Yanni & Associates
Investment Advisors, LLC

*Firm update:*
***15* year Anniversary YAIA fact:**

→ The Dow Jones Industrial Average (DJIA) price on YAIA's inception date was 12,459.54.

→ As of 04/05/2021, the DJIA was trading at 33,551.13.

*As we transition to SEC registration later this year, we will continue to update our clients on the respective compliance changes. We are aware we will have to circulate Form CRS to everyone. Beyond that, the other changes appear to be internal in nature.*

**FIRST QUARTER – 2021 CLIENT NEWSLETTER**
**REVIEW OF THE MARKETS:**

| Index: | 1Q21 | 2021 |
|---|---|---|
| S&P 500 | 6.17% | 6.17% |
| S&P Mid-Cap | 13.47% | 13.47% |
| S&P Small Cap | 18.24% | 18.24% |
| Morgan Stanley's EAFE (International Stocks) | 3.48% | 3.48% |
| Barclay's US Aggregate (Bonds) | -3.37% | -3.37% |

**ECONOMY & MARKETS:**

The stock market continued its upward trend into the first quarter, but not without the return of volatility. Mainly, this volatility was caused by the continued rise in longer-term interest rates (*discussed on the latter pages*). Further, there appears to have been a shift in the stock market where some of the laggers have now become the leaders. For example, the "techy related" names (Growth stocks) that we have noted in past newsletters that propelled stocks out of the Covid recession have not kept pace with other stock market segments. When news of the vaccine came to fruition in the Fall, we did neutralize our former overweight to Growth stocks. Their counterparts, Value stocks, have since become the recent stock market leaders. Market rotations are completely normal and a reason to utilize an academically diversified approach.

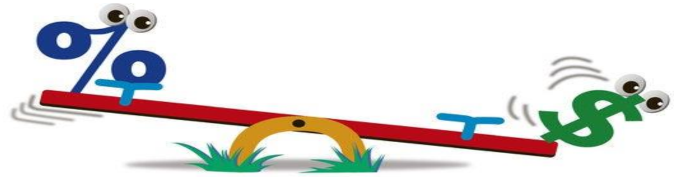
GDP for the fourth quarter came in at 4.3%. We believe GDP is poised to continue to be strong with additional support from the latest $1.9 trillion stimulus package. As widely known, it will include another direct payment of $1,400 to all Americans who have earned under $75,000. The latest monthly unemployment report indicated employers added 916,000 jobs as compared to an expected increase of 675,000. Prior months were revised upwards as well. Further, the unemployment report fell from 6.2% to 6.0%. Still, as of March, there are 8.4 million fewer jobs than in February 2020 before the pandemic hit. Inflation remains tame, but with all of the stimulus packages and the rise in longer-term interest rates, there are serious concerns of it rising in the long-term. The Federal Reserve meetings are now scrutinized not so much in terms of if they will raise short-term interest rates (which will not happen anytime soon), but more on the specific language it uses in addressing long-term inflation concerns. Quoting a recent Wall Street Journal article *"many investors are betting that inflation and interest rates are still poised to rise due to the massive fiscal and monetary stimulus and the broadening distribution of coronavirus vaccines."* While many economists are projecting a continued further rise in longer-term interest rates, we are approaching those peak projections.

We remain more bullish on the stock market as compared to the bond market. This rise in longer-term interest rates has put a lot of pressure on bonds. We have made a few internal strategic adjustments to both our stock and bond segments and will continue to monitor their progress. The S&P 500's valuation remains slightly elevated with a price-to-earnings ratio of 21.9. We do not see any major signs of a recession in the near-term.

*The DOL Rule - The Department of Labor (DOL) reinstituted a rule regarding all types of retirement plan rollovers (including IRA transfers from brokers and other Advisors). The DOL is now requiring Registered Investment Advisors to internally document in extreme detail "why it is beneficial for clients to roll over retirement plans to be under YAIA's formal jurisdiction". The Rule requires a side-by-side comprehensive analysis (benefits, fees, etc…) for the client's current situation compared to transferring the retirement account to be under YAIA's formal jurisdiction. While we will adhere to this rule and understand the essence of it, to complete the analysis will require clients to gather an exorbitant amount of data on their current situation. Clients will be given the choice as to whether they want to gather their portion of the analysis. However, we will still fully disclose our Firm's required information to clients and internally document accordingly.*

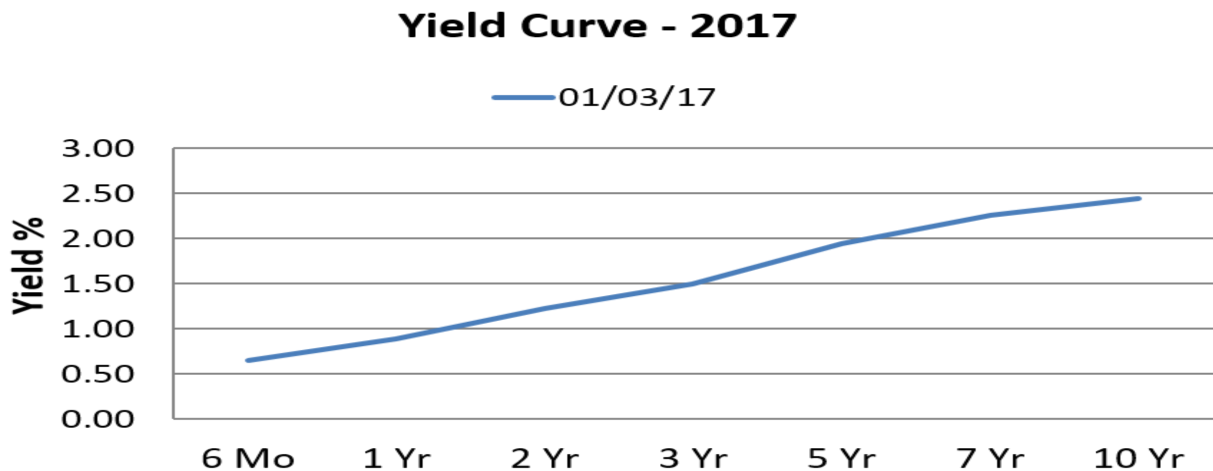
# Yield Curve's Rollercoaster Ride

The Yield Curve is a graphical representation of interest rates at varying maturities. Short term interest rates are highly influenced by the Federal Reserve (the Fed). Longer-term interest rates are more determined by long-term economic prospects. "Yield" is another term for interest rates.

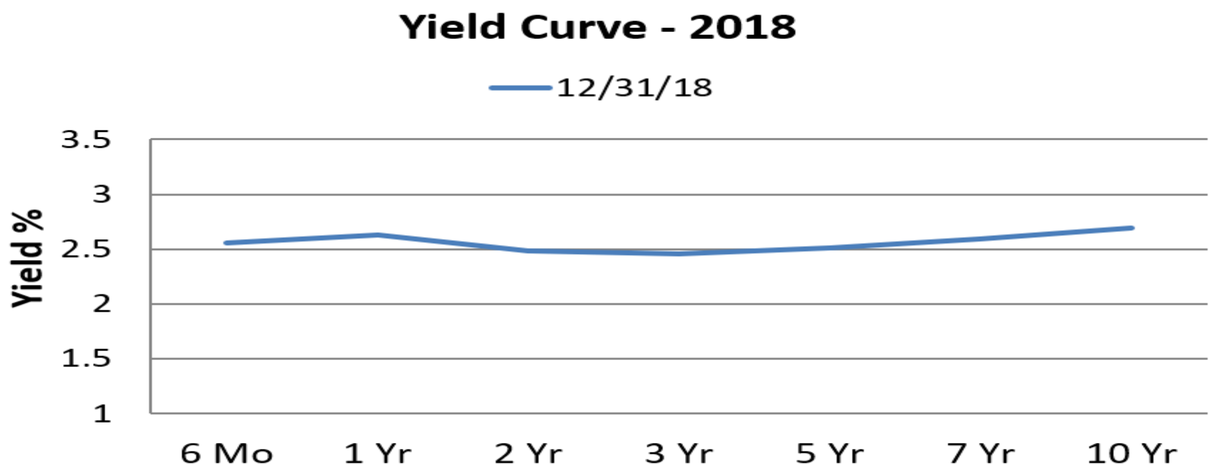


**What is happening now?** - Longer term interest rates are rising, which is putting a lot of pressure on most bond segments and causing volatility in the stock market. *We generalize this in what we call "the see-saw effect". When interest rates (%) rise, bond prices fall ($); see graphical depiction above. Let's rewind history, shall we?*

***2017*** – The depiction below is what's termed a "Normal Yield Curve" or a "positively sloping yield curve". Interest rate yields are lower for shorter maturity bonds and increase steadily as we move towards higher maturities. A normal yield curve implies stable economic conditions and is the most common. *Again, see the 2017 positive yield curve below.*

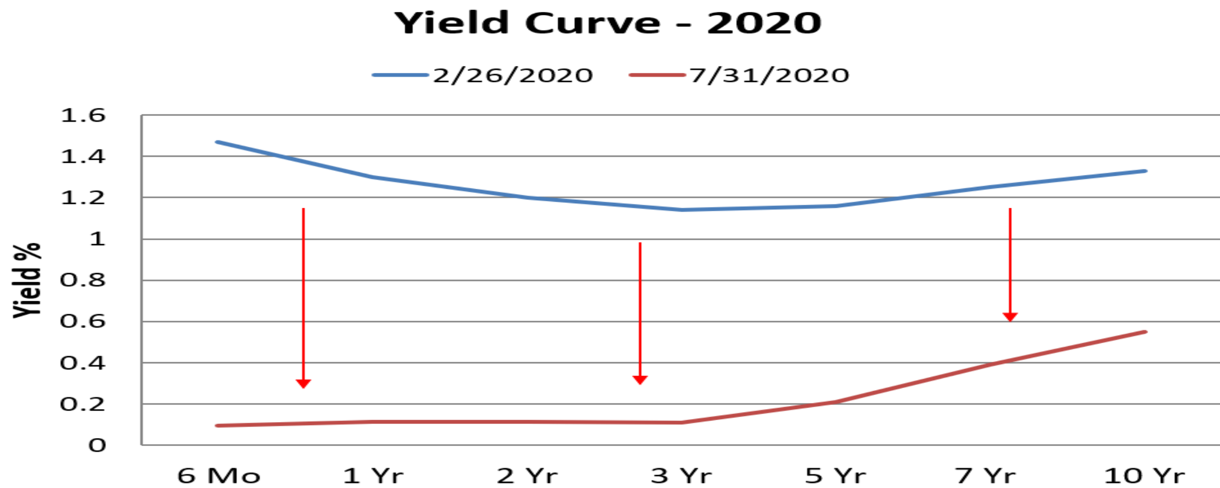



***Let's fast-forward to 2018***. Due to continued strengthening in economic activities, the Fed began increasing short-term interest rates. As a result, the Yield Curve flattened by the end of 2018. *Please see the flat 2018 yield curve below.*

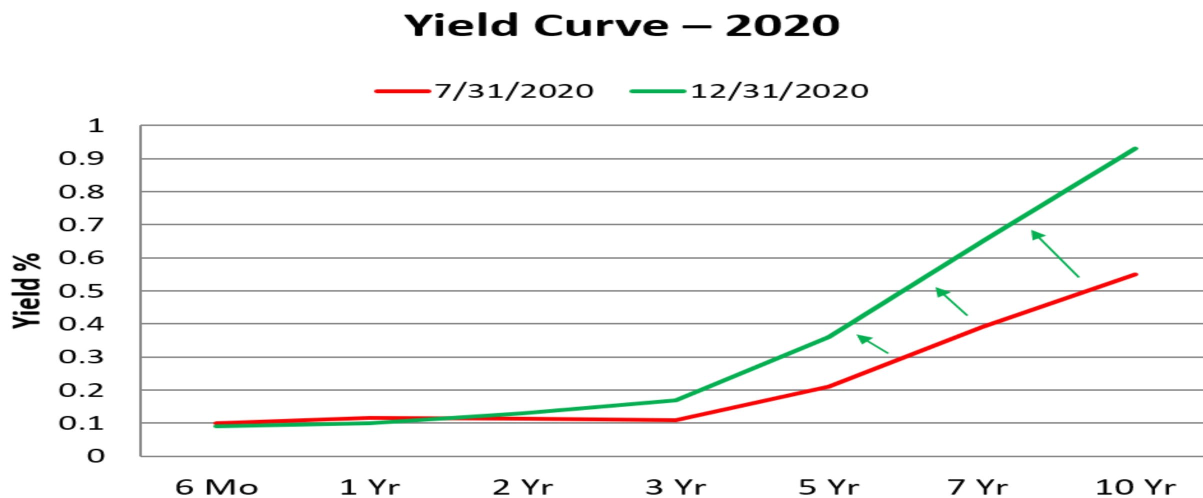



*Short-term rates rising, ugh! What next?*

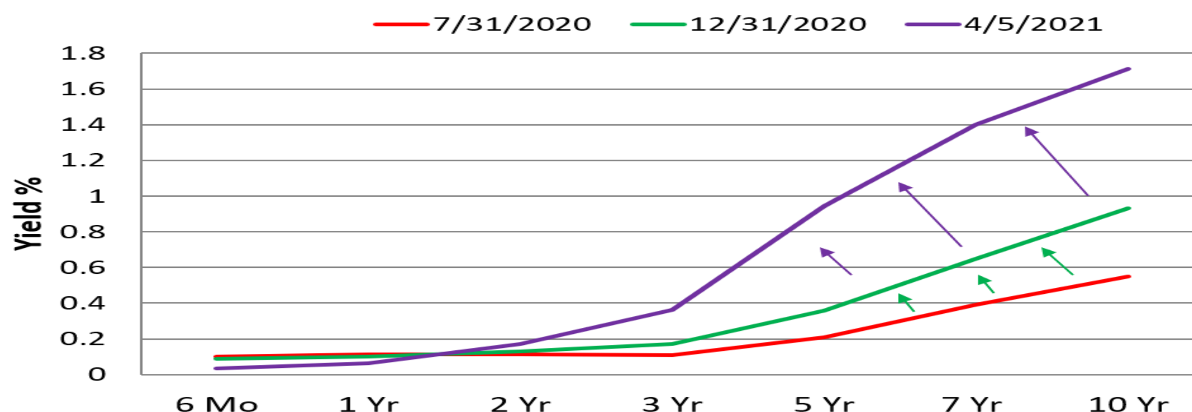
By February 2020 the yield curve inverted with the Fed moving short-term rates higher and investors were growing weary on Covid's affect on economic conditions (pushing longer-term rates lower). The dreaded "inverted yield" curve occurs when the yields on short-term rates are higher than long-term rates. Inverted yield curves are not very common and are often been followed by economic recessions; the stock market does not like them. In March of 2020, the coronavirus outbreak caused the stock market to drop by 25% and the economy plunged into recession. The Fed took an emergency action by dropping the short-term rates to near zero *(some short-term Treasury Bills temporarily turned negative)*. Longer-term interest rates followed this downward trend and by the summer of 2020, the ten-year Treasury Bond was trading between 0.5-0.6%. (Follow the red arrows to visually see how interest rates moved lower from the blue February 2020 inverted yield curve to the Red July 2020 yield curve.)




Long-term interest rates hit bottom in the summer, 2020 and have since began their upwards climb. By the end of 2020, longer-term interest rates started rising (Follow the green arrows to visually see how longer-term interest rates rose from the red July yield curve to the green December yield curve.)




The pressure on bond funds has mainly been exhibited starting in December. The Fed made it clear - they would not be raising short-term interest rates anytime soon. **However, with the economy recovering, there was really no other place for longer-term bond yields to go, but up!**




**Where are we today in 2021?** Follow the path above to see how longer-term interest rates have risen from December's green line to today's purple line. The economy and interest rates are now in a "double-edged sword scenario". In some regards, we want longer-term interest rates to rise. But, in other regards, this movement will likely continue to cause stock market volatility and considerable pressure on the bond market.

## Rise in Interest Rates typical effects.

a) Stock market - Banks are generally profitable as they benefit from higher interest rates. Loan rates go up, thus increasing profit margins.
b) Stock market - The high debt leveraged companies are generally negatively impacted as higher rates mean higher interest payments. *(generally, technology companies are more highly leveraged)*
c) Bond market - Interest rates also impact bond prices. Again, there is an inverse relation between bond prices and interest rates. In general, as interest rates rise, bond prices fall.
d) Inflation - Inflation tends to increase when interest rates rise, but again history never 100% repeats itself.
e) Currency - Higher interest rates generally will cause the dollar to rise. An increase in interest rates attracts foreign investments and thus increasing the demand and value of our country's currency.
f) Commodity – Studies have shown differing results on Gold's price effect on rising interest rates. Some studies have concluded that if "real interest rates" rise (interest rates adjusted for inflation), gold prices will fall.

## What to do now?

Advanced academic investment studies all conclude with the use of diversification. We have made several internal adjustments to our clients' portfolios, with some already proving beneficial. However, we need to point out a few important facets:

1. For the last several years, most major economists (including the Fed itself) had been projecting short and long-term interest rates to move higher. In many of these instances, other factors caused the Fed to make unexpected changes to its own projections. Had anyone "bet against" bonds during those last few years, you likely would have been wrong. With that said, there are still some strategies that can be used as a hedge in rising interest rate environments.
2. Longer-term interest rates tend to move over a few years with no one knowing its certain path.
3. The bond market has still historically been considerably less volatile than the stock market. If one's solution to a fear of rising long-term rates is to move to a 100% stock portfolio, we suggest you be prepared for the volatility that may occur.
4. As noted earlier, we are approaching Economists' projected levels for longer-term bond rates.