MARKET REVIEW & OUTLOOK

October 2021

KEY TAKEAWAYS

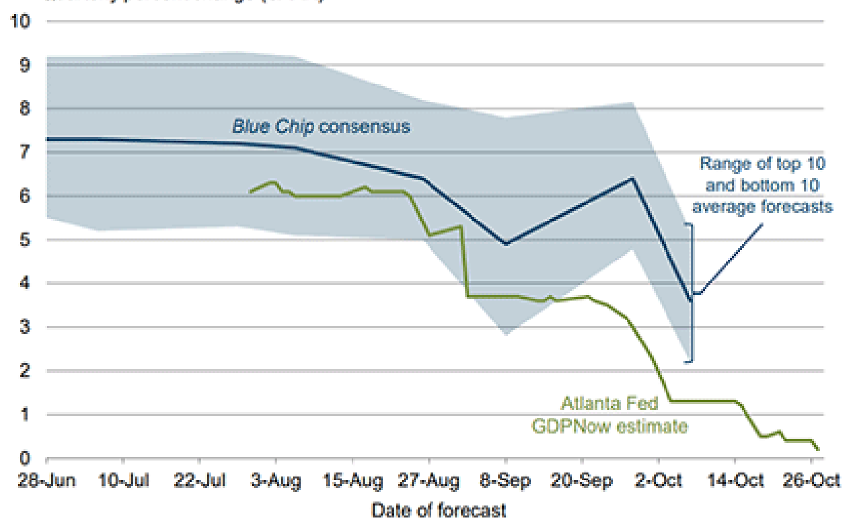
- We waited almost a year for a 5% decline, then it happened and disappeared before you could blink. Well not quite, but the start of October finished what September started and we achieved the 5% decline, which after chopping around for a few days became a rocket ship higher to new all-time highs in equities pretty much across the board.
- Interest rates spent the first half of the month moving modestly higher, but mostly digesting the large increase in rates from September. Then rates made a charge higher but turned around almost as quick on fears that the soon to be announced tapering by the Fed, will end up being a policy error, to which rates retreated from where they came.
- Gridlock in D.C. continues! It seemed like 27 days of going nowhere and then out of left field it seemed that there was some comprise taking place, but alas, other than a “smaller” package not much else seems to have been accomplished.

The U.S. Economy

The initial report for 3rd quarter GDP came in at 2%, which was below expectations of 2.6% and well below the 6 – 7% that was expected in late August. The chart below illustrates the steady decline in expectations, which became reality of a rather modest GDP report.

GDPNow is not an official forecast of the Atlanta Fed. Rather, it is best viewed as a running estimate of real GDP growth based on available economic data for the current measured quarter. There are no subjective adjustments made to GDPNow—the estimate is based solely on the mathematical results of the model.

In particular, **it does not capture the impact of COVID-19 and social mobility** beyond their impact on GDP source data and relevant economic reports that have already been released. It does not anticipate their impact on forthcoming economic reports beyond the standard internal dynamics of the model.



Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

Source: https://www.frbatlanta.org/cqer/research/gdpnow

Now that 3rd quarter is in the rear-view mirror and 4th quarter is full steam ahead it is time to see the forecast. Quite surprisingly, at least to us, is that after the meager 2% GDP report of 3rd quarter we spring back to the mid-single digits. We are not sure how that gets accomplished given the trajectory of last quarter. Maybe they expect cum-by-yah in government and quick passing and implementation of spending. Please see the chart below.

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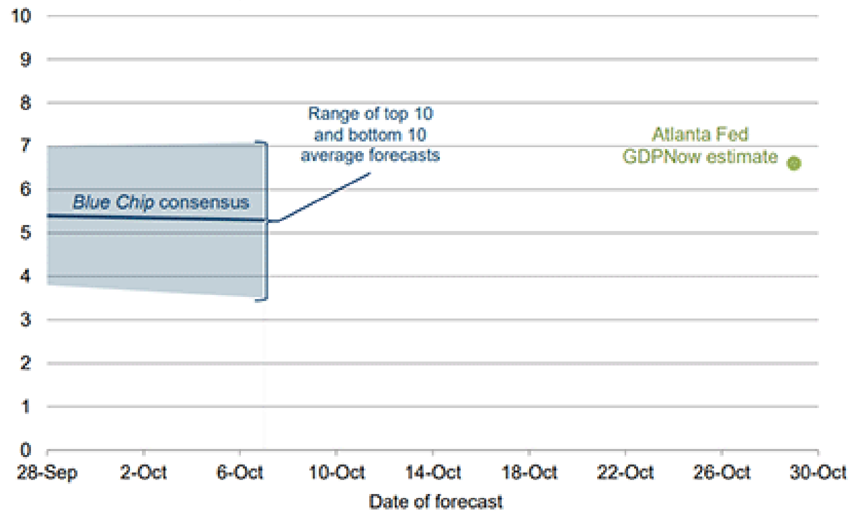

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Stocks and Bonds

The fixed income markets traded in an upward biased consolidation of the large increase seen in rates during September. By mid-month the market was focused on inflation pressures and the Fed reducing/tapering bond purchases, which drove yields to near the highs of the year. However, just as quickly as that fear came, it left, and the attention turned to the potential of tapering being a policy error by the Fed and rates quickly retreated near the levels they started the month. The rollercoaster ride in the base Treasury rates, left most of the fixed income complex, including high quality fixed income, where it started. High-quality fixed income, as measured by the iShares US Aggregate Bond ETF, saw essentially flat returns, finishing the month with a very modest loss of -0.04%. The U.S. 10-year Treasury bond yield ended the month near where it started, though it was a wild ride, 1.56%, up from September's close of 1.53%.

The Dow Jones Industrial Average rallied +5.84%, the S&P 500 jumped +6.91%, and the small cap Russell 2000 rose +4.21%. The international markets traded in a muted, but similar fashion as the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index climbed +2.53%, and the MSCI Emerging Markets iShares Core ETF Index increased +1.48%.

In October, we saw a lot of very green performance and almost no red.

The best performers were…

- Consumer Discretionary: +10.23%
- Energy: +8.66%
- Technology: +7.40%

The worst performers were…

- Consumer Services: -0.07%
- Consumer Staples: +1.64%

Source: https://www.sectorspdr.com/sectorspdr/tools/sector-tracker

Oil Report

The glide path for oil at the end of September continued relatively unabated for October as well. There was a brief dip near the end of the month on discussions from Iran that they planned on renewing nuclear talks within 30 days. The talk 18 months ago, in the middle of global lockdowns, was that there is nowhere to store oil, everything is full, which lead to negative oil prices in May 2020. Now, the fear is that there is not enough oil and that oil supplies may not be brought online fast enough to prevent a super spike in oil prices. What's that saying, "may you live in interesting times". Absolutely amazing the turn of events. The current NYMEX WTI Crude Oil futures settled at $83.22 and posted a gain of almost 11% from the prior month close of $75.03 a barrel. The price for RBOB gasoline was also strong posting a gain of over 7%. The aftermath of Hurricane Ida remains as oil production is still not all back on-line, contributing to the aforementioned low oil supplies. The virus seems to have abated for now, but as GDP showed, growth doesn't seem to be very rampant. The tug-of-war continues and for now, tight supplies is winning the battle.

The Rest of the Data

The September ISM Manufacturing Index increased 1.2 points to 61.1 from August's reading of 59.9. Additionally, the ISM Services Index increased to 61.9 from 61.7 in September, modestly improving from August's print. The prices paid component increased from last month in both surveys, suggesting last month's reprieve may have only been temporary that the worst of the inflation pressures are behind us. Any reading above 50 generally indicates improving conditions. Consumer confidence increased to 113.8 in October, which compares to an upwardly revised figure of 109.8 in September. The unemployment rate dropped, coming in at 4.8%, though the economy added a much weaker than expected 194,000 jobs in September vs consensus of 500,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) was up +0.4% in September, modestly reversing the 2-month downtrend seen previously, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index increased modestly, versus the previous report, to +5.4% on a non-seasonally adjusted basis. The CPI ex Food and Energy was 4.0%, unchanged from the August reading. Overall, these numbers show that the economy is coming off the torrid pace set earlier this year. The level of activity is good, but the pressures from supply constraints because of the rampant early year growth are continuing to impact the data, especially inflation pressures. Will more fiscal stimulus reignite more robust growth or kick inflation into overdrive. The next couple of quarters merit close observation.

Summary

Last months' commentary rings even more true today… The clear trends are that the turbo charged boost to earnings and GDP from fiscal stimulus are waning/expiring and as such, the rate of earnings and GDP growth are normalizing. What is not known is what the equilibrium point is for each. This is further complicated by the world's central banks starting to raise interest rates or reduce Quantitative Easing measures. Additionally, the supply chain issues continue to mount. On one hand, a lack of goods increases inflationary pressures, but on the other hand a lack of product to sell reduces economic activity. Economists have persistently underestimated the duration of strengthening inflation. The next 6 months will be very telling: does the corona virus rear its' ugly head? Do supply chain issues lead to more scarcity or slowly resolve themselves? Does that translate into longer run high inflation? What is the "new" normal for earnings and GDP growth? These are among the many questions we will continue to be looking for answers to in the coming quarters.

With all that said, in closing, we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is still sustained vs. transitory inflation, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. If the markets continue to march higher, we will capture some of those gains and reallocate to less volatile high-quality bonds. If the equity markets enter a period of negative performance, we have dynamic investment vehicles that utilize rules-based defense mechanisms to reduce the risk of the portfolio. Further, if the market gets too extended on the upside, some of the vehicles will capture partial gains and wait for the extension to correct.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-

term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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