ECONOMIC AND MARKET COMMENTARY

2nd Quarter 2021

SMITH SHELLNUT WILSON

INVESTMENT COUNSEL AND MANAGEMENT

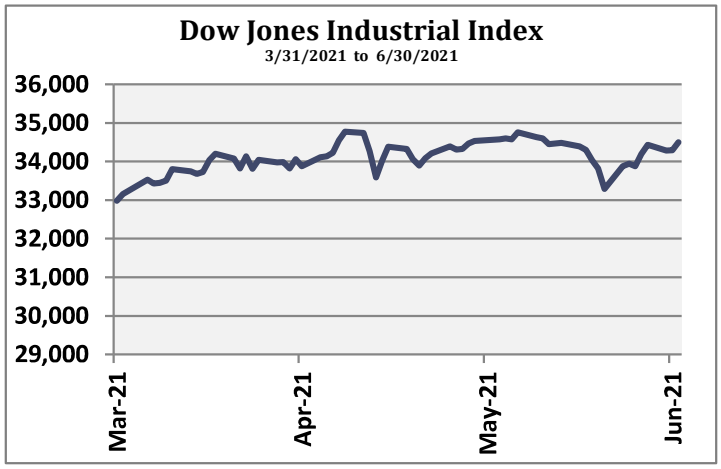
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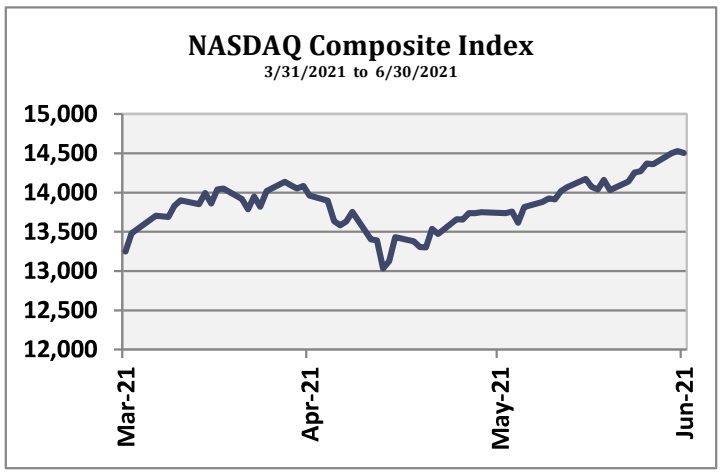
OUR MISSION

Smith Shellnut Wilson is a registered investment adviser* specializing in managing investment portfolios for banks, individuals, corporations, foundations and public entities. Smith Shellnut Wilson offers its clients skilled investment management and unremitting client service. Smith Shellnut Wilson is dedicated to the premise that client relationships and performance, not transactions, are the ultimate goals.

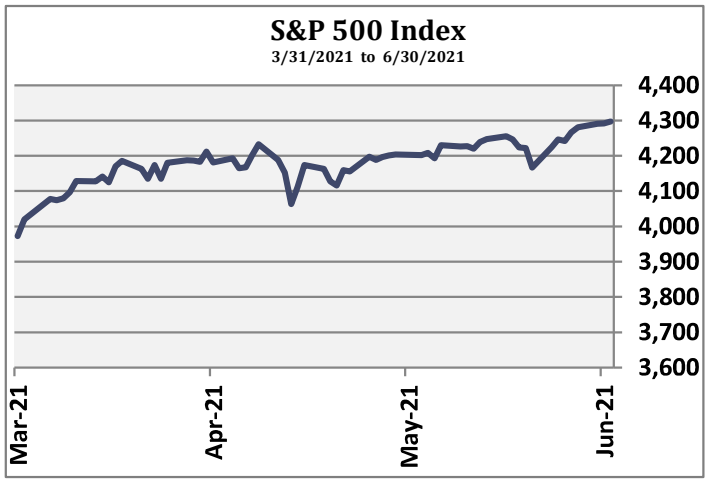
I. SECOND-QUARTER 2021 EQUITY MARKET RECAP

The U.S. stock market ended the second quarter on a positive note, with major U.S. stock indexes closing at or near record highs. For the quarter, the Dow Jones Industrial Average posted a gain of 5.8% including dividends, while the Standard & Poors 500 notched a gain of 8.55% and the tech-heavy NASDAQ Composite Index rose by 9.68% on a dividends-reinvested basis, supported by an ultra-low interest rate environment and solid economic and earnings growth.





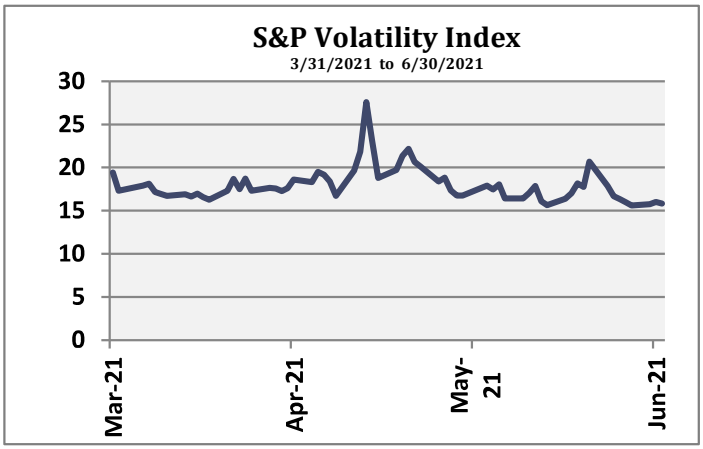
Gains for the quarter were paced by the real estate, energy, communications services, and information technology sectors, while, on a year-to-date basis, industrial and financial stocks have led the way.



Looking forward, as the business cycle evolves, investors will increasingly divert their attention toward potential party spoilers. A chief concern is inflation, and whether rising prices seen in some pockets of the economy are transitory or the first signs of an enduring new regime. Inflation fears, while dampened recently, may stoke volatility in the stock market over the course of the rest of the year, even amid Fed assurances of continued accommodation. Similarly, tax policy

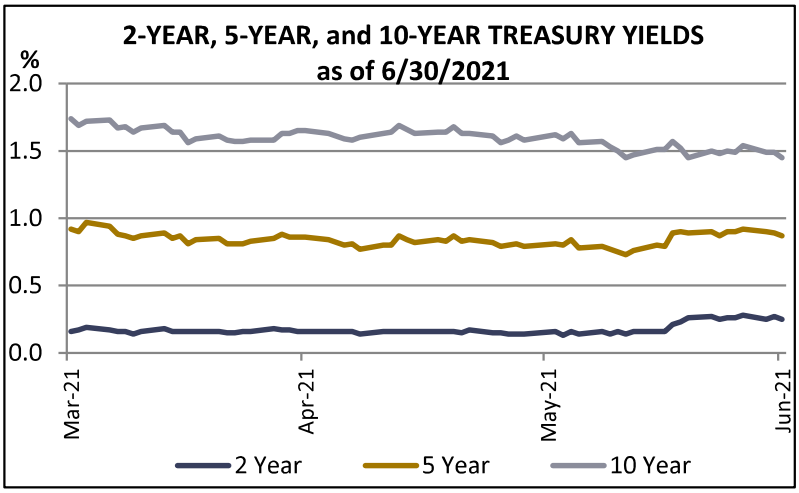
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may become a volatility trigger as lawmakers debate further stimulus proposals. .



II. SECOND-QUARTER 2021 BOND MARKET RECAP

Intermediate-term U.S. Treasury yields fell slightly in the second quarter despite a pick up in inflation. Five-year Treasuries fell by 5 basis points to end the quarter at 0.89%, while ten-year Treasury yields fell by 27 basis points to end the quarter at 1.47%, resulting in a flattening in the Treasury yield curve over the quarter.



The Bloomberg Barclays U.S. Aggregate Bond Index, representative of the U.S. investment grade taxable bond universe, posted a total return of 1.71% for the quarter, and a negative 1.79% return for the first half of the year as a whole, one of the worst showings in years.

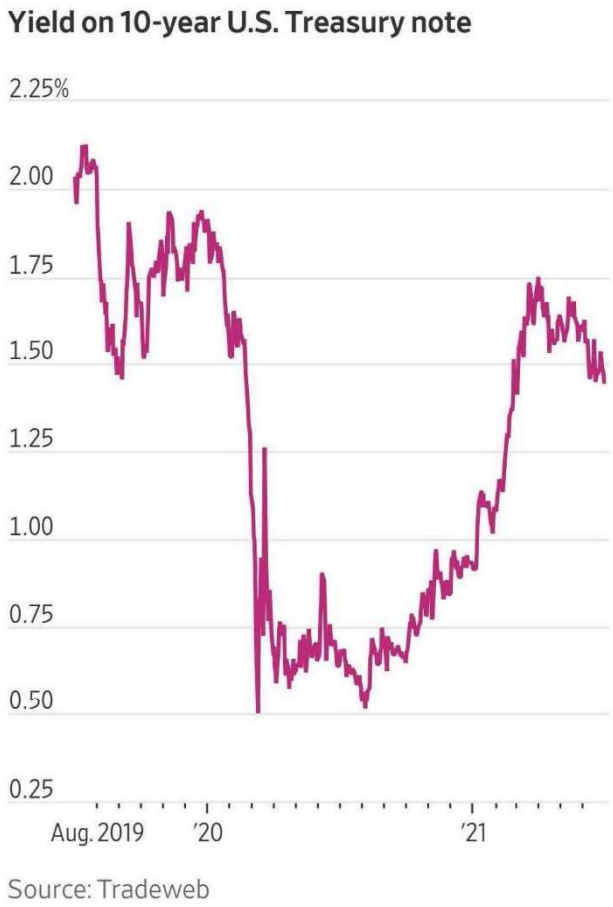
On a forward basis, the market is pricing in a 15-20 basis point increase in intermediate-term interest rates between now and year end, with the five-year Treasury expected to close the year at 1.07% and the ten-year Treasury expected to end the year at 1.59%, resulting in a slight further flattening in the yield curve.

III. TREASURY YIELDS SIGNAL INVESTORS' WANING ECONOMIC EXUBERANCE

By: Sam Goldfarb

The recent drop in U.S. Treasury yields reveals some investors' doubts about how strong the economy will be in the coming years, even as inflation pushes to its highest level in more than a decade.

Yields, which fall when bond prices rise, have surprised many by sliding in the second quarter of the year. That marks a reversal from the sharp rise in the year's first three months, when markets generally rode a wave of optimism that stimulus and reopenings would spur a roaring economic acceleration.



Treasury yields play an important function in the economy, helping to set borrowing costs on everything from mortgages to corporate bonds. They are also a closely watched economic barometer, with longer-term yields in particular tending to rise when the growth outlook improves and decline when it falters.

Yields on conventional and inflation-protected Treasuries still suggest the economy will grow at a healthy pace in the coming years. But expectations aren't as buoyant as they were in March. Back then, yields reflected forecasts that the Federal Reserve's benchmark federal-funds rate would remain near zero this year but start climbing by 2023 without causing the inflation rate to fall to below the central bank's 2% target.

Today, investors still expect the Fed to raise rates at roughly the same time, if not possibly a little sooner. But projections for rates over the longer term have subsided somewhat- -as have inflation expectations- -indicating a slightly weaker economy, less able to withstand interest-rate increases.

Investors' economic confidence has been eroded by waning expectations for both fiscal and monetary stimulus, according to some investors and analysts.

From the start of the year, many investors have bet that large-scale government spending, near-zero short-term interest rates and continued bond buying by the Fed would lift an economy already rebounding from the pandemic.

Expectations reached their recent peak in March, when Democrats passed a larger-than expected coronavirus-relief bill, fueling bets that they could have similar success in passing other priorities such as spending on infrastructure.

Since then, however, progress has been slow, with moderate Democrats insisting on a bipartisan infrastructure bill. Meanwhile, Fed officials have started discussions about tapering bond purchases and have pushed forward the time frame when they expect to raise interest rates.

Such developments have more than offset the recent increase in inflation. Over the course of April and May alone, the consumer-price index jumped 1.4%, with core prices, excluding volatile food and energy categories, logging their biggest year-over-year gain in May since 1992. Many investors, though, have largely dismissed such gains as aberrations related to the reopening of the economy. Fed Chairman Jerome Powell recently pointed to the recent decline in sky-high lumber prices as a possible sign of things to come.

"Markets are forward looking," said John Bellows, a portfolio manager at Western Asset Management. "Even with high inflation prints, forward inflation has been reassessed lower."

A good number of investors still expect unusually strong growth in the second quarter and over the next couple of years, and argue that inflation may also remain elevated, eventually driving a more aggressive response by the Fed.

Private economists surveyed by Bloomberg expect second-quarter real GDP growth of 10% on an annualized basis, tempering to a still-strong pace of 4% in 2022.

Caught off guard by the recent decline in yields, some investors and analysts have blamed idiosyncratic factors such as demand from pensions and foreign central banks.

One popular explanation is that the bet on higher yields became too crowded. "When everybody is short and the market just rallies a little bit," hedge funds can be forced to buy bonds to reduce their risk of further losses, said Zhiwei Ren, a portfolio manager at Penn Mutual Asset Management. That causes yields to fall even further.

Still, investors and analysts generally agree that Treasury yields are at least eventually determined more by economic fundamentals and the outlook for interest-rates set by the Fed than by technical factors.

"There is a growing contingent of market participants that are buying into the idea that we've reached peak growth--essentially that the most impressive days of the recovery are behind us," according to Thomas Simons of Jefferies Securities.

His view, he said, is that investors have just become too pessimistic and that the 10-year yield could still rise to 2% by the end of the year.

The source of the information in this commentary is SSW, Wall Street Journal, Nasdaq and Bloomberg.