Market Strategy
by STRATEGAS A BAIRD COMPANY

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Strategas – a Baird Company provides market strategy and perspective to help you better understand what is happening in the world today and how it impacts your portfolio and plans. Exclusive to Baird, these premier market, macroeconomic, and policy insights complement the planning and investment strategy work of your Financial Advisor.

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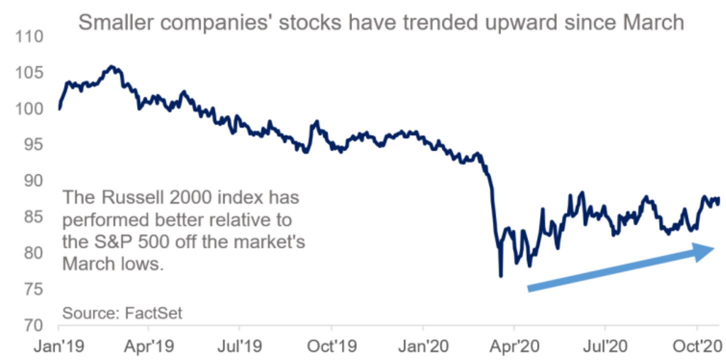
STOCKS VS. ECONOMY I RECOVERY FIRMING I SMALL-CAP INTRIGUE

We’ve always been fascinated by the relationship between the economy and the markets, and today is no different. To ask the obvious question: **Why is the stock market up while parts of the economy are still so weak?** We could make the answer as complicated as we wanted to, but we view it a little differently—it boils down to how we feel about risk, and what our time horizon as investors truly is.

Though the recovery is well under way, we continue to grapple with high unemployment and the ongoing closure of whole areas of the economy. It's why policymakers (and investors) have been so focused on fiscal stimulus recently. Dislocation in the job market puts strain on the entire system, creating uncertainty and raising questions about how quickly we can actually recover to previous levels of activity and output. In some ways, however, this dislocation can be helpful, as it brings some clarity to the recovery of corporate profits. The more profitable our businesses, the more innovative and focused on future growth they can be, and the more dearly investors will value them. **It's this looking ahead that creates the perception of divergence between the economy and the markets, and why a focus on time horizon is so important.**

But what does this mean for our portfolio? it is important to balance what we need today with longer-term goals that may let us shift our investment focus into the future. We’ve leveraged this idea by maintaining above-benchmark exposure to stocks, favoring Growth over Value and Large over Small. But the quiet improvement of small-caps in recent weeks has decidedly caught our attention.

Part of this improvement is due to recent softness in the “Big 5” mega-cap new economy stocks, but it also reflects investor attention shifting beyond the election to a strengthening economic recovery. As you can see in the chart to the right, the general trend has favored small-caps off the March lows. As longer-term investors, we are watching for a firm and sustainable economic recovery develop. We will also be watching to see if this shift favoring small-caps continues to develop.



Two final thoughts to consider: First, it's been 540 days since the Russell 2000 (a small-cap index) made a new high. This stretch has only been exceeded three times in the last forty years and each time it was broken in the wake of major recessions. The second thought is that small-caps are the only major asset class to outpace inflation every decade since the 1930s (per economist Roger Ibbotson)—something to keep in mind as inflation concerns bubble up.

As always, we remind you to work with your Baird Advisor to see how it all fits into *your* financial plan. Keep your eyes downfield, trust your plan, and keep the questions coming. See you next time, and have a great weekend.

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