GALECKI FINANCIAL MANAGEMENT FINANCIAL SENSE

	LAST MONTH	LAST 3 MONTHS	YTD
S & P 500 Index	2.33%	8.55%	15.25%
Russell Midcap Index	1.47%	7.50%	16.25%
Russell 2000 Index	1.94%	4.29%	17.54%
Dow Jones Industrial Average	2.52%	8.52%	15.10%
Morgan Stanley EAFE Index	-1.13%	5.17%	8.83%
DJ US Real Estate Index	2.31%	11.68%	20.28%
S&P Commodity Index	8.21%	15.99%	35.40%
Barclays Aggregate Bond Index	0.70%	1.83%	-1.60%

INDEX RETURNS

Stocks continued to rise in the second quarter as states in the U.S. opened, and countries around the world are turning the corner. The S&P 500 increased 8.55% in the second quarter. Growth stocks staged a comeback as they increased 5.68% while value stocks were down 1.17%. The Russell Mid-cap index was up 7.5% in the quarter while the Russell 2000 index rose 4.29%.

International stocks advanced in the second quarter although June was negative. The MSCI EAFE Index was up 5.17% in the quarter led by a 10% return in Canada. Emerging Market stocks rose by 5.05% in the second quarter led by Brazil and Russia advancing 22% and 14% respectively.

Bond markets staged a comeback on the second quarter surprising most investors. The Barclays Aggregate Bond index rose 1.83% in the second quarter and is now only down 1.6% on the year. Global bonds advanced 4.49% in the quarter and are now only down 1.03% on the year.

ECONOMIC REVIEW AND OUTLOOK

The U.S. economy increased by a 6.4% annualized rate in the first quarter of 2021. Early estimates for the second quarter are in the 6-8% range. Economic activity is on fire in the U.S. and is accelerating abroad. It is now estimated that more than 70% of adult Americans have some sort of resistance to COVID-19 through either prior exposure or vaccination. This is creating consumer confidence in renewing pre-COVID activities.

Consumer debit/credit transactions are up 23% from 2 years ago, which shows that consumer spending is strong. Consumers want to spend their own money and the money they received from the government. The Leading Economic Index was up 1.3% in May to 113. This is an all-time high for this index. Industrial Production increased 0.8% in May primarily due to a large increase in motor vehicle production. The Capacity Utilization rate (which measures how much slack is in the economy) was at 75.2 percent in May.

Non-farm payrolls rose by 850,000 in June. The unemployment rate declined to 5.9%. Weekly unemployment claims were 373,000 for the week ending July 3, 2021. The four-week moving average dropped to 394,500. There were 9.28 million job openings at the end of June. This is the highest number on record and is equal to the number of unemployed Americans. Roughly 48% of small businesses in the U.S. report that they are having a hard time filling one or more positions.

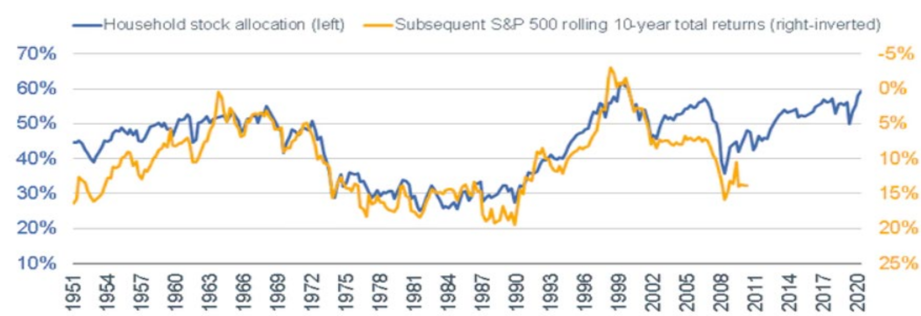
Manufacturing increased to 60.6% on the ISM PMI index in June. The New Orders Index came in at 66% which was a decrease of 1% from May. The ISM Services index was at 60.1% in June which was a drop of 3.1% in May. This marks the 13th straight month of growth for the services sector. The Business Activity Index came in at 60.4%. This continues to suggest strong economic growth over the second half of the year.

Global economies are also seeing impressive growth. The JPM Global Manufacturing PMI was at 56.6 in June which is a record high for the index. This marks the eleventh straight month of expansion. The European zone saw a big improvement to 59.2. Germany led the surge with a 60.4 reading and Spain had a 62.4 reading. Russia had a reading of 55 and Brazil had a reading of 54.8. Emerging economies have crept up above 50. As vaccines increase outside of the U.S., economic activity should continue to surge over the next six months.

EQUITY AND BOND MARKETS

Equities continued to move higher in the second quarter as earnings expectations have risen dramatically. Investors are pouring money into stocks as bonds appear to be expensive. After all, how attractive is a 10-Year Treasury bond at 1.4% while inflation is running over 3%? That is a losing proposition in the long run. Investors have turned to equities where the dividend yield on the S&P 500 is 1.6% and the yield on international equities is around 2.7%. That does seem more prudent than locking in at 1.4% over the next ten years.

Households' Lofty Exposure to Stocks



Household stock allocation quintile	Average household stock allocation	S&P 500 annualized return (10-years later)		
		Low return	High return	Average return
Highest 20%	54.6%	-3.0%	8.4%	4.1%
2nd highest 20%	50.0%	2.8%	13.8%	7.1%
3rd highest 20%	45.8%	5.5%	16.4%	10.7%
4th highest 20%	36.7%	8.5%	18.1%	13.2%
Lowest 20%	29.1%	13.2%	19.4%	16.3%

American households now have stock exposure of around 60%. The chart above shows how stocks have fared going back to 1950 with various equity allocations. Equity allocations have only been this high in 1999 and 2007. The subsequent 10-year average return for the S&P 500 is only 4.1%. This would suggest that stock valuations are high and could find double-digit gains harder to come by in the future. Investors should adjust their future return expectations accordingly.

There is not enough room in this newsletter for another chart, but we do want to mention the most recent Ned Davis Research Crowd Sentiment Poll. The most recent reading on July 6 shows a reading of 74. This puts the poll reading in extreme optimism territory (Bearish for the market). With data going back to 1995, the subsequent annualized return for the S&P 500 has been -0.5% when we are in this optimistic zone.

The bond market made an interesting shift in the second quarter. Rates began to decline, and investors saw gains on their existing positions. The most logical explanation for this would be normal rebalancing. Bond allocations have become smaller over the last year as equities have risen. In order to keep proper allocations, investors must sell equities at these higher levels and purchase bonds. This surprise move down in bold yields has the bond market almost back to flat on the year. We will see if this continues as inflation pressures begin to mount.

PORTFOLIO MANAGEMENT

The Investment Committee continues to monitor current allocations and risks to the portfolio. Right now, the biggest risk would be the elevated P/E ratio for domestic equities. The S&P 500 is trading at around 23 times forward earnings. This is well above the 25-year average of 16 times earnings. However, we are also aware that the best hedge against rising inflation (which is occurring) are stocks. They offer a 6.6% after-inflation rate of return historically speaking. This is better than any other type of investment.

International returns have not kept up with domestic returns for nearly 14 years. We do believe that returns are cyclical and international stocks will have their day. At this point, they offer better valuations with a P/E ratio around 16, and a much better dividend yield at 2.7%. Therefore, we are maintaining our current international exposure, with the expectation that the next ten years could be much different than the last ten.

We have spent a lot of time reviewing our fixed income side of the portfolio. It is not easy to achieve proper portfolio returns if the bond side of the portfolio does not stay above water. The good news is that some of our more aggressive bond holdings, like convertible bonds have done quite well. We just may need to be more creative in the future and allocate more funds to positions like the market neutral fund to enhance returns.

FINANCIAL PLANNING

Small businesses have a variety of tax deductions available to them. Below are a few lesser-known tax deductions that may be of value to our clients.

<u>Automatic Enrollment to 401(K)</u> – Employers can earn a $500 tax credit for adding an automatic enrollment feature to a new or existing 401(K) plan. This credit is available for the first 3 years the automatic enrollment feature is effective, resulting in a total credit available of $1,500.

<u>COVID-19 Vaccine</u> – Employers who provide time off for employees to receive or recover from the COVID-19 vaccine are able to deduct the wages paid, up to $511 per day per employee. These wages should be reported quarterly on the employer’s Form 941.

<u>Parental Leave</u> – Employers who provide additional time off for parental leave are eligible for a credit based on the percentage of wages paid to the qualifying employee. The maximum credit is 25% of wages. Employers must have a written policy in place and cannot pay less than 50% of wages under the policy. The qualifying employee must have been employed for at least 1 year.

COMPANY NEWS

For this quarter's newsletter, we asked Greg Galecki to share his plans for this next chapter of his life:

Let me start by recognizing how fortunate I have been to have found a career in financial planning that I have been so passionate about. I cannot imagine living without passion. I have no intention of starting now!

Here is a passage that I have kept printed in my office and condo for years. I do not know the original author:

> *Master of the Art of Life draws no sharp distinction between work and play. His labor and leisure, his mind and body, his education and recreation... he hardly knows which is which. He simply pursues his vision of excellence through whatever he is doing and leaves others to determine whether he is working or playing.*
>
> *To him, He Always Seems to Be Doing Both!*

I will continue to do both!

Let me next acknowledge my life-long responsibilities. As most of you know, I have a 20-year-old son with autism. He will still be a student at Homestead High School for the next two years in their vocation education/transition program. Jack stays with my wife (Barb) and I for nine days every month. I will maintain a physical presence in Fort Wayne as we continue to help Jack through this part of his life's transition.

After that, Barb and I will spend time with our other 6 children and our 5 (and counting!) grandchildren. My oldest son and his wife have 2 children (ages 8 and 6) in Indianapolis. My daughter and her husband have 2 children (ages 6 and 4) in Williamsburg, Virginia. I have a daughter still in Ft. Wayne and a son in Seattle. Barb's oldest daughter and her husband just had their first baby and live in Rochester, Minnesota. Barb's other daughter lives in Madison, Wisconsin.

My parents live in Virginia Beach (ages 86 and 85), and Barb's parents live north of Milwaukee (ages 88 and 87). We expect that we will travel 12 to 15 times a year just to visit our children and families!

Barb and I bought a 36-foot power catamaran that we keep in Florida. We named it "Namaste". We have come to enjoy overnight trips to various marinas up and down the Florida West Coast. I expect that we will be venturing down into the Keys in the near future and maybe eventually up through the East Coast of the country. In 2019, I took classes, tests and have received the US Coast Guard Captain's license; more for the knowledge and safety.

I have a dream to live summers for two or three months at a time in various parts of the world: Ireland, Nova Scotia, the North Shore of Lake Superior in Minnesota, and Alaska. That may never happen, but it would be pretty cool to get an Airbnb place for three months at a time and have each of the kids come up and visit us for tours around that particular area.

I am at peace that I leave my clients with a well-seasoned and cohesive team at Galecki Financial Management. Literally, I could not retire if I had any doubt about their abilities, integrity, and qualifications! Thank you, Team GFM!

Other than that, I want to play more tennis. I want to volunteer for Habitat for Humanity. I want to read more history (maybe even teach history!!). I want to study eastern philosophies and religion more, meditate more, find my peace. I want to leave behind a path where a good man walked.

I am eager to see what the next part of my journey brings! I shall take a part of all of you with me 😊 - Greg

- Galecki Financial Management Investment Committee

Special Note: If you would like to schedule an appointment with a Certified Financial Planner™ Professional, please visit www.galecki.com