Market Review and Outlook
September 30, 2021

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Market Environment

September 30, 2021

- Economic
  - Vaccine distribution and administration in the US has led to a near full reopening of the economy with schools reopening and increased social activity into the fall season; however, the Delta wave paused some activity in Q3. Delta seems to have peaked amid high vaccination rates.
  - Excessive stimulative policy has pulled forward consumption, with Q2 GDP growth at 6.7%, including 12% rise in consumption and 6.1% rise in prices.
  - The supply/demand imbalance is contributing to high inflation and near-term reduction in economic activity as demand can't be met.
  - A byproduct of excessive stimulative policy, the Housing market strength has moderated amid low supply and high prices. Home prices rose 5% in Q2, and home prices are up 20% YOY through July. Housing affordability has dropped considerably while rental costs accelerated by 20% over the past year.
  - The dislocations in the housing market are evident in many other industries such as auto's, grocery stores, restaurants, hotels and other goods and services where having the goods to sell and/or having the workers to deliver the services has become problematic.
  - Input costs including commodities and raw materials, manufacturing and operating, freight and transportation and employment costs have risen significantly, and companies are passing those costs along to increased final prices and fewer discounts**. Price pressures are persistent, not transitory.**
  - Manufacturing and operations in many industries is scaled back or shutting down due to lack of input materials and/or labor.
  - Inflation remains on the rise with home prices, food, services, and consumer goods. Oil has risen into the high $70's, and CPI hit 5.4% YOY.
  - Payrolls should increase as bonus unemployment benefits expired, higher vaccination rates, schools reopened, and the number of jobs available outnumber the unemployed.
  - We feel the current Delta wave will be shorter lived than other waves due to increased immunity and treatment, but that adverse consequences of monetary and fiscal policy, economic disruptions, and inflation may be longer lasting.
- Policy
  - The Fed indicated at their September meeting that tapering the purchases of $40B MBS and $80B Treasuries per month is imminent, likely announced at the November meeting and concluding by mid year 2022. Several FOMC members are bringing forward expected timing of a rate hike to 2H 2022.
  - A total of $5.5T in government programs has been passed, with a contentious $1.2T infrastructure bill and $3.5T another package currently being debated.
- Markets
  - After trending in a narrow range at low levels, interest rates have begun to rise reflecting expectations of removing excess monetary stimulus. The 10-year Treasury note ended little changed for the quarter at around 1.5% after dropping as low as 1.2% in Q3 amid the peak of the Delta wave.
  - Intermediate yields have risen to about 1% from a low of .65% as higher inflation has pulled expectations of Fed policy tightening forward into 2022.
  - Treasury Inflation Protected Securities (TIPS) continued to perform very well during the quarter but may still be under valued.
  - Equity markets ended flat after reaching record highs during the quarter with S&P 500 reaching 4,545 until pulling back in September by about 5%
  - The notion of higher inflation and higher interest rates has begun to work into the equity markets, with Growth stocks again reacting negatively to rates.
  - Market leadership had shifted early in the quarter with Banks, Industrials, and Energy lagging while technology and other highflyers had regained leadership. But that changed back again in September as talk of shifting fed policy amid higher, more sticky inflation picks up.
  - Our inflation expectations have come to fruition. Looking forward, the market may begin to discuss, and perhaps factor in the risk of lower earnings growth amid cost pressures, lower margins, and lower overall economic activity as consumers balk at higher prices.

Market Outlook

September 30, 2021

- We are in the midst of perhaps one of the greatest policy mistakes, simultaneously on fiscal and monetary policy, in history.
- We indicated that we thought inflation will be a key focus of markets in the near term as it continues to rise above expectations and may force the Fed to pull plans forward to remove excess stimulus more quickly, pushing rates higher and upsetting equity markets.
- The Fed has recently begun to come to grips with the notion that inflation is higher than expected and perhaps not as transitory as thought. They have indicated they will begin to "taper" in November and expectations of a rate hike have been pulled forward.
- The Delta wave surely slowed some economic activity in Q3, but that is peaking, kids are in school, and sports stadiums are filled.
- The reopening economy is meeting markets expectations, with 6-8% rate of economic growth, evidenced by continued job openings, however those openings are not being filled rapidly and businesses are scaling back due to "unavailable workers" and supplies.
- With government extended unemployment benefits and bonuses expired, children back in school, a high level of vaccination and new covid 19 treatment progress, employment and growth should begin to accelerate, subject to inflationary pressures pushing back.
- Debate regarding vaccine requirements and return to the office are currently at hand, which may slow job growth, but if jobs don't get filled and business continues to operate at limited capacity, the ripple effects may slow overall economic growth and profitability.
- Evidence is showing businesses are having to raise wages to attract workers, while also cutting back on service hours and production as the cost and unavailability of labor prevents business growth.
- Rising costs of labor, raw materials, transportation, and other input costs are being passed through, with CPI printing 5.4% for August.
- The inability to source materials or to produce finished goods, together with higher input costs being passed through to final prices, may both decrease sales and margins, curbing corporate cash flow and profit growth.
- As previously discussed, manufacturing will likely exhibit continued growth amid onshoring of supply chains and growth in logistics, new technology, including alternative energy, electric vehicles, efficient operations and transportation of goods and services.
- The process of onshoring manufacturing and modifying supply chains is a long term process.
- If job growth expands with people going back to work and supply chains begin to flow, economic growth could accelerate; however, if the current record number of open jobs don't get filled and inflation remains high, a recession is possible.
- Continued monetary and fiscal stimulus has flooded markets with liquidity, supporting high asset prices. With monetary policy removing excess stimulus and expiration of fiscal programs, fundamentals will have to support markets going forward.

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Investment Strategy

September 30, 2021

- September marked an inflection point in markets and the economy, prompting some rebalancing in investment strategy.
- The excessive monetary and fiscal stimulus, along with vaccinations, reopening, and warmer weather had provided a foundation for relatively robust near-term economic growth, (reflected in Q2 earnings) that supported markets.
- After setting new record highs in Q3, growth stocks fell back in September as rates rose in response to changes in Fed policy.
- Investment strategy remains fully invested but has been reducing risk by rebalancing back to a neutral strategic asset allocation overall, and within equity and fixed income sectors and reinvesting conservatively.
- Investment strategy has been reducing overall equity allocation by harvesting gains/trimming core positions in strong performers at record highs and rebalancing to high quality dividend paying value stocks and fixed income. Within fixed income risk has also been reduced by harvesting gains in High Yield credit and MBS (selling HYT and BKT at premiums), reducing credit risk and increasing quality into short term Treasuries and Treasury Inflation protected securities (TIPS).
- The lack of resolution to supply chain issues together with persistent and broad-based inflation may slow economic activity through lower production, sales and profits. Lower profit growth, actual or expected, could weigh on markets.
- Themes of onshoring of supply chains and new technology will continue to push growth allocations, while income producing value companies in banking, industrial, energy, and utility sectors will occupy core equity and corporate bond allocations.
- Fixed income allocations will continue to defend against interest rate sensitive longer-term bonds as interest rates rise, while looking to generate income in shorter term securities across the range of sectors.
- We felt that despite high current valuations, asset prices may move higher perhaps pushing the S&P 500 to 5,000 (likely driven by broader participation – reached 4545) and 10-year treasury yields to 2.25% over the next few quarters.
- As we move into Q4, higher interest rates, a growing debt burden, and the expiration of current economic stimulus provides risk of decelerating economic activity. Rates could reach 2%, and S&P 500 could rise another 5%, with a real risk of a 20% correction.
- As we move through the year, the next discussion on the fiscal front will include increased tax burdens, which will detract from economic growth and corporate and individual profitability.
- As we see progress unclogging the supply chains, jobs getting filled in critical sectors, and pricing pressures ease, we will feel more comfortable increasing risk exposures; however, significant progress is needed. Q4 earnings and pre-announcements will be telling.

Market Review

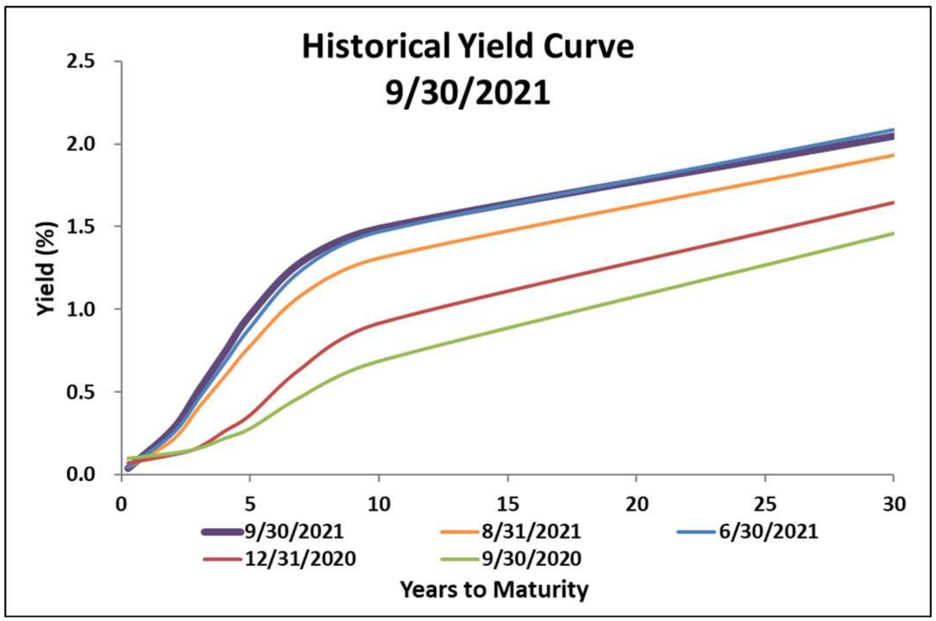
S&P 500 – September 30, 2021

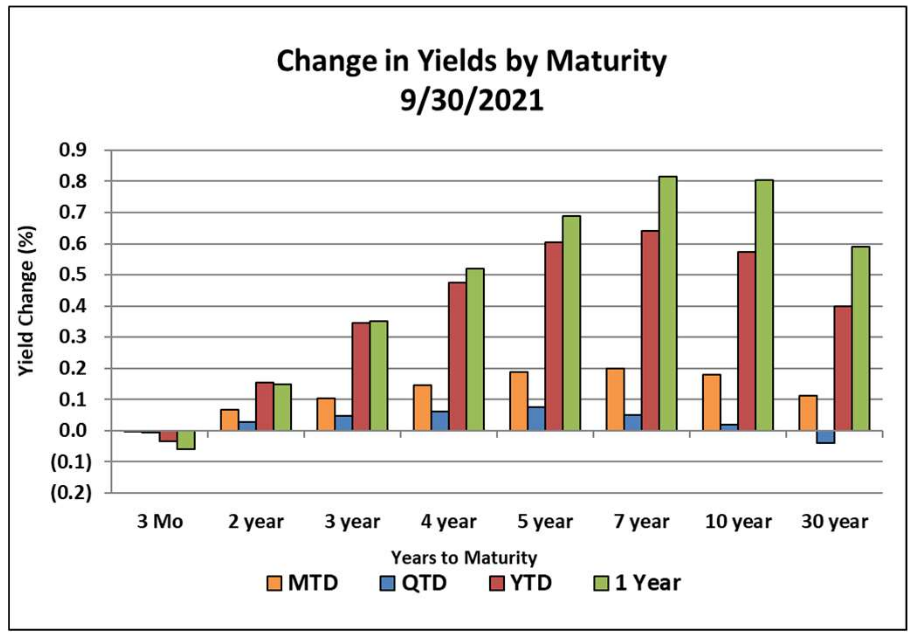
- Equity markets have slide off their recent highs as rising input costs and inflationary pressures, higher rates due to expectations of a tighter fed, and a divided congress weigh on valuations.
- This earnings season will be crucial to support future equity valuations amid potential margin squeeze and reduced top line revenue growth.
- Interest rates are poised to rise amid inflation, continued debt issuance, and tapering.

Market Review

Yield Curve – September 30, 2021

- Interest rates rose in September as the Fed indicated a shift in policy to "taper", acknowledging inflation was running higher than expected.
- After dropping earlier in the quarter due to potential slowing economy from the Delta wave, rates ended slightly higher than where they were mid year.
- Intermediate term rates rose in Q3 as markets pulled forward the timing of the first Fed rate hike.





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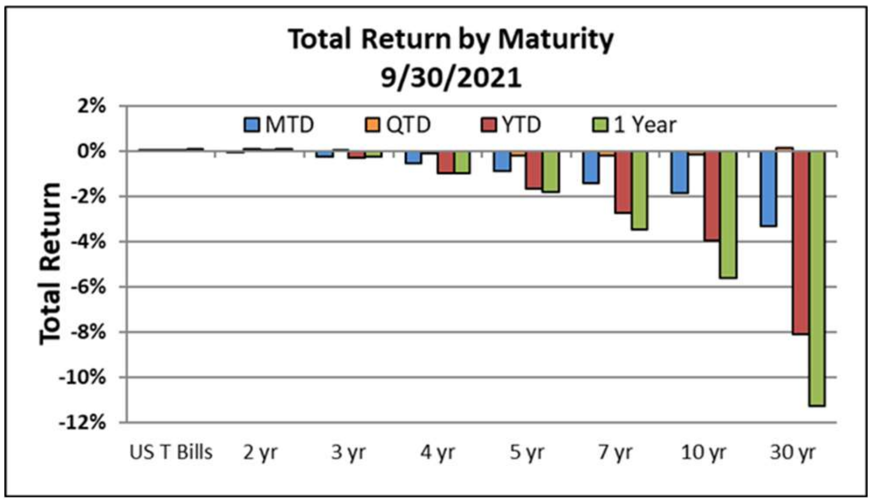
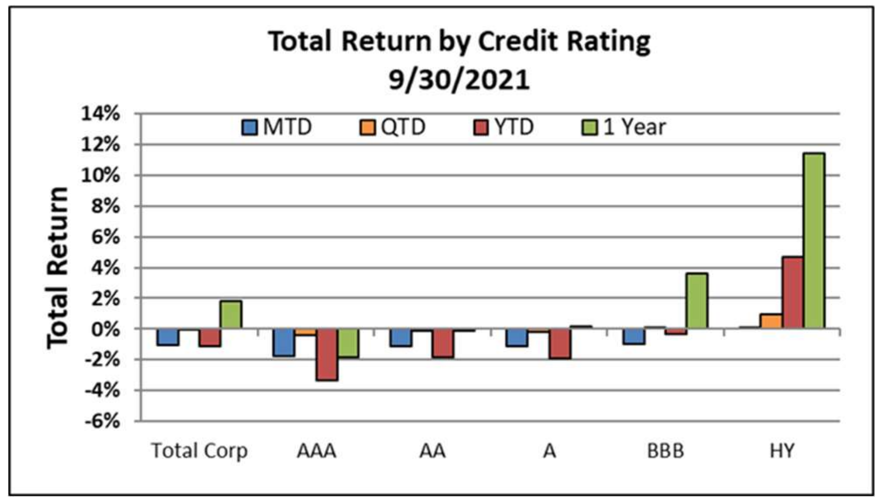
Market Review

Yield Curve and Credit Rating Returns – September 30, 2021

- Total returns on longer term Treasuries were flat for the quarter, however, are negative MTD, YTD, and YOY given the overall move up in rates.
- Shorter term Treasuries were less negative given their lower interest rate sensitivity (duration) while longer term returns were much worse, given their higher sensitivities to rising rates.
- Investment grade corporate bonds generated negative returns in Q3 largely due to longer durations with rising rates. Spreads also widened in Q3 which further pushed negative returns. High Yield generated positive returns as their higher income was enough to more than offset negative price movement.
- Longer term securities are still vulnerable if rates continue to rise amid massive issuance and rising inflation, including longer term corporate bonds given relatively narrow yield spreads.

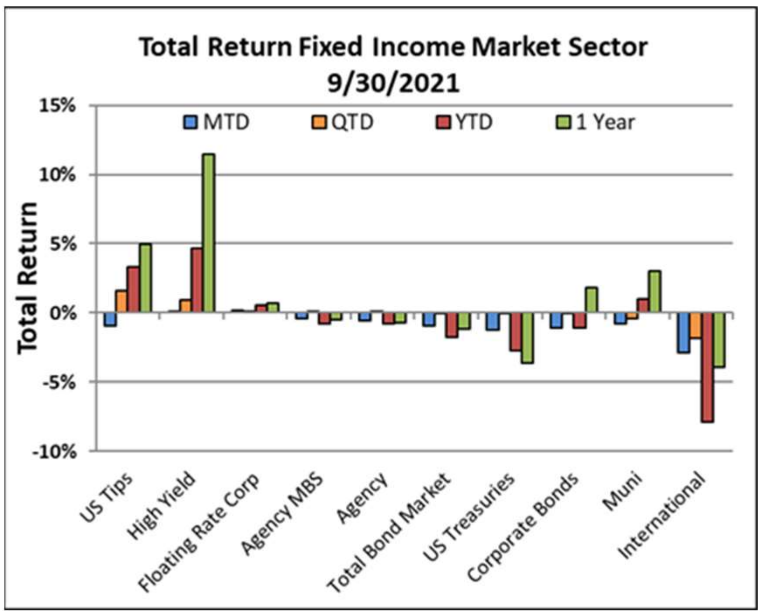


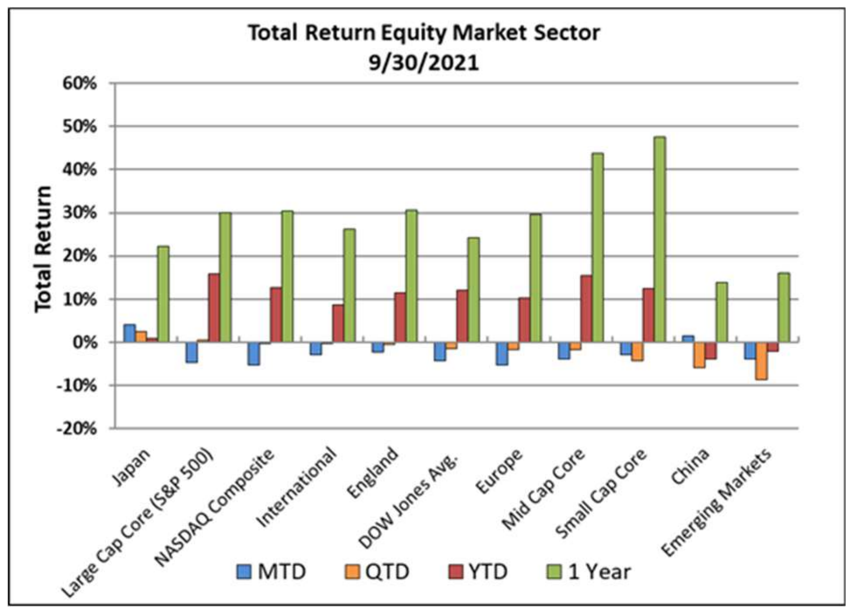


Market Review

September 30, 2021

- TIPS (Treasury Inflation Protected Securities) led fixed income returns in Q3, 2021 as inflation reached 5.3% on a Year over Year basis and continues to accelerate.
- Lower rated and High Yield corporate bonds also led bond market returns amid a reach for Yield and a historically low default rate. International bonds have struggled this year with negative yields as a starting point, and rates rising (prices falling) from there.
- Equity markets were flat to negative in Q3 after the September fall. US Domestic investments continue to lead global stock market returns.
- Japan showed some stability in Q3 while China and emerging markets continued to struggle amid events like China's Evergrande and regulatory restrictions.

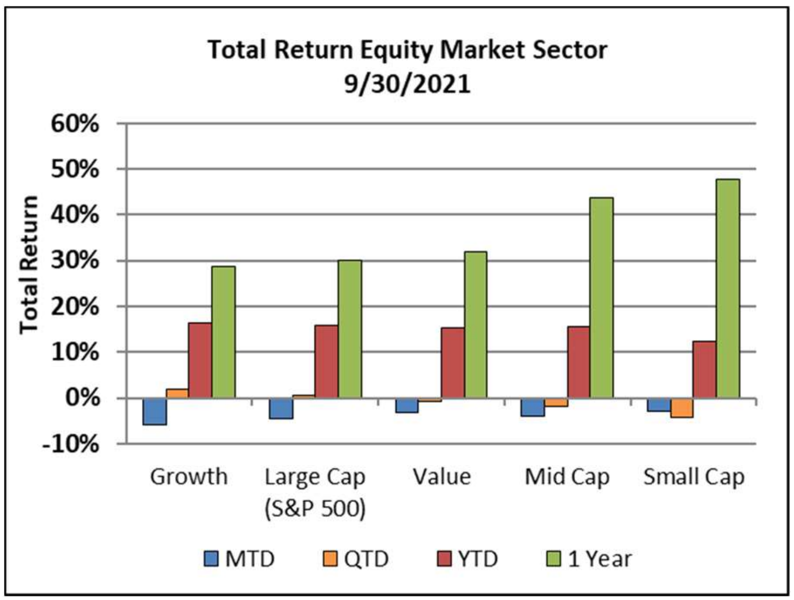


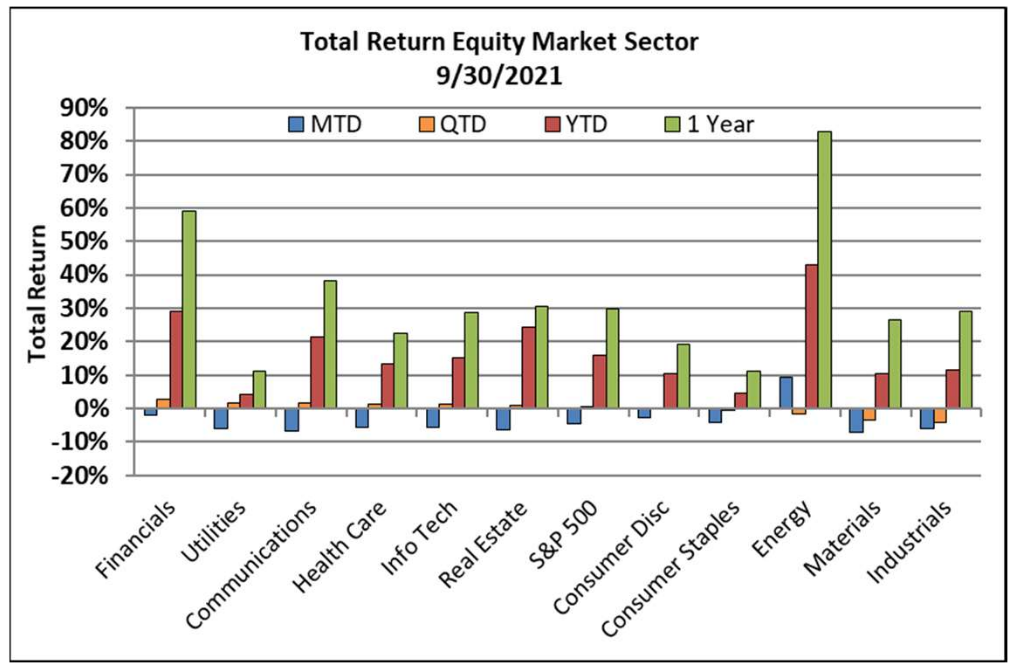


Market Review

Equity Market Returns – September 30, 2021

- Growth stocks performed well during the quarter, however, gave back most of their gains in September during the market selloff. Small Cap gave back some gains amid potential margin compression.
- Financials were among the top performers as rising rates pave the way for higher interest margins, utilities also performed well after struggling much of the year in a move to safety in the selloff.
- Materials and Industrials are plagued by supply chain bottlenecks with expectations of whiplash (better known as the "bullwhip effect") are expected to keep volatility high as producers try to match demand forecasts with increasingly higher input costs.





Market Scoreboard

September 30st, 2021

Market Summary - September 30th, 2021					
Bond Market	**MTD**	**QTD**	**YTD**	**1 Year**	**Yield**
Total Bond Market	-1.0%	0.0%	-1.7%	-1.2%	1.5%
US Treasuries	-1.2%	0.0%	-2.7%	-3.6%	1.0%
US TIPS (Inflation Prot.)	-0.9%	1.6%	3.3%	4.9%	1.7%
Corporate Bonds	-1.1%	-0.1%	-1.1%	1.8%	2.1%
Floating Rate Corp	0.1%	0.1%	0.5%	0.7%	0.4%
US MBS Index	-0.4%	0.0%	-0.8%	-0.5%	1.7%
Merrill Muni Index	-0.8%	-0.4%	1.0%	3.0%	1.4%
High Yield Corporates	0.0%	0.9%	4.7%	11.5%	4.2%
International Bonds	-2.8%	-1.8%	-7.9%	-3.9%	0.2%
Commodities/Other	**MTD**	**QTD**	**YTD**	**1 Year**	**End Value**
Oil (WTI)	9.9%	5.8%	56.8%	74.4%	75
Gold	-3.1%	-0.7%	-7.4%	-6.8%	1,757
Dollar Index	1.7%	1.9%	4.8%	0.4%	94

Market Summary - September 30th, 2021					
Stock Market Indices	**MTD**	**QTD**	**YTD**	**1 Year**	**End Value**
NASDAQ Composite	-5.3%	-0.2%	12.7%	30.3%	14,449
DOW Jones Avg.	-4.2%	-1.5%	12.1%	24.2%	33,844
Large Cap Core (S&P 500)	-4.7%	0.6%	15.9%	30.0%	4,308
Large Cap Growth	-5.8%	1.9%	16.4%	28.8%	2,984
Large Cap Value	-3.3%	-0.9%	15.3%	32.0%	1,438
Mid Cap Core	-4.0%	-1.8%	15.5%	43.7%	2,641
Mid Cap Growth	-4.3%	-2.0%	10.1%	33.3%	1,285
Mid Cap Value	-3.7%	-1.6%	21.0%	55.7%	827
Small Cap Core	-2.9%	-4.4%	12.4%	47.6%	2,204
Small Cap Growth	-3.8%	-5.7%	2.8%	33.3%	10,718
Small Cap Value	-2.0%	-3.0%	22.9%	63.9%	15,892
Europe	-5.3%	-1.7%	10.3%	29.6%	454
England	-2.3%	-0.6%	11.5%	30.7%	7,086
Japan	4.0%	2.6%	0.8%	22.1%	29,453
China	1.5%	-5.8%	-3.8%	13.8%	4,866
International	-2.9%	-0.4%	8.7%	26.2%	2,281
Emerging Markets	-3.9%	-8.6%	-2.1%	16.0%	50

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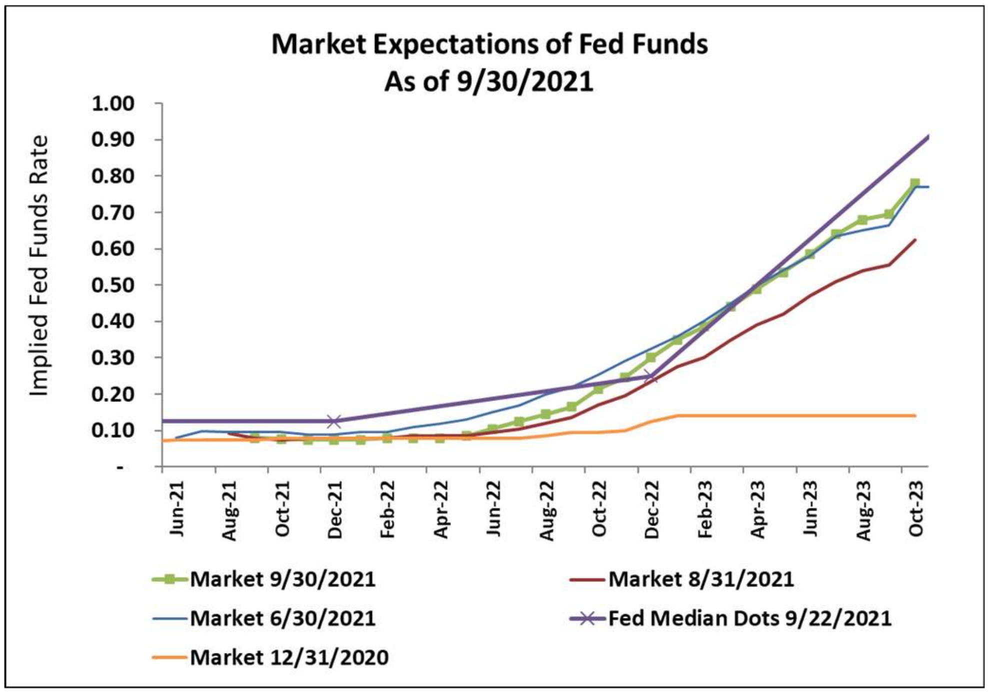
Market Review

Monetary Policy – September 2021

- The Fed held rates at their "lower bound" near zero, and continued purchases of Treasuries and Mortgages as the US Government issues record amount of debt to support Covid relief, and other programs. The Fed is buying $80 billion UST and $40 Billion MBS per month. They have recently revised their economic projections including higher inflation.
- The Fed has indicated it will announce it will begin tapering (reduce its purchases of Treasuries and MBS) at its November meeting. Further, Governors have pulled forward timing of the first-rate hike closer to markets expectations.
- Monetary policy will explicitly seek to let inflation run above targeted levels to achieve an average 2% over time, however actual inflation continued to accelerate well ahead of their expectations.



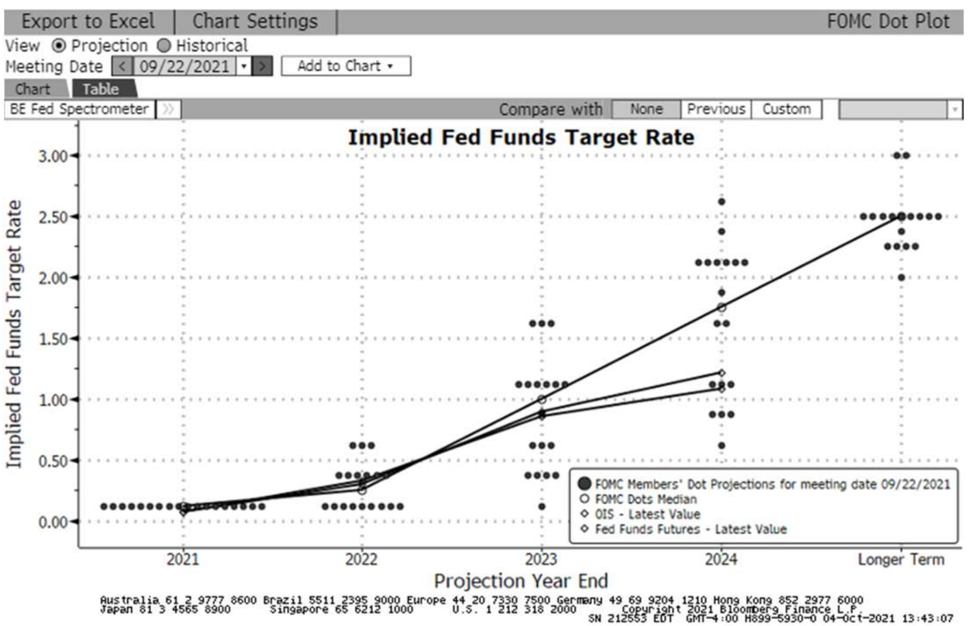
Federal Reserve Median Economic Projections
As of 9/22/2021

Change in GDP	Actual	2021	2022	2023	2024	Longer Run
Sept. 2021 Projection		5.9	3.8	2.5	2.0	1.8
June 2021 Projection		7.0	3.3	2.4		1.8
Actual Q2 2021 yoy/qoq	**12.2%/6.7%**					
Unemployment Rate						
Sept. 2021 Projection		4.8	3.8	3.5	3.5	4.0
June 2021 Projection		4.5	3.8	3.5		4.0
Actual August 2021	**5.2%**					
PCE Inflation						
Sept. 2021 Projection		4.2	2.2	2.2	2.1	2.0
June 2021 Projection		3.4	2.1	2.2		2.0
Actual August 2021	**4.3%**					
Core PCE Inflation						
Sept. 2021 Projection		3.7	2.3	2.2	2.1	
June 2021 Projection		3.0	2.1	2.1		
Actual August 2021	**3.6%**					
Projected Policy Path- Fed Funds						
Sept. 2021 Projection	0.1	0.0	0.3	1.0	1.8	2.5
June 2021 Projection	0.1	0.1	0.1	0.6		2.5

Market Review

Monetary Policy – September 2021

- Some Fed Governors pulled forward their expectations of the timing of the first tightening amid stronger than expected economic growth and rising inflation above expectations.
- Inflation expectations have risen but long-term inflation implied by TIPS remain well below actual inflation and our expectations.
- The strong economy, particularly the housing market, is leaving the Fed with little reason to continue to purchase US Treasuries and MBS.



Current Fed Funds Rate
0.06

10 Year Tip	10 Year UST	Implied Inflation Premium
(0.99)	1.31	**2.30**

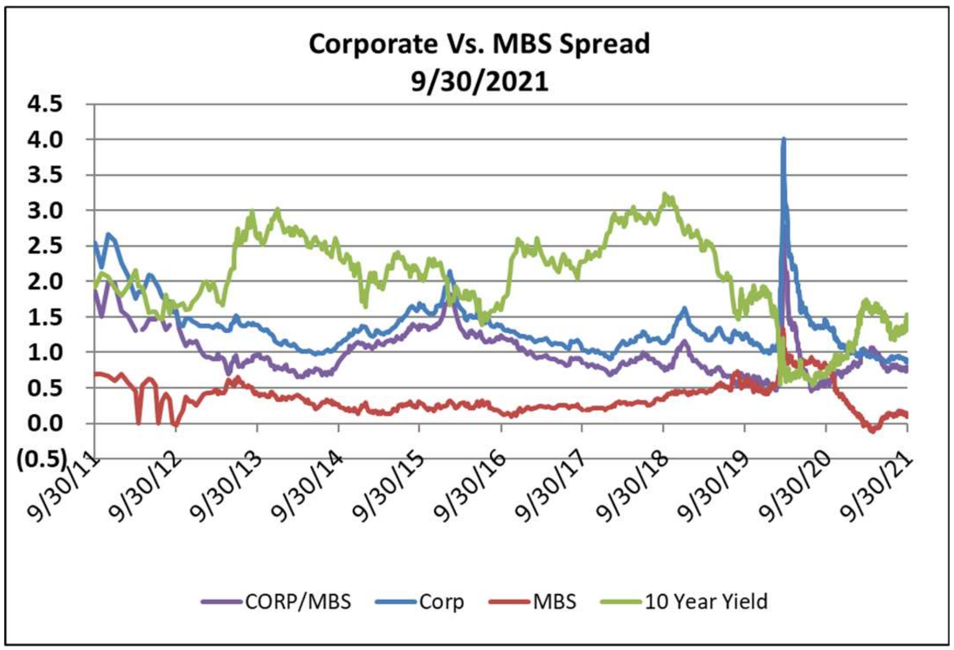
5 Year Tip	5 Year UST	Implied Inflation Premium
(1.76)	0.82	**2.58**

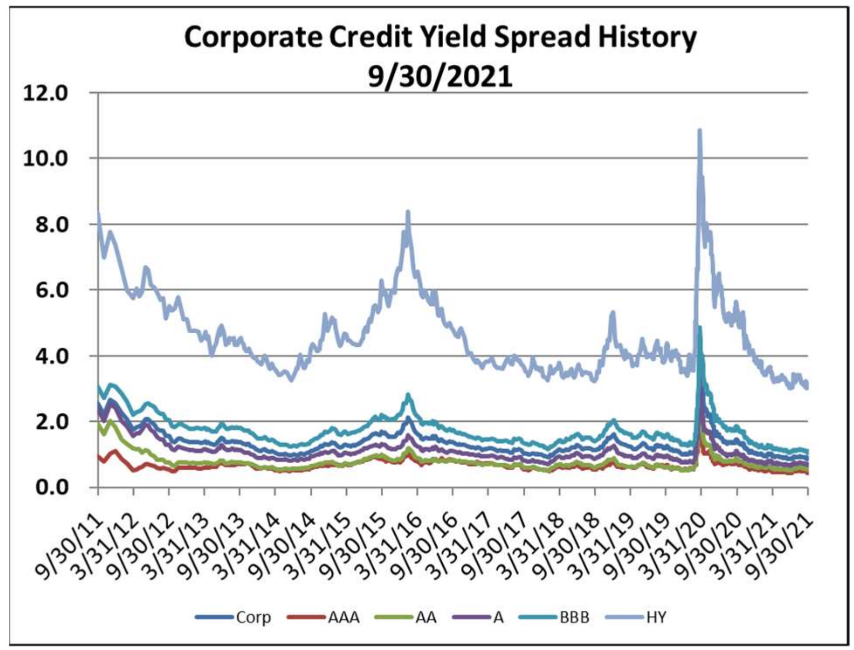
2 Year Tip	2 Year UST	Implied Inflation Premium
(2.53)	0.20	**2.72**

Market Review

Yield Spreads – September 2021

- Corporate yield spreads widened slightly in Q3 from historically tight levels, correlating with the equity market as increased risks surrounding corporate profitability crept into valuations.
- Corporate credit conditions have been strong; however, supply chain issues, increased costs, margin pressures, reduced operating ability, and or lower cashflow may increase risk.
- Some stressed sectors such as energy, airlines, and hotels risk premiums remain wide.

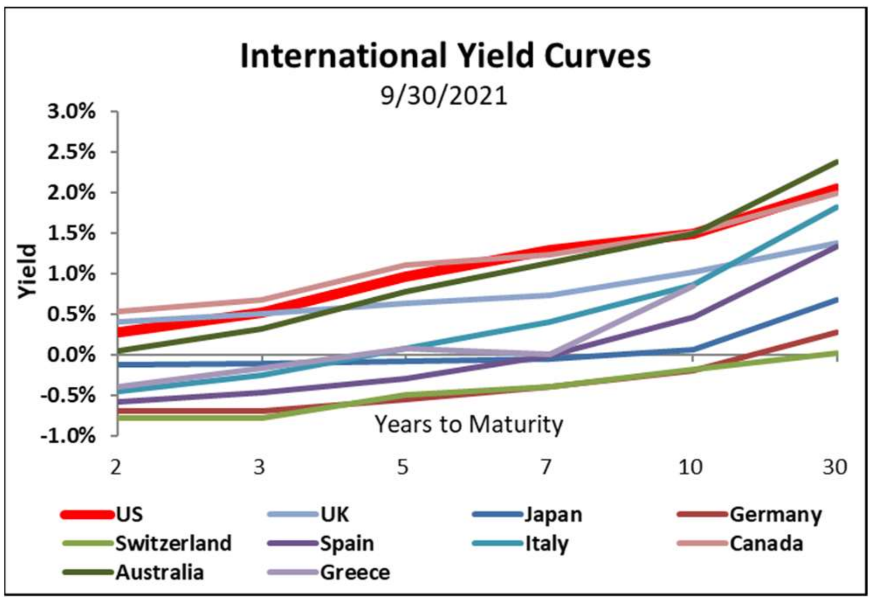


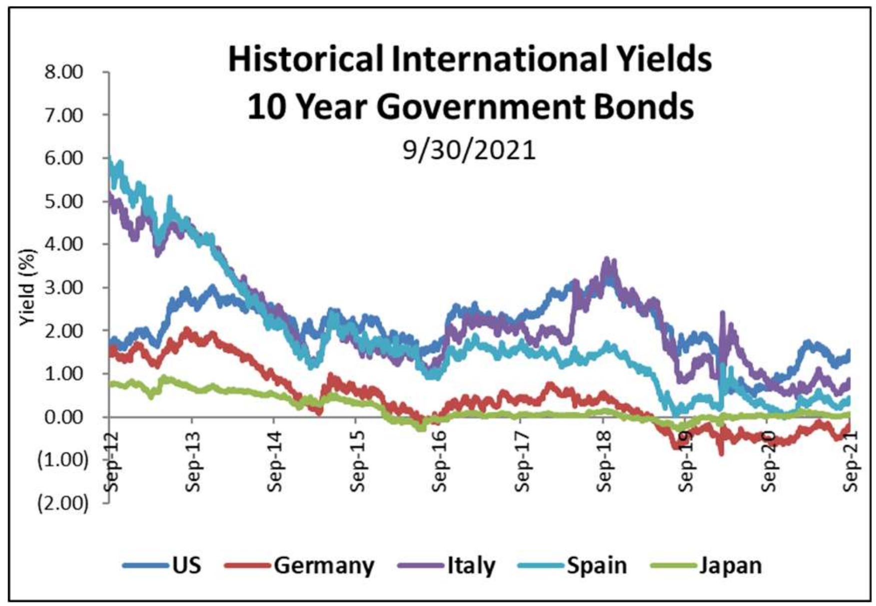


Market Review

International Yield Curves– September 2021

- Global central banks have continued easy monetary policy keeping rates low and significant bond purchases to support fiscal policy that provides relief for COVID-19 amid a global resurgence.
- The US continues as one of the highest yielding developed countries as rates remained negative in Europe and flatlined at 0% in Japan.
- These interest rate differentials also contribute to a strengthening dollar.

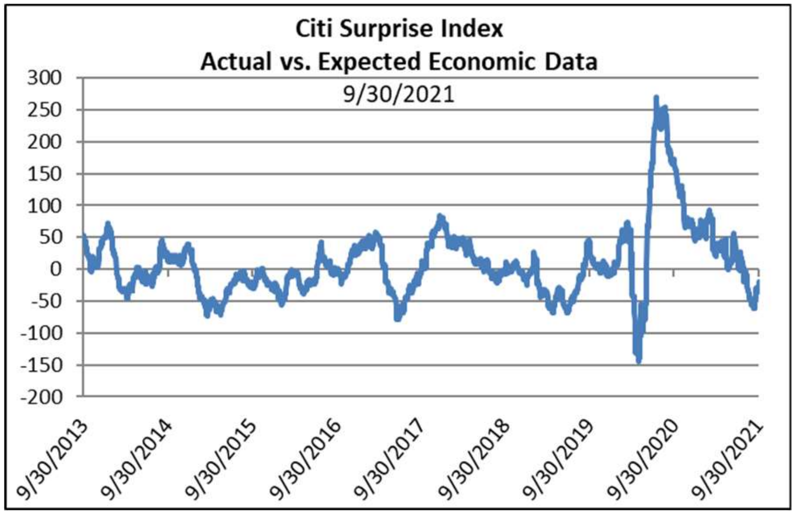




Economic Environment

September 2021

- Global GDP shows extreme YOY growth as we move out of COVID-19 trough valuations, moving forward it could be expected these value to normalize.
- Inflation has moved higher with expectations of future inflation continuing to rise due to significant stimulus and the increased cost of doing business.
- The Citi surprise index has come down from its highs as economic results moderated amid the resurgence of the Delta wave, that is now fading.



GDP YoY % Change	Q2 2021	One Year Ago	Change
US	12.20	(9.10)	21.30
Eurozone	14.30	(14.50)	28.80
Germany	9.40	(11.30)	20.70
France	18.70	(18.60)	37.30
Italy	17.28	(18.16)	35.44
UK	23.60	(21.40)	45.00
Canada	4.70	(5.60)	10.30
Mexico	19.56	(18.72)	38.28
Australia	9.60	(6.20)	15.80
Japan	7.60	(10.10)	17.70
China	7.90	3.20	4.70
Russia	10.50	(7.80)	18.30
Brazil	12.42	(10.90)	23.32

Canada GDP as of 7/31/2021

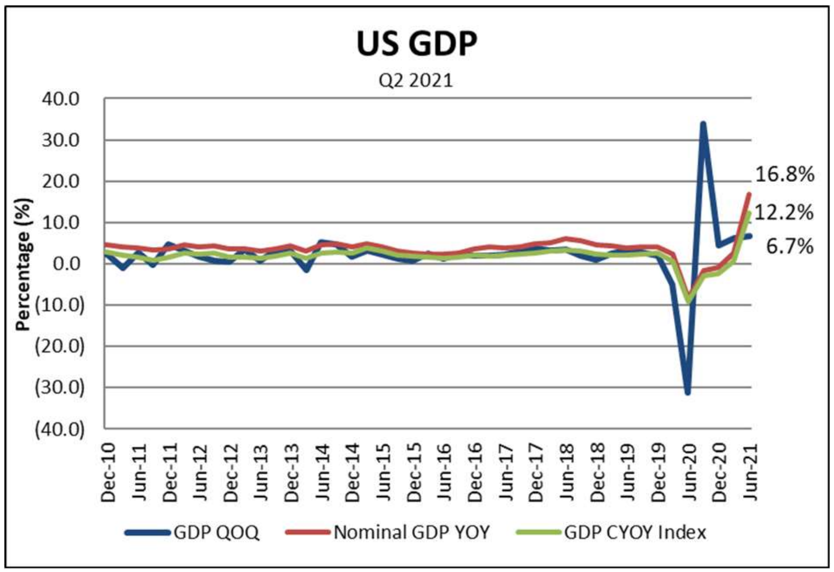
Inflation YoY % Change	Aug-21	One Year Ago	Change
US	5.30	1.30	4.00
Eurozone	3.40	(0.30)	3.70
Germany	4.10	(0.20)	4.30
France	2.10	0.00	2.10
Italy	2.60	(0.60)	3.20
UK	3.20	0.20	3.00
Canada	4.10	0.10	4.00
Mexico	5.59	4.05	1.54
Australia	9.60	(6.20)	15.80
Japan	(0.40)	0.20	(0.60)
China	0.80	2.40	(1.60)
Russia	6.70	3.60	3.10
Brazil	9.68	2.44	7.24

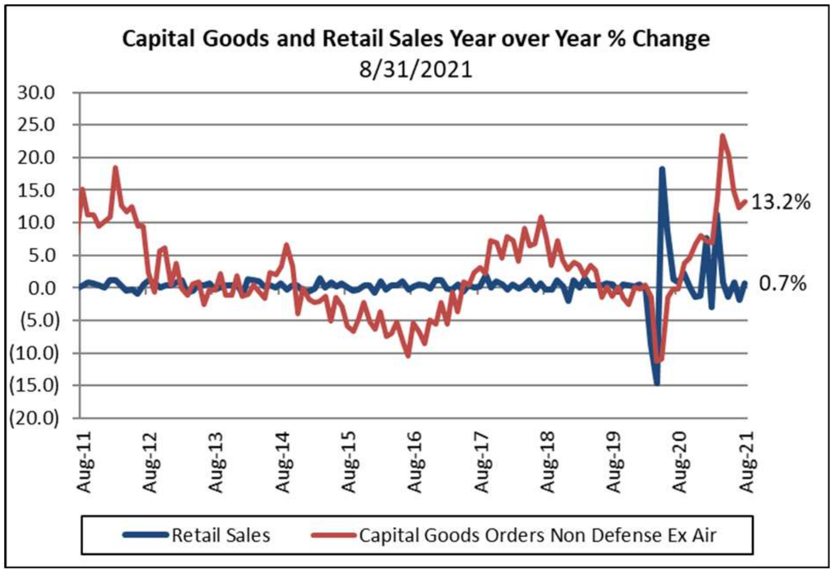
Eurozone, Germany, France, & Italy as of 9/30/2021
Australia CPI as of 6/30/2021

Economic Environment

September 2021

- US Economic activity is accelerating amid excessive monetary and fiscal stimulus, vaccination roll out, reopening of the economy, and warmer weather. We are evaluating potential growth for Q3 as the economy fully opens amid the fading Delta variant and people shake off pandemic habits.
- Consumption has been robust amid significant stimulus, including cars and homes, and associated goods and services, to the degree they have been available.
- Investment has been industry dependent, with significant growth in remote communications technology. Manufacturing has slowed significantly in Q3 as parts are unavailable, forcing factories to shut down production and unfinished goods pile up.

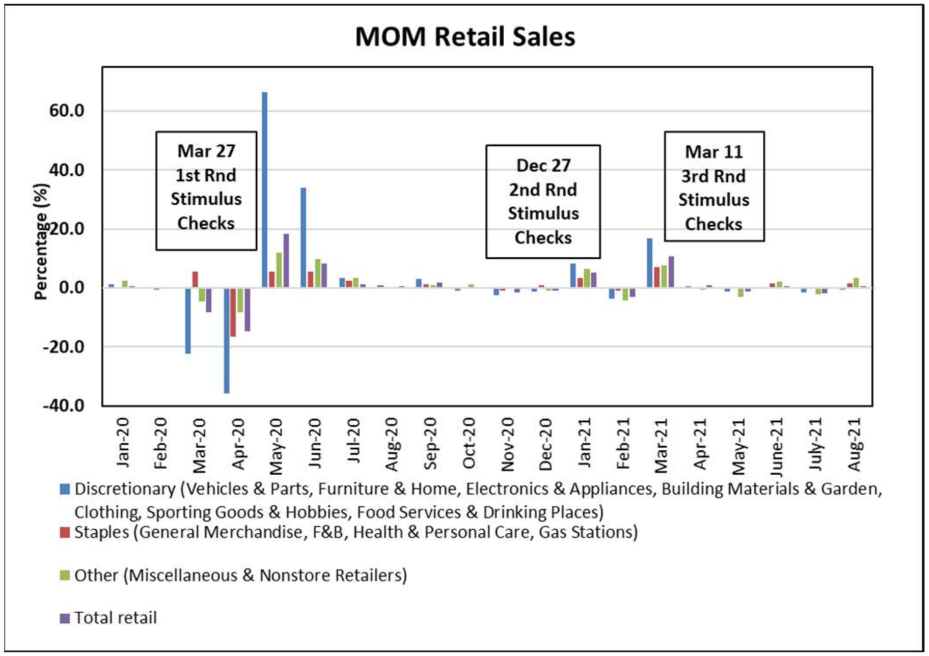


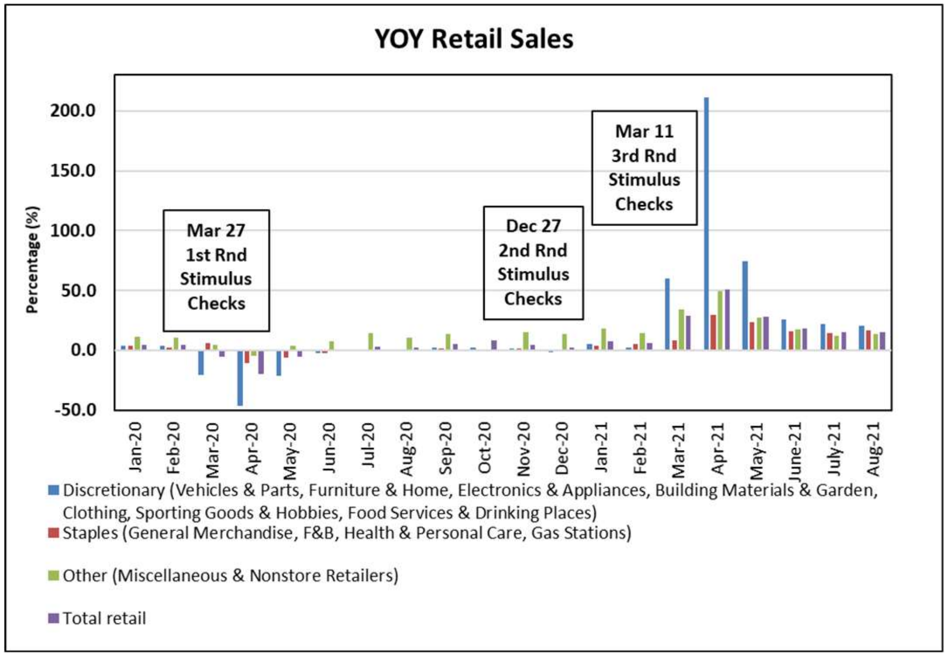


Economic Environment

Retail Sales – September 2021

- Spending on discretionary items followed closely in-line with stimulus payments, proving much more volatile than any other grouped category.
- Month-over-month data shows a sluggish consumer as unemployment benefits roll off and consumers are forced to seek employment, lowering MOM spending.
- The significant YOY comparisons due to base level comparisons will soon roll off.

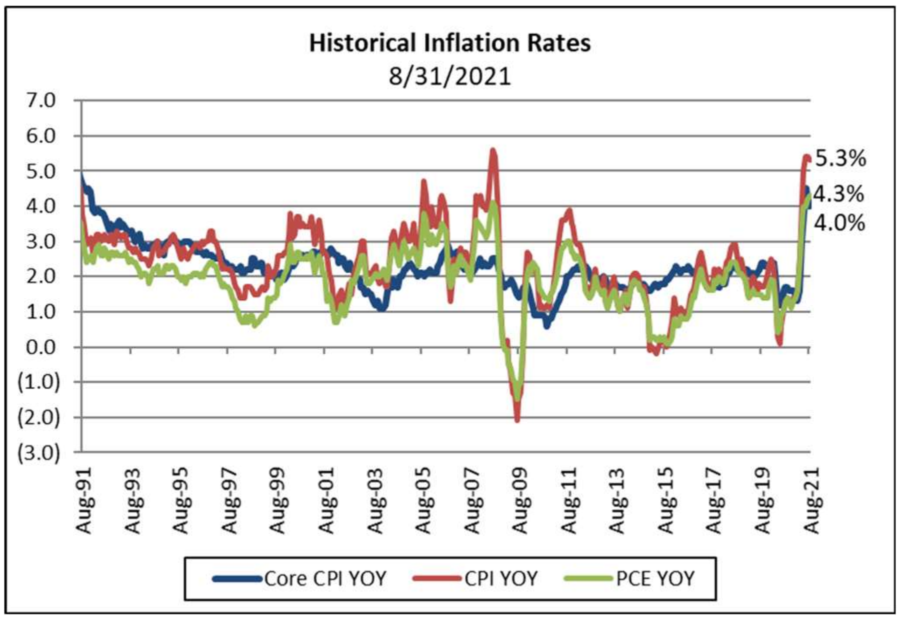


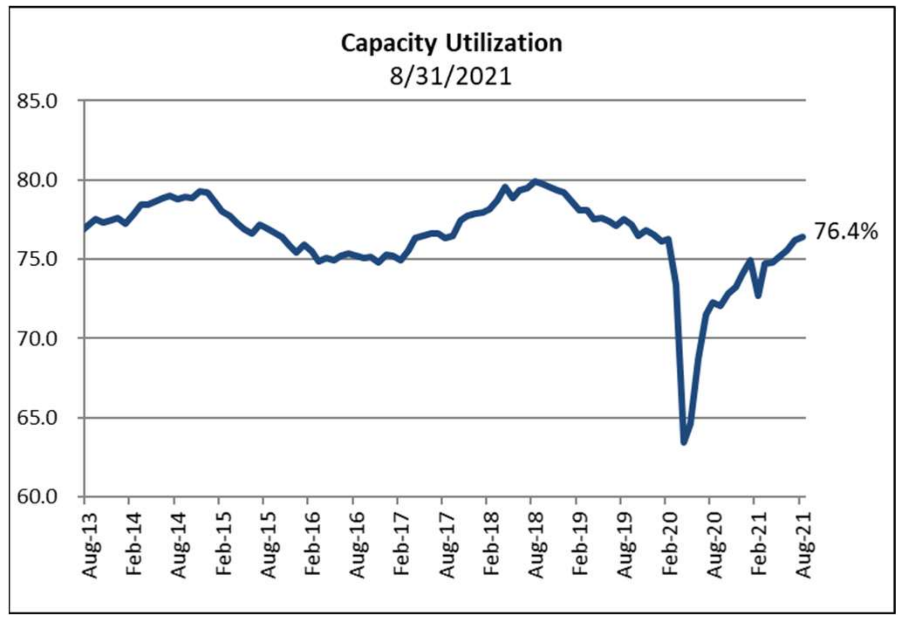


Economic Environment

Employment and Inflation – September 2021

- Inflation levels continue to rise amid resurgence of growth and supply disruptions.
- Expectations of inflation are increasing as the realization of the increased costs associated with working, living, and operating in a post-pandemic world with increased health and safety measures.
- Capacity utilization has retracted as factories face significant supply chain issues and are having trouble sourcing materials, such as the chip shortage limiting auto production.

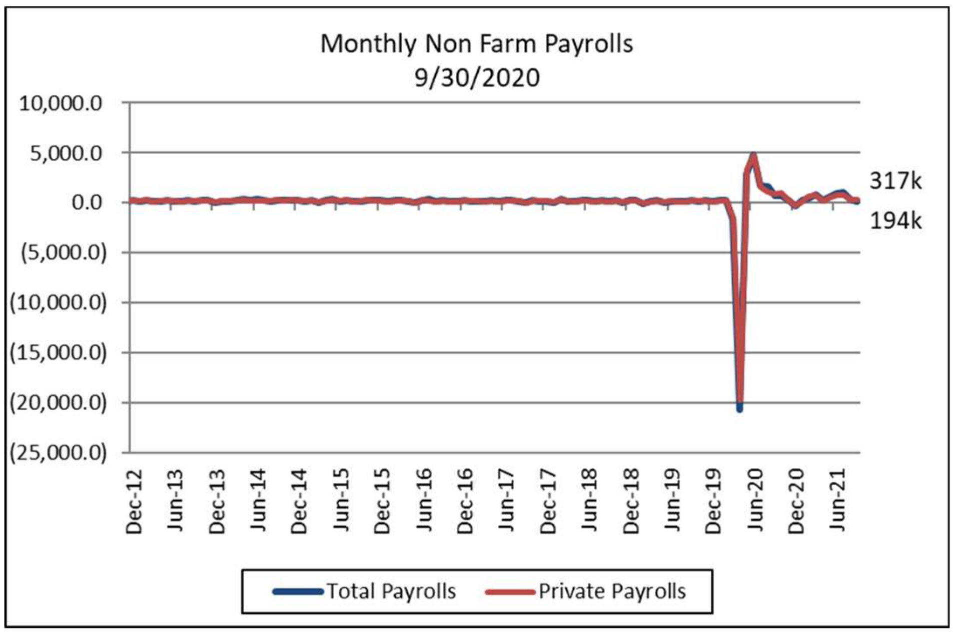


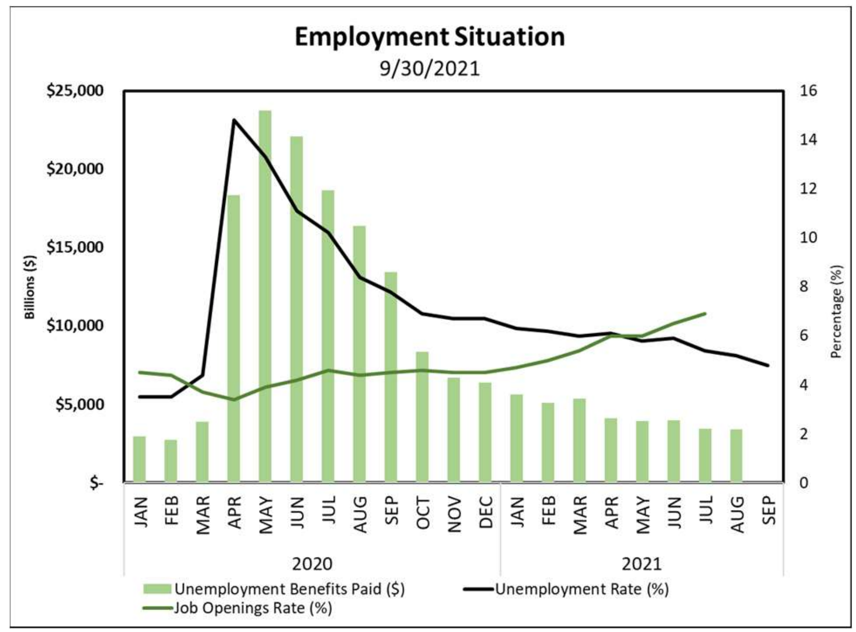


Economic Environment

Employment – Monthly Payrolls – September 2021

- Monthly Payrolls has not been as robust as expected but may begin to accelerate as services like hospitality fully open and unemployment benefits run out.
- The unemployment rate has fallen and is running just above 5%. The US has recovered about half the jobs lost during the pandemic.

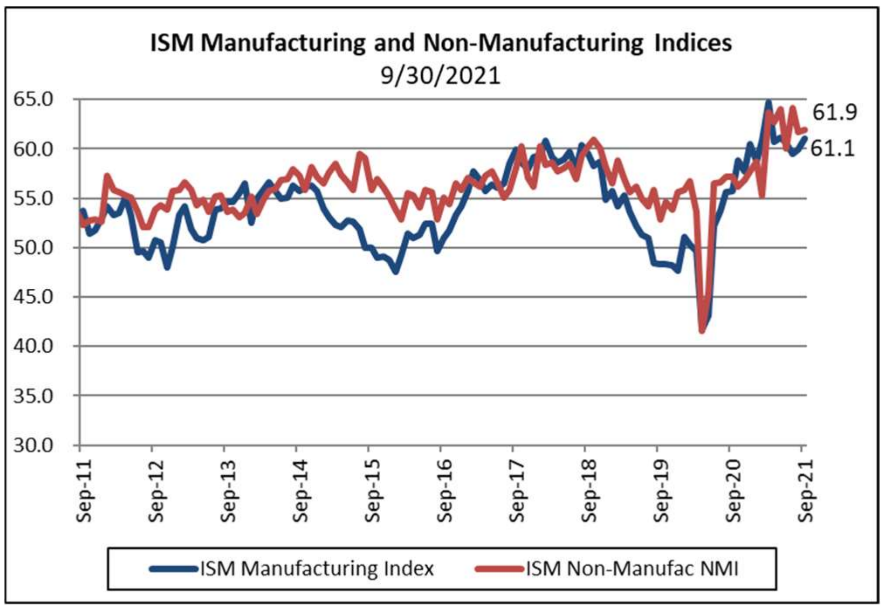


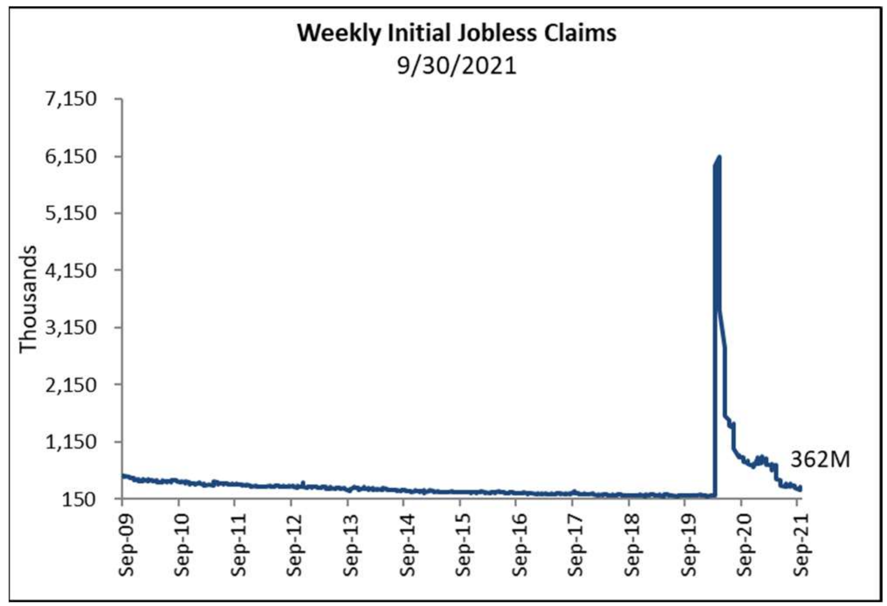


Economic Environment

Employment – Monthly Payrolls – September 2021

- The manufacturing sector, as measured by the manufacturing purchasing manager index continues to rebound as factories bring people back in and restart production, subject to available parts.
- The Non-Manufacturing index has also accelerated amid reopening of the service sector, however, is struggling to find workers.
- Initial claims for unemployment have come down, however remain stubbornly high, particularly since there are more jobs available than unemployed workers.

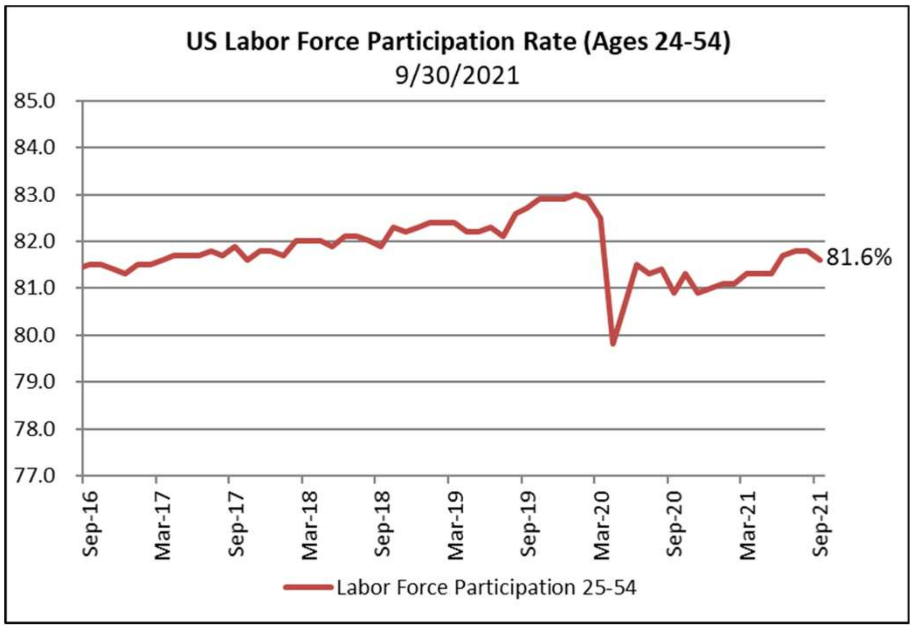


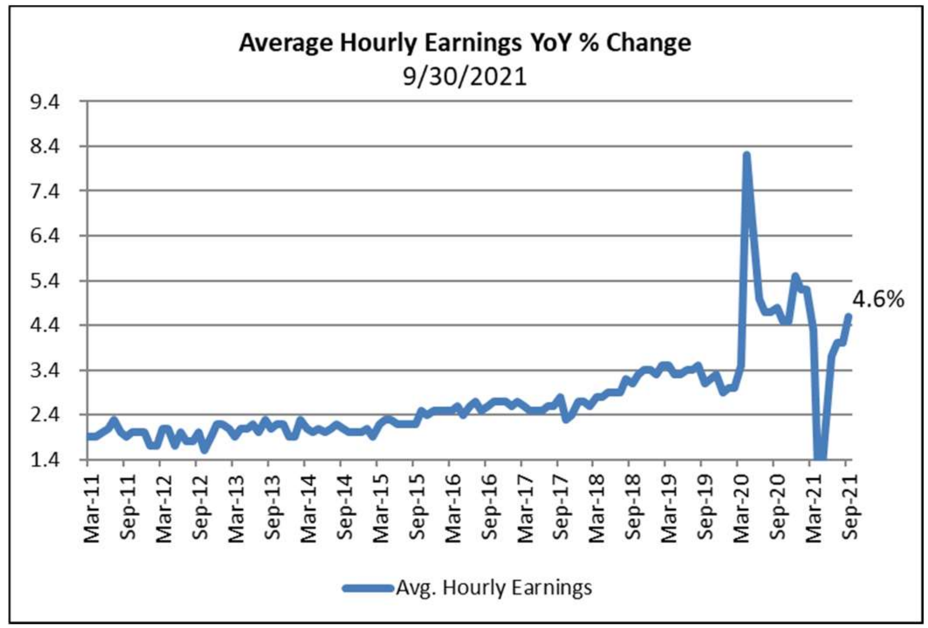


Economic Environment

Employment and Inflation – September 2021

- The prime working age participation rate has been increasing again but has further to go.
- There are several pandemic related frictions in the labor market including remote work and required vaccination mandates that are impacting worker choices.
- Average hourly earnings have risen amid the need to provide incentive to bring people into the workforce.

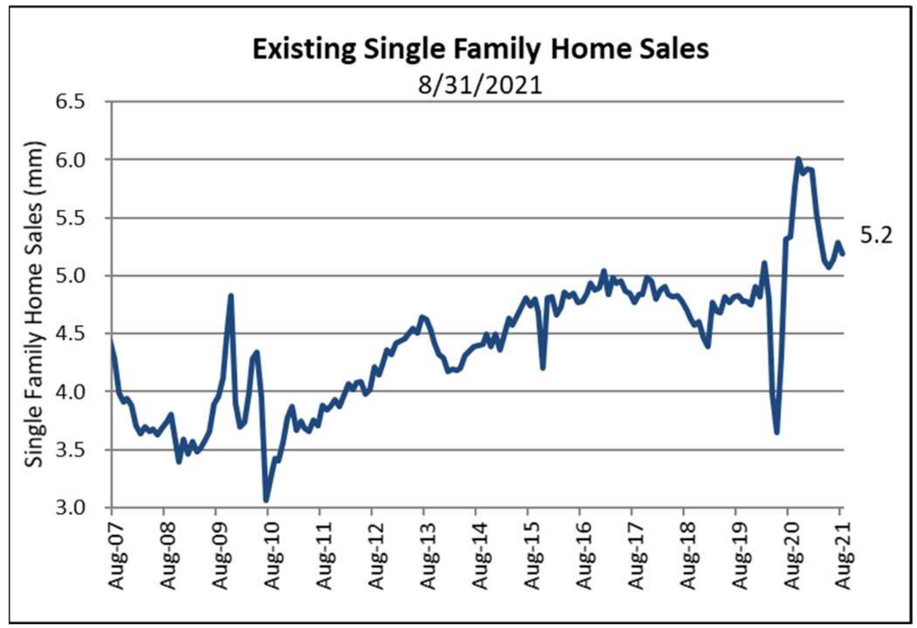




Economic Environment

Mortgage Rates and Housing – September 2021

- The drop-in interest rates over the past year has brought mortgage rates down with it, more than 1% from their highs of last year and 2% lower than 2018. Rates continue to be pushed down by Fed purchases; however, tapering may push rates higher.
- Lower mortgage rates have supported home sales to some degree, but the significant migration to suburbs from cities has been a driving factor, which has also pushed housing prices higher.
- The slowdown in home sales is due to lack of supply and higher prices.



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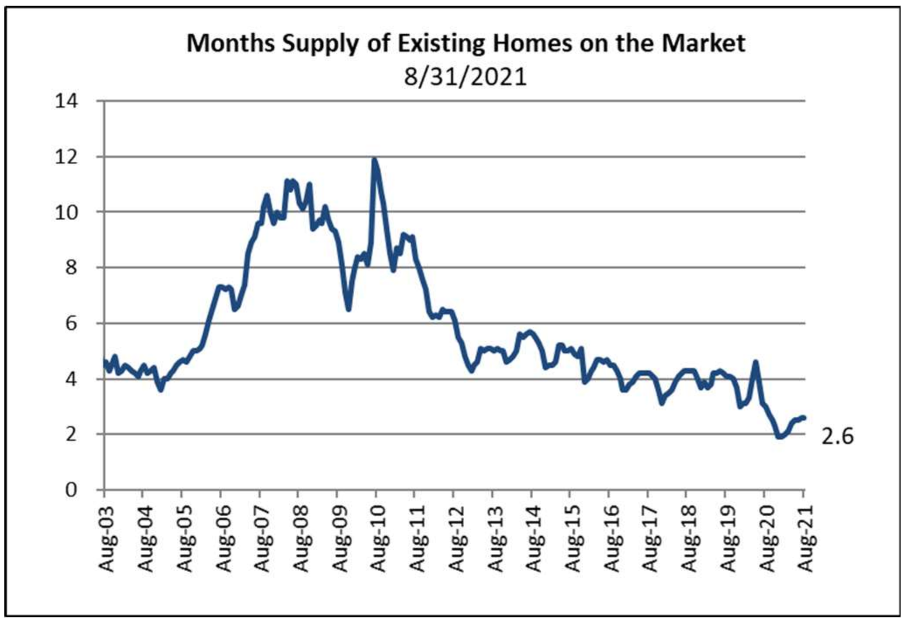
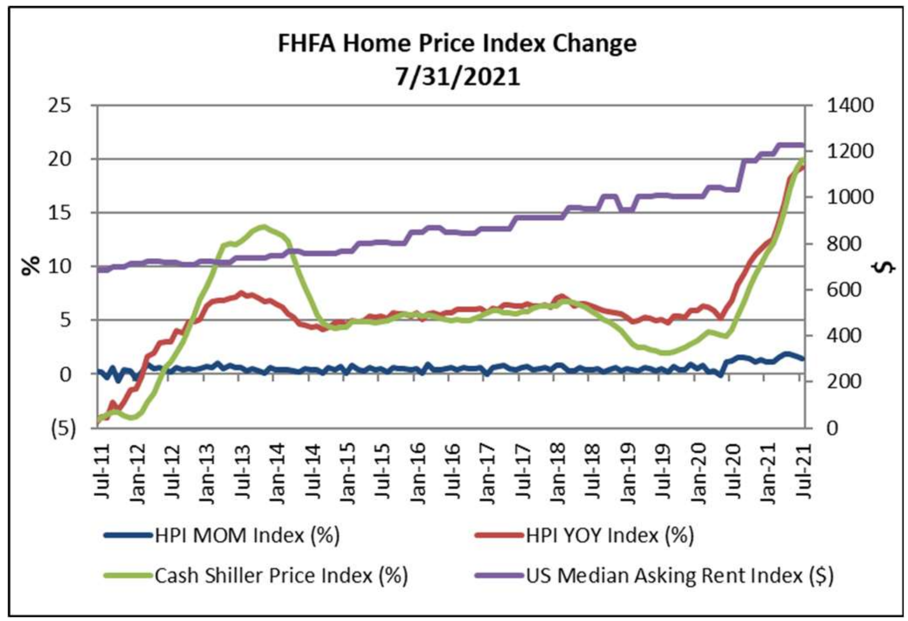
Economic Environment

Mortgage Rates and Housing – September 2021

- The high level of activity in the housing market with fewer new homes built has taken inventory of homes on the market to historically low levels.
- The high demand for housing has also pushed home prices up over 20% vs. year ago levels. The pace of home purchases and price gains has been broad based.
- There continues to be elevated mortgage prepayment activity from both housing turnover and refinancing.

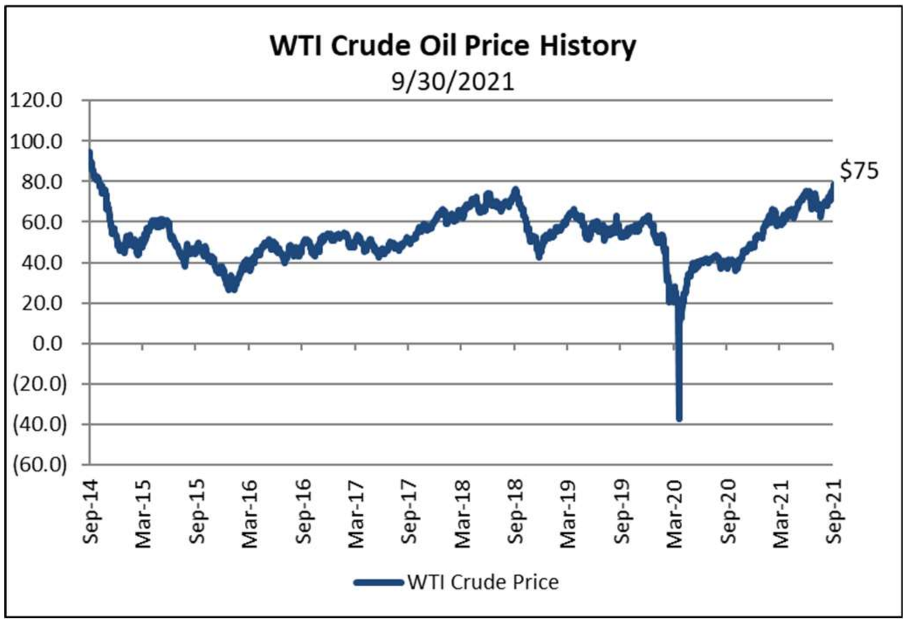


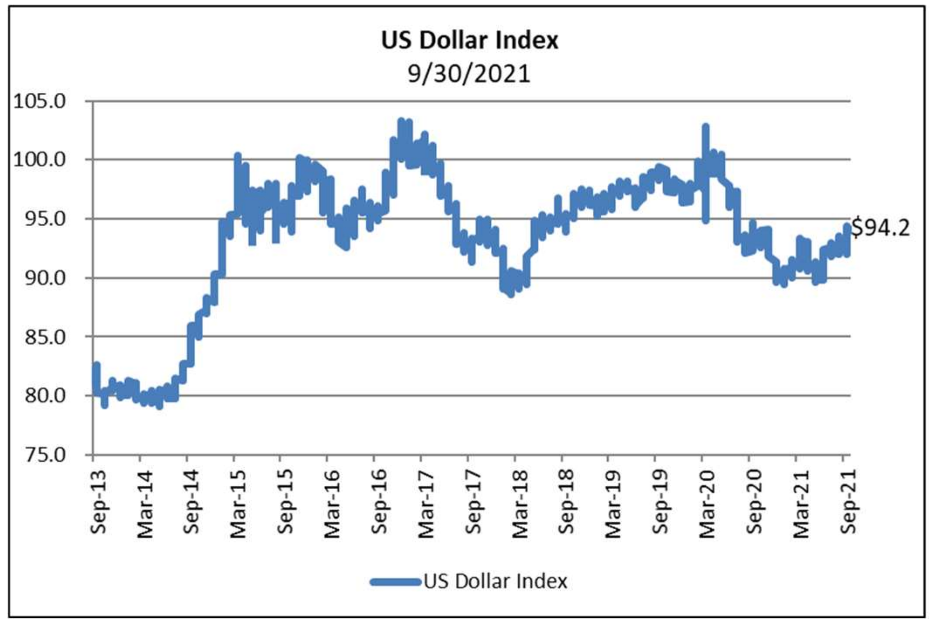


Economic Environment

September 2021

- As economies come back online, oil has rebounded and stabilized above $75.   Much of the supply glut from last year has been worked off amid production cuts and increased demand from factories coming back online and expected increased demand as economies reopen..
- The Dollar has strengthened off its lows last year and may continue to do so as the US economy is the global leader of economic recovery.





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