Quarter 4 - 2021 Market Update
The economic consequences of lockdowns

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We hope you are doing well as you read this Market Update Letter. This is our quarterly newsletter where we review the past quarter and share our current and forward-looking perspective.

Third quarter index performance

Before we go on to discuss the broader picture as we see it currently, please take a few moments to review second quarter-2021 returns. The market took a bit of a breather in the third quarter, after primarily rising since October 2020 as we progressed from the worst of the COVID-19 impacts. This is reflected in the twelve-month gains shown below.

Dow Jones Target Risk Indexes	QTD	YTD	Past 12 months
Dow Jones Aggressive Index	(1.16%)	12.75%	32.95%
Dow Jones Moderate Aggressive Index	(0.98%)	9.63%	25.50%
Dow Jones Moderate Index	(0.83%)	6.37%	18.19%
Dow Jones Moderately Conservative Index	(0.67%)	3.08%	11.00%
Dow Jones Conservative Index	(0.51%)	(0.45%)	3.55%
U.S. Equity Indexes			
S&P 500 (Total Return)	0.58%	15.92%	30.00%
RUSSELL 2000 (Total Return)	(4.36%)	12.41%	47.68%
International Equity Indexes			
MSCI EAFE DEVELOPED MARKETS	(0.45%)	8.35%	25.73%
MSCI EMERGING MARKETS	(8.09%)	(1.25%)	18.20%
Fixed Income Indexes			
BLOOMBERG BARCLAYS US AGGREGATE BOND	0.05%	(1.55%)	(0.90%)
BLOOMBERG BARCLAYS US CORPORATE HIGH YIELD BOND	0.89%	4.52%	11.28%

Returns provided by Morningstar as of 9/30/2021

Each wave of COVID – 19 has impacted the economy less

The good news is that gradually a larger and larger percentage of the population has antibody protection, due to either having COVID or from vaccination and once again, after a surge of Delta variant cases, the numbers are seemingly coming down in many places, especially the south. Additional good news is that treatments of COVID and therapeutics have improved. This, along with our generally having a better understanding of COVID has resulted in fewer and fewer lockdowns. The economy has been open to a greater extent as a result.

We are currently having to contend with the consequences of almost two years of partial and full lockdowns across our country and the globe. Most of the rest of this letter will be devoted to discussing these consequences and their impact on the economy and markets.

Economic crosswinds exist following COVID lockdowns

Under-Employment: Where are all the workers?

With the end of stimulus money at the Federal level and most states ending their own programs by the end of the year, we anticipate that U.S. non-farm payrolls to be several million below where it was before the pandemic. There are so many factors at work that no one really knows how many of those who have exited the work force will return. Businesses in all sectors of the economy need to and are desperately trying to hire more people. Many report a lack of candidates interested in working.

Raymond James Chief Economist Scott Brown, Weekly Economic Monitor *October 29, 2021*
"*The start of the school year was expected to lead to an increase in female labor force participation. That hasn't happened. Childcare remains a key constraint, more expensive and less available now than before the pandemic – and that's not going to change anytime soon. Those that opted for early retirement last year are unlikely to came back. Many of those in low-paying jobs are reluctant to return. During the last decade, the labor market had more slack than was implied by the unemployment rate. Extra slack may still be out there, but it's unclear whether it can or will be tapped."*

Supply Chain dislocations: Will the packages arrive in time for Christmas?

Surely you have heard the advice to shop early for Christmas this year. Every segment of our economy is being affected by supply chain issues and it is being reflected in GDP as well. In the last quarterly letter, we wrote about supply dislocations and their impact on the economy. Since then, as expected, U.S. economic growth slowed in the third quarter. Demand for goods remains high and the economy continues to struggle with supply constraints, breakdowns, and dislocations due to residual lockdown effects, and labor and transportation shortages. We expect these issues to gradually lessen over the next 6-12 months as COVID and restrictions fade further.

Giulio Martini, Partner at Lord Abbett, Economic insights, November 1, 2021.
"The U.S. economy should be expected to accelerate sharply following the lull in GDP growth during the third quarter, as supply shortages ease, and strong demand is reflected in accelerating consumer spending, fixed investment, residential construction, and government spending. Moreover, U.S. exports should pick up sharply, as demand improves in key trading partner economies, and global travel resumes. An added kicker from inventory restocking should be enough to propel GDP back into a series of above-trend-growth quarters, starting with Q4 2021.

However, there is a potentially countervailing factor that we will be watching. Recent declines in the weekly Bloomberg consumer confidence index hint at a bifurcation in the consumer spending recovery. While generous income support programs lifted spending for households at all income levels during the early months of economic recovery, the termination of the transfers—supplemental unemployment insurance ended in early September, and other measures expired earlier in 2021—coincided with declining consumer confidence and less robust consumer spending. Rising gasoline prices have gone hand in hand with an erosion in buying plan."

Inflation: How much of it is transitory?

We discussed inflation in last quarter's letter. We noted that one reason for the inflation spike is simply the comparison to very depressed levels during 2020 lockdowns. For example, airline prices plummeted because no one was flying in 2020. Now people are flying, but the number of flights is still constrained and demand for tickets is strong (the flights we have been on have been 100% full). However, there is more to it than that. We believe a few key causes of inflation, or rise in prices include:

- Shortages due to the supply chain issues we have been discussing are driving prices up. Ports in Los Angeles and New York have seeing ships waiting weeks to be unloaded. Some businesses, are now leasing their own ships to try and have more control (and gain efficiency). Brian Westbury, with First Trust Advisors wrote October 4, 2021 "– The Cost of Lockdowns, the cost to ship containers has soared by nearly 500% this year!"

- A lot of money chasing the same products also drives prices up. Currently there is more demand than supply for goods but recent data shows demand may be shifting more towards services , which could help ease the demand for some goods.

- A shortage of workers drives prices up as businesses have to pay higher wages to retain and attract workers.

- Rising energy costs are having an outsized effect on price increases. Oil has risen to its highest level since October of 2014.

The Federal Reserve, whose balance sheet reached a record $8.6 trillion this past month, continues to state they believe the level of inflation we have been experiencing will moderate and settle around 2%-3%, which is a healthy level of inflation the economy can handle. The increase in Employment Costs will get their attention though. Prices for goods can fluctuate, but once wages are increased it is very difficult to pull back. Many firms are already stating they have or intend to increase the price of the goods and services they offer to help mitigate the impact of higher wages. Additionally, concerns exist that prolonged supply chain issues lead to higher inflation than expected and an under-employed workforce may continue to exasperate those supply chain issues. That in turn would force the Fed to be more aggressive in raising short term interest rates to keep inflationary pressure from building up. For now, we remain hopeful the Fed is correct and that inflation will settle back into the 2%-3% range, but think it may take some time for all these issues, and the resulting inflation, to level out. We are watching these numbers closely.

As expected, Fed Chairman Jerome Power announced November 4th, they will start to taper bond purchases this month. This will be the first of many 'break taps' we expect to come. We expect the Fed to allow some time between the end of bond purchase tapering and the start of interest rate increases so they can monitor the effects of tapering bond purchases and see if inflation is receding as economic conditions normalize. Currently we expect the Fed to begin increasing interest rates in 2023. We will keep monitoring all this, watching for signs indicating which way inflation and interest rates will go.

Inflation perhaps, but not stagflation

As prices have risen, so have concerns about stagflation. Stagflation is an economic condition caused by slow economic growth, high unemployment and rising prices. Stagflation most notably occurred during the 1970s because of the oil embargo as well as monetary and fiscal policies. Circumstances are very different and we do not believe stagflation will take hold now. We expect the economy to remain healthy, jobs are available for those who need one and while oil prices are rising that in itself is in no way near the crisis of the oil embargo. Larry Adams, Raymond James CIO discusses in this short two and a half minute video posted on our website why Raymond James does not think stagflation is likely to occur in 2022.
https://www.raymondjames.com/hilliard/resources/2021/10/25/does-stagflation-threaten-the-us-economy

Stock rotation has turned into a broad rally

For much of 2021 momentum in the stock market has switched back and forth between value-oriented stocks (i.e. energy and financials) and growth-oriented stocks (technology, consumer discretionary) and the lockdown stocks (technology, online shopping) versus re-opening stocks (restaurants, travel).

> **Saira Malik, CIO Nuveen Global Equities, Weekly Equities Commentary November 1, 2001**
> “*The style debate drags on, as markets grapple with rate volatility, inflation and caution about central bank policy. Growth and value equities continue to trade jabs, with leadership shifting monthly, weekly and even daily. Although last week's retreat in rates allowed growth to outperform, poor 3Q earnings reports for several tech giants weighed heavily, giving some investors pause as to how much more upside growth may have following a remarkable 2020 and 2021. While secular trends may favor growth-oriented industries, the next move in interest rates will almost certainly be upward, which should enable cyclical sectors to outperform their growth/defensive counterparts.”*

The S&P 500 experienced a pullback during the third quarter that at its lowest, was down a little over 5% on a closing basis. Historically speaking, this is considered a mild pullback, as ones closer to 10% commonly occur each year.

Recently, as the market has rallied from those levels participation of stocks rising has been very broad. This is encouraging, as it is a sign of a healthy market. We are also now in the more seasonally favorable time of year.

This economic recovery from COVID-19 induced lockdowns has been most unusual and like no other ever experienced. One thing we have all learned is there are consequences from artificially shutting down complex economies that are intertwined globally. Economic activity can't just be shut off and turned back on and expected to function normally. We have all had to exercise patience through these past two years and it appears we will need to be patient a while longer as we move towards a normally functioning economy. The very good news though is that we believe the economy will continue to grow and that should continue to fuel the secular bull market.

We will continue e-mailing you invitations to informative conference calls when they occur. Please also check our website and social media pages regularly for timely updates on all these topics.

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As always, please let us know of any significant changes in your life or situation that could impact your financial plan. In the meantime, we continue to follow the processes we have developed over the years that enable us to provide you our very best.

Thank you for your trust in me and in our practice.

Sincerely,

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DJ GLB Aggressive Index - The DJ GLB Aggressive is a total-portfolio index that allow investors to evaluate the returns on their portfolios considering the amount of risk they have taken. These profiles are defined based on incremental levels of potential risk relative to the risk of an all-stock index. It's made up of composite indices representing the three major asset classes: stocks, bonds and cash. The asset class indices are weighted differently within each relative risk index to achieve the targeted risk level. The weightings are rebalanced monthly to maintain these levels. The DJ GLB Aggressive index is 100% of All Stock Portfolio Risk.

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The Dow Jones Industrial Average is an unmanaged index of 30 widely held stocks. The S&P 500 is an unmanaged index of 500 widely held stocks. The MSCI EAFE (Europe, Australia, Far East) index is an unmanaged index that is generally considered representative of the international stock market. MSCI Emerging Markets Index is designed to measure equity market performance in 23 emerging market countries. The index's three largest industries are materials, energy and banks. The Russell 2000 is an unmanaged index of small cap securities. The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The Bloomberg Barclays U.S. Corporate High Yield Bond

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