July 7, 2021

323 QUARTERLY UPDATE

The Newsletter of 323 Wealth Management LLC

THE LATEST FROM 323:

PRELUDE

Story by Greg Wilson, CFA, CFP, MBA

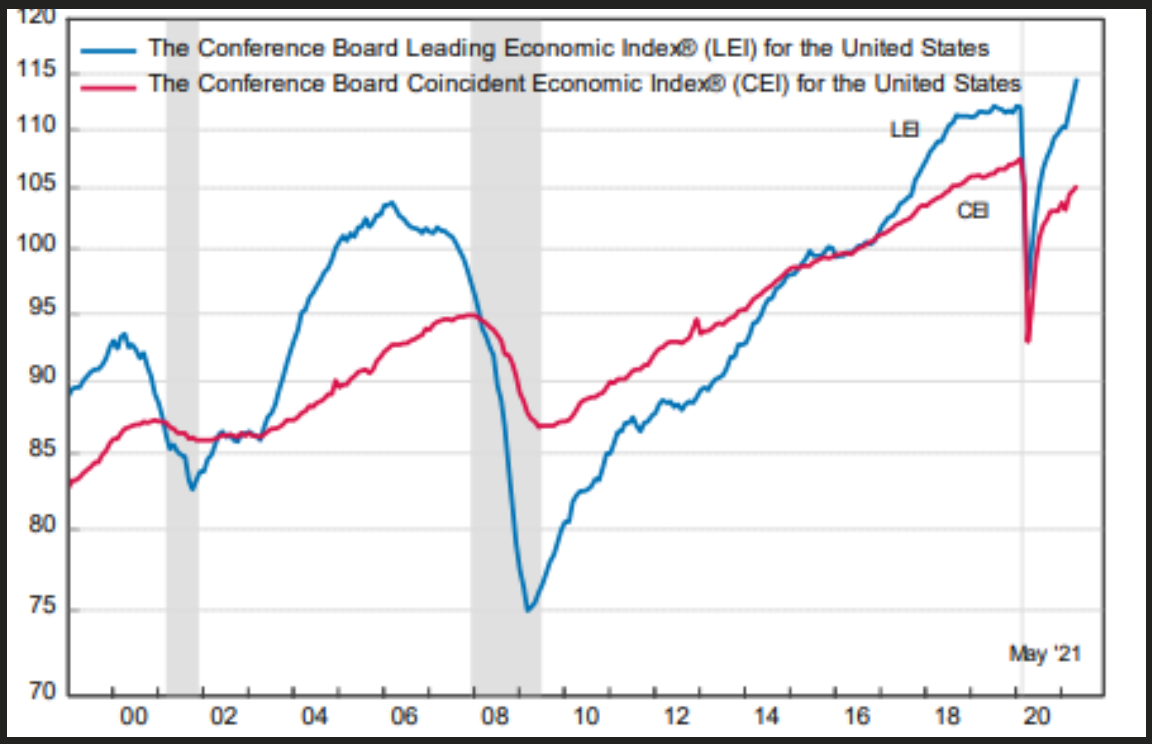
While there never seems to be a shortage of negative events, I think most people would agree that the second quarter of 2021 seemed tame compared to the previous four quarters. As the U.S. continues to emerge from the pandemic, there are still people, families, towns, states, businesses, and industries that are in need of repair and recovery. Those processes are well underway and will continue for months, and most likely for years. For investors, the second quarter was robust, but not without volatility. Some positives are: the economy continues to recover, the labor market continues to improve, and corporate earnings continue to look strong. Some challenges are inflation and the labor market. I will unpack this throughout this update.

Understanding the economy is one of the first steps to understanding investing.

ECONOMICS SUMMARY

The LEI takes off

In a sign of optimism, the Leading Economic Index (LEI) went nearly vertical this quarter and now appears to be back on trend from the previous market/business cycle.



Source: https://www.conference-board.org/us/

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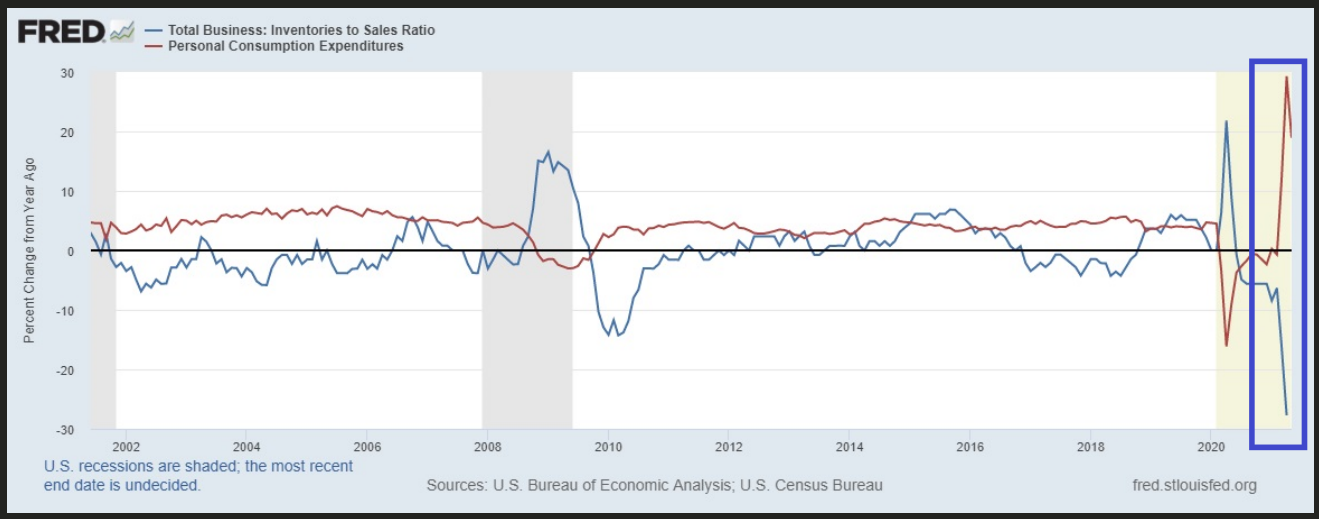
ECONOMICS SUMMARY (CONT.)

Continued Recovery

With Personal Consumption Expenditures (Consumer Spending) driving Retail Sales higher and higher, inventories are looking like they need to be replenished. While this is a good sign for overall economic recovery and growth, it continues to put pressure on already strained supply chains. I said in the beginning of the pandemic that supply chain management would have to fundamentally change and the companies that figured that out would likely forge ahead of the companies that struggled with this evolving dynamic.



Source: https://research.stlouisfed.org/

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ECONOMICS SUMMARY (CONT.)

Continued Recovery

Paradoxically, one of my rules is to stay away from absolutes. Therefore, I will not make a statement such as "interest rates cannot stay low forever". Interest rates are a complex topic. There are many different interest rates both in type and duration. There are interest rates on government bonds, corporate bonds, municipal bonds; all of which have short-term, intermediate-term, and long-term duration option. It is important to specify a general category when you are discussing interest rates. The Federal Reserve ***controls*** short-term interest rates in the U.S. The Federal Reserve ***influences*** intermediate and long-term interest rates in the U.S. The market has more of an impact on intermediate and long-term interest rates than the Federal Reserve. For this discussion, I am referencing intermediate and long-term interest rates. You see, for centuries, bond investors have largely set interest rates via the pricing of bonds in the market. Conventional interest rate and bond theory hold that if inflation rises and stays at an elevated level, it is likely that bond investors will demand a higher rate of return on their investment. It is true that we have a coordinated central bank response from around the globe to keep interest rates low, but I do question how aptly they can sustain their influence. After the Financial Crisis of 2008-2009, U.S. interest rates were anchored by Europe's relatively anemic economic recovery. Europe's interest rates stayed lower (to stimulate growth) and thus U.S. Treasury and Corporate Bonds looked more attractive. Buyers snatched up U.S. bonds at a record pace which helped to keep U.S. interest rates lower. So, you have a central bank policy from one continent affecting interest rates on another. This time seems to be similar. I thought we would see higher rates in the U.S. this summer. There's still time for that, but it seems that interest rates are anchored to the lowest common denominator, or other developed country interest rates. You can see this in the chart on the next page.

ECONOMICS SUMMARY (CONT.)

Continued Recovery

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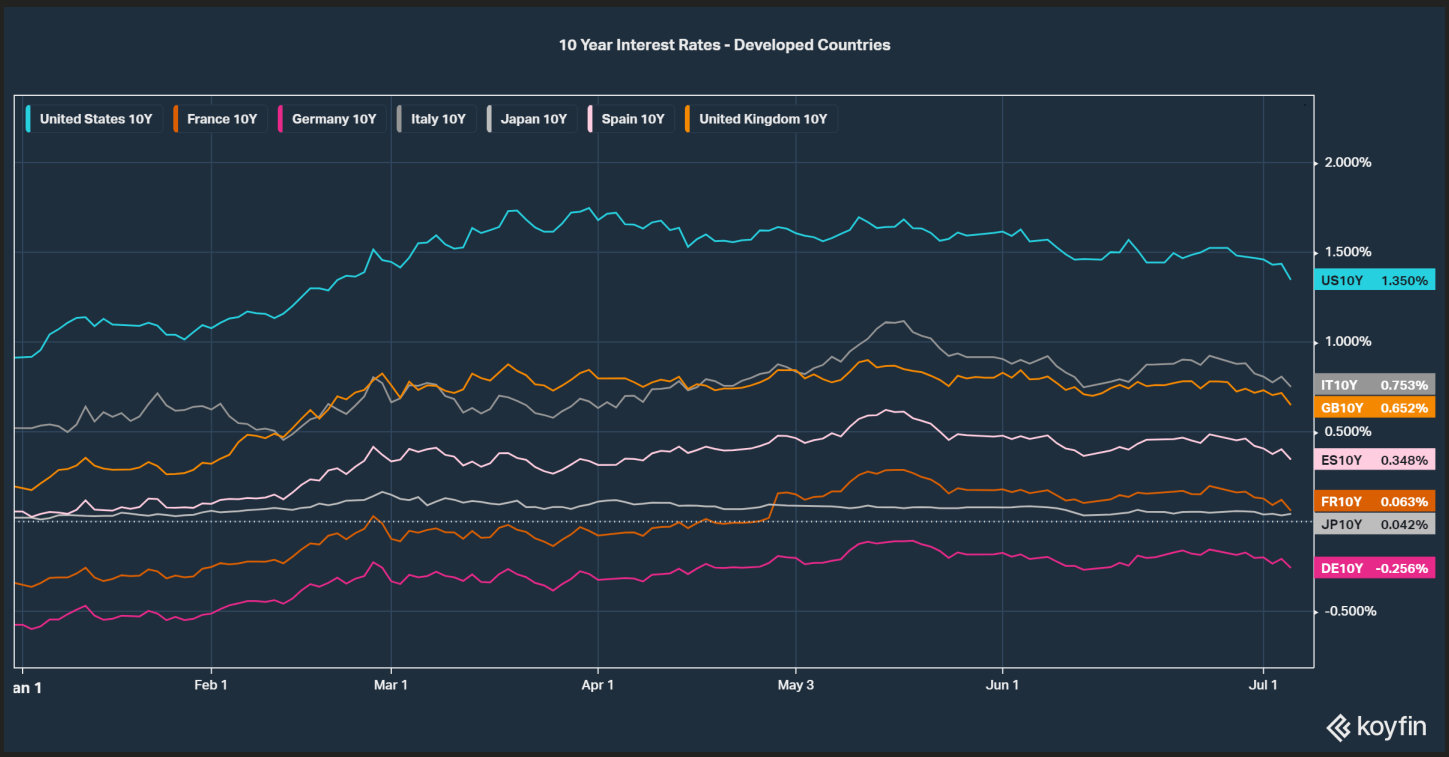


Source: www.koyfin.com

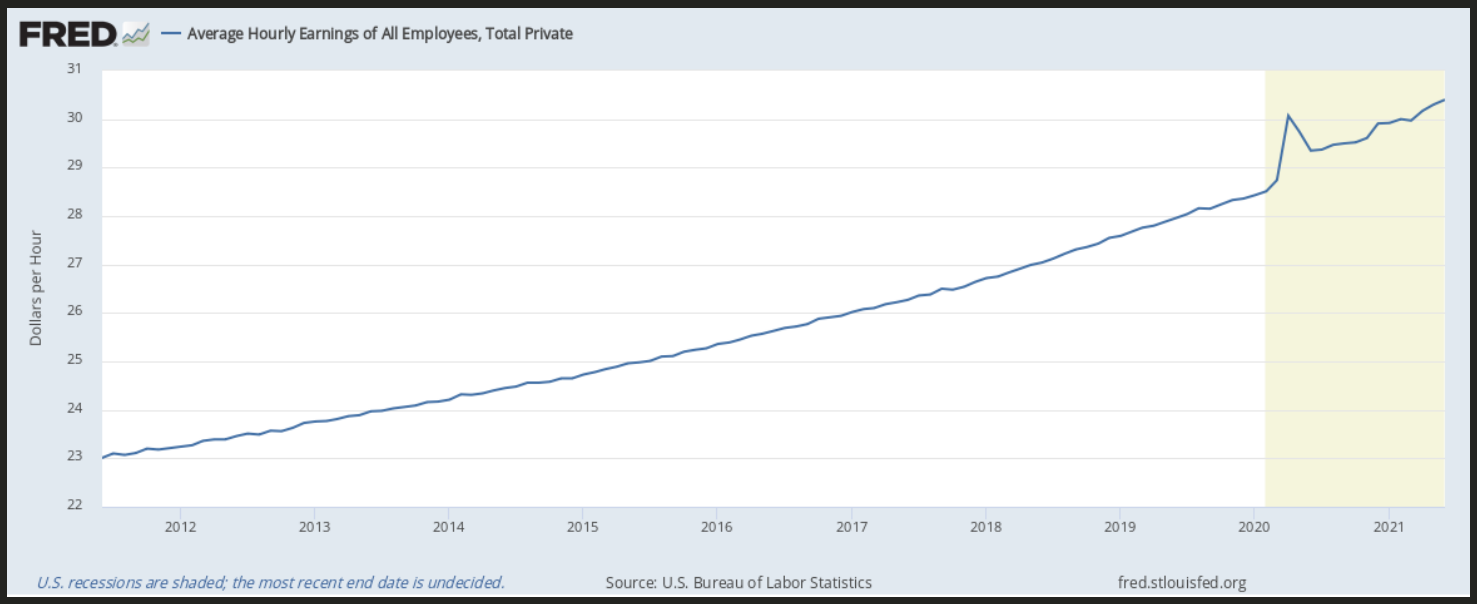
ECONOMICS SUMMARY (CONT.)

Understanding the economy is one of the first steps to understanding investing.

Continued Recovery

For investors, lower interest rates can be favorable. It means lower borrowing rates for companies which makes it easier to maintain or expand their profit margins. At the very least, it can help offset some of the inflation on their input costs, which leads me to my next topic.

Inflation typically takes on one of two forms: 1) Cost Push Inflation; or 2) Demand Pull Inflation. Cost Push Inflation is generally driven by input costs like labor, raw materials, and capital. So, while wage growth is occurring (labor), the cost of capital remains low (interest rates). These could at least partially offset each other. Commodity prices continue to stay elevated, and companies have indicated for multiple quarters now that they can no longer absorb the increased costs so those costs must be passed on to the end user. (See the wage growth chart below and the commodity charts on the next page).



Source:
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ECONOMICS SUMMARY (CONT.)

Continued Recovery

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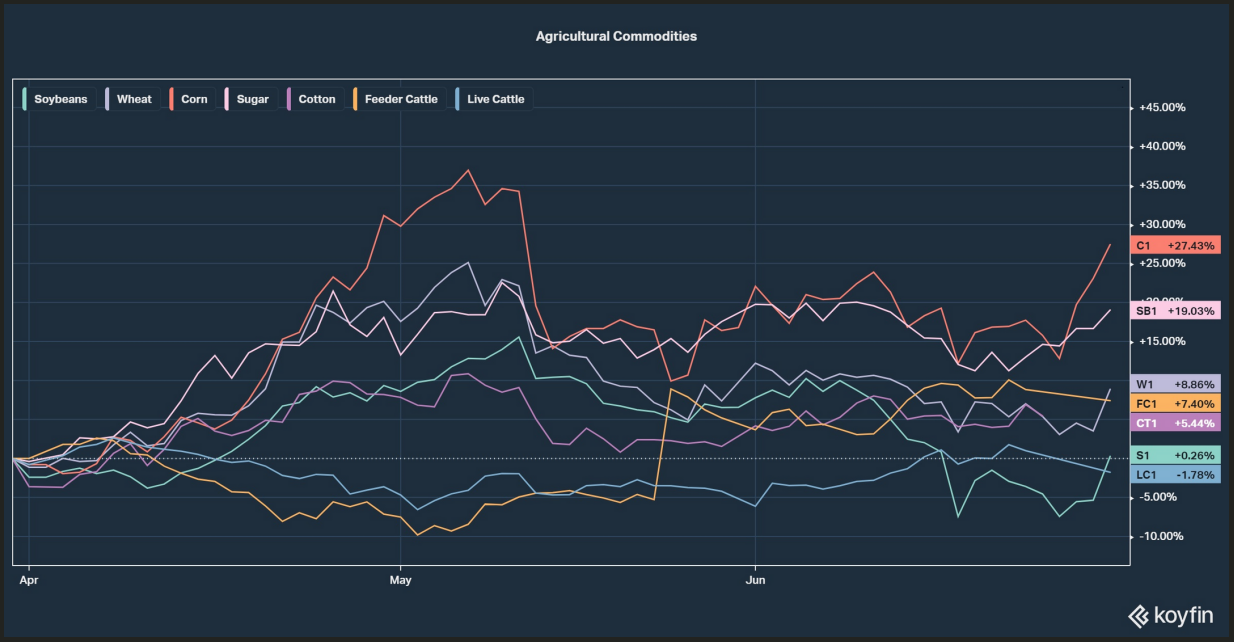

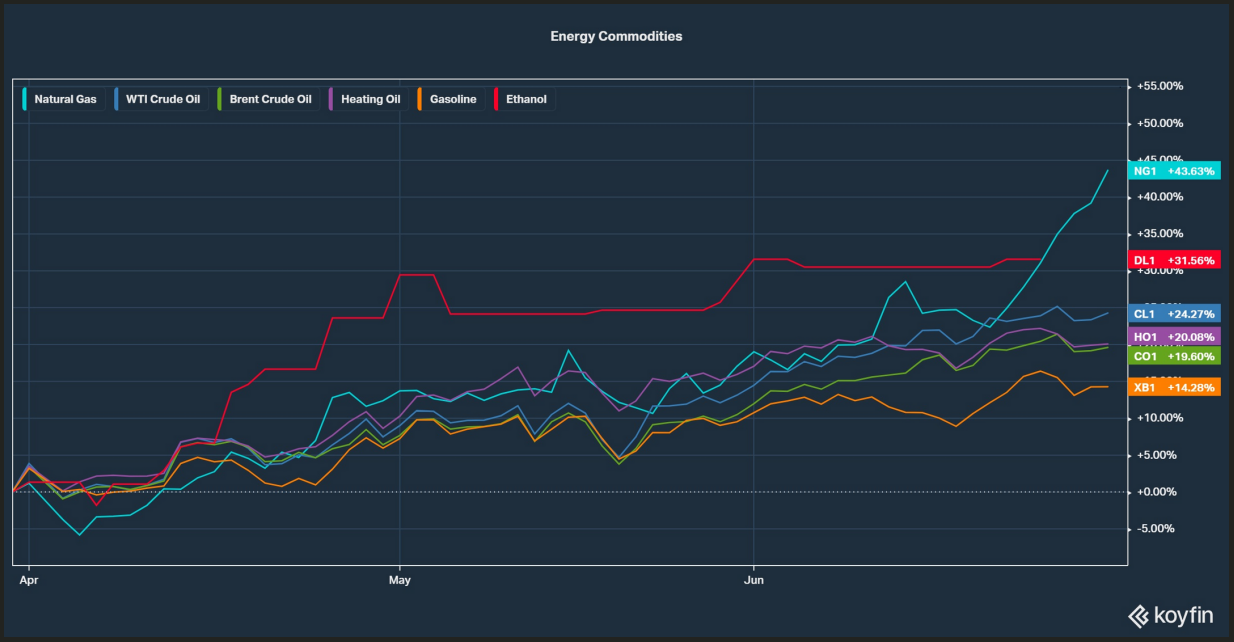

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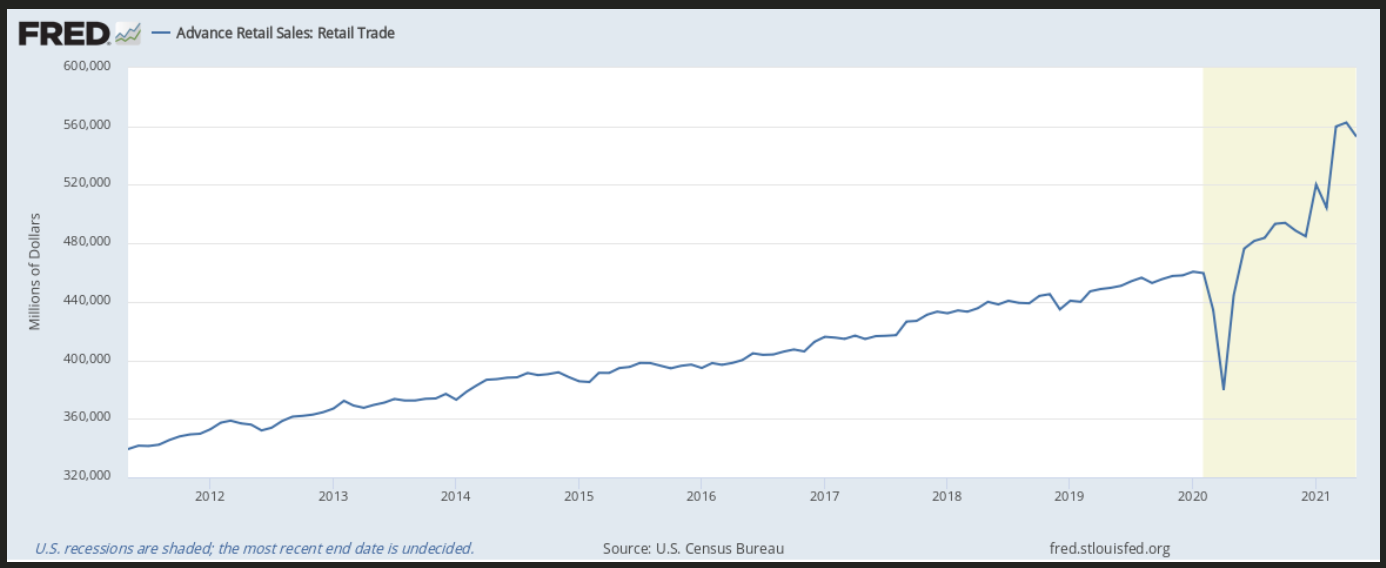
www.koyfin.com

ECONOMICS SUMMARY (CONT.)

Continued Recovery

Understanding the economy is one of the first steps to understanding investing.

Demand Pull Inflation is generally driven by greater demand for products and services. We are certainly seeing this in the Retail Sales numbers and the Housing numbers. (See the chart below and on the next page) The main point here is that there are inflationary pressures from both types of inflation. They could be "transitory" as the Federal Reserve has posited, but, as I have stated previously, the longer those inflationary forces hang around, the more ingrained they get in the economic system and the more ingrained they get in consumers' psyches. That is when you get inflation shifting from transitory (short-term or cyclical) to structural (long-term).



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ECONOMICS SUMMARY (CONT.)

Continued Recovery

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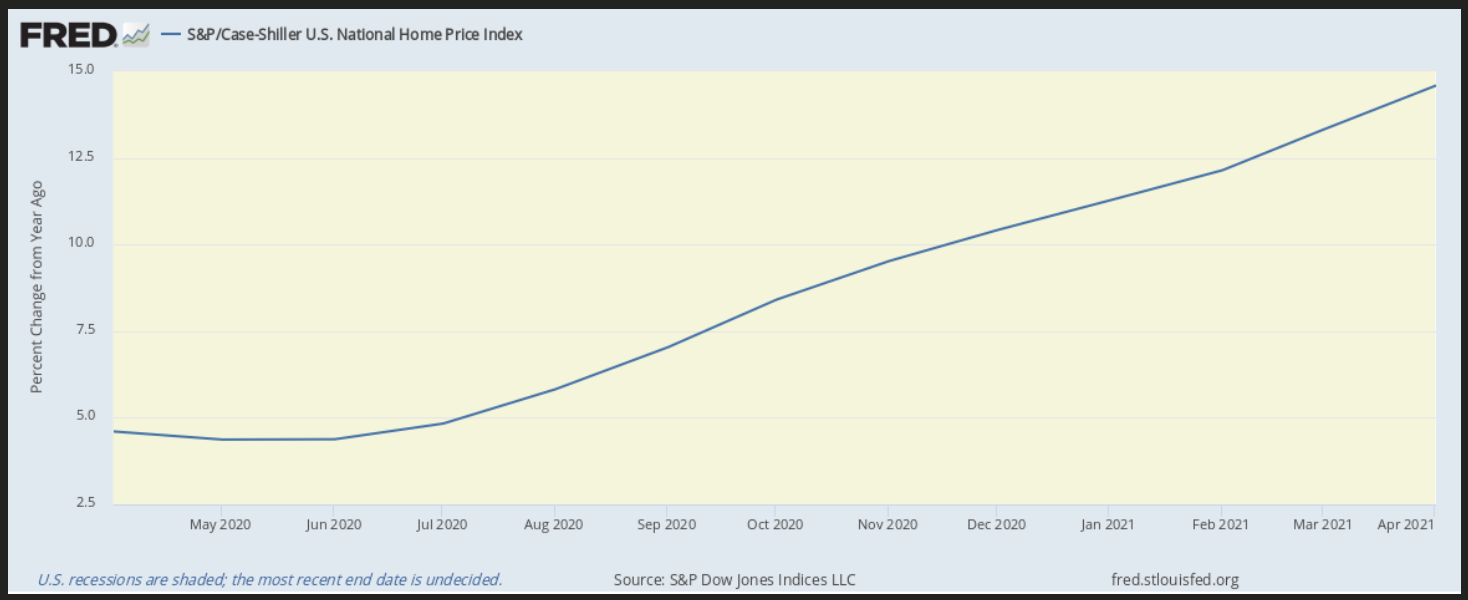

Source: https://research.stlouisfed.org/

ECONOMICS SUMMARY (CONT.)

Continued Recovery

Understanding the economy is one of the first steps to understanding investing.

The U.S. economy looks strong, and it is still recovering. Other countries are recovering but not at the same rate. You can see this in the first two columns of the next graphic.

WORLD ECONOMIC DASHBOARD

Country	GDP (USD)	GDP QoQ	GDP YoY	CPI YoY	Core CPI YoY	Retail Sales	Industrial Production	Policy Rate	10Y Yield	Govt Debt/GDP	Current Acct/GDP	Jobless Rate	Population
United States	21,427.70B	6.40%	0.40%	5.00%	3.80%	28.10%	16.30%	0.25%	1.49%	107.60%	-3.10%	5.80%	329.13M
China	14,342.90B	0.60%	18.30%	1.30%	0.90%	12.40%	8.80%	3.85%	3.14%	52.60%	1.00%	5.20%	1.40B
Euro Zone	13,335.84B	-0.60%	-1.80%	2.00%	0.90%	23.90%	39.30%	-0.55%	-	98.00%	2.70%	8.00%	341.90M
Japan	5,081.77B	-1.30%	-1.60%	-0.10%	-0.90%	8.20%	15.40%	-0.10%	0.06%	236.60%	3.60%	3.00%	126.01M
Germany	3,845.63B	-1.70%	-3.00%	2.30%	1.90%	-9.00%	26.40%	-0.55%	-0.17%	69.80%	7.10%	4.40%	83.20M
India	2,875.14B	2.10%	1.60%	6.30%	-	-	134.40%	4.00%	6.05%	69.62%	1.70%	11.90%	1.31B
United Kingdom	2,827.11B	-1.50%	-6.10%	2.10%	2.00%	24.60%	27.50%	0.10%	0.74%	100.20%	-3.50%	4.70%	66.65M
France	2,715.52B	0.40%	1.50%	1.40%	0.90%	42.10%	43.90%	-0.55%	0.17%	115.70%	-1.90%	8.10%	66.98M
Italy	2,001.24B	-0.40%	-1.40%	1.30%	0.80%	30.40%	79.50%	-0.55%	0.88%	155.60%	3.00%	10.70%	60.36M
Brazil	1,839.76B	1.20%	1.00%	8.06%	4.16%	23.80%	34.70%	4.25%	9.11%	75.79%	-0.72%	14.70%	210.15M
Canada	1,736.43B	1.40%	0.30%	3.60%	2.80%	56.70%	1.83%	0.25%	1.42%	117.80%	-1.90%	8.20%	37.78M
Russia	1,699.90B	-0.20%	-1.00%	6.02%	6.04%	27.20%	1.10%	5.50%	7.22%	17.80%	3.90%	5.20%	146.80M
South Korea	1,642.38B	1.10%	-1.40%	2.30%	1.40%	3.10%	12.40%	0.50%	2.11%	42.60%	3.50%	3.70%	51.71M
Spain	1,394.12B	-0.50%	-4.30%	2.60%	0.20%	19.60%	48.20%	-0.55%	0.46%	95.50%	2.00%	15.98%	46.94M
Australia	1,392.70B	3.10%	-1.10%	1.10%	1.10%	25.00%	-1.60%	0.10%	1.49%	45.10%	2.50%	5.10%	25.60M
Mexico	1,200.00B	0.40%	-3.80%	5.89%	4.37%	30.10%	36.60%	4.25%	6.93%	45.50%	-0.20%	4.00%	126.58M
Indonesia	1,119.19B	-0.96%	-0.74%	1.42%	1.37%	15.60%	2.00%	3.50%	6.63%	38.50%	-2.70%	6.26%	266.10M
Turkey	754.41B	1.70%	7.00%	16.59%	16.99%	41.70%	66.00%	19.00%	16.40%	33.10%	-5.10%	13.90%	83.15M
Switzerland	703.08B	-0.50%	-0.50%	0.60%	-0.40%	35.70%	4.80%	-0.75%	-0.19%	42.90%	3.80%	3.10%	8.54M

Source: www.koyfin.com

MARKET SUMMARY

Continued momentum

Understanding the markets can help us build a better plan for our financial futures AND sleep easier at night.

While all the major equity indices were positive for the quarter, there were ~4-5% drops in some of those equity indices around mid-May and the Nasdaq was down ~8% from peak to trough around the same time, before recovering and closing at its all-time high on June 29, 2021. International equities have lagged U.S. equities, but that is not surprising since I thought Europe would have a harder time coming out of the pandemic than the U.S.

Source: www.koyfin.com

MARKET SUMMARY (CONT.)

Corporate Profits/Earnings

I tend to discuss Corporate Profits/Earnings quite a bit. The reason for that is stock prices, and thus returns, tend to follow Corporate Earnings which continue their strong recovery pace. (See Chart Below)

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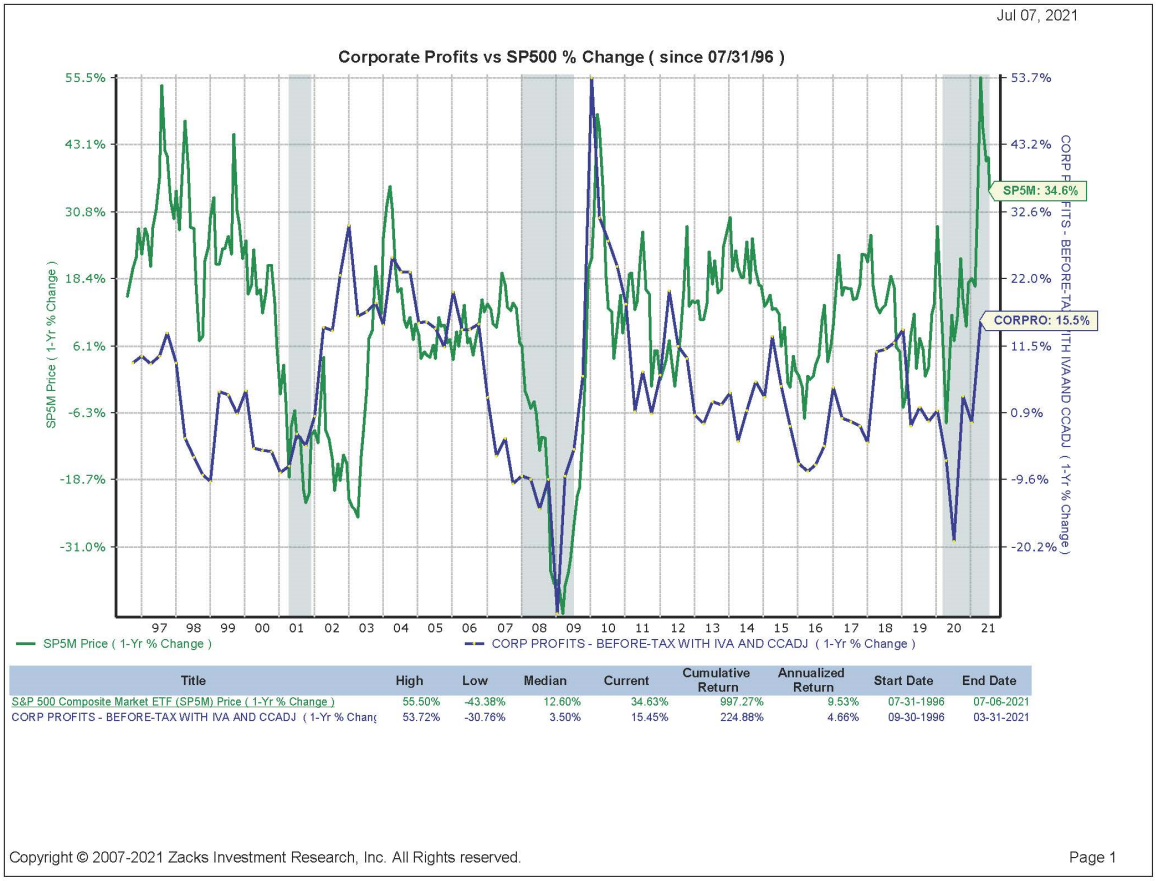


Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
S&P 500 Composite Market ETF (SP5M) Price (1-Yr % Change)	55.50%	-43.38%	12.60%	34.63%	997.27%	9.53%	07-31-1996	07-06-2021
CORP PROFITS - BEFORE-TAX WITH IVA AND CCADJ (1-Yr % Chang	53.72%	-30.76%	3.50%	15.45%	224.88%	4.66%	09-30-1996	03-31-2021

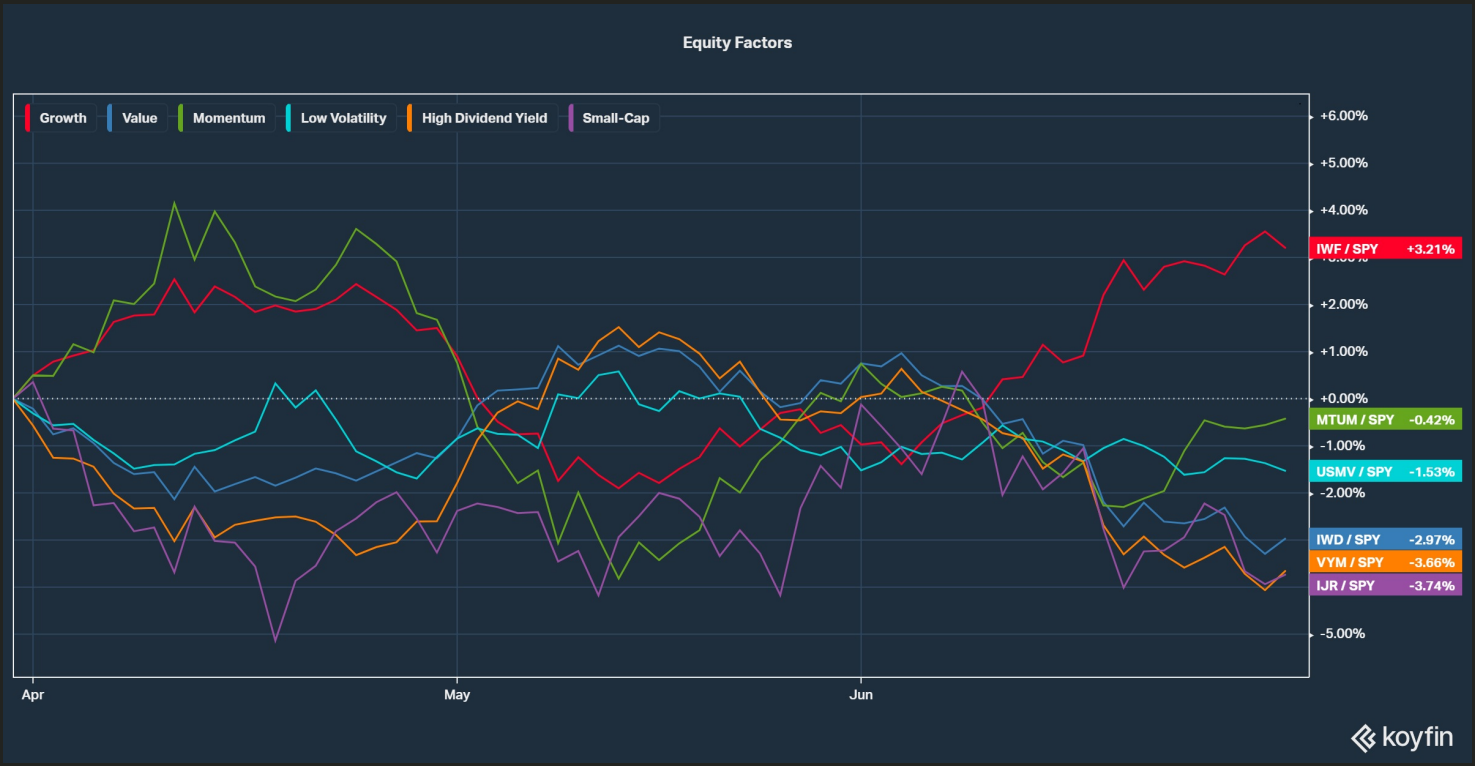
Source: Zacks Investment Research

MARKET SUMMARY (CONT.)

Equity Factors

For Equity Factors, Growth led the way while Small Cap, High Dividend Yield, and Value lagged. The main takeaway here is that Factors appear to be decoupling which means they are no longer bunched together in one or two packs trading in the same direction every day. When different types of assets trade similarly, that is a form of volatility clustering. While volatility clustering is part of the market, I prefer to see less of it because it reduces the benefits of diversification. Since interest rates were generally down, bonds were generally up. I'm skipping the charts for bonds because there's not much to report.

Understanding the markets can help us build a better plan for our financial futures AND sleep easier at night.



Source: www.koyfin.com

FINANCIAL PLANNING UPDATE

Are you charitably inclined?

Financial planning is an ongoing process that evolves with your life's changing circumstances.

If you are charitably inclined but unsure of the most tax-efficient way to facilitate your giving, please let me know. I can help. For those that would like to know more about a Donor Advised Fund, please check this link out, https://www.schwabcharitable.org/donor-advised-funds.

Donor Advised Funds are a great way to maximize your tax savings, maintain control over your gifting, and even continue to grow funds that you have earmarked for future giving.

CONCLUSION

What's next?

Looking forward, I think investors will need to pay more attention to what types of investments they own. The rising tide lifts all boats scenario is starting to look played out or it's at least in the latter stages. I think international developments will start to impact the U.S. more as well, for good and for bad. Overall, I am optimistic about economic and earnings growth.

If you have questions and/or concerns, please give us a call. We are here to help. If this update has been forwarded to you and you would like to be included on future emails, please subscribe at our website at www.323wm.com.

Thank you very much
for your time.

DISCLOSURES