Market Commentary

As of September 30, 2021

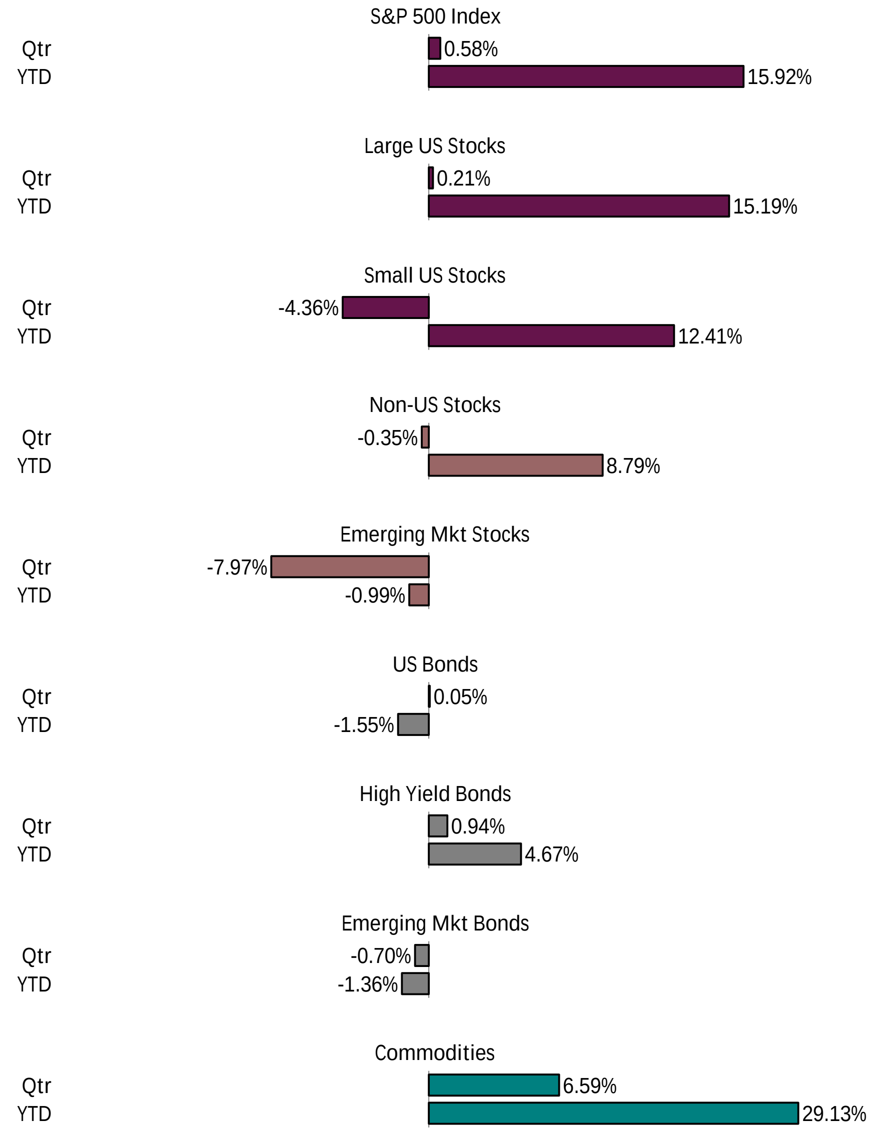
Economy & Market Review

Third Quarter 2021

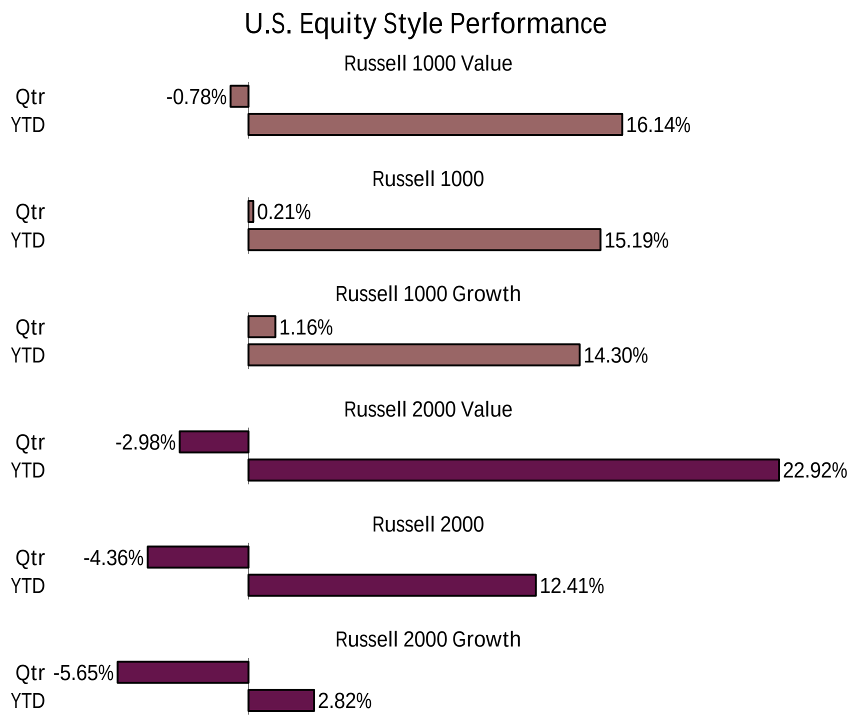
Transitory inflation for longer seems contradictory based on Merriam-Webster's definition of transitory as temporary or of brief duration. In the past, rates remaining "lower for longer" has been a mantra, now it seems the Fed has defined transitory inflation in a much longer time period than investors anticipated. Recent inflation readings may be temporary, but they have piqued both Wall Street and main street interests alike. According to major indices, rent and housing prices are both escalating quickly, although the CPI index for shelter has only risen 2.8% year-over-year through August, quite possibly the increase will show up in CPI fairly soon. Rental price inflation will likely be "stickier" than home price increases and other inflationary signs. With prices levels increasing and after a spectacular first half of 2021, markets produced muted results in the third quarter. US large cap stocks barely provided a positive return, but US small cap, non-US stocks, and emerging markets all provided negative returns. Even as inflation expectations moved higher and the chance of the Fed tapering increased, bond returns were mostly subdued for the quarter. Investors seem a little more skittish as the refrain for "buy the dip" in equities has been less vigorous recently.

As Congress actually slows fiscal stimulus and the Fed talks about slowing monetary stimulus, economic growth expectations based on the Atlanta Fed GDPNow tracker slowed to 1.3% for quarter three. Adding to the growth and inflation challenges, the global supply chain remains fractured. For instance, a record-breaking number of cargo ships are waiting off the coast of California due to the backup at the ports of Los Angeles and Long Beach. Much of the problem is rooted in congested rail lines and a shortage of trucks and drivers to move material off the docks. A broader shortage of workers can be seen in the latest JOLTS (Job Openings and Labor Turnover Survey) which has the latest job openings at 10.9 million as of July. The US unemployment rate declined 0.4% in September to 4.8%, but this measure is still above the pre-pandemic level of 3.5%. All of these factors could slow down the pandemic reopening growth that has occurred. With inflation already trending above the Fed's 2% target and judging by the Fed's preference to err on the side of optimism and dovishness, this could increase the risk of a major policy error.

Global Market Performance



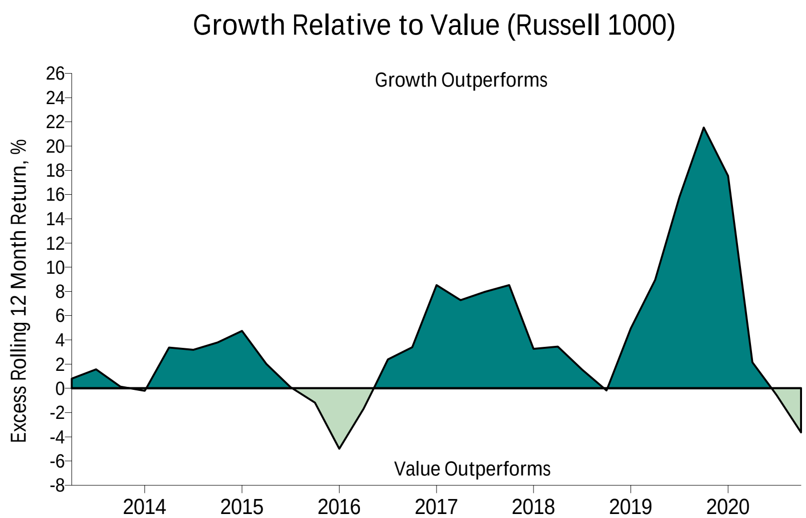
U.S. Equity Markets

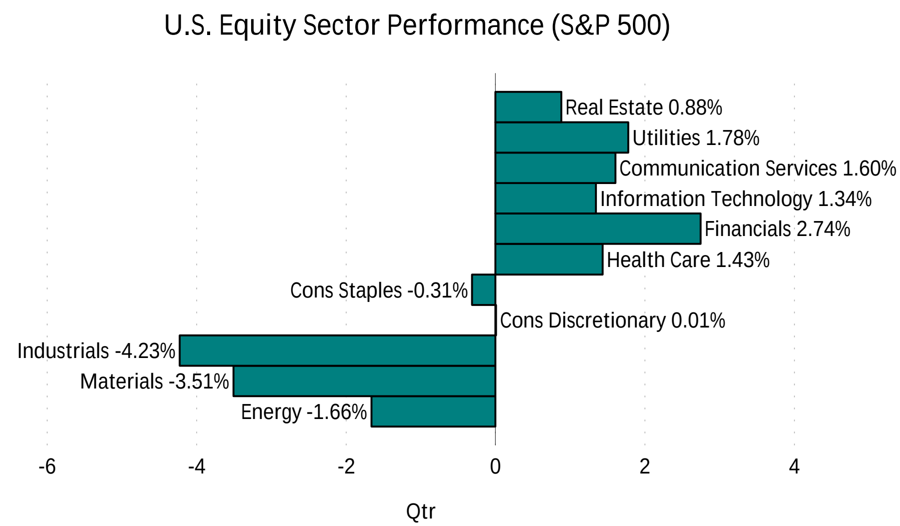


The S&P 500 Index of large cap stocks slightly increased 0.6% during the quarter and increased 15.9% YTD. Small cap stocks as measured by the Russell 2000 Index were down 4.4% during the quarter and have lagged large stocks YTD with a 12.4% return. Although most US equity styles produced negative returns for the quarter, growth stocks outperformed value for the quarter except in the small cap space. Growth stock performance seems highly correlated to interest rates. Rising rates have generally been a head wind for growth stocks especially large cap growth stocks.

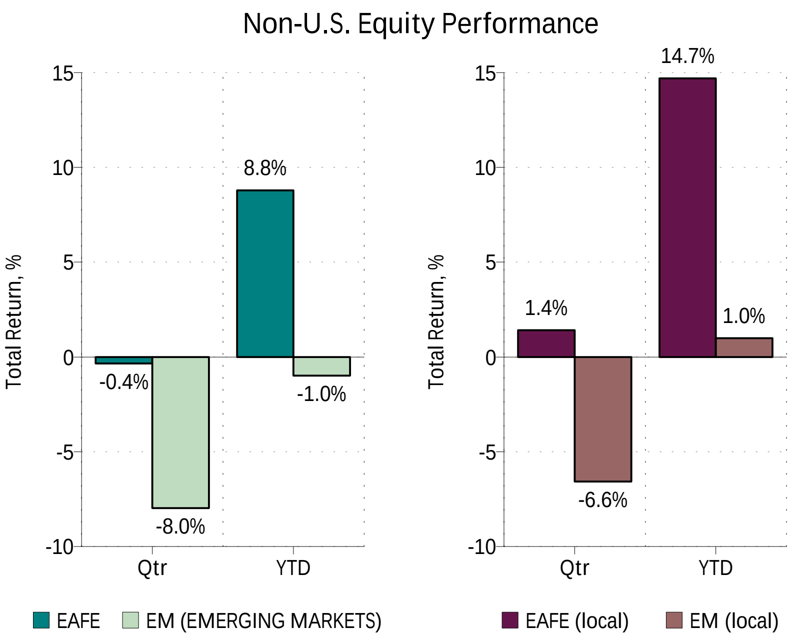
All asset class valuations seem stretched, but equity valuations have improved slightly. Although lower than recent quarters, the current 20.1x forward price-to-earnings multiple on the S&P 500 is still above historic averages. Economic growth and inflation trends will likely determine the next step in this journey.

The best sector performers for the quarter Financials, Utilities, and Communication Services are an assortment of defensive and cyclical sectors. Financials performed well aided by the third quarter rise in interest rates. Communication Services performance was driven mostly by Google and NetFlix returns. Industrials, Materials and Energy were the worst quarterly performers and are very cyclically driven. As future growth prospects become less obvious, cyclical stocks waned.



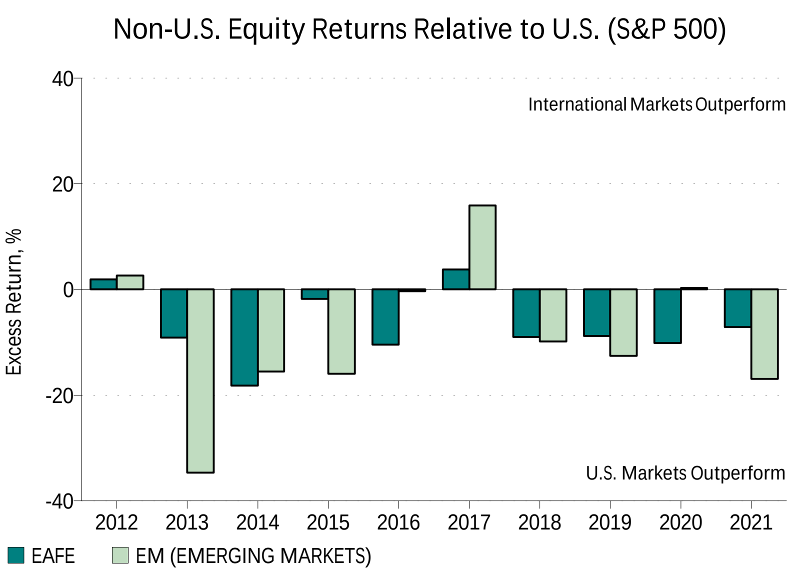


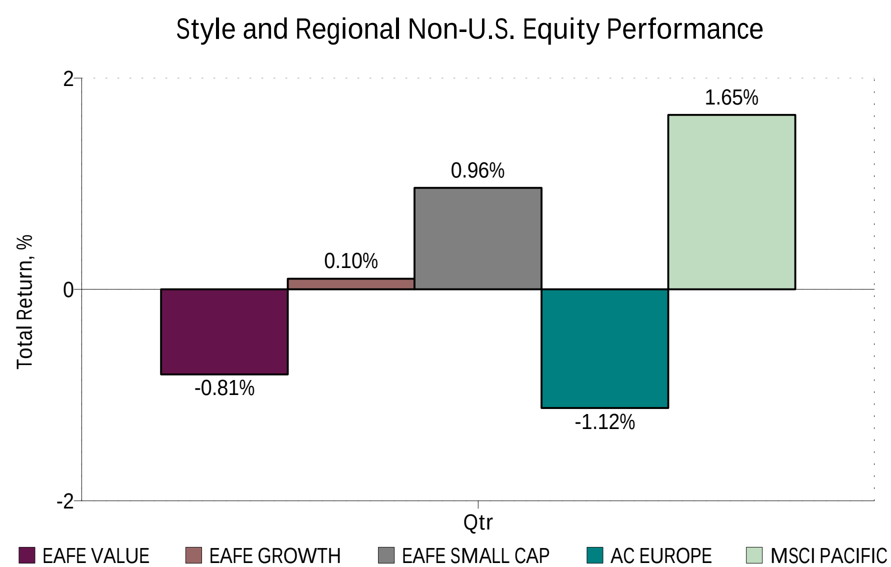
International Equity Markets



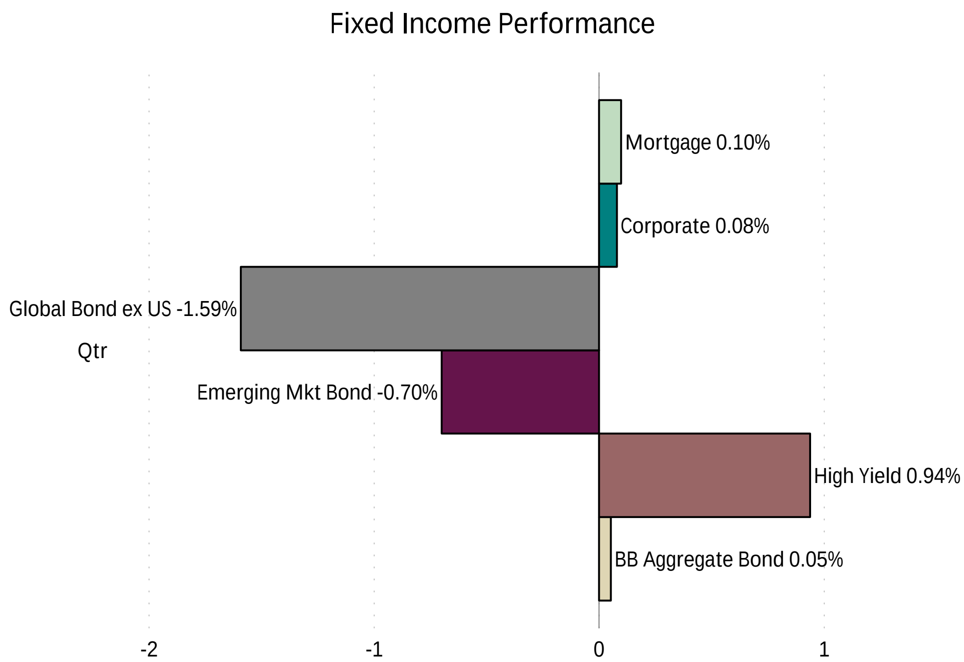
Emerging markets (EM) really struggled during the quarter and easily underperformed developed international. China and Chinese stocks were the main culprit in the underperformance. Investors in China are conditioned to accept that the government will silently deal with large financial problems, discipline those it views at fault, and protect those it believes deserve protection. In the past year, the main theme has been that Chinese Communist Party is willing to exceed people's previous expectations, risking capital market stability on multiple occasions to achieve political and social outcomes. As a result, the MSCI China Total Return Index was down 18.1% during the quarter dragging the broader EM market down 8%.

The MSCI EAFE Index, a proxy for large international developed equity markets, was down 0.4% during the quarter. Developed international again lagged US markets, but just slightly during the quarter and also produced lower returns YTD. As global central banks kept policy rates low, International growth stocks outperformed value. In a reversal from last quarter, the Pacific did much better than Europe. International equity markets continue to face the challenge of a fairly strong dollar.



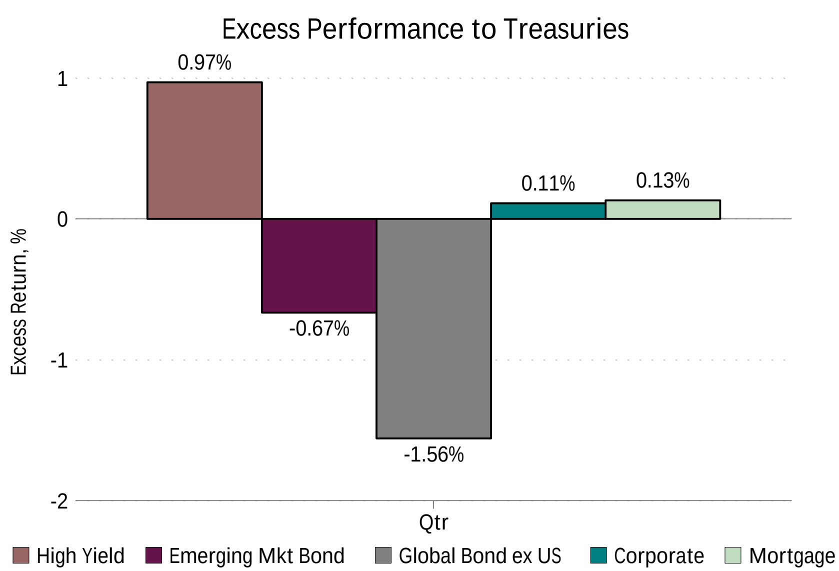


Fixed-Income Markets



As happens fairly regularly, the debt ceiling, which really appears to be merely an ascending ramp, is back in the news. Both US political parties rarely seem concerned about expanding the US debt except when influence is necessary regarding current legislation. Democrats have said they will not unilaterally raise the debt ceiling and Republicans have pledged not to vote for it. As in the past with this "game of chicken", one party will likely swerve keeping the US out of default. That isn't to say that the financial markets or economic disruptions won't add some additional volatility.

The bond market in general appears to be very expensive and future bond return expectations reflect this. The first selloff in treasuries at the beginning of the year was likely driven by accelerating growth and to a lesser extent increasing inflation expectations, but the most recent backup in yields has been led by the Fed's more hawkish turn. As the US 10 Year yield moved higher to around 1.6%, the Bloomberg Barclays Aggregate Bond Index fought to stay positive with a return of 0.05% for the quarter. Fixed income segments were mixed, but as investors continued to reach for yield in spread products, high-yield performed the best. High-yield corporate spreads continue to compress further with low default rates. Global and emerging market bonds struggled in the face of a strong US dollar.



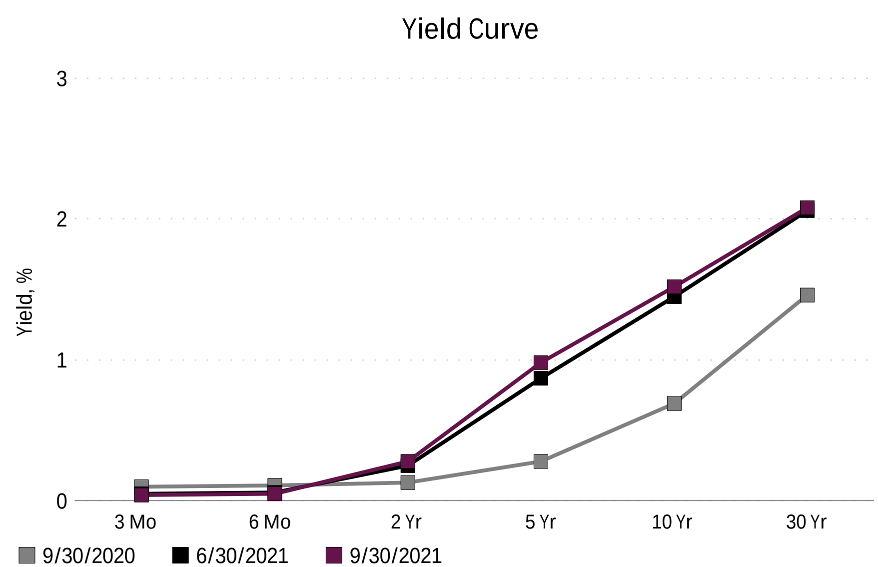
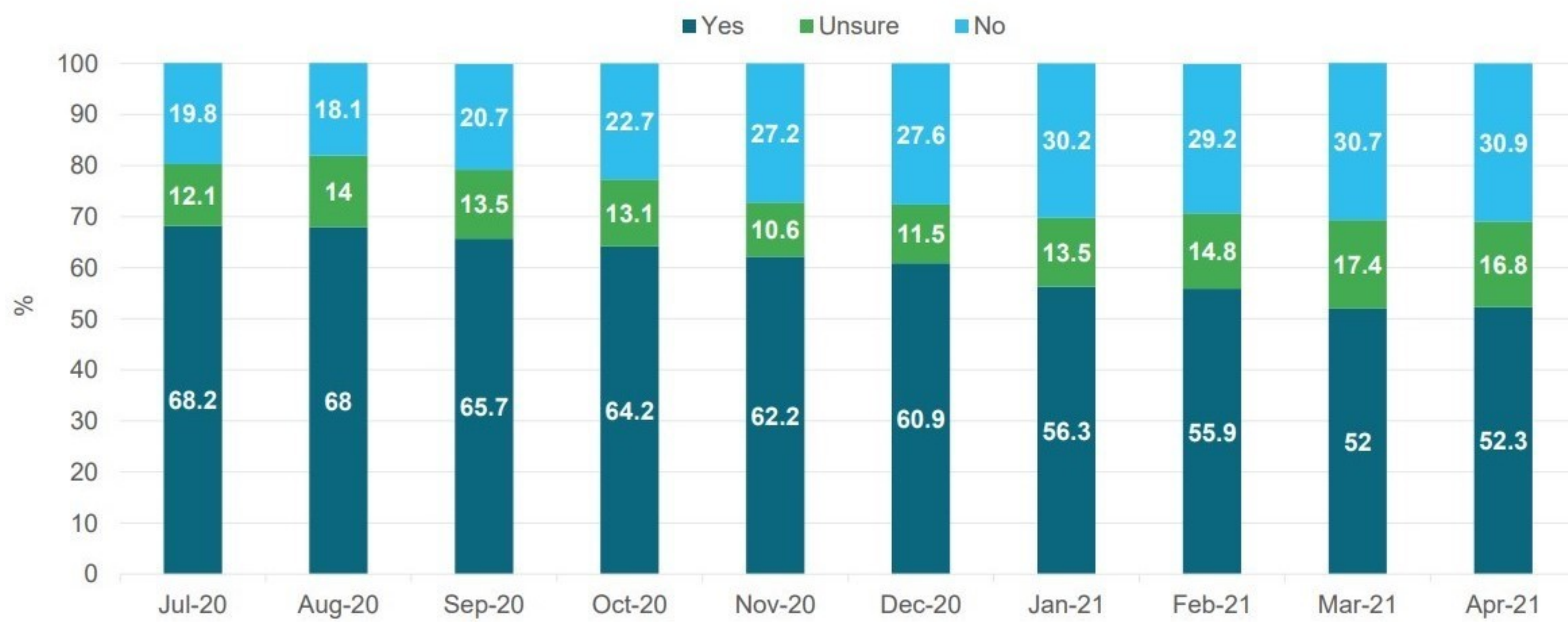


Chart of the Quarter

Labor Challenges - Percent willing to return to previous job (same pay/hours)



Source: Dallas Fed real-time population survey and Fathom Consulting

From the grass is always greener portion of workers' psyche… the chart shows that an escalating percentage of workers are either not willing to return to their previous job (same pay/hours) or are unsure. This trend is exhibited in the Job Openings and Labor Turnover Survey (JOLTS). A record 4.3 million people quit their jobs in August with the number of workers who quit rising 242,000 from July. Also, labor force participation continues to languish at 61.6% and has been on a downward trend since 2001.

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Annualized Return
					Small Cap Stocks 21.31%	Emerging Mkt Stocks 37.75%		Large Cap Stocks 31.43%			
	Emerging Mkt Stocks 18.63%				High Yield 17.49%	International Stocks 27.77%		Small Cap Stocks 25.52%	Gold 24.61%		
	International Stocks 17.39%				Large Cap Stocks 12.05%	Large Cap Stocks 21.69%		International Stocks 22.13%	Large Cap Stocks 20.96%		
	Large Cap Stocks 16.42%		Large Cap Stocks 13.24%		Commodities 11.77%	Small Cap Stocks 14.65%		Emerging Mkt Stocks 18.90%	Small Cap Stocks 19.96%		
Real Estate 15.99%	Small Cap Stocks 16.35%		Real Estate 12.49%		Emerging Mkt Stocks 11.60%	Gold 12.66%		Gold 18.43%	Emerging Mkt Stocks 18.69%	Commodities 29.13%	-3.80
Gold 8.93%	High Yield 15.58%	Small Cap Stocks 38.82%	US Bonds 5.97%		Real Estate 8.76%	60/40 Blended Index 12.07%		60/40 Blended Index 16.50%	60/40 Blended Index 12.24%	Large Cap Stocks 15.19%	14.47
US Bonds 7.84%	60/40 Blended Index 11.09%	Large Cap Stocks 33.11%	60/40 Blended Index 5.51%		Gold 8.10%	Intl/EM Bonds 10.41%		High Yield 14.41%	International Stocks 11.13%	Real Estate 13.12%	10.41
Intl/EM Bonds 5.88%	Real Estate 10.94%	International Stocks 15.78%	Small Cap Stocks 4.89%	Real Estate 15.01%	60/40 Blended Index 7.85%	Real Estate 7.62%		Intl/EM Bonds 9.98%	Intl/EM Bonds 7.90%	Small Cap Stocks 12.41%	11.59
High Yield 4.38%	Intl/EM Bonds 10.60%	60/40 Blended Index 14.85%	High Yield 2.50%	Large Cap Stocks 0.92%	Intl/EM Bonds 5.77%	High Yield 7.48%		US Bonds 8.72%	US Bonds 7.51%	60/40 Blended Index 6.69%	7.60
Large Cap Stocks 1.5%	Gold 8.26%	Real Estate 13.94%	Intl/EM Bonds 2.08%	US Bonds 0.55%	International Stocks 5.01%	US Bonds 3.54%	Real Estate 8.35%	Commodities 7.69%	High Yield 6.17%	International Stocks 6.29%	5.61
60/40 Blended Index 0.49%	US Bonds 4.22%	High Yield 7.42%	Gold 0.12%	60/40 Blended Index 0.11%	US Bonds 2.65%	Commodities 1.70%	3-month T-Bills 1.87%	Real Estate 5.35%	Real Estate 1.17%	High Yield 4.67%	6.60
3-month T-Bills 0.1%	3-month T-Bills 0.11%	3-month T-Bills 0.07%	3-month T-Bills 0.03%	3-month T-Bills 0.05%	3-month T-Bills 0.33%	3-month T-Bills 0.86%	US Bonds 0.01%	3-month T-Bills 2.28%	3-month T-Bills 0.67%	3-month T-Bills 0.04%	0.59
2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	
Small Cap Stocks (4.18)%	Commodities (1.06)%	US Bonds (2.02)%	Emerging Mkt Stocks (1.82)%	Intl/EM Bonds (2.42)%			Gold (0.93)%		Commodities (3.12)%	Emerging Mkt Stocks (0.99)%	3.62
Commodities (13.32)%		Emerging Mkt Stocks (2.27)%	International Stocks (3.44)%	Small Cap Stocks (4.41)%			High Yield (2.26)%			US Bonds (1.55)%	3.42
International Stocks (13.33)%		Intl/EM Bonds (4.13)%	Commodities (17.01)%	High Yield (4.64)%			Intl/EM Bonds (3.17)%			Intl/EM Bonds (3.66)%	3.49
Emerging Mkt Stocks (18.17)%		Commodities (9.52)%		International Stocks (5.25)%			60/40 Blended Index (3.71)%			Gold (7.67)%	2.02
		Gold (27.33)%		Gold (12.11)%			Large Cap Stocks (4.78)%				
				Emerging Mkt Stocks (14.60)%			Small Cap Stocks (11.01)%				
				Commodities (24.66)%			Commodities (11.25)%				
							International Stocks (13.78)%				
							Emerging Mkt Stocks (14.25)%				