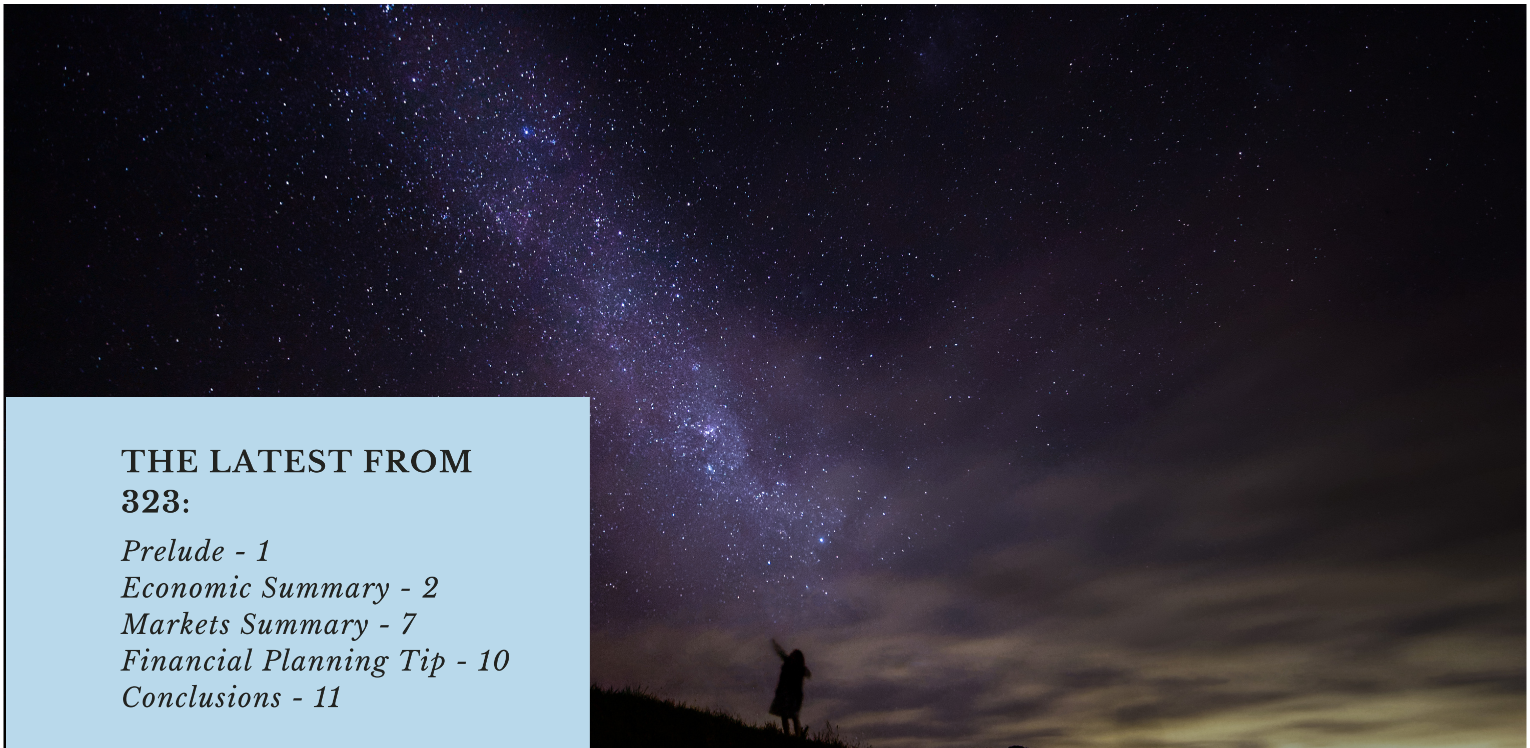
October 10, 2021

# 323 QUARTERLY UPDATE

*The Newsletter of 323 Wealth Management LLC*



**THE LATEST FROM 323:**



## PRELUDE

*Story by Greg Wilson, CFA, CFP, MBA*

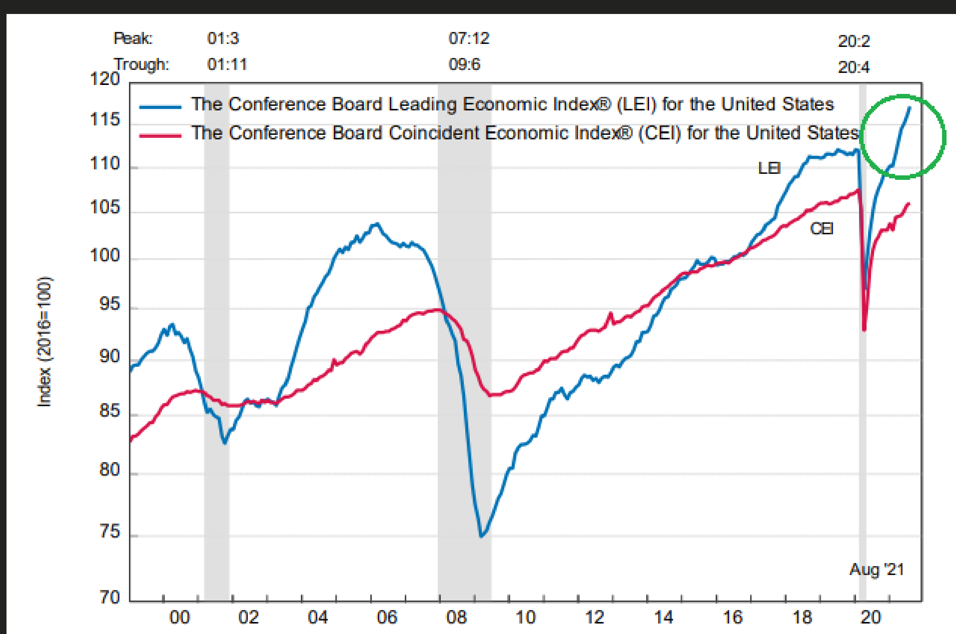
Compared to previous quarters, and from an economics, finance, business, and markets standpoint, the third quarter of 2021 had fewer extreme events but there are several interesting and meaningful tailwinds, headwinds, and cross-currents to discuss. The Delta variant and politics should continue to be short to intermediate term drivers of market volatility. The underlying economy continues to strengthen while the financial markets are having another strong year. We will unpack this and more in this update.

# ECONOMICS SUMMARY

*The LEI continues upward*

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

If you remember from last quarter, I showed that the Leading Economic Index (LEI) had gone vertical in a sign of optimism. That trend continued this quarter as you can see in the green circle in the graph below.



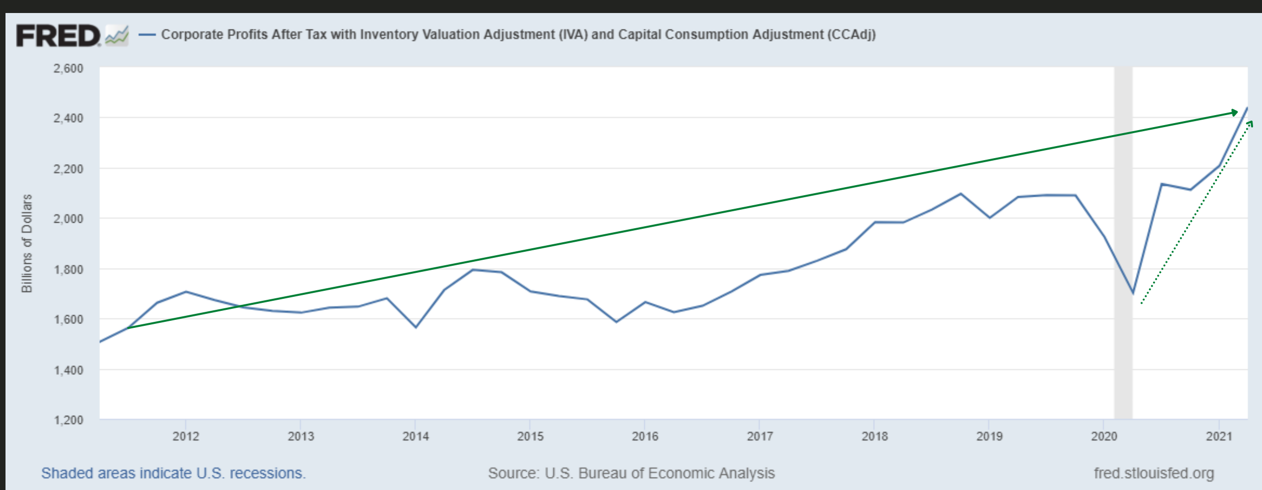

Source: https://www.conference-board.org/us/

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

# ECONOMICS SUMMARY (CONT.)

*Continued Recovery*

As I have been mentioning in our weekly update, Corporate Profits (earnings) accelerated this year.  They are above the long-term trend growth rate, but that is expected to slow in 2022 and 2023.  It is important to note that forecasted earnings growth is positive, but not as positive as it was a few months ago.  I have been targeting ~9% earnings growth and analysts are now forecasting 9-10% versus the over 11% rate a few months ago.  This is partially due to lower economic growth forecasts, but also due to the fact that some earnings were pulled forward due to larger than expected demand.  It will be interesting to see if demand comes in higher than expected over the next 3-6 months.  That could lead to positive earnings revisions.



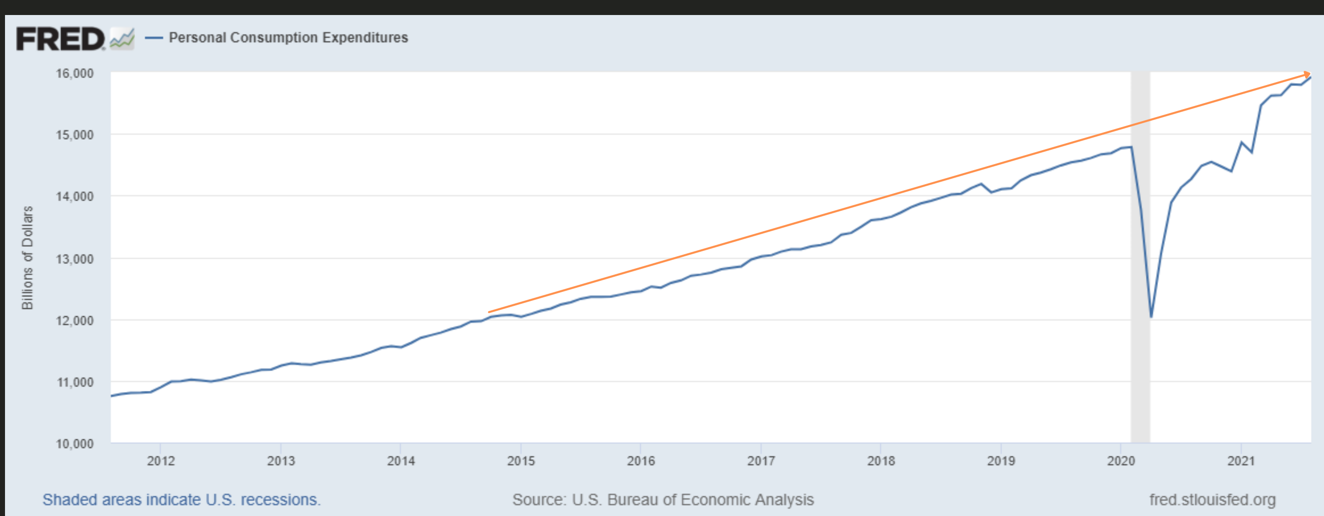

Source: https://research.stlouisfed.org/

# ECONOMICS SUMMARY (CONT.)

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

*Continued Recovery*

In a chaotic world of irrationality, there is one relatively consistent phenomenon here in the United States. Americans have a drive to spend money. Of course, consumer tastes and patterns change over time. And, there are dips when the future looks uncertain such as the onset of a pandemic, but overall the American spending pattern is persistent. As such, Personal Consumption Expenditures (PCE, aka Consumer Spending) has continued to stay on it's previous trend after fully recovering last quarter. This should bode well for the economy and for corporate profits.




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



# ECONOMICS SUMMARY (CONT.)

*Continued Recovery*

The U.S. economy continues to lead the global recovery for developed nations as you can see by the GDP QoQ growth rate below compared to other countries. Of course, as well all know, there is no free lunch, so the trade off is higher than targeted inflation (CPI YoY and Core CPI YoY).

**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 | 20,936.60B | 6.50% | 12.20% | 5.30% | 4.00% | 15.80% | 5.90% | 0.25% | 1.51% | 107.60% | -3.10% | 5.20% | 329.48M |
| China | 14,722.73B | 1.30% | 7.90% | 0.80% | 1.20% | 8.50% | 5.30% | 3.85% | 2.87% | 66.80% | 1.90% | 5.10% | 1.44B |
| Euro Zone | 12,933.36B | 2.00% | 13.70% | 3.00% | 1.60% | 3.10% | 7.70% | -0.56% | - | 98.00% | 2.70% | 7.60% | 342.41M |
| Japan | 5,081.77B | 0.30% | 7.50% | -0.30% | -0.20% | 2.40% | 11.60% | -0.10% | 0.06% | 266.20% | 3.60% | 2.80% | 125.67M |
| Germany | 3,806.06B | 1.50% | 9.40% | 3.90% | 2.80% | -0.30% | 5.10% | -0.56% | -0.20% | 69.80% | 7.10% | 3.60% | 83.16M |
| United Kingdom | 2,707.74B | 4.80% | 22.20% | 3.20% | 3.10% | 2.40% | 3.80% | 0.10% | 1.01% | 100.20% | -3.50% | 4.60% | 67.20M |
| India | 2,622.98B | 2.10% | 20.10% | 5.30% | - | - | 11.50% | 4.00% | 6.22% | 69.62% | 1.70% | 7.00% | 1.35B |
| France | 2,603.00B | 0.90% | 18.70% | 1.90% | 1.50% | 7.80% | 7.10% | -0.56% | 0.15% | 115.70% | -1.90% | 8.00% | 67.29M |
| Italy | 1,886.45B | 2.70% | 17.30% | 2.10% | 0.60% | 7.70% | 13.90% | -0.56% | 0.85% | 155.60% | 3.60% | 9.30% | 59.64M |
| Canada | 1,643.41B | -0.30% | 12.70% | 3.70% | 3.30% | 6.20% | 8.20% | 0.25% | 1.51% | 117.80% | -1.90% | 7.10% | 38.01M |
| South Korea | 1,630.53B | 0.70% | 5.90% | 2.60% | 1.30% | 7.90% | 9.60% | 0.75% | 2.24% | 42.60% | 3.50% | 2.80% | 51.78M |
| Russia | 1,483.50B | -0.20% | 10.30% | 6.46% | 7.07% | 4.70% | 4.70% | 6.75% | 7.31% | 17.80% | 3.90% | 4.50% | 146.20M |
| Brazil | 1,444.73B | -0.10% | 12.40% | 9.68% | 5.42% | 6.30% | 1.20% | 5.25% | 11.09% | 88.83% | -0.72% | 14.10% | 211.82M |
| Australia | 1,330.90B | 0.70% | 9.60% | 3.80% | 1.60% | -3.10% | 0.80% | 0.10% | 1.49% | 24.80% | 2.50% | 4.50% | 25.68M |
| Spain | 1,281.20B | 2.80% | 19.80% | 4.00% | 0.70% | 0.10% | 11.10% | -0.56% | 0.47% | 120.00% | 2.00% | 15.26% | 47.33M |
| Mexico | 1,076.16B | 1.50% | 19.70% | 5.59% | 4.66% | 17.70% | 7.30% | 4.50% | 7.38% | 52.10% | 2.40% | 4.30% | 126.01M |
| Indonesia | 1,058.42B | 3.31% | 7.07% | 1.59% | 1.31% | 2.50% | 2.00% | 3.50% | 6.36% | 38.50% | -2.70% | 6.26% | 270.20M |
| Switzerland | 747.97B | 1.80% | 7.70% | 0.90% | 0.20% | -2.60% | 15.70% | -0.75% | -0.17% | 42.90% | 3.80% | 2.70% | 8.61M |
| Turkey | 720.10B | 0.90% | 21.70% | 19.25% | 16.76% | 17.40% | 8.70% | 18.00% | 17.92% | 39.50% | -5.10% | 12.00% | 83.61M |

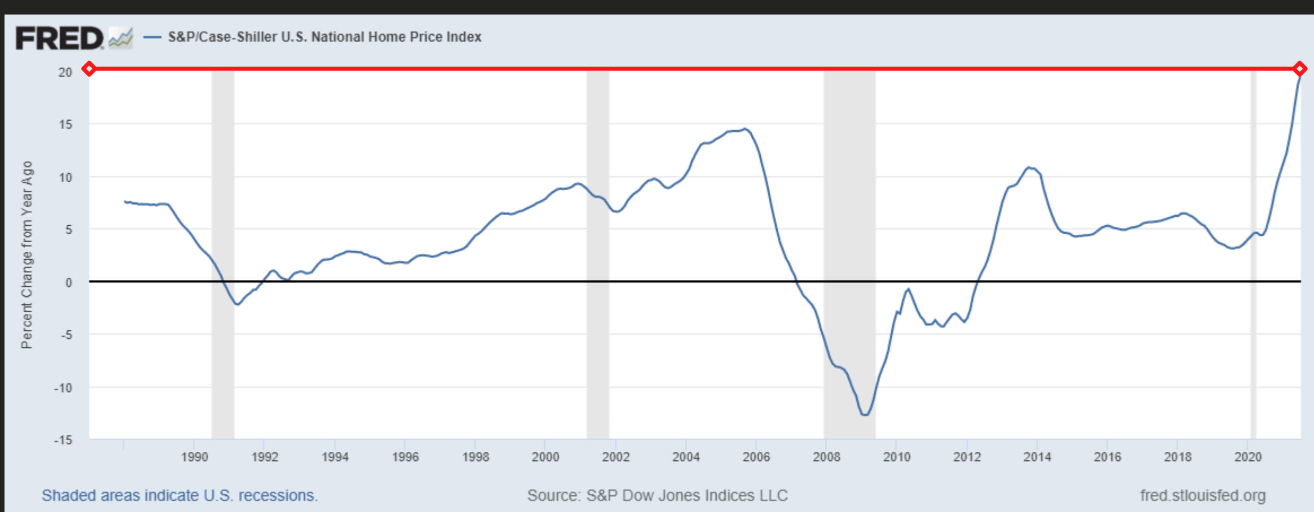
Source: www.koyfin.com

# ECONOMICS SUMMARY (CONT.)

*Continued Recovery*

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

I think most folks are reasonably aware of home price growth over the last year and a half.  The latest 1-year growth rate of home prices is the highest we have seen since the Case-Shiller metric started back in the 1980s.  Please note that I am not sounding the alarm bell, mostly because home prices tend to be inelastic, with the notable exception of 2007-2009.  During the years preceding that period, there was excess home buying and irresponsible mortgage lending.  Although we have some excesses today, lending standards are higher and the drivers behind the home price appreciation are more related to supply and demand.  Simply put, there has been a lower amount of supply than demand and the market price has compensated in an attempt to find an equilibrium point.  More supply should come online in the form of new houses and prices will likely adjust.  Hopefully, that adjustment will simply be a lower growth rate and not a contraction.  Barring any exogenous shocks, I think it will be the former versus the latter.



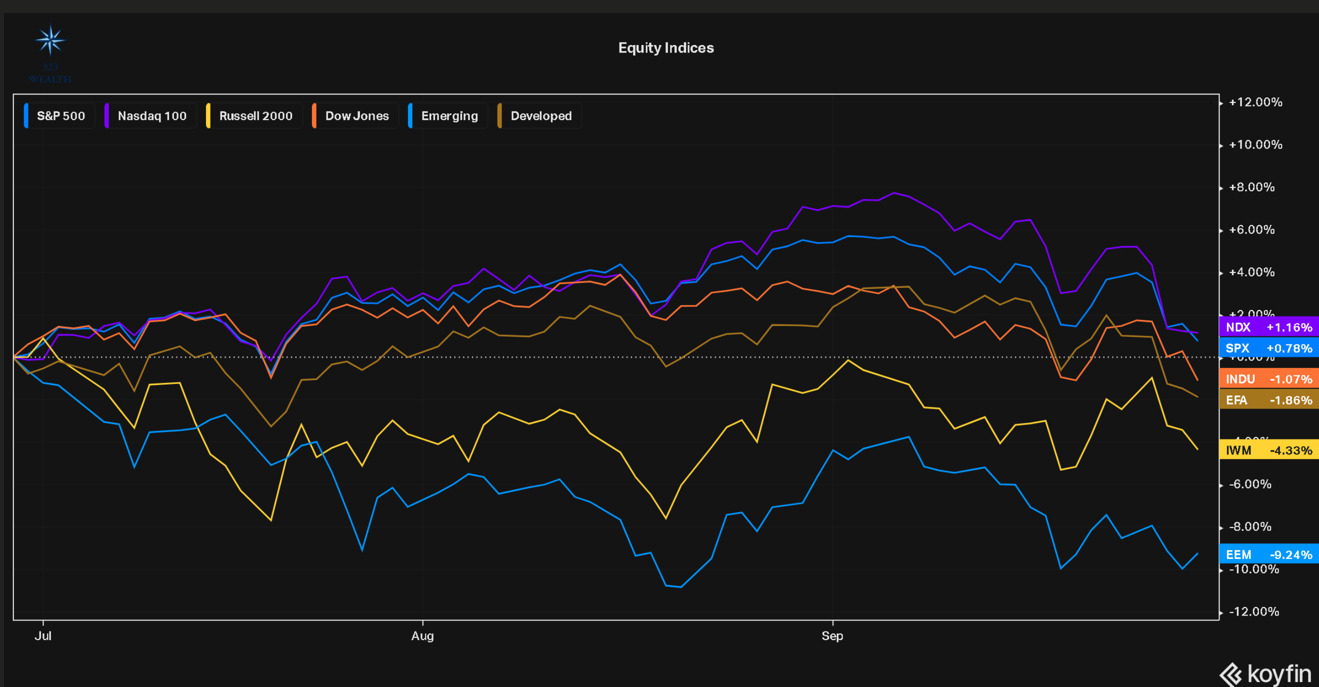

Source:
https://research.stlouisfed.org/

# MARKET SUMMARY

*Letting off some steam*

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

For July and August, the equity markets had been trending up, but then came September. September saw the retracement (aka pullback) of the major equity indices as you can see in the chart below. This is not surprising when you combine the fact that we had a strong equity market year-to-date, corporate earnings pulled forward, the Delta variant complicating the economic outlook, supply chain issues, and geopolitical issues. Emerging Markets (EEM) showed particular weakness and volatility as you might expect in this type of situation. Those are markets that money flows into and out of in a hurry when there are risk-on and risk-off periods. In the industry, this is known as "hot money". This is one of many reasons we, at 323, are staying away from Emerging Markets. We prefer to take as little risk as possible to achieve our clients' goals which includes minimizing volatility risk. While being mindful of short-term volatility, as long-term investors, we should also be focused on the long-term fundamentals, which in my view, appear to be healthy. Please note that this assessment is focused on U.S. companies which is where we have over 95% of our exposure.



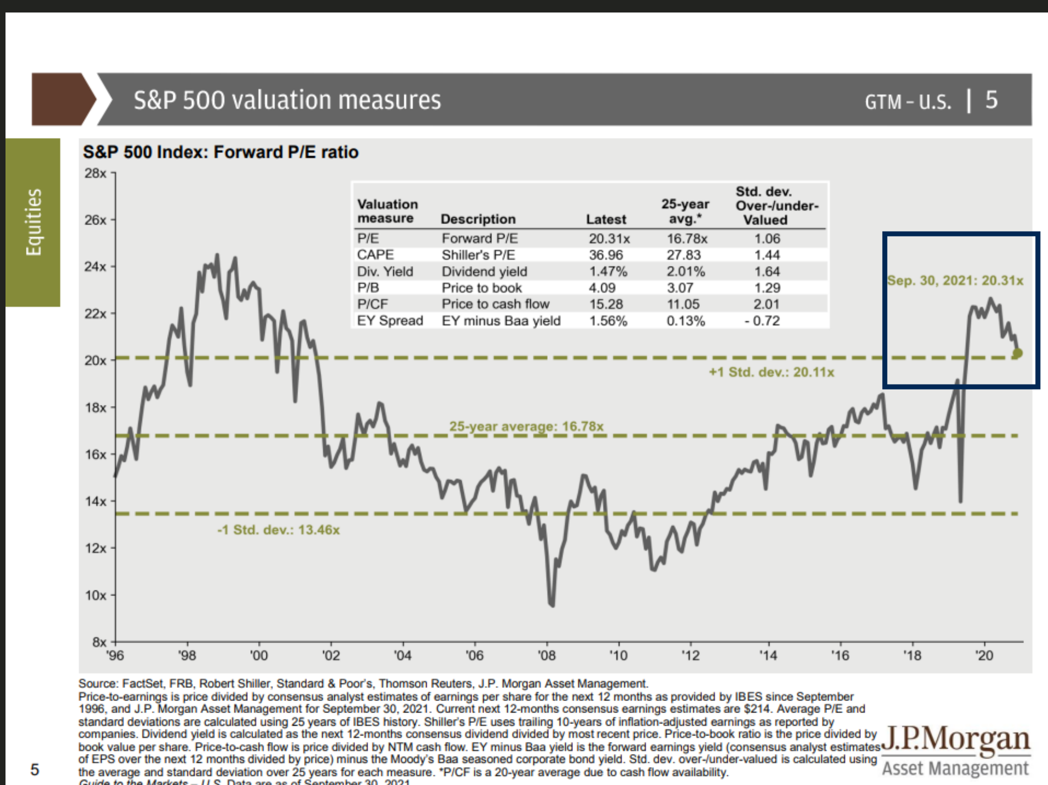

Source: www.koyfin.com

# MARKET SUMMARY (CONT.)

*Equity Valuations*

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

When you have equity prices flat and/or down for a period of time and the underlying fundamentals like Corporate Profits continuing to show strength, the byproduct is better valuations. The Forward P/E ratio is a valuation metric that takes the "Price" of the S&P 500 Index (as a whole) and divides it by the expected earnings over the next 12 months. If earnings grow at a faster rate than stock prices, then this metric will decline which tends to be a sign of a healthier stock market. You can see this trend highlighted in the blue square in the chart below. Please note that this is a general statement and there are dozens of other primary variables that go into a more comprehensive assessment.




| Valuation measure | Description | Latest | 25-year avg.* | Std. dev. Over-/under-Valued |
|---|---|---|---|---|
| P/E | Forward P/E | 20.31x | 16.78x | 1.06 |
| CAPE | Shiller's P/E | 36.96 | 27.83 | 1.44 |
| Div. Yield | Dividend yield | 1.47% | 2.01% | 1.64 |
| P/B | Price to book | 4.09 | 3.07 | 1.29 |
| P/CF | Price to cash flow | 15.28 | 11.05 | 2.01 |
| EY Spread | EY minus Baa yield | 1.56% | 0.13% | - 0.72 |

Source: FactSet, FRB, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Price-to-earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since September 1996, and J.P. Morgan Asset Management for September 30, 2021. Current next 12-months consensus earnings estimates are $214. Average P/E and standard deviations are calculated using 25 years of IBES history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-months consensus dividend divided by most recent price. Price-to-book ratio is the price divided by book value per share. Price-to-cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 25 years for each measure. *P/CF is a 20-year average due to cash flow availability.
*Guide to the Markets – U.S.* Data are as of September 30, 2021.

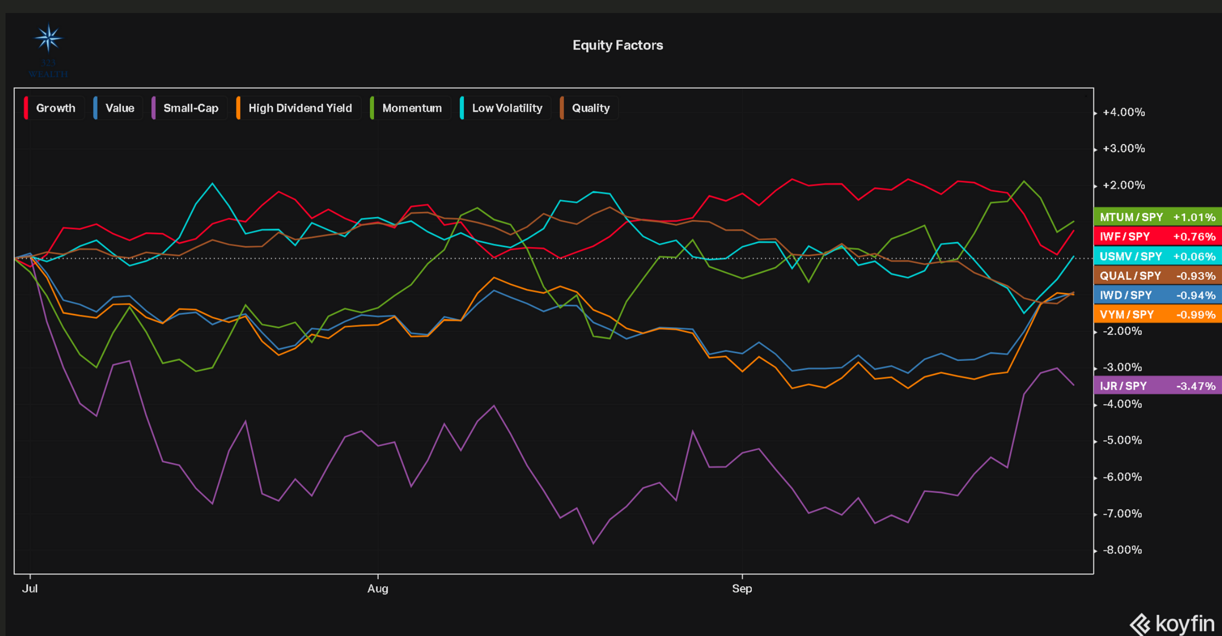
Source: JP Morgan

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

# MARKET SUMMARY (CONT.)

*Equity Factors*

For Equity Factors, Growth (IWF) and Momentum (MTUM) led the way while Low Volatility (USMV) and companies with quality financials (QUAL) lagged. This is counterintuitive for a flat to down quarter, as you would expect more defensive companies to fare better.  But, as we all know, the market can be irrational from time to time.  As the famous economist, John Maynard Keynes said, "Markets can remain irrational longer than you can remain solvent".  As long-term investors, we should remained focused on our long-term goals and how we are tracking towards those goals.



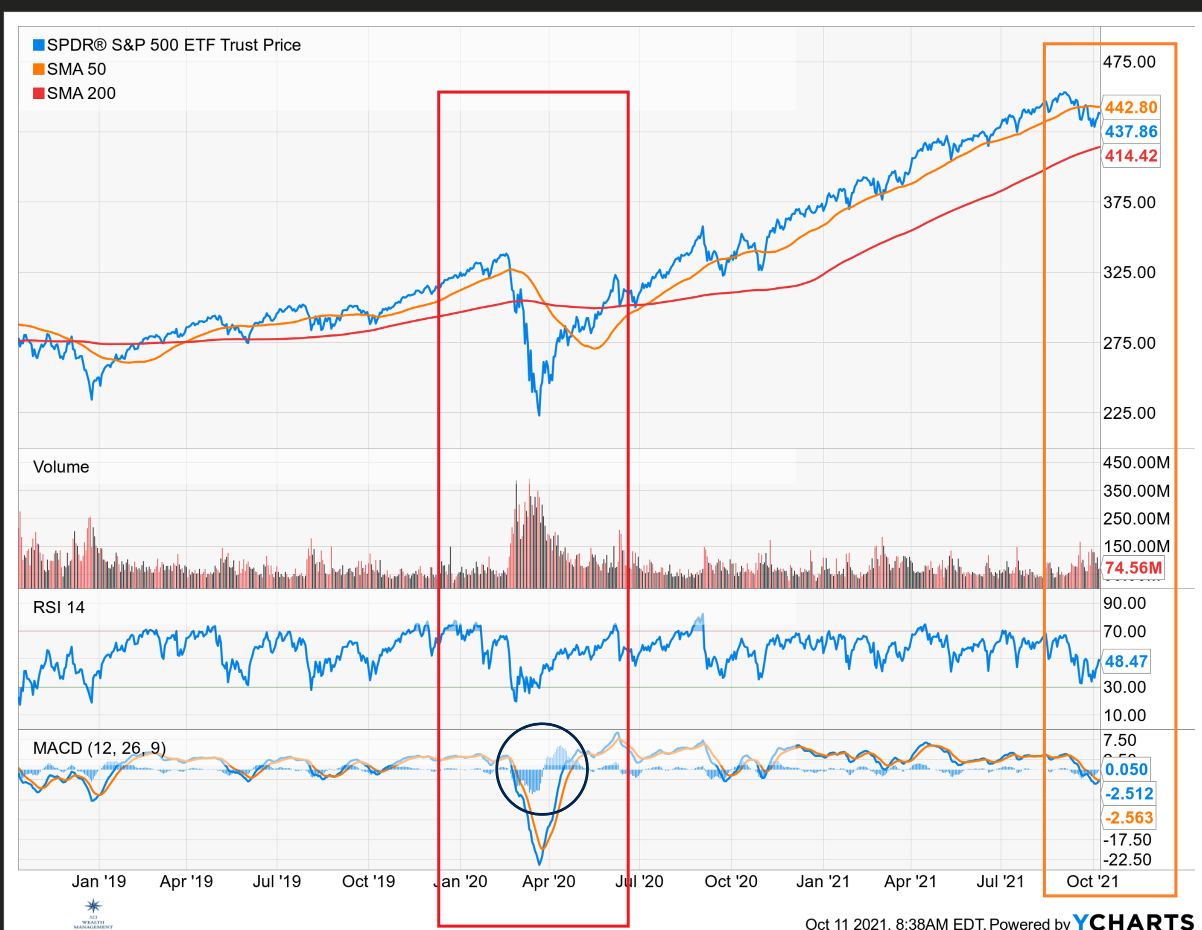

Source: www.koyfin.com

# MARKET SUMMARY (CONT.)

## *Technical Excerpt*

Most people are not interested in technical analysis so feel free to skip this section if that is the case. There is a seemingly endless list of technical indicators, but a few of the most widely used are below, Simple Moving Average (SMA), Relative Strength Index (RSI), and Moving Average Convergence Divergence (MACD). As single metrics, these indicators are not very reliable, but when you combine them, they can give you a sense of the market's short-term health and possible direction. Let's contrast April 2020 (red rectangle) with September 2021 (orange rectangle). April 2020 saw the 50 day SMA (orange line) drop below the 200 day SMA (red line), short-term traders refer to this as a "death cross" and they use it as a signal to sell. For the RSI, a reading above 70 is an "overbought" signal and a reading below 30 is an "oversold" signal. For the MACD, you should look at it in totality and the trends within the metrics. As you can see in the blue shaded areas (in the blue circle), there was a shift in the negative momentum in April 2020 to the positive side. Sometimes, these can be false signals, but when you combine this information with the fact that the Federal Reserve and the Federal Government had announced extraordinary monetary and fiscal stimulus measures, it seemed the market was responding in a positive fashion. When you contrast all of this with September 2021 (orange rectangle), you see the 50 day SMA is above the 200 day SMA which is a positive indicator; the RSI is 48.47 which is within the 30-70 range and thus a neutral indicator; and the MACD is only slightly negative compared to history. So, what does all this mean? While short-term traders use these indicators to buy and sell into and out of the market, as long-term investors, we use these indicators to determine when to rebalance, either buying more stocks when they appear weaker or taking gains when they appear stronger.

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

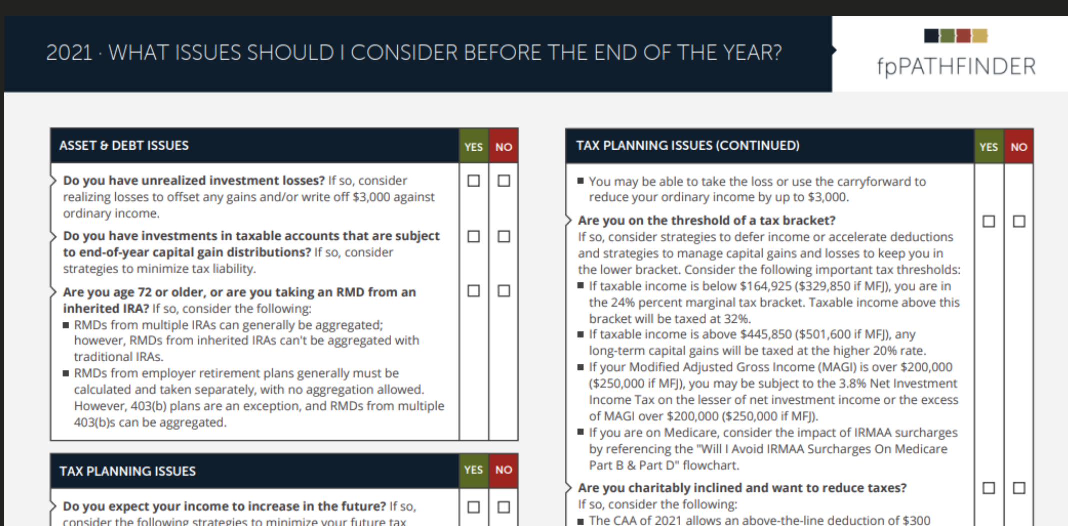



Source: www.ycharts.com


## FINANCIAL PLANNING UPDATE

*As we get closer to year-end, do you have your financial to-do list ready? If you would like a PDF copy of this comprehensive list that covers 5 core areas of financial planning, please email me at gregwilson@323wm.com and I will be happy to provide it.*

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



2021 · WHAT ISSUES SHOULD I CONSIDER BEFORE THE END OF THE YEAR?

fpPATHFINDER

| ASSET & DEBT ISSUES | YES | NO |
|---|---|---|
| **Do you have unrealized investment losses?** If so, consider realizing losses to offset any gains and/or write off $3,000 against ordinary income. | ☐ | ☐ |
| **Do you have investments in taxable accounts that are subject to end-of-year capital gain distributions?** If so, consider strategies to minimize tax liability. | ☐ | ☐ |
| **Are you age 72 or older, or are you taking an RMD from an inherited IRA?** If so, consider the following:<br>■ RMDs from multiple IRAs can generally be aggregated; however, RMDs from inherited IRAs can't be aggregated with traditional IRAs.<br>■ RMDs from employer retirement plans generally must be calculated and taken separately, with no aggregation allowed. However, 403(b) plans are an exception, and RMDs from multiple 403(b)s can be aggregated. | ☐ | ☐ |

| TAX PLANNING ISSUES | YES | NO |
|---|---|---|
| **Do you expect your income to increase in the future?** If so, consider the following strategies to minimize your future tax | ☐ | ☐ |

| TAX PLANNING ISSUES (CONTINUED) | YES | NO |
|---|---|---|
| ■ You may be able to take the loss or use the carryforward to reduce your ordinary income by up to $3,000. | | |
| **Are you on the threshold of a tax bracket?**<br>If so, consider strategies to defer income or accelerate deductions and strategies to manage capital gains and losses to keep you in the lower bracket. Consider the following important tax thresholds:<br>■ If taxable income is below $164,925 ($329,850 if MFJ), you are in the 24% percent marginal tax bracket. Taxable income above this bracket will be taxed at 32%.<br>■ If taxable income is above $445,850 ($501,600 if MFJ), any long-term capital gains will be taxed at the higher 20% rate.<br>■ If your Modified Adjusted Gross Income (MAGI) is over $200,000 ($250,000 if MFJ), you may be subject to the 3.8% Net Investment Income Tax on the lesser of net investment income or the excess of MAGI over $200,000 ($250,000 if MFJ).<br>■ If you are on Medicare, consider the impact of IRMAA surcharges by referencing the "Will I Avoid IRMAA Surcharges On Medicare Part B & Part D" flowchart. | ☐ | ☐ |
| **Are you charitably inclined and want to reduce taxes?**<br>If so, consider the following:<br>■ The CAA of 2021 allows an above-the-line deduction of $300 | ☐ | ☐ |

https://www.fppathfinder.com/

## CONCLUSION

*What's next?*

Looking forward, I think investors will need to pay more attention to what types of investments they own. Monetary policy is likely to be less accomodative/stimulative. The amount of fiscal accommodation looks to be uncertain. There are plenty of companies that have shown a propensity to do well in a variety of economic currents whether those currents are inflationary, riddled with supply chain issues and labor market distortions, or a combination.

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