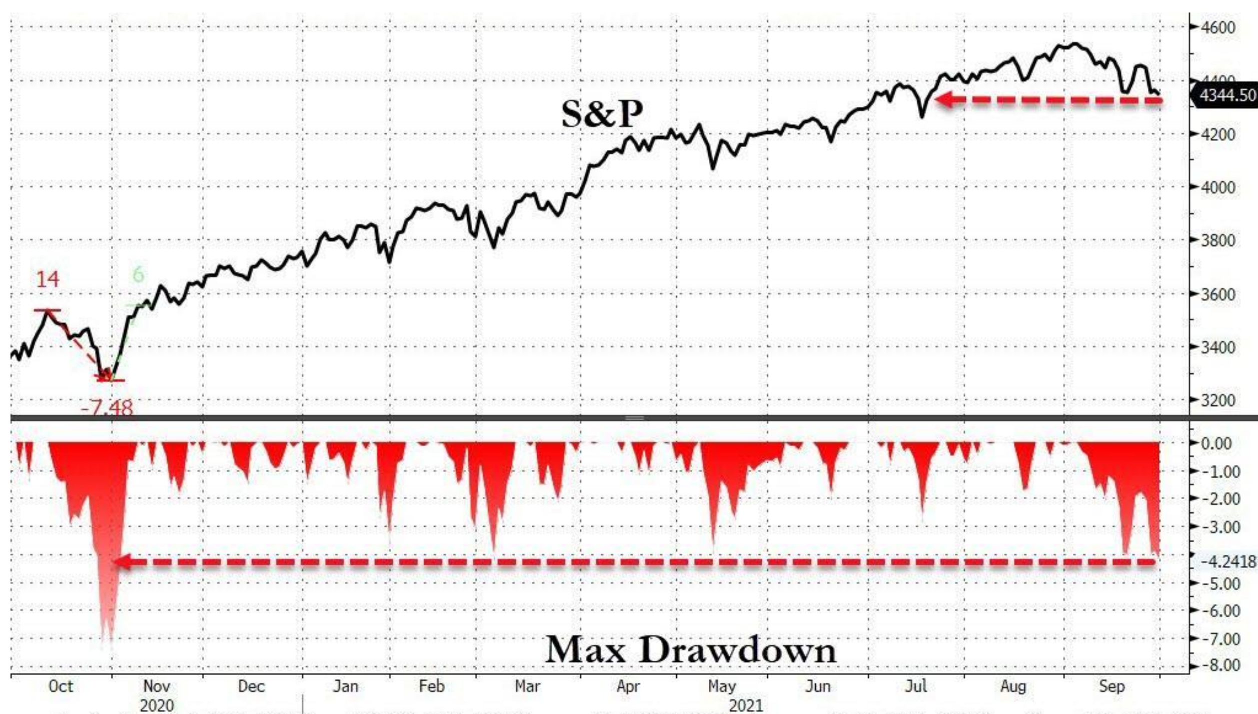
MARKET REVIEW & OUTLOOK

September 2021

KEY TAKEAWAYS

- To start the month, Global Equities were continuing to march higher but started consolidating the large gains of the year. Then, government gridlock and Fed inflation concerns led to volatility and "large" declines, though still less than 5%, to finish the month. Please see the chart below.
- Interest rates shuffled along during the month until Fed head Powell used the dreaded 'T' and 'I' words. Tapering and Inflation, which led to a sharp end of month rally in yields.
- Gridlock in D.C., shocking! The Debt Ceiling, Government Funding and the Infrastructure deals have all come to a head. In typical government fashion, funding has been "fixed" for 9 weeks, then we get to do it all over again.



Source: https://www.zerohedge.com/markets/slumptember-big-tech-bonds-bitcoin-bullion-dumped-dollar-jumped

The U.S. Economy

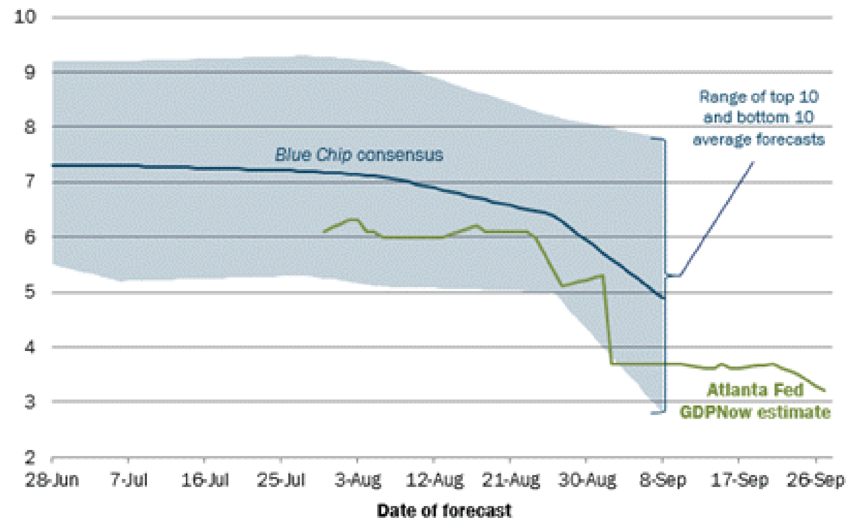
The robust economy of the 2nd quarter is now in the rearview mirror. The initial reduction in 3rd quarter GDP expectations that we saw at the tail end of August, through the Atlanta Fed, have continued and the delayed Blue-Chip consensus is following suit with reduced expectations, as shown in the chart

below. The Atlanta Fed is now forecasting closer to 3% growth, with the delayed Blue-Chip consensus still near 5%. Either number is decent compared to pre-Covid but seems to be returning to "normal". The next couple of quarters will be telling as to what the "new" normal for growth looks like going forward.

GDPNow™

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.



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

Stocks and Bonds

The fixed income markets traded in a relatively tight range for the first 3 weeks, but that all changed when the Fed uttered Taper and that inflation may not be as transitory as they thought, or is that hoped? Last month's previous resistance at 1.38% was easily cleared and yields finished near the highs of the month. The rise in the base Treasury rates, again weighed on results throughout the fixed income complex, including high quality fixed income. High-quality fixed income, as measured by the iShares US Aggregate Bond ETF, saw weak returns, finishing the month with a loss of -0.92%. The U.S. 10-year Treasury bond yield ended the month near the top of the range at 1.53%, up from August's close of 1.30%.

The Dow Jones Industrial Average slumped -4.29%, the S&P 500 dropped -4.76%, and the small cap Russell 2000 declined -3.05%. The international markets traded in a very similar manner as the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index fell -3.40%, and the MSCI Emerging Markets iShares Core ETF Index eased -2.04%.

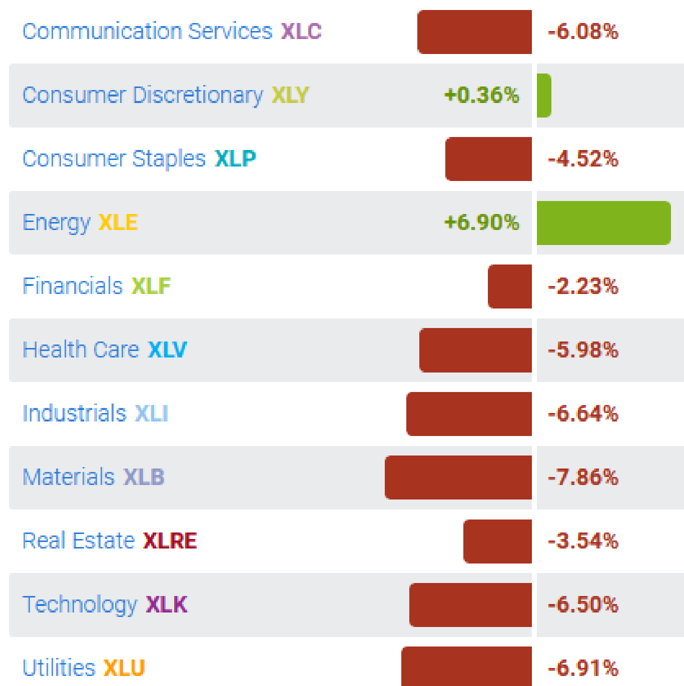
In September, we saw a lot of deep red performance with one bright star being Energy.

The best performers were…

- Energy: +6.90%
- Consumer Discretionary: +0.36%

The worst performers were…

- Materials: -7.86%
- Utilities: -6.91%
- Industrials: -6.64%



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

Oil Report

The August fear of the “delta” variant quickly dissipated, and the resumption of supply constraints aided a strong recovery in oil prices, taking us back near the highs of the year. Inventory reductions in the oil market supported prices along with cross-over effects of the global shortage of coal and natural gas. China and Europe have been closing factories to deal with either the lack of power or the prohibitively high prices of power. The current NYMEX WTI Crude Oil futures settled at $75.03 and posted a gain of almost 10% from the prior month close of $68.50 a barrel. The price for RBOB gasoline was relatively muted for the month as economic slowing eased pressure on gas prices. And while Hurricane Ida still has production off-line, the waning economic activity neutralized that lost production. RBOB finished with a modest gain of just over 2% for the month of September. The “delta” variant seems to have peaked, which should steady demand, but with driving season behind us and hurricane season nearing the end, we may finally see gas prices ease.

The Rest of the Data

The August ISM Manufacturing Index increased modestly 0.4 points to 59.9 from July's reading of 59.5. However, the ISM Services Index dropped to 61.7 from 64.1 in August, reversing most of July's improvement and fell from all-time highs. The prices paid component, while still elevated in both surveys, did show sharp decreases in prices paid, potentially signally that the worst of the inflation pressures may be behind us. Any reading above 50 generally indicates improving conditions. Consumer confidence dropped again to 109.3 in September, which compares to an upwardly revised figure of 115.2 in August. The unemployment rate fell again, coming in at 5.2%, though the economy added a much weaker than expected 235,000 jobs in August. The Consumer Price Index for All Urban Consumers (CPI-U) was up +0.3% in August, again easing the pace of increase seen the last two months, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index eased modestly to +5.3% on a non-seasonally adjusted basis, which is just below the highest readings since 2008. The CPI ex Food and Energy was 4.0%, a second monthly decline from the previous month's 12-month increase. Overall, these numbers show that the economy is settling into the aforementioned "new" normal and that initial signs are signaling the worst of the inflationary pressures may be behind us. Though the strength in housing and rental prices may yet have a voice to be heard in the numbers. The Fed seems to be slowly, but consistently moving away from "transitory" inflation. That may be a result of robust housing and/or the continued supply chain bottlenecks throughout the world.

Summary

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. As seen in the chart on the next page, economists have persistently underestimated the strength of inflation since before the pandemic hit. The next 6 months will be very telling: does the corona virus rear its' ugly head again? Do supply chain issues lead to more scarcity or slowly resolve themselves? Does that translate into longer run inflation? What is the "new" normal for earnings and GDP growth? This are among the many questions we will be looking to for answers in the coming quarters.

Source: https://www.zerohedge.com/markets/theres-inflation-central-banks-want-and-theres-inflation-we-get

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 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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