
EXPANSIONARY LINKS

Market Review **FEBRUARY 2021**

People need currency to conduct financial transactions in the economy. The demand function for currency says that lesser quantities of currency are demanded when interest rates are high, and larger quantities are in demand when rates are low. Currency supply, on the other hand, is generally fixed at any one point in time. Supply, however, can be changed through monetary intervention, which happened in 2020. Since the supply of currency is generally a fixed quantity, the rates on money are changed and set by shifts in demand to hold currency.

Why does anyone want to hold currency? People will want to hold currency for all sorts of reasons. Two hypothetical examples might be to finance a home project or to expand a business. A home project will require either currency, a loan of currency, or both. In addition, a business owner that is in demand for currency can obtain it by issuing debt or equity certificates. Therefore, it should become apparent that when rates on money are low, people will become more inclined to consume and invest, which drives demand for more currency in the process. On the contrary, when rates on money are high, people are more incentivized to keep their assets tied up in high interest-bearing accounts and minimize currency transactions in the economy.

Therefore, the demand for currency should say something about the level of confidence in the economy. Increasing consumption and investment are trends when confidence is usually strong, and we have observed a positive sentiment shift recently in these areas. However, a shift to increased currency demand will put upward pressure on interest rates when the supply of that currency is fixed. Therefore, the latest interest rate increases may actually serve as an expansionary sign for the economy and a monetary system that is operating as intended.

There are many types of bond-related assets that can serve as a proxy for currency demand. One of the more common markets to consider is the market for US treasuries. US treasuries are a close substitute for a default-free asset, because of their guarantees and fungibility. Therefore, the rates quoted on US treasuries are a close approximation of the rates that are used to clear the supply and demand of currency transactions. In recent weeks, rates on treasury notes and bonds moved higher. The increase in rates led to a steepening of the yield curve, which means that longer-term bond yields rose by more than shorter-term bond yields. In addition, the rate changes

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were not motivated by inflation worries, but were brought on by improved growth expectations. This was a turn of events compared to the prior twelve months when interest rates were being moved based on inflation expectations.

The recent steepening of the yield curve is being taken as a healthy indicator of economic activity. The rise of longer-dated rates is thought to reflect a positive change for preferences to hold currency. Instead of keeping currency locked up in low government yields, people were thought to be demanding currency for reasons that are linked to consumption and investment. The natural effect of such a demand shift, however, is an uptick in the interest rates as we have seen in recent weeks. However, these interest rate increases are actually a good thing as long as the currency is being used in procyclical transactions that expand consumption and investment.

Still, jitters can be sent into the stock market as interest rates start to climb. But any sort of stock market selling may also be linked to people simply wanting their currency back for other endeavors. When there is confidence, people can be motivated to cash in on their stock market profits and direct their currency towards other expenditures that are expansionary for the economy. People that choose to consume or invest are participating in the expansion of economic growth. Economic expansions are responsible for stock dividend growth and dividends are a critical component of stock returns. So, as long as stock dividends grow based on people doing more with currency transactions, stock valuations should continue to do well, despite having some dips along the way due to certain investors' preference for liquidity.

Asset Categories	US STOCKS	FOREIGN STOCKS	US BONDS	FOREIGN BONDS	HARD ASSETS	HYBRIDS
Monthly	5.66%	2.39%	-0.57%	-1.39%	1.68%	1.61%
Year to Date	6.77%	2.71%	-0.48%	-2.11%	1.39%	2.29%

*DATA USED IS SOURCED FROM MORNINGSTAR®, DATE ENDING FEBRUARY 28, 2021.



US STOCKS

US Stocks took on more gains last month, which raised the year-to-date average return to 6.77% on the entire asset category. Small-caps brought in 8.00% in February, bringing the return to 11.55% since the beginning of the year. Mid-caps were another strong performing asset class in February. The mid-cap return closed at 5.82% by the month's end. Large-caps earned less, but they still posted a respectable gain of 3.18% in February.



FOREIGN STOCKS

Foreign Stock returns grew more modestly in February relative to US Stocks. Developed stocks held a small performance advantage in the prior month. One-month returns on large-caps and small-cap developed stocks were 2.26% and 2.97%, respectively. In comparison, emerging market returns finished last month at 1.93%. Year-to-date, average returns on the full asset category of foreign stocks are now about 2.71%. Emerging markets lead in that figure on two-month returns that come to about 4.06%.



US BONDS

US Bond saw little return in February as high-quality bonds were handed losses. Losses on treasuries and corporates were in the range of -1.00% to -1.50%. Year-to-date performance of treasuries and corporates are in the red this year. Corporates have been weak in the two-month period resulting in total losses of -2.43%. But high-risk bonds etched small gains by the end of February. Year-to-date, the average returns of this high-risk category are now about 1.0%.



FOREIGN BONDS

Foreign Bonds sustained more losses in February relative to the US Bond category. One-month losses on world bonds were -1.53% and -1.24% on emerging market bonds. The year-to-date returns of foreign bonds is very similar to that of US bonds. Average losses for the entire Foreign Bond category over the two-month period are close to -2.11%.



HARD ASSETS

Hard Assets made overall gains in February, but were held back due to losses in precious metals. Overall category gains came from the assets of energy partnerships. The one-month return on energy partnerships was 5.72%, which raised the year-to-date return to 10.35%. Real estate booked gains of about 3.75% last month. However, precious metals experienced another sell-off in February with returns ending at -6.48% which lessened the year-to-date returns to -10.67%.



HYBRIDS

Hybrids were up in February on more gains that came out of the convertible bonds space. The convertible bond return was 3.37% last month and now holds a year-to-date gain of 5.13%. That measure of return is generally in line with the returns of the total US stock market. Preferred stock returns have been essentially flat in the month and since the beginning of the year.

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