FAYEZ SAROFIM & CO.

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Economic Comment and Market Outlook

A flurry of superlative second quarter earnings reports has just completed the most recent chapter of the US equity market's advance in 2021. Supported by an adaptable, resilient private sector and copious fiscal and monetary stimulus, profits have rebounded rapidly from the initial pandemic impacts and spurred additional stock price increases. Through the end of July, the S&P 500 provided a total return of 18% in the year-to-date period, following a similarly-sized gain for all of last year.

Unlike last year's "K-shaped recovery," this year's gains have demonstrated greater breadth, with all sectors of the market participating. In the first quarter, with the promise of newly-discovered vaccines, investors favored more cyclical, value-oriented "reopening" plays. However, the market quickly discerned that the recovery was not as smooth and easy as initially anticipated. Different geographies have different vaccination rates, and troublesome virus variants continue to produce economic impacts. In addition, some companies and industries are facing supply chain and labor difficulties, leading to an inability to capitalize on demand for their products or services. As a result, investors began to gravitate back to selected companies that could reliably generate results in an uneven environment. Our typical Sarofim portfolios often display relative strength when investors are attuned to fundamentals and differentiated businesses, so we have been pleased with our results so far in 2021.

Alleviating some trepidation about the valuation level of the market, corporate earnings have been coming in far higher than expectations, resulting in substantial upgrades to forecasts for S&P 500 profits. At the beginning of the year, forecasters were expecting the companies in the index to earn approximately $170 per share, which would have surpassed the previous record from 2019. Now, it appears like the S&P will earn an estimated $200 per share for 2021, representing almost $1.7 trillion in profits and a 40% increase over 2020. Using figures from Jonathan Golub at Credit Suisse, 85% of companies are beating consensus estimates, with both revenue and earnings coming in far higher than estimated for the index overall. While stock prices have risen appreciably this year, the faster increase in earnings has resulted in a decline of the market's price-to-earnings multiple, which rests at approximately 22 times expected 2021 earnings. Balance sheets remain highly liquid, with data from S&P Global showing cash and short-term investments sitting at a record high of $6.8 trillion at the end of the second quarter. High levels of profitability and "dry powder" suggest companies are poised to ramp up cash payments to shareholders along with capital investments and M&A activity.

Interest rates remain exceptionally low, with the 10-year Treasury bond yield sitting at 1.23% at the end of July. The yield on that instrument began the year at 0.92% before rising to 1.74% at the end of March as the market began anticipating reopening and a strong economic recovery. However, from that time forward, investors recognized some of the obstacles that remained for sustained economic growth, and the Federal Reserve managed to convince the market that it would not let "transitory" higher levels of inflation get out of hand. Even with yields declining again from March to July, the Barclays Aggregate fixed income index delivered slightly negative total returns of -0.5% for the year-to-date period. Market participants will be watching the Fed's upcoming conference for clues, but the tapering of asset purchases and increases in short-term interest rates seem unlikely in the short run.

Our clients will not be surprised that we remain confident in our approach and encouraged by the long-term growth opportunities that our portfolio companies are pursuing. There are clearly risks to manage in the uncertain world today, but we believe highly profitable and financially-strong enterprises are well positioned to mitigate those risks and navigate through volatile, surprising times like we have experienced.

Thank you for placing your trust and confidence in Fayez Sarofim & Co. We also remain hopeful that this pandemic continues to diminish in its impact on our lives and that you and your families remain safe and healthy during this time. Please contact us if you have any questions or feedback for our firm.