

Market Commentary

Crypto, Corporate Earnings and Covid

July 2021

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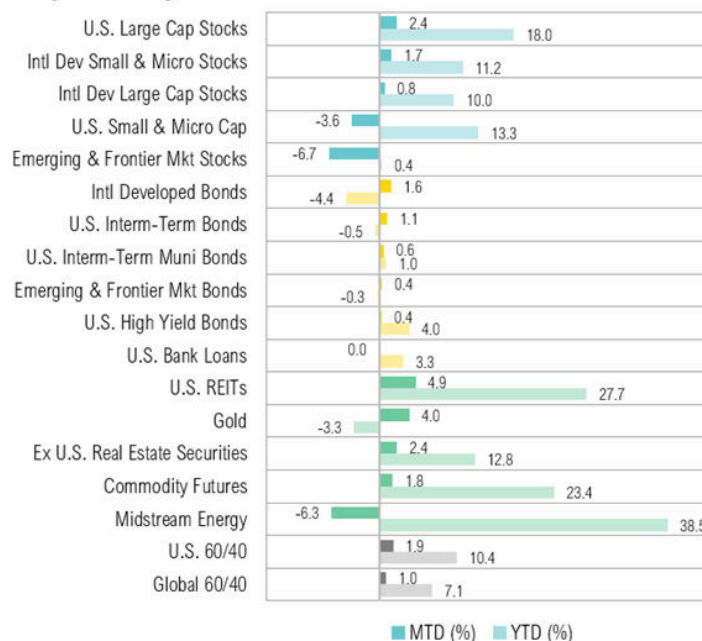
Summary

- During July, fears of impending inflation declined, sparking a positive response in yield-sensitive assets and mixed results in other markets.
- A regulatory crackdown in China, combined with lower energy prices, hurt emerging market stocks, which severely lagged behind other equity markets.
- Digital assets stopped their three-month slide and won big during the month due to a plethora of positive developments, including speculation over a single job posting from e-commerce giant Amazon.
- Corporate earnings announcements were overwhelmingly positive and are on pace for their largest year-over-year growth since Q4 2009.

Overview

Treasury yields fell sharply in July, as fears of higher inflation, which had dominated investing discussions for months, began to dissipate. The U.S. 10-year Treasury yield fell below 1.2% for the first time since February 2021 and closed the month at 1.24%, a drop of 21 basis points from the start of the month. Interest-rate-sensitive assets rallied. Longer term bonds outperformed short-term bonds, while U.S. growth stocks, led by the technology sector, returned 2.9%, beating their value counterparts by 3%. Growth stocks are generally considered to benefit more than their value counterparts during periods of declining rates. U.S. real estate investment trusts (REITs) gained 4.9%, as their yields declined to 2.1%, near the lowest level ever. Despite lower inflation expectations, gold bounced back modestly after a disappointing June, rising 4.0%.

July 2021 Key Market Total Returns



Source: Bloomberg

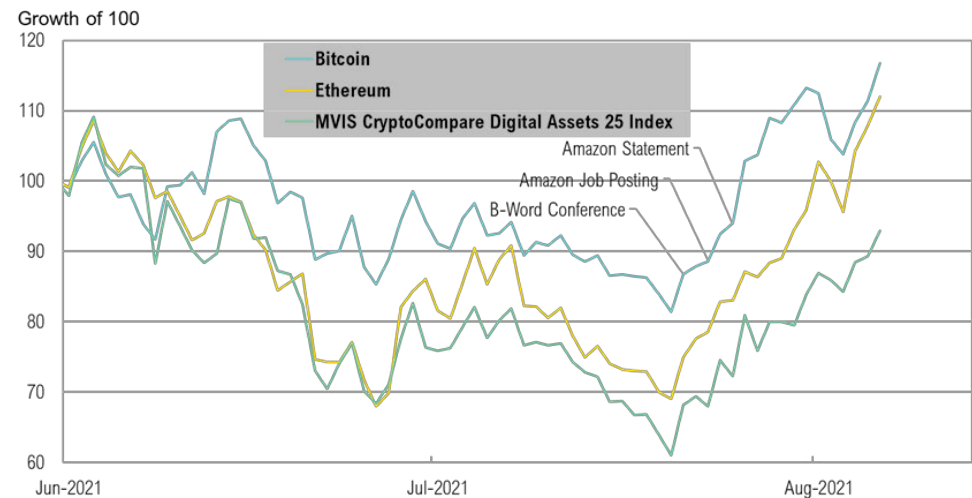
After months of low crude inventories pushed oil prices higher, energy assets were hit hard in July by fears of declining demand as coronavirus cases surged. Crude oil was down 3.9% for the month, sending energy stocks and midstream investments down 8.4% and 6.3%, respectively. Although overall crude inventories remain low, data from the Energy Information Administration revealed sharply declining exports, indicating that the drop in demand is most likely driven by lower travel activity outside the United States.¹ Emerging and frontier market equities also performed poorly over the month, dropping 6.7%. Chinese equities generated particularly weak returns due to increased government scrutiny in the private sector, falling 14%.²

Crypto's Wild Week

Digital assets performed exceptionally well in July, increasing 9.8% as measured by the MVIS CryptoCompare Digital Assets 25 index, a broad proxy for the 25 largest cryptocurrencies. Highlighting two of the top cryptocurrencies, bitcoin rallied 18.1%, and ether, the native cryptocurrency of the Ethereum network, rose 11.4%. The cryptocurrency rally started on July 20 in anticipation of the “The B-Word” Bitcoin conference taking place the next day. The conference keynotes, all well-known and public bitcoin enthusiasts, included Tesla CEO Elon Musk, Twitter CEO Jack Dorsey, and ARK Invest founder Cathie Wood. According to its website, the purpose of the conference was to “demystify and destigmatize mainstream narratives about Bitcoin, explain how institutions can embrace it, and raise awareness around areas of the network that need support.”³ At the conference, Musk announced that Tesla will likely start accepting bitcoin for vehicle purchases again after suspending the form of payment in May out of concern over the “rapidly increasing use of fossil fuels for bitcoin mining.”⁴ He went on to explain the reversal was due to the shutdown of mining operations using “heavy-duty coal plants...especially in China.” Bitcoin finished the day 8% higher than the prior day's low.

Crypto's Wild Week

Bitcoin, Ethereum and MVIS CryptoCompare Digital Assets 25 Index Growth of 100, as of 8/6



Source: Bloomberg

On July 23, just two days later, a job posting for a “Digital Currency and Blockchain Product Lead” was discovered on Amazon’s website. The posting sparked frenzied speculation over whether the e-commerce giant was going to start accepting cryptocurrency as a form of payment.⁵ After denying a rumor that it would start accepting cryptocurrencies this year, Amazon released the following statement:⁶

"We are inspired by the innovation happening in the cryptocurrency space and are exploring what this could look like on Amazon. We believe the future will be built on new technologies that enable modern, fast, and inexpensive payments, and hope to bring that future to Amazon customers as soon as possible."⁷

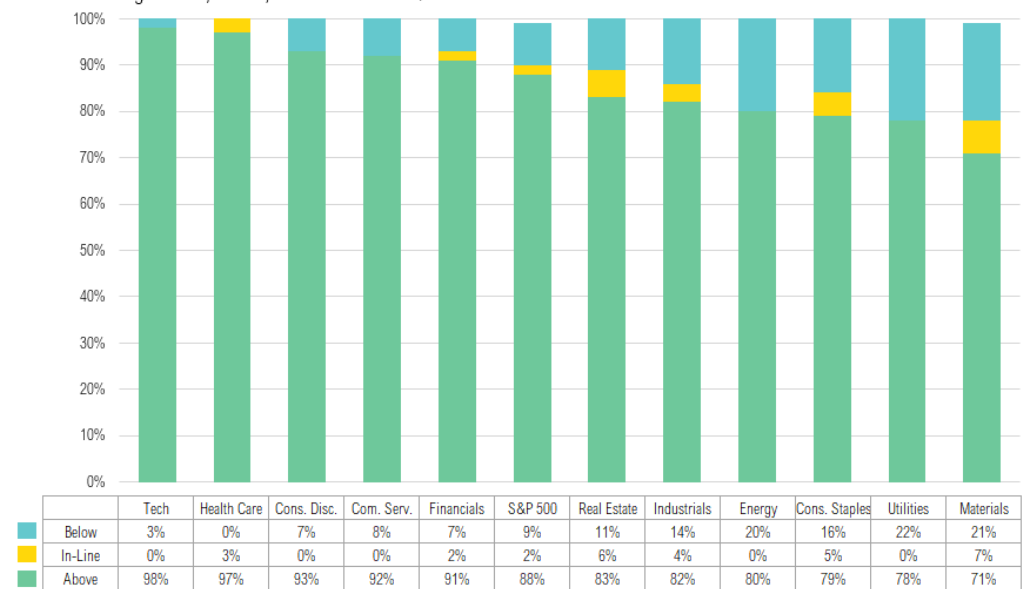
Whether this is just an exploration or a serious-minded foray into digital payments remains to be seen, but by the time the dust had settled on July 27, Bitcoin was 20% higher than before the posting.

Earnings Explosion

By the end of July, 59% of the companies in the S&P 500 had reported earnings for the second quarter, and results were overwhelmingly positive. According to FactSet, companies in the S&P 500 Index reported their highest year-over-year earnings growth since the fourth quarter of 2009, during the global financial crisis recovery.⁸ Although the size of this earnings growth is heavily influenced by the lower earnings base set during the coronavirus crisis a year ago, the breadth and magnitude of earnings surprises demonstrate how impressive the economic snapback has been. Of the companies that have reported, 88% reported earnings that exceeded expectations—a considerable step up from the five-year average of 75%. If these kinds of results continue throughout this earnings season, it will mark the highest percentage of positive surprises in an earnings season since FactSet started tracking this data in 2008. The magnitude of positive earnings is as remarkable as the breadth, too. In aggregate, companies in the S&P 500 are beating estimates by 17.2%, almost 10% higher than the five-year average of 7.8%. The updated expected second-quarter earnings growth rate is a staggering 85.1%, up from an expected 63.1% just one short month ago. This again is the highest year-over-year earnings growth since 2009. The chart below shows the break-out by sector of earnings above, in-line, and below expectations.

Earnings Explosion

S&P 500 Earnings Above, In-line, Below Estimates: Q2 2021



Source: FactSet

The sectors with the highest percentage of earnings surprises have been technology, health care, consumer discretionary, and communication services—mostly asset-light, growth-oriented sectors. That said, all 11 sectors reported year-over-year earnings

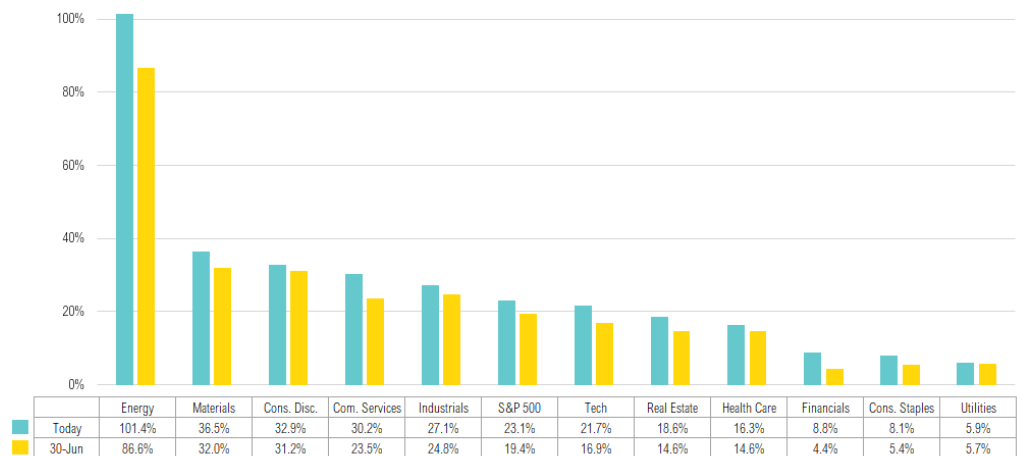
growth, and the sectors that were hardest hit a year ago—energy, industrials, and consumer discretionary—have led the recovery. At the individual company level, the biggest earnings surprises for the quarter belonged to Valero Energy, Twitter, V.F. Corporation, PNC Financial Services, and Hasbro; all of them more than doubled analyst estimates.⁸

From a revenue perspective, 88% of S&P 500 companies reported revenues above estimates, also crushing the five-year average of 65%. In absolute terms, year-over-year revenue growth for the index is now projected to be 23.1%, which would be the highest since FactSet started publishing this data back in 2008.⁸

Looking ahead to the rest of 2021, analysts are projecting double-digit earnings growth for both the third and fourth quarters.⁸ Despite the impressive earnings season, the strong rally in stocks has kept stock valuations near the higher end of historical ranges and well above averages. The forward 12-month price-to-earnings ratio (P/E) is 21.2x, considerably higher than the 10-year average of 16.2x.⁸

On Pace for Highest YoY Revenue Growth in Over a Decade

S&P 500 Revenue Growth: Q2 2021



Source: FactSet

Looking Forward

With earnings exploding, inflation concerns abating, and vaccinations increasing across the globe, the proverbial “wall of worry” the stock market is said to climb seems to be getting smaller. But markets are forward looking, and as coronavirus cases rise, risks loom. As of August 3, the seven-day moving average of COVID-19 cases topped 90,000 in the U.S. for the first time since February.⁹ While that number is alarming, the seven-day average of the number of deaths, while sadly trending higher, remained 87% lower than the February peak. Looking forward, we will remain focused on hospitalizations and deaths as important metrics of pandemic recovery. We must also consider that the severity of, and reaction to, future coronavirus waves may be extremely varied across countries, regions, states, and even cities.

Sincerely,

The SpringTide Investment Team

Performance Disclosures

All market pricing and performance data from Bloomberg, unless otherwise cited. Asset class and sector performance are gross of fees unless otherwise indicated.

Citations

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Asset Class Definitions

Asset class performance was measured using the following benchmarks: U.S. Large Cap Stocks: S&P 500 TR Index; U.S. Small & Micro Cap: Russell 2000 TR Index; Intl Dev Large Cap Stocks: MSCI EAFE GR Index; Emerging & Frontier Market Stocks: MSCI Emerging Markets GR Index; U.S. Interm-Term Muni Bonds: Bloomberg Barclays 1-10 (1-12 Yr) Muni Bond TR Index; U.S. Interm-Term Bonds: Bloomberg Barclays U.S. Aggregate Bond TR Index; U.S. High Yield Bonds: Bloomberg Barclays U.S. Corporate High Yield TR Index; U.S. Bank Loans: S&P/LSTA U.S. Leveraged Loan Index; Intl Developed Bonds: Bloomberg Barclays Global Aggregate ex-U.S. Index; Emerging & Frontier Market Bonds: JPMorgan EMBI Global Diversified TR Index; U.S. REITs: MSCI U.S. REIT GR Index, Ex U.S. Real Estate Securities: S&P Global Ex-U.S. Property TR Index; Commodity Futures: Bloomberg Commodity TR Index; Midstream Energy: Alerian MLP TR Index; Gold: LBMA Gold Price, U.S. 60/40: 60% S&P 500 TR Index; 40% Bloomberg Barclays U.S. Aggregate Bond TR Index; Global 60/40: 60% MSCI ACWI GR Index; 40% Bloomberg Barclays Global Aggregate Bond TR Index.

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