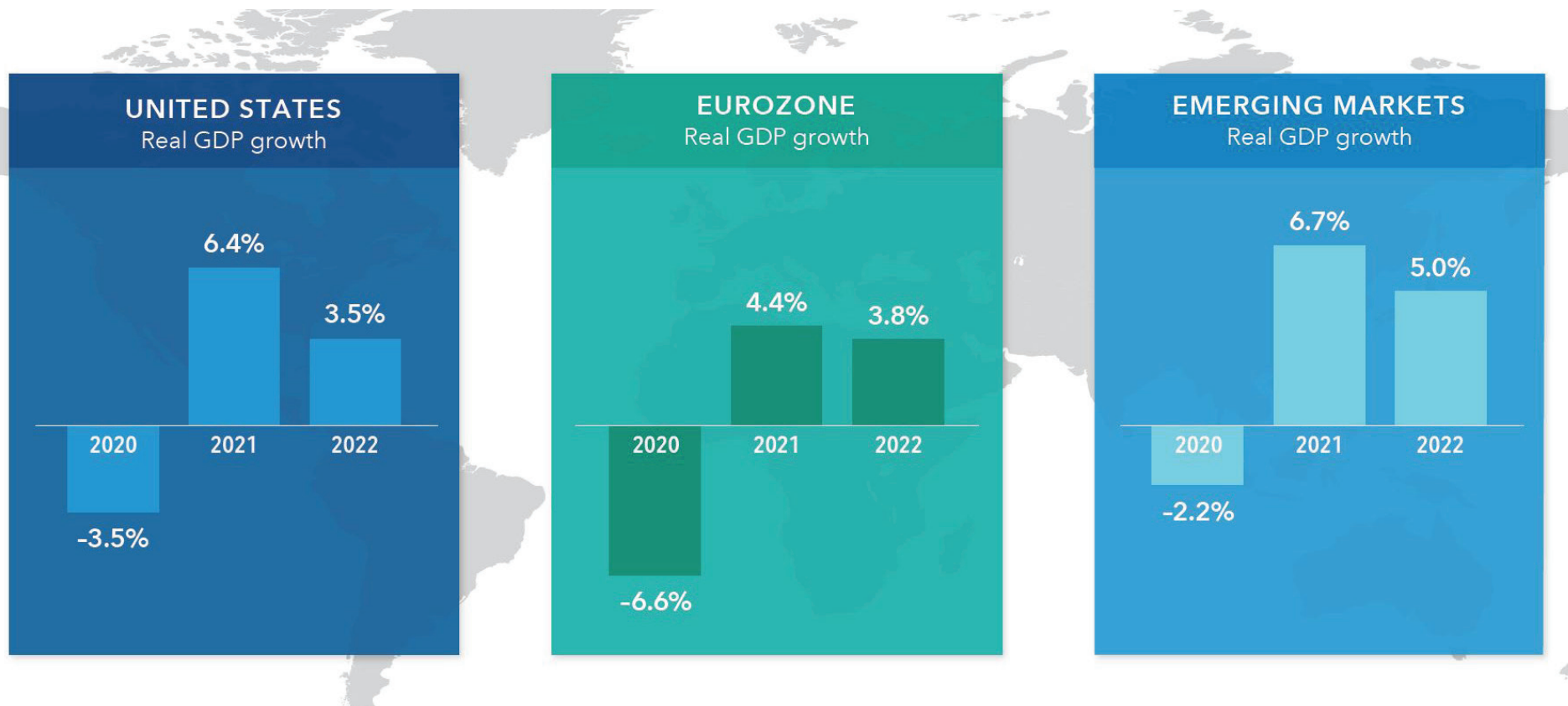


Progress to herd immunity Percentage of population, end of month

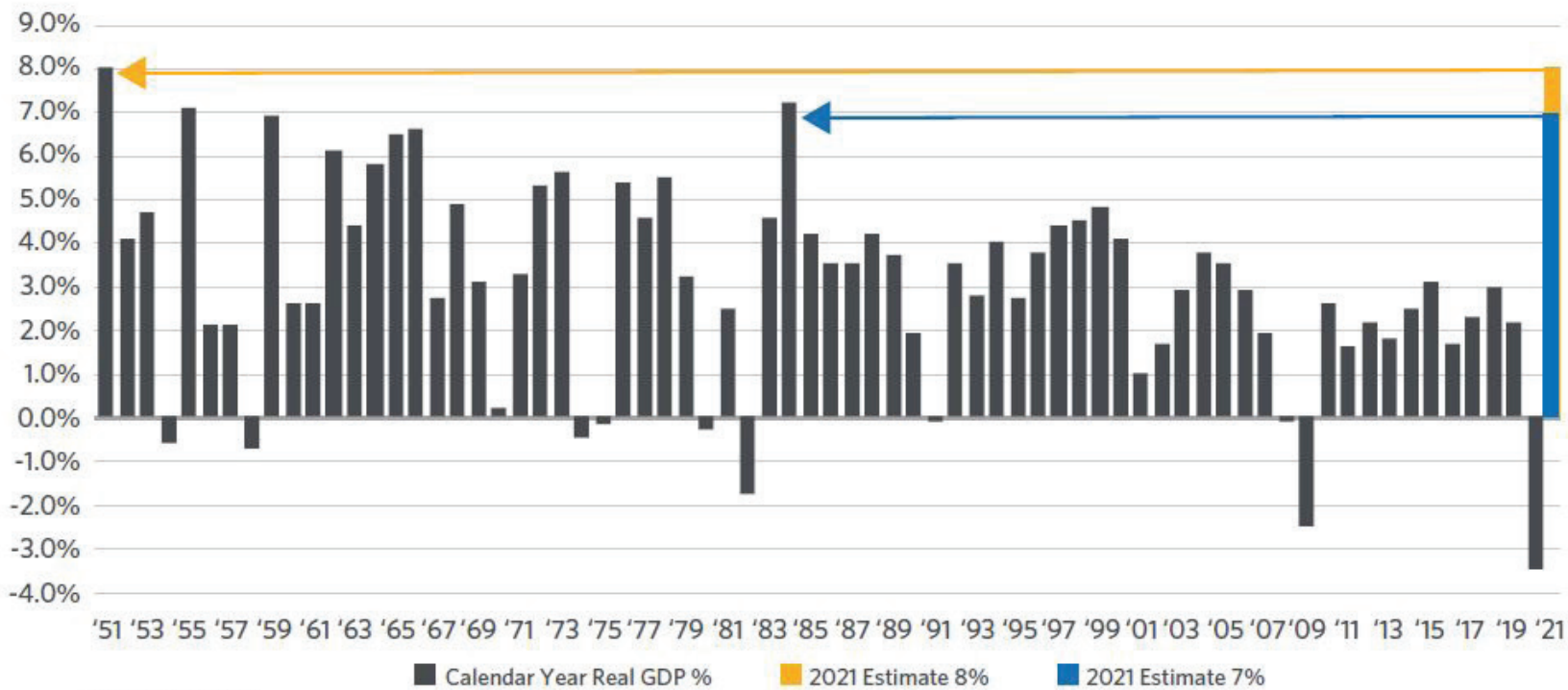


Source: J.P. Morgan Asset Management

Major economies come roaring back.

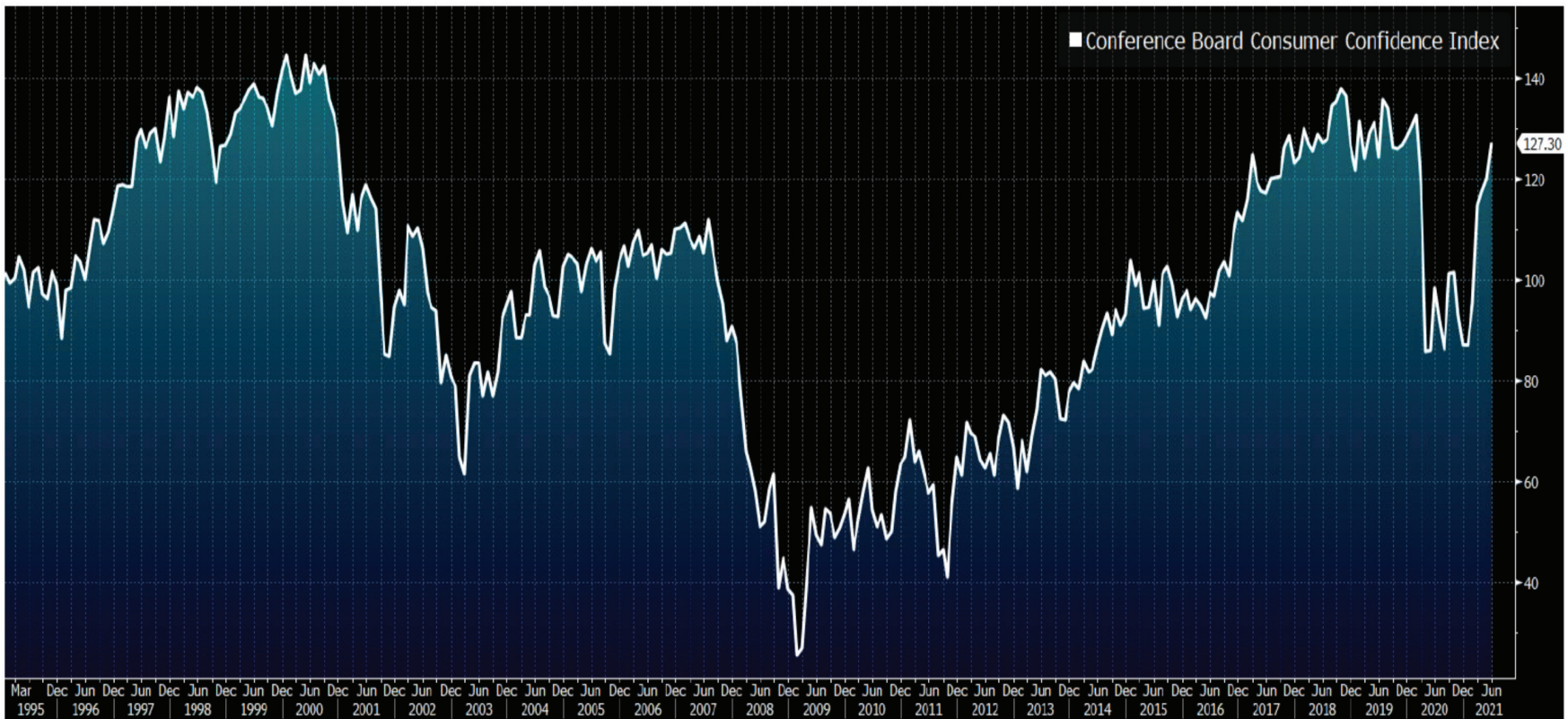


US GDP growth is likely to be the highest since 1957.



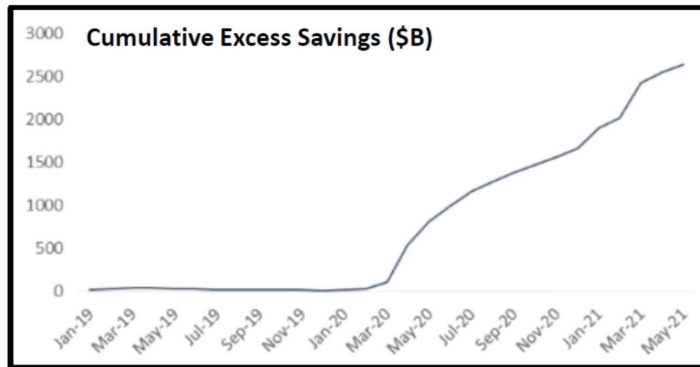
Source: Bloomberg

Consumers are back to feeling great.

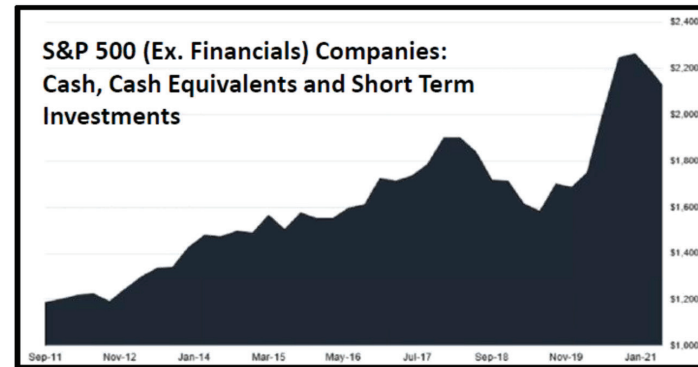


Source: Bloomberg

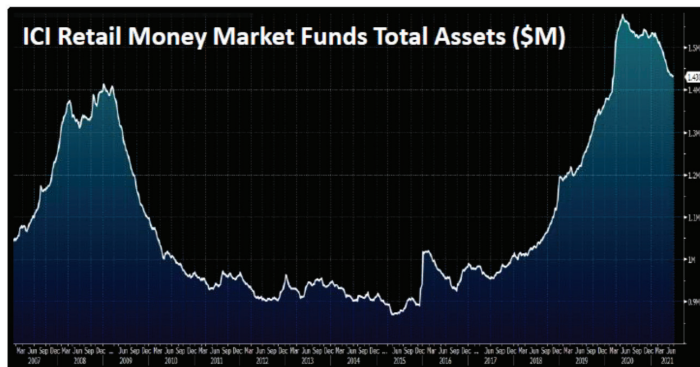
And dry powder appears to be everywhere.



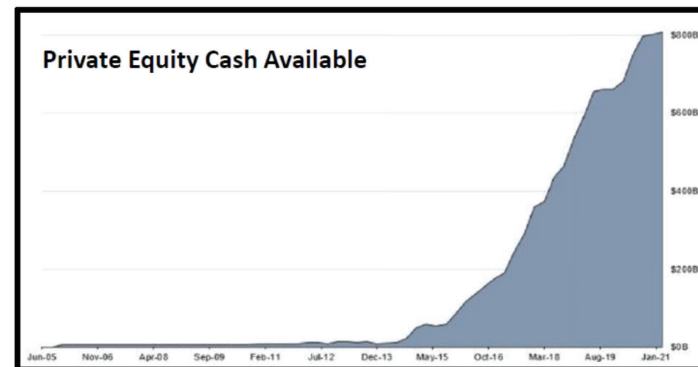
Data as of 6/28/21
Source: RBC



Data as of 3/31/21
Source: Bloomberg



Data as of 6/30/21
Source: Bloomberg

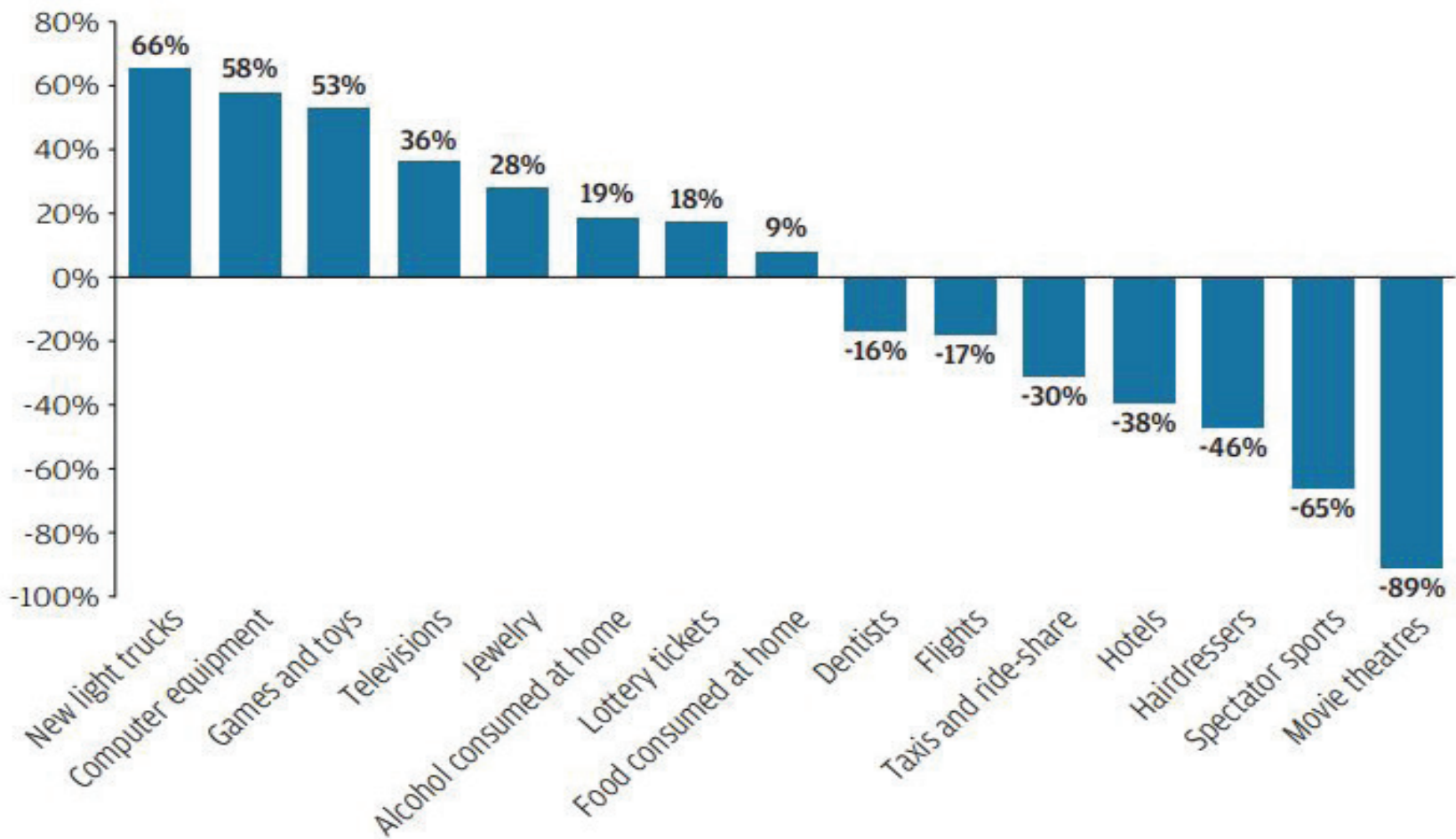


Data as of 3/31/21
Source: Bloomberg

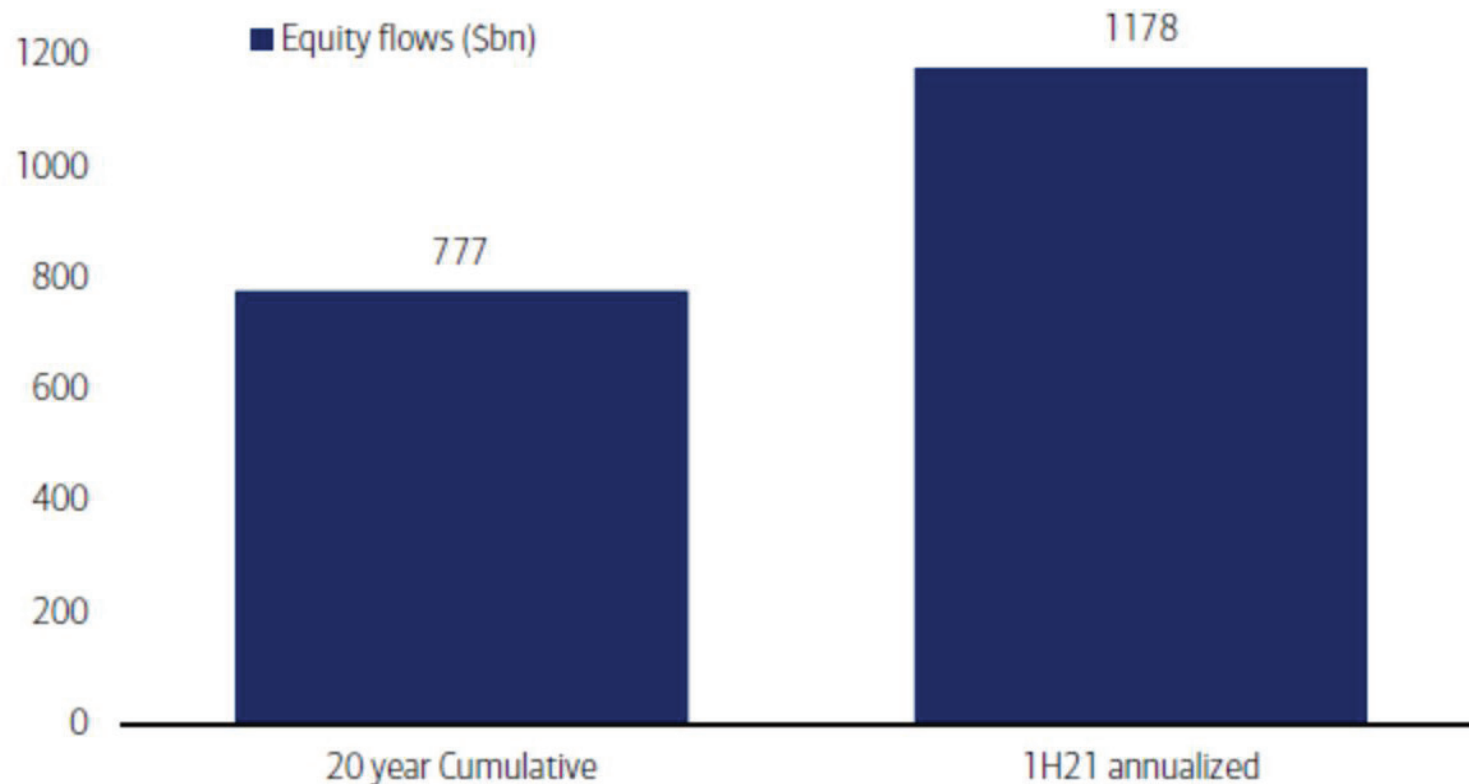
Source: Bloomberg

Consumer spending has changed materially in the pandemic.

PERCENT CHANGE IN REAL CONSUMER SPENDING FROM APRIL 2019



And investors are flocking to stock market with 2021 equity fund inflows estimated to be greater than total investments in prior 20 years...



Source: BofA Global Investment Strategy, EPFR; note H1'21 is annualized

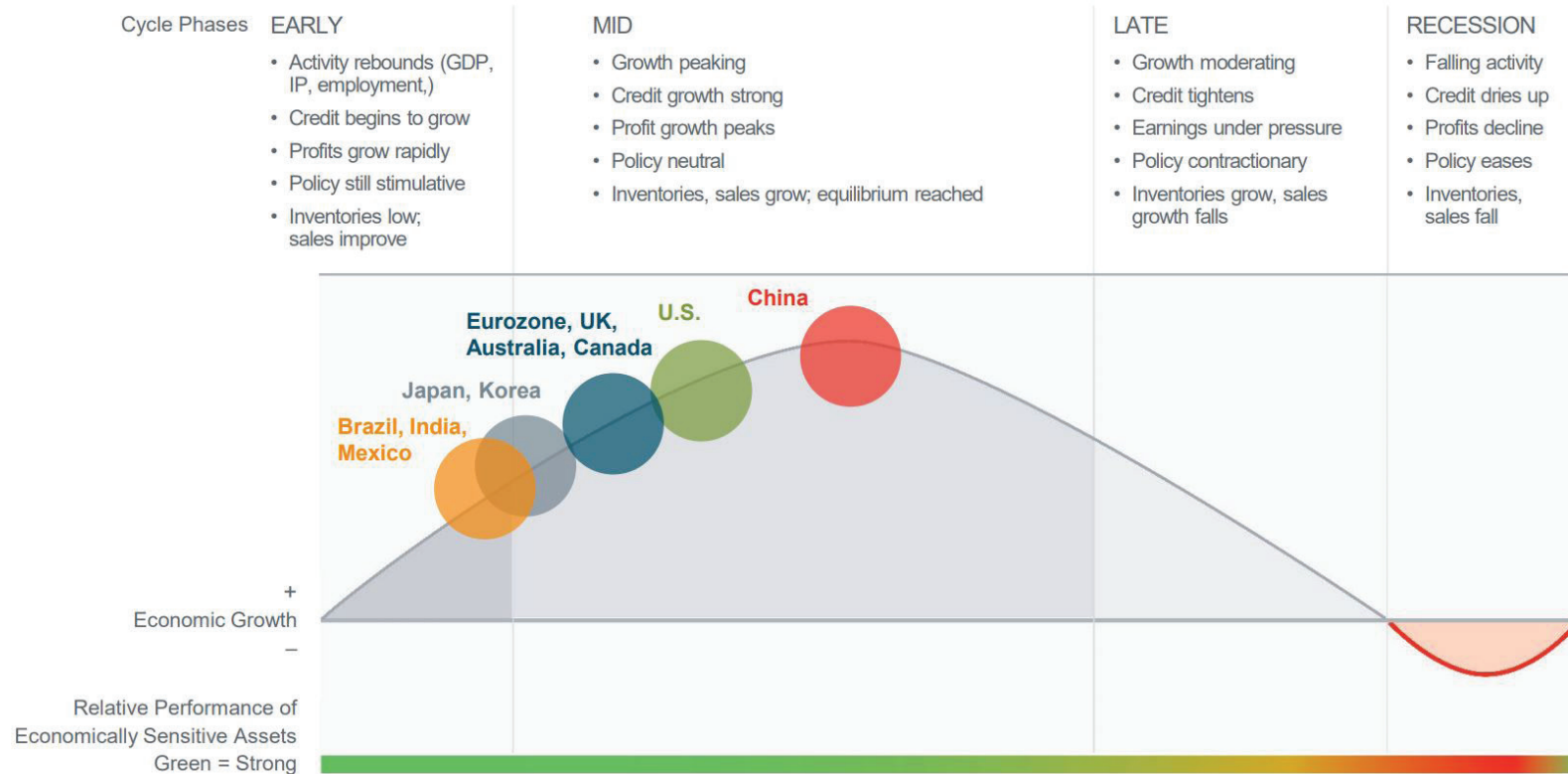
... all of which are contributing to the great economic recovery.



Source: Bloomberg

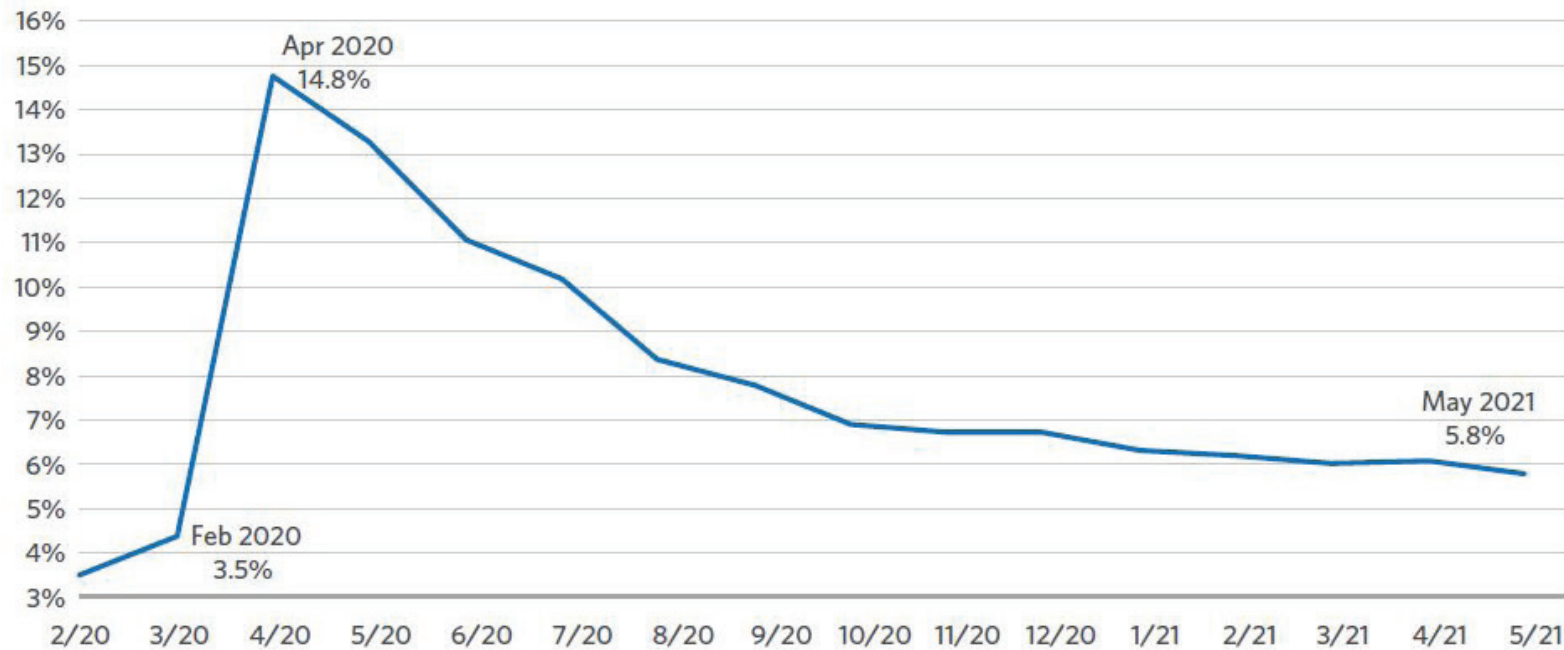
At this point in the recovery, Fidelity investments estimates our economy is in the middle of the expansion.

Business Cycle Framework



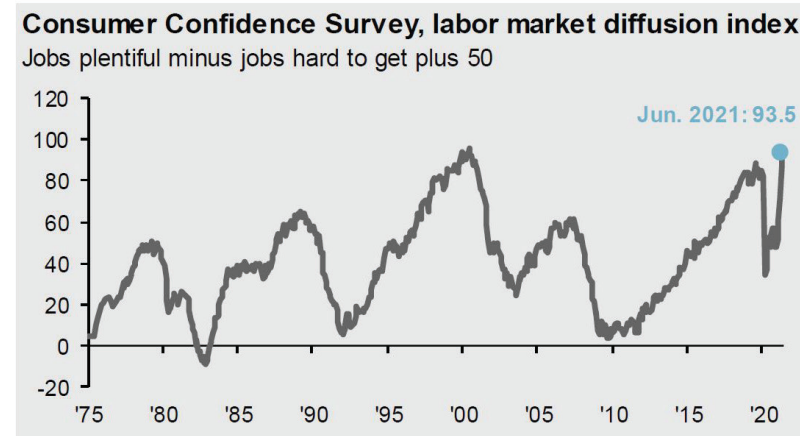
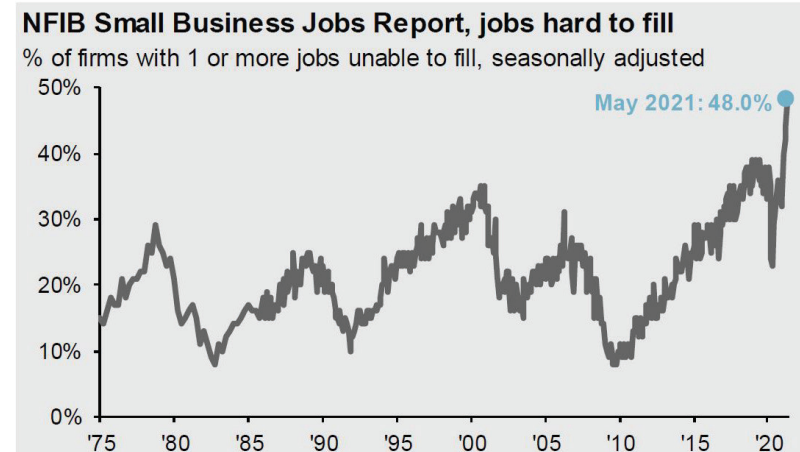
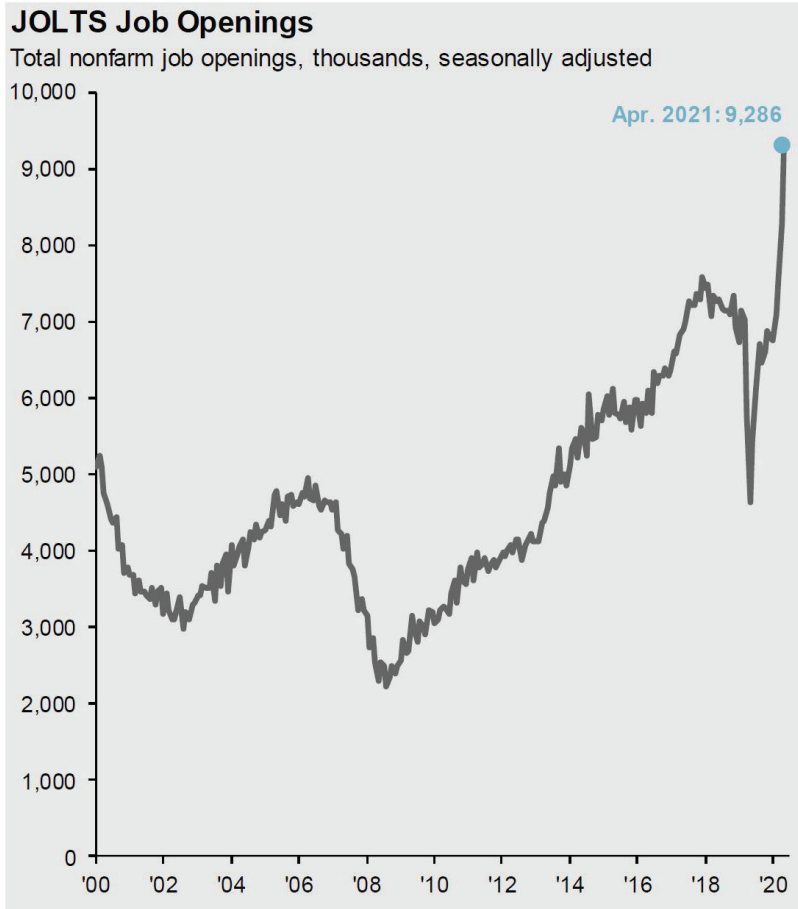
There is still improvement to be made in unemployment numbers...

Unemployment Rate Feb 2020 - May 2021



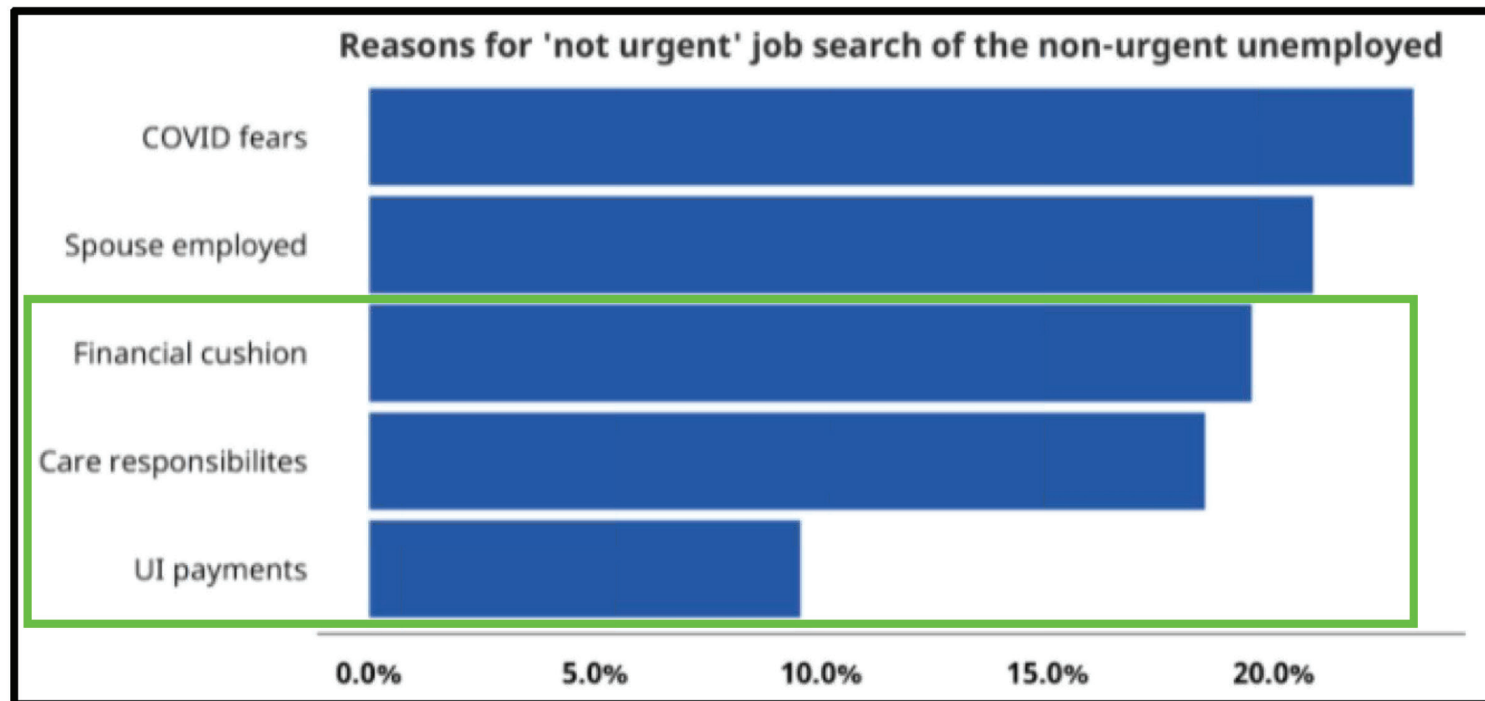
Source: Bloomberg

But there are more job openings in the US than there are unemployed persons.



Source: J.P. Morgan Asset Management

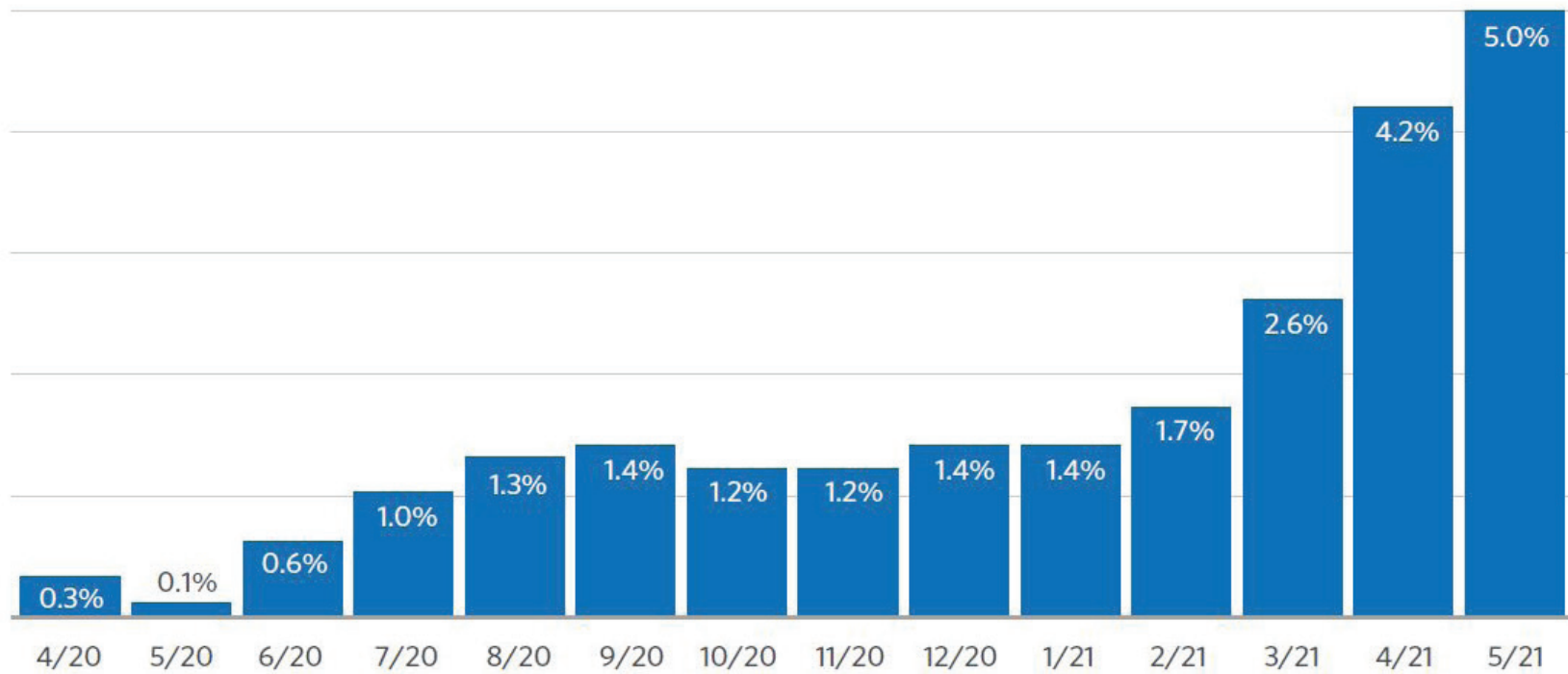
And reasons not to work likely begin to fade in September.



Data as of 7/1/21

Source: Indeed Hiring Lab Job Seeker Survey

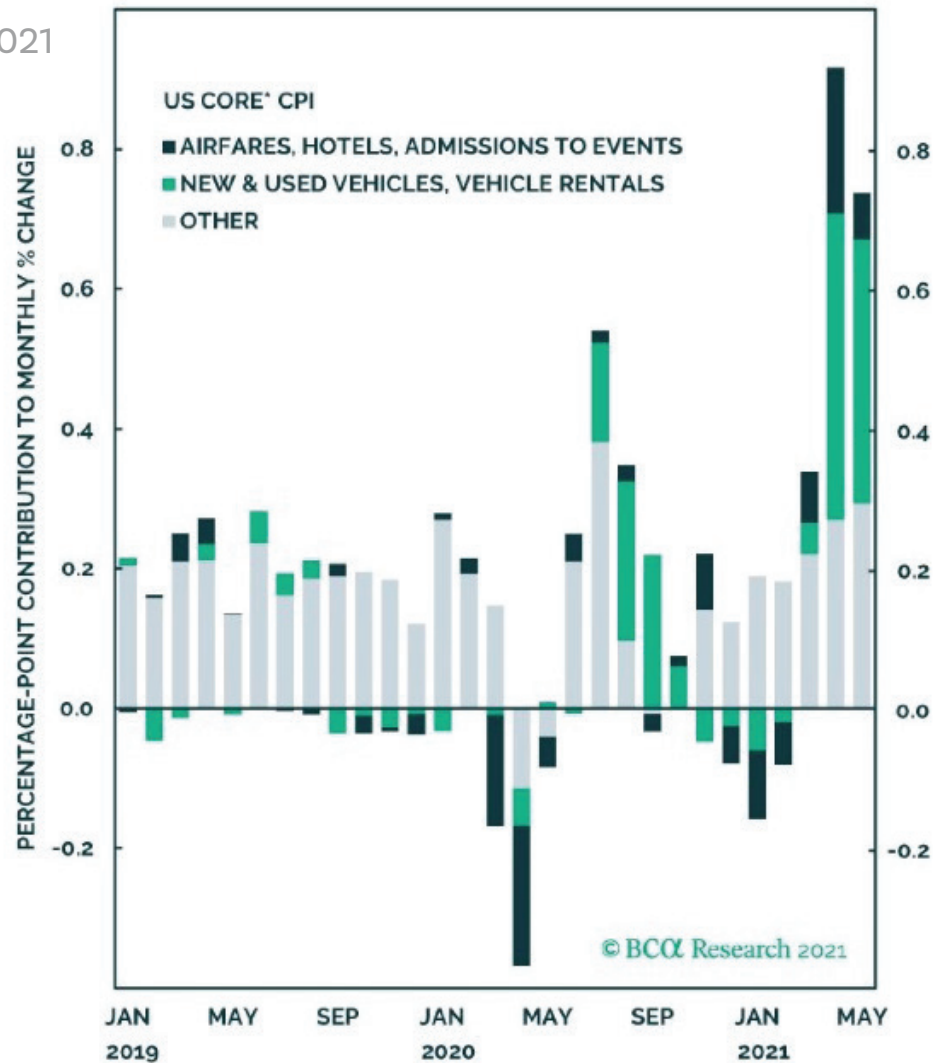
Inflation numbers spooked some investors in April and May...



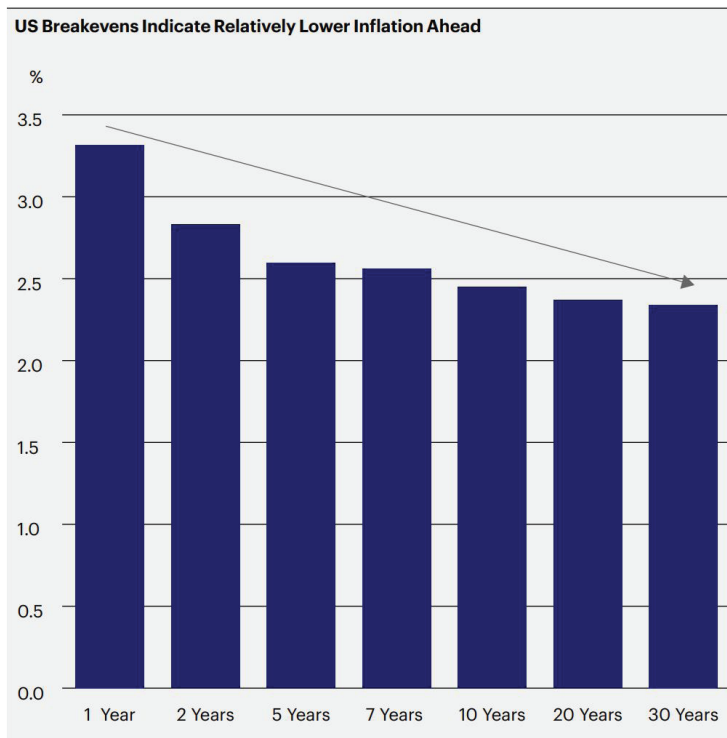
Source: Bloomberg

... But pandemic-affected prices are pushing up overall inflation.

6/29/2021



The market is not expecting inflation to be persistent.



Source: Bloomberg L.P. As of May 31, 2021.

Why is inflation expected to be transitory?

Markets see price pressures moderating but not dissipating

Pent-up demand is a one-off factor.

Pent-up demand will likely cause a pickup in inflation, but we expect this effect to be a one-off and short-lived.

Temporary supply-side issues.

Commodity and freight prices are partly surging on temporary, pandemic-induced supply factors. We believe this to be transitory.

Spending re-orienting.

Spending had shifted into goods due to social distancing. As reopening continues, spending is likely to rebalance more to services.

Income replacement fading.

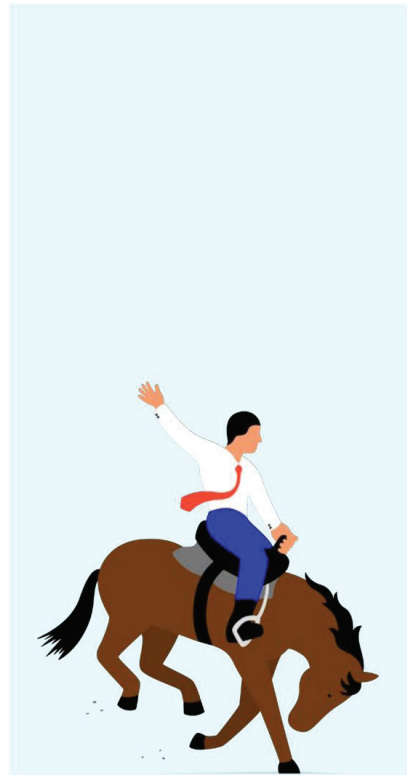
Income replacement programs are beginning to fade, which is likely to reduce overheating risk.

Slack remains.

Capacity utilization remains depressed, indicating supply-side slack. Labor force participation is also rising.

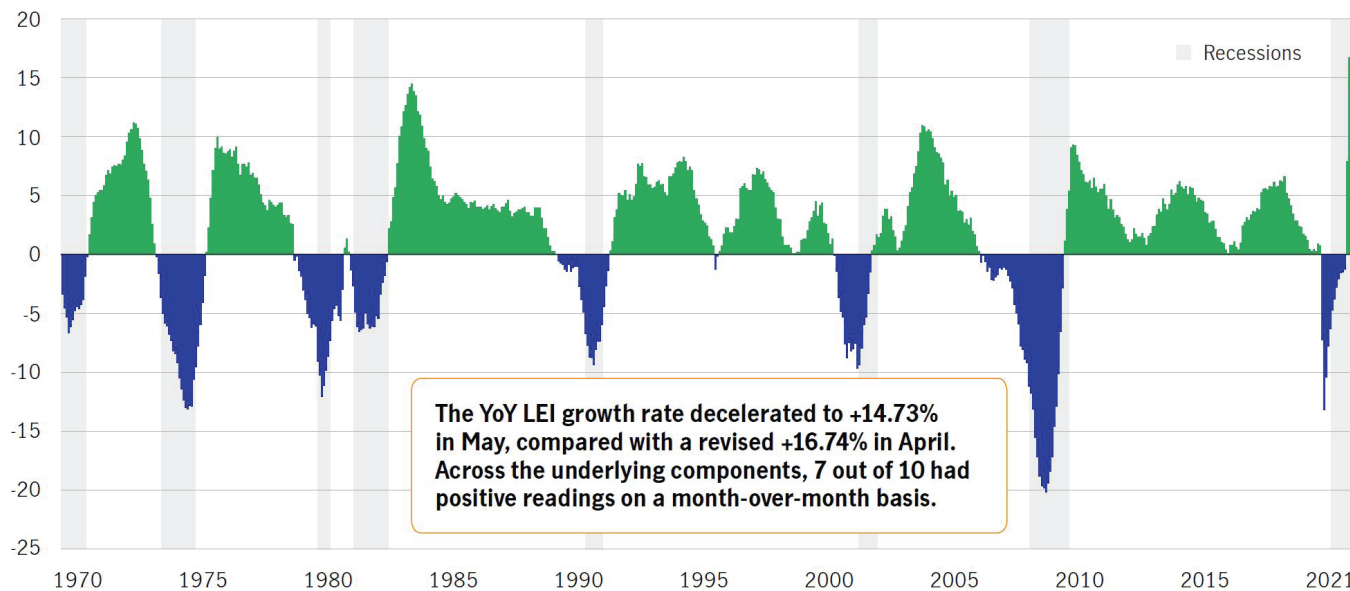
Base effects to roll off.

Due to a substantial pullback in demand last year as the pandemic hit, there was a depressed level of prices that today will contribute to a higher year-over-year print in inflation measures, but this should be temporary as we roll off that time period.



It appears that leading indicators of economic expansion peaked in April, but are still positive.

YoY change in the LEI (%)

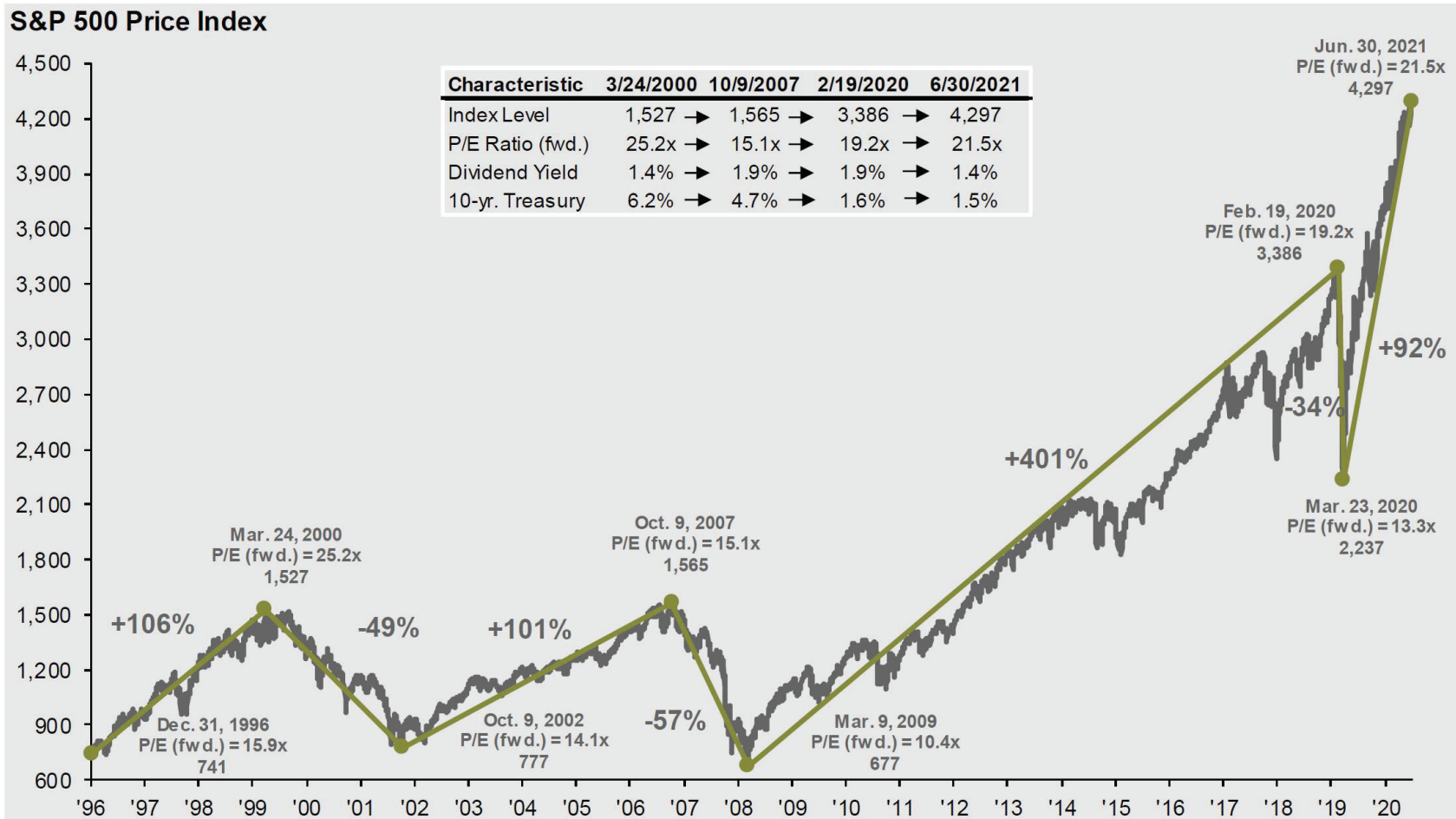


LEI (ranked by weighting in the index)

Weekly manufacturing hours worked	28%	—
ISM Index of New Orders	16%	▲
Consumer expectations	14%	▲
Yield spread	11%	▲
New orders of consumer goods and materials	8%	▲
Leading Credit Index	8%	▲
New orders of nondefense capital goods	4%	▼
Stock prices	4%	▲
Weekly unemployment claims	3%	▲
Building permits	3%	▼

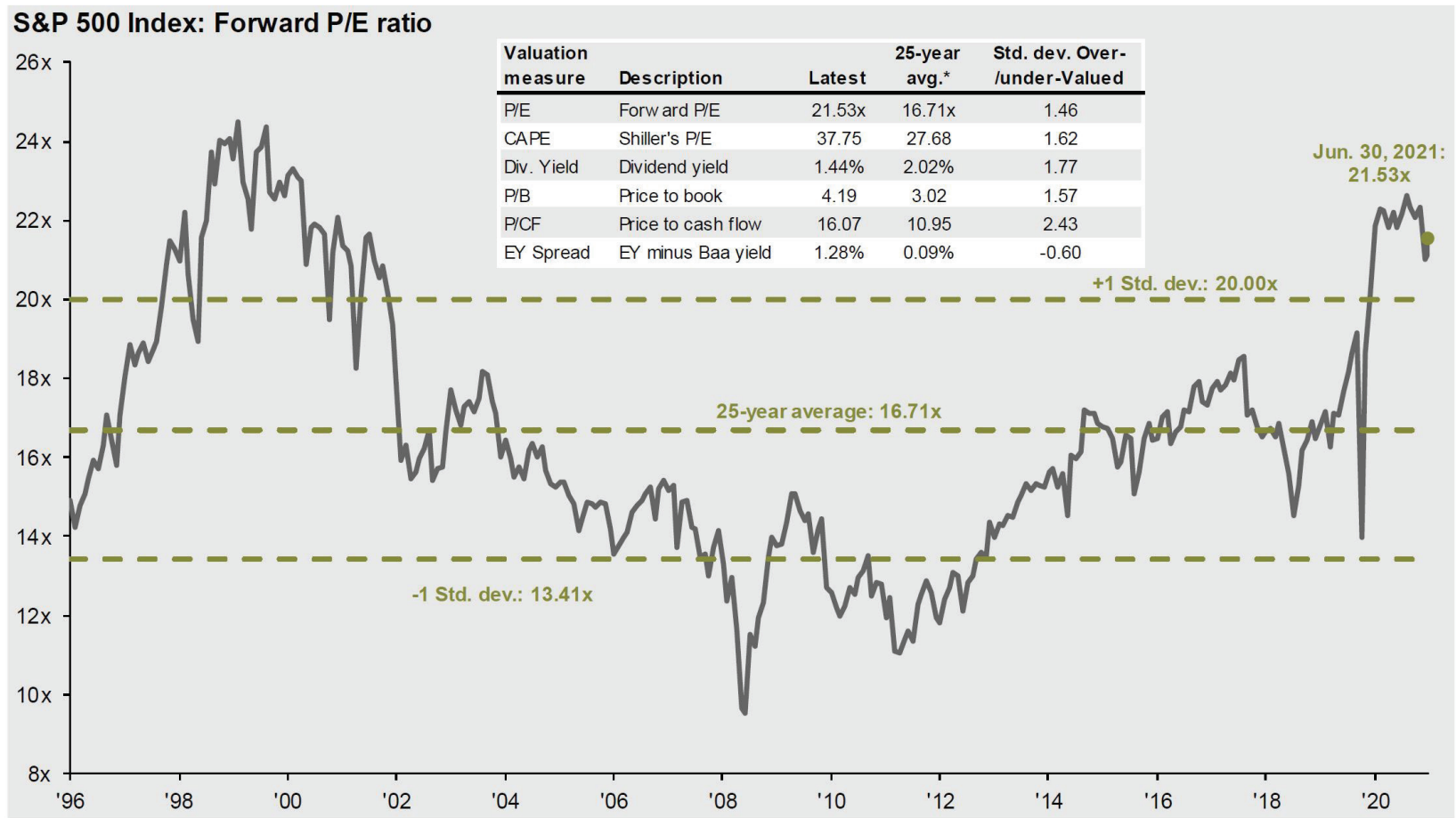
Source: The Conference Board, as of 5/31/21. The Composite Index of Leading Indicators (LEI) is an index published monthly by The Conference Board, used to predict the direction of the economy's movements in the months to come. The index is made up of 10 economic components whose changes tend to precede changes in the overall economy. It is not possible to invest directly in an index. YoY refers to year over year. Past performance does not guarantee future results.

The S&P 500 has returned to all time highs...



Source: J.P. Morgan Asset Management

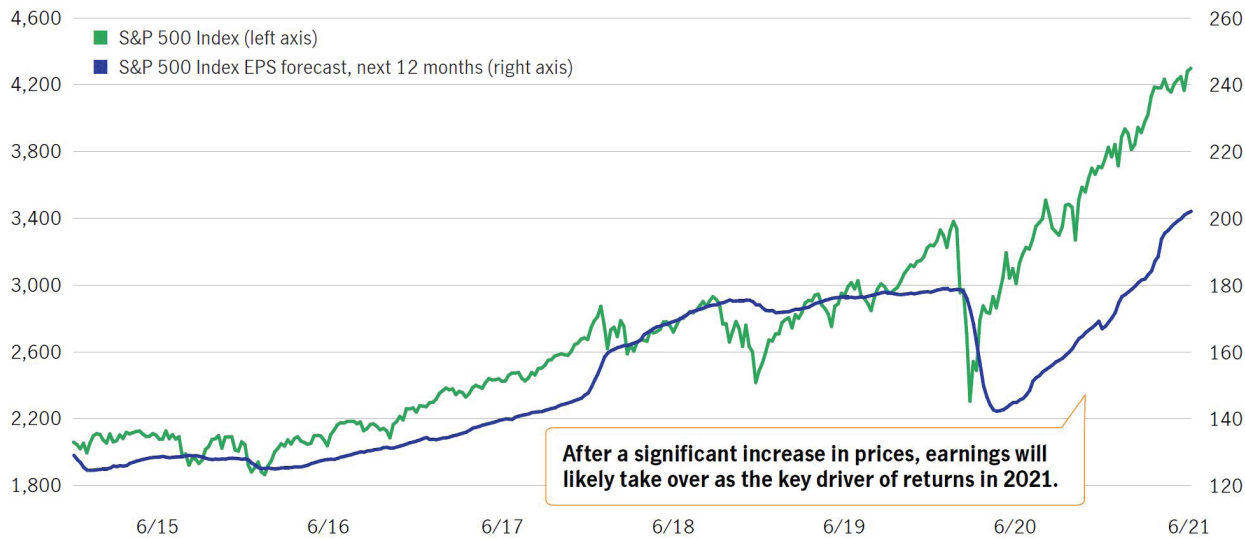
... and valuations are a bit extended...



Source: J.P. Morgan Asset Management

... so earnings will need to catch up to drive further growth.

Stock prices and earnings estimates have moved higher nearly in lockstep

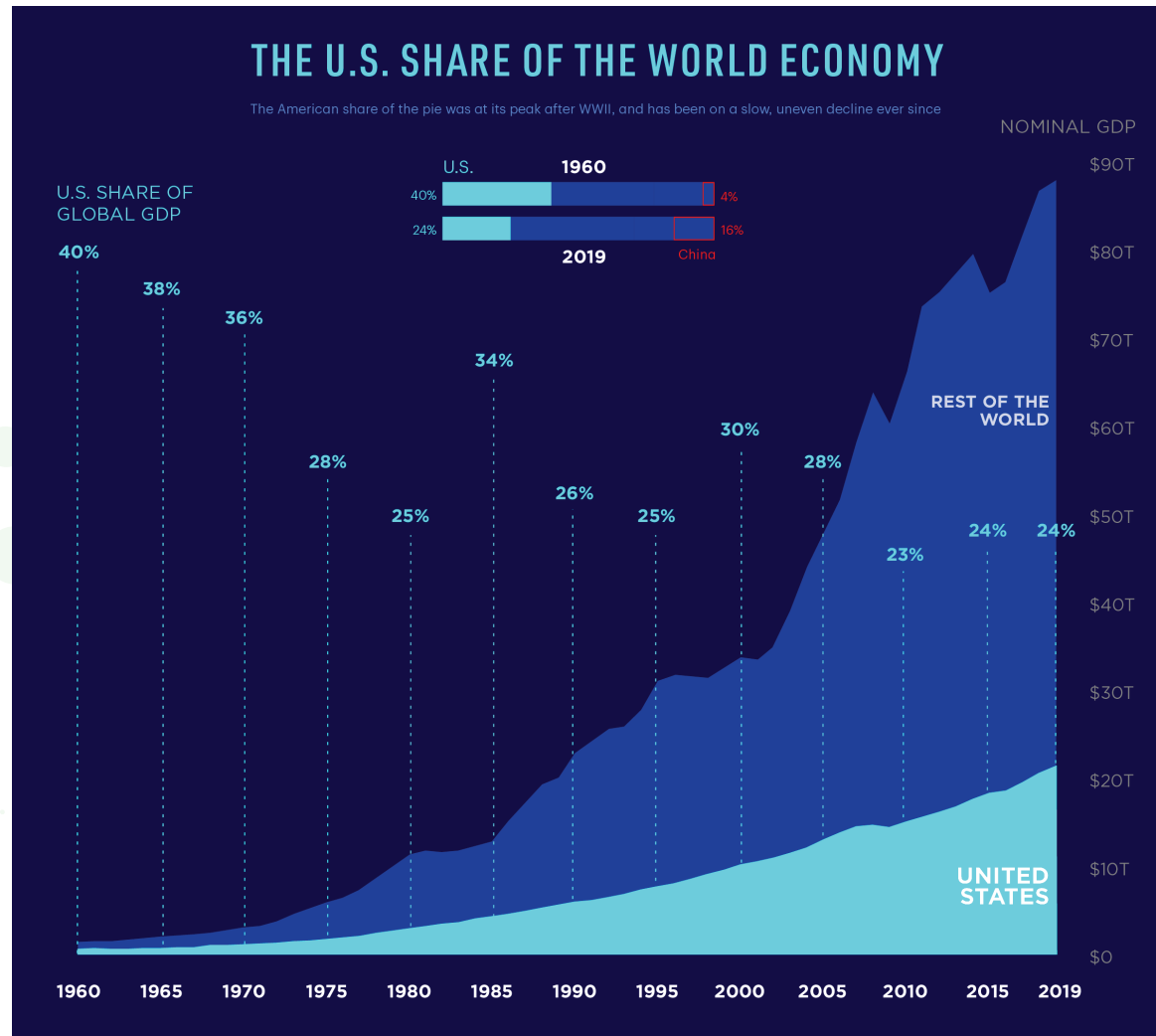


EPS growth estimates YoY (%)

	2021	2022
Energy	—	31.55
Industrials	97.10	32.55
Consumer discretionary	70.76	29.51
Materials	67.74	2.04
Financials	45.04	-1.70
S&P 500 Index	35.28	11.14
Communication services	23.98	11.97
Information technology	22.82	8.69
Healthcare	15.00	8.21
Real estate	9.97	9.13
Consumer staples	7.40	7.05
Utilities	2.06	18.77

Source: FactSet, as of 6/30/21. The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States. It is not possible to invest directly in an index. Earnings per share (EPS) is a measure of how much profit a company has generated calculated by dividing the company's net income by its total number of outstanding shares. YoY refers to year over year. Past performance does not guarantee future results.

A large part of global growth exists outside the US...

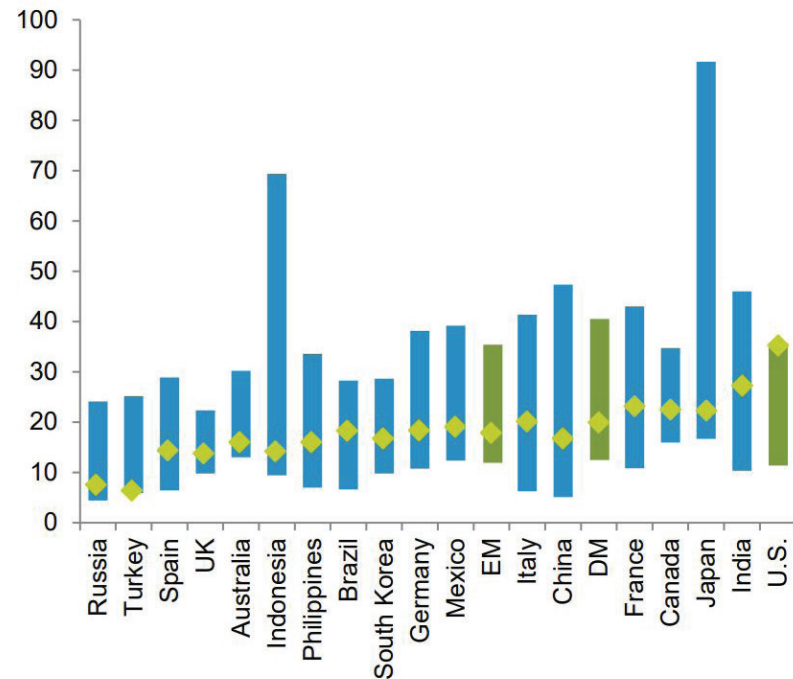


... and valuations in international markets are a bit more compelling.

Cyclically Adjusted P/Es

◆ 5/31/21 ■ 20-Year Range

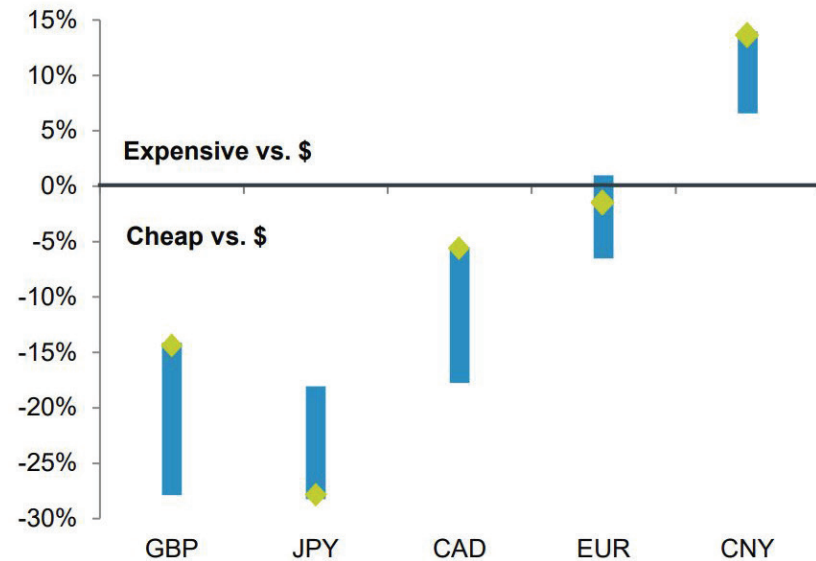
Shiller CAPE



Valuation of Major Currencies vs. USD

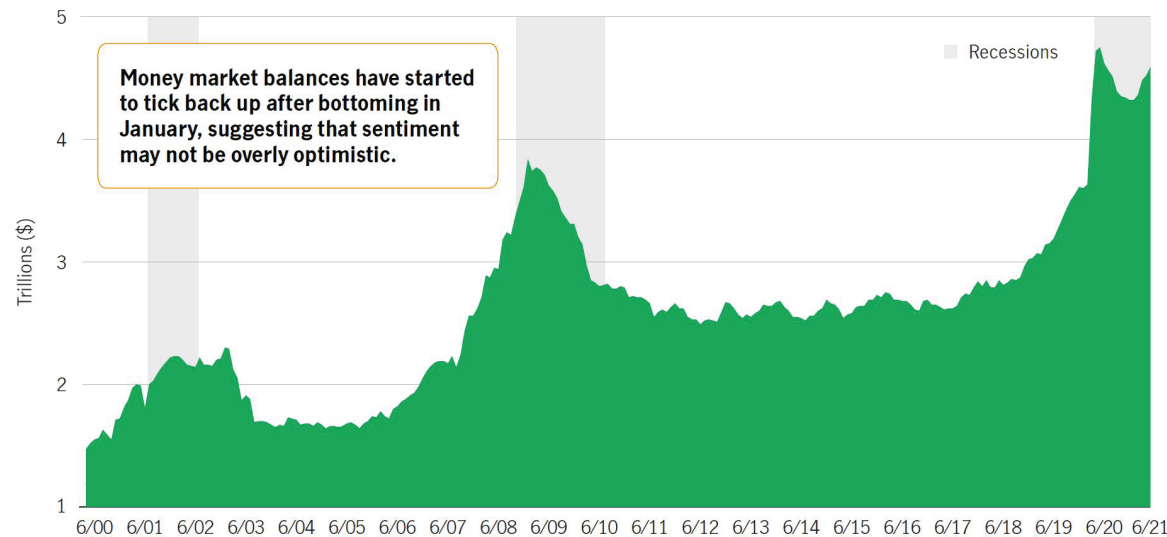
■ Last 12-Months Range ◆ 6/30/21

Valuation of Real Exchange Rates

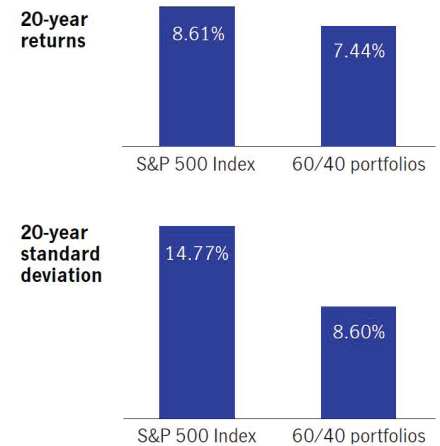


Cash on the sidelines has fallen slightly but is still near an all-time high.

Money market assets have soared in the pandemic

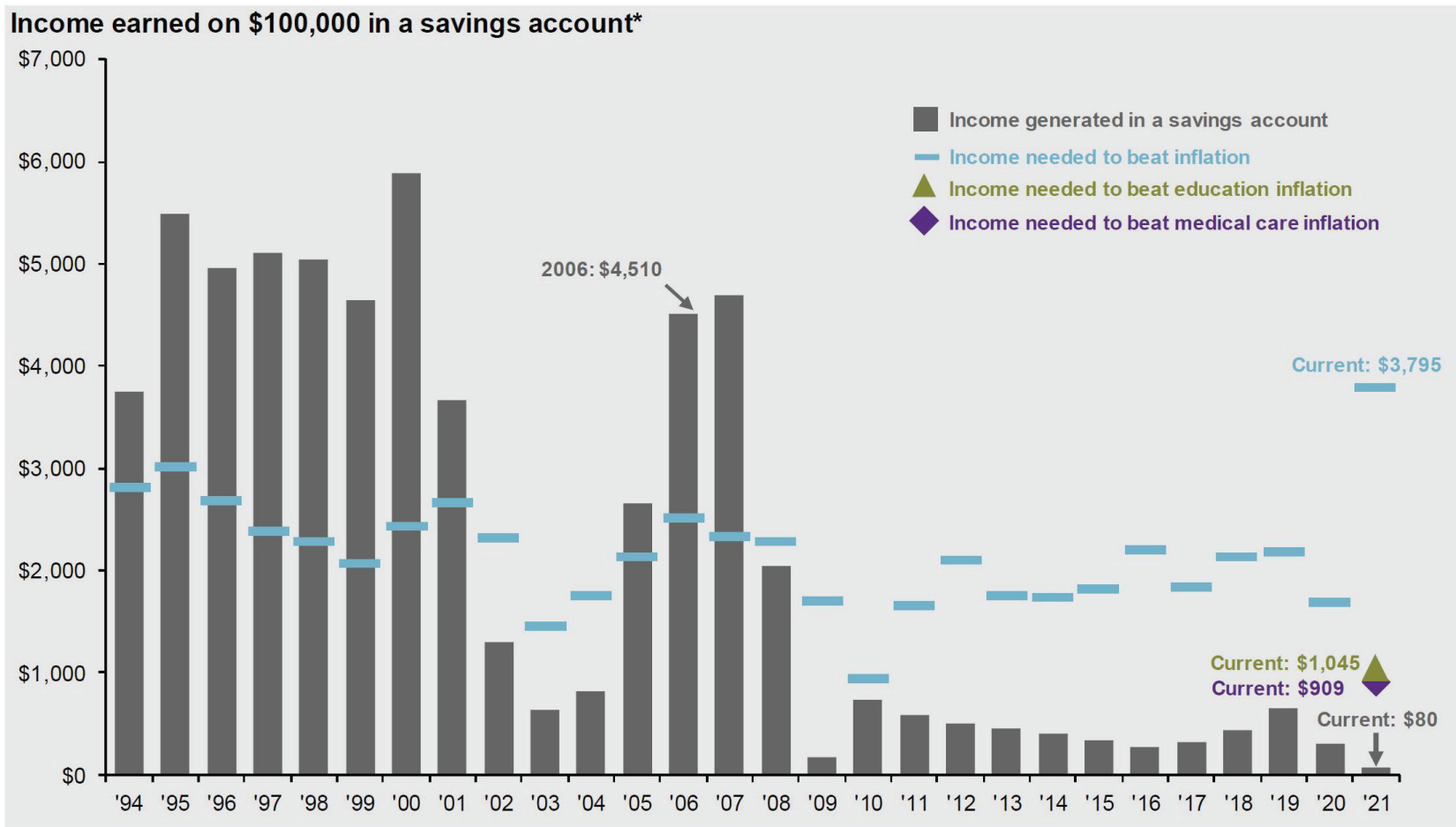


A 60/40 portfolio has provided long-term investors with a similar return to stocks, but with less risk



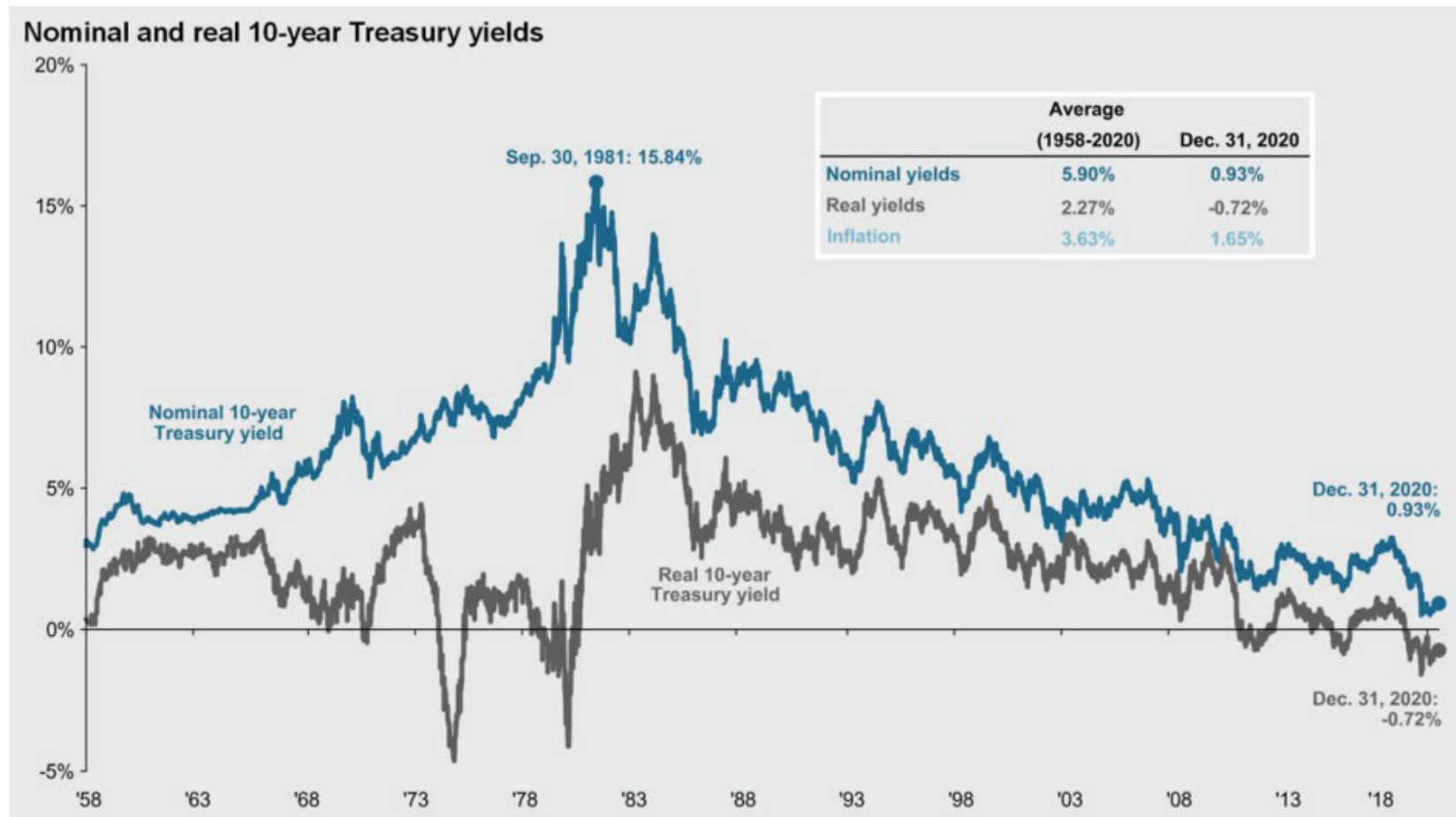
Source: FactSet, as of 6/30/21. The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States. It is not possible to invest directly in an index. Standard deviation is a statistical measure of the historic volatility of a portfolio. It measures the fluctuation of a fund's periodic returns from the mean or average. The larger the deviation, the larger the standard deviation and the higher the risk. Past performance does not guarantee future results.

And savings account income has been decimated by low rates...



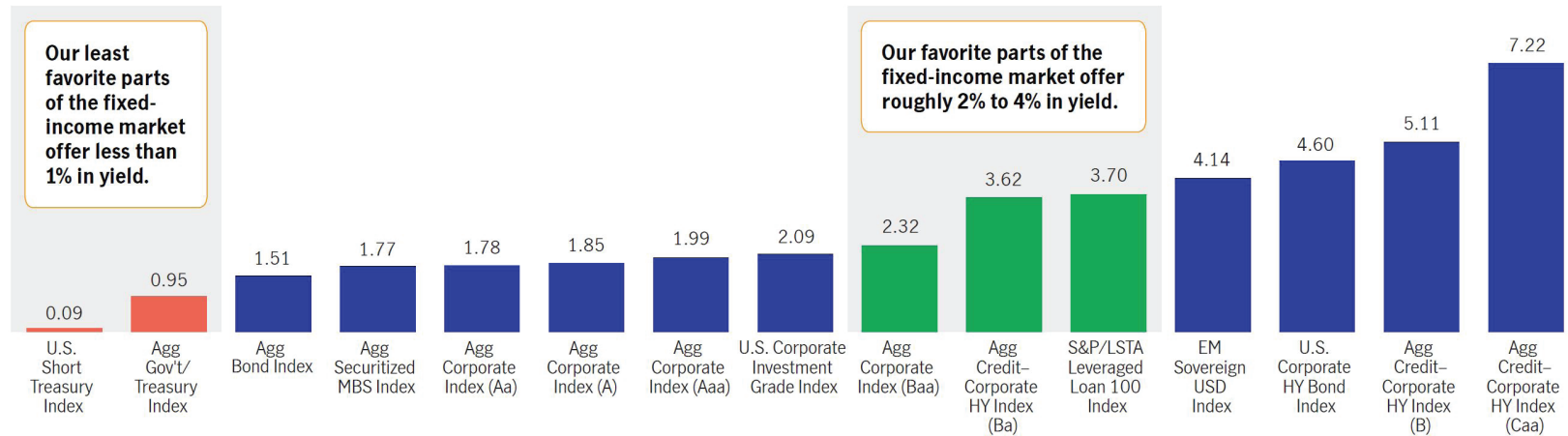
Source: J.P. Morgan Asset Management

... including negative real returns (after inflation) in core bonds.



So, careful bond selection may lead to favorable risk/reward trade-offs...

Yield to maturity (%)

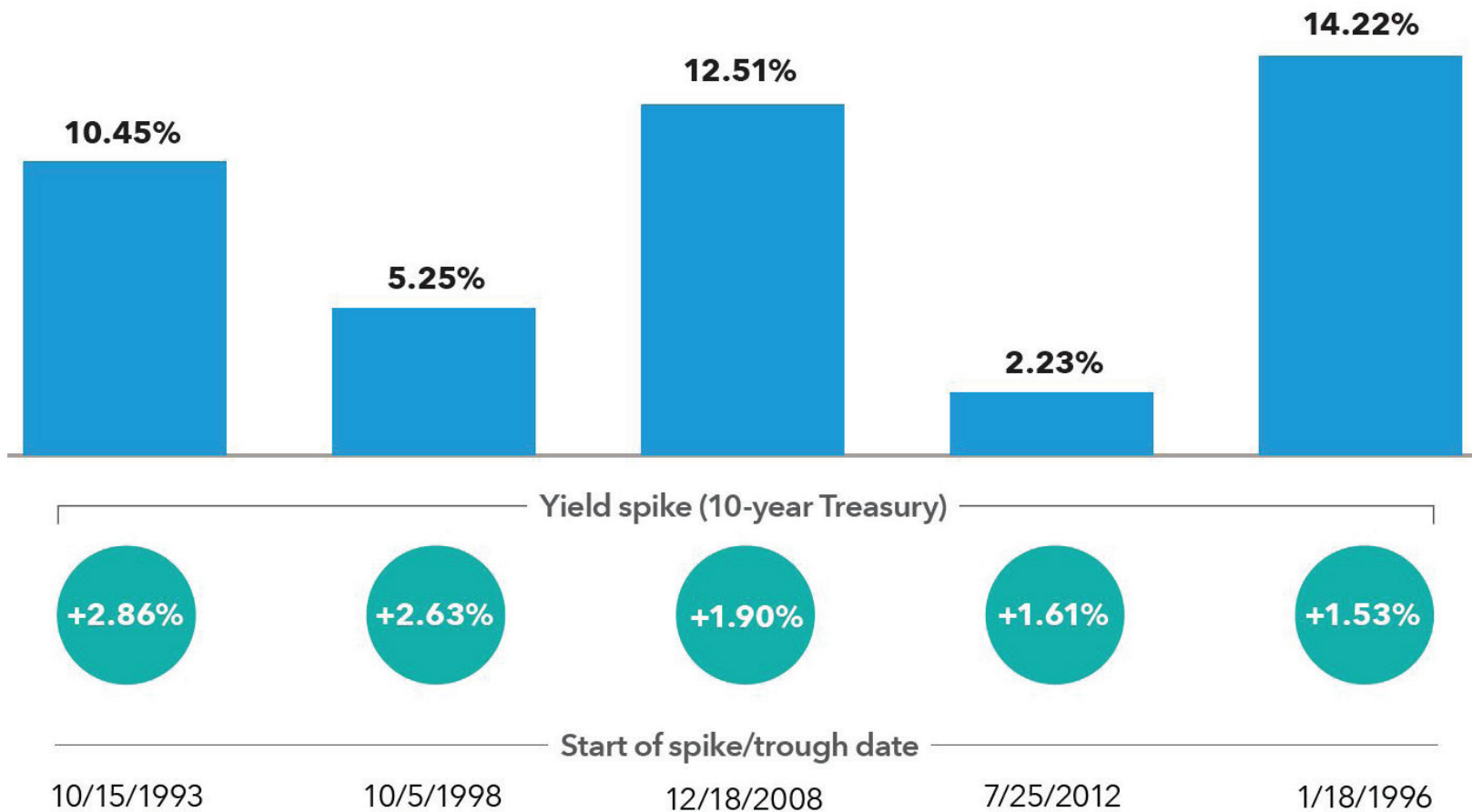


All indexes are Bloomberg Barclays except S&P/LSTA Leveraged Loan 100 Index.

Source: FactSet, Moody's, as of 6/30/21. The U.S. Short Treasury Index tracks the performance of the U.S. Treasury bills, notes, and bonds under one year to maturity. The Aggregate (Agg) Government/Treasury Index tracks public obligations of the U.S. Treasury comprising U.S. Treasury bonds and notes across maturities ranging from one to thirty years. The Agg Bond Index tracks the performance of U.S. investment-grade bonds in government, asset-backed, and corporate debt markets. The Agg Securitized Mortgage-Backed Securities (MBS) Index tracks the performance of investment-grade U.S. securitized mortgage-backed securities. The Agg Corporate Index tracks the performance of the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate bond market. U.S. Corporate Investment Grade Index tracks the investment-grade, fixed-rate, taxable corporate bond market. The Agg Credit-Corporate High Yield (HY) Index is a broad-based benchmark that tracks the high-yield, U.S. dollar-denominated, fixed-rate, taxable corporate bond market. The S&P/LSTA Leveraged Loan 100 Index tracks the market-weighted performance of the largest U.S. dollar-denominated institutional leveraged loans. The Emerging Markets (EM) Sovereign U.S. Dollar (USD) Index tracks the performance of USD-denominated government bonds from more than 60 emerging markets. The U.S. Corporate HY Bond Index tracks the performance of the USD-denominated, HY, fixed-rate corporate bond market. It is not possible to invest directly in an index. Past performance does not guarantee future results.

... even in a rising rate environment.

Two-year total returns: Bloomberg Barclays U.S. Aggregate Index



Portfolio Implications

As COVID-19 vaccinations and immunity spread across the globe, we continue to expect a strong global economic recovery contributing to healthy corporate earnings growth. This should bode well for riskier but higher-returning asset classes over the near term (next 12 months) at least. Credit markets should benefit as well. While the Federal Reserve is now signaling it is moving closer to beginning to taper its quantitative easing asset purchases, monetary policy and interest rates should still remain accommodative for a while.

Our portfolio positioning reflects this view, with a modest overweight to global equities in most models. We believe non-U.S. equities, which are generally more economically sensitive and trading at cheaper valuations, are likely to outperform. We also have meaningful allocations to flexible bond strategies that we expect to do better than core bonds.

While our base case is positive, the range of possible outcomes is always wide, and these are far from ordinary times. As a result, we don't make aggressive

bets on a single outcome. We are tilted modestly toward reflationary, return-generating assets. But we acknowledge there are scenarios that could drive inflation to be higher and occur sooner than we expect. There could also be shorter-term deflationary shocks like more-dangerous COVID-19 variants or political unrest that leads to a market correction or worse.

While a sustained period of high inflation would be bad initially for most equities, over time many areas would likely do well, including value stocks. And in the event of a macro shock and deflationary pressure, we maintain meaningful positions in core bonds, which would help offset declines elsewhere. Put simply, we are diversified, as always.

Disclosures

Please remember that past performance may not be indicative of future results. Therefore, no current or prospective client should assume that the future performance of any specific investment, investment strategy (including the investments and/or investment strategies recommended by the adviser), will be profitable or equal to past performance levels.

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39 S. 4th Street,
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info@meridianfinancialpartners.com