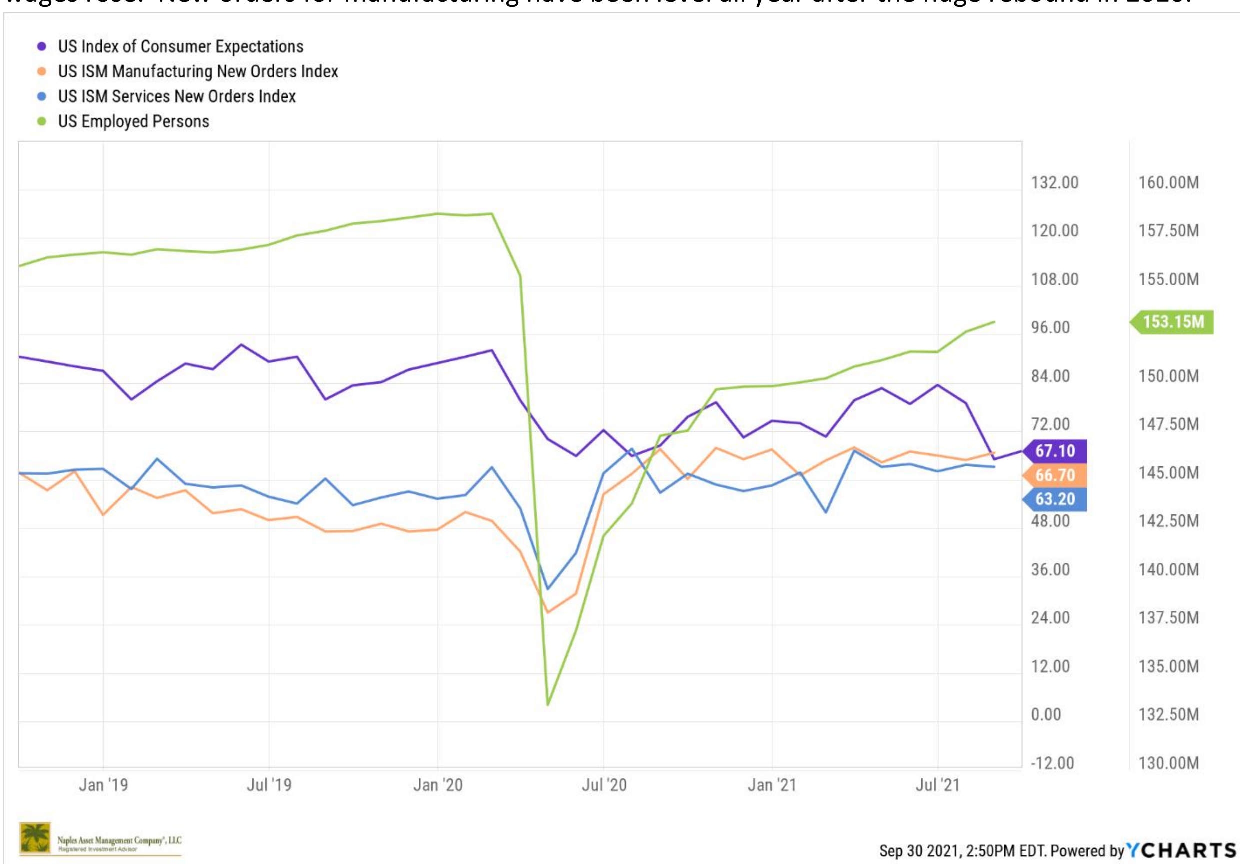
Client Note

September 30, 2021

Stock markets ended the 3rd quarter of 2021 with a thud as we find ourselves in the middle of a correction. Markets saw the end of a 7-month streak of positive monthly gains. The SP500 has been up 14 of the last 18 months, and 7 of the last 8. Looking across asset classes, the SP500 is down 5% for September, and essentially **flat** on the quarter. Gold is down 3% on the month, and down almost 1% for the quarter. The 20yr Treasury bond is down 3.6% on the month **and 0% on the quarter**. Small cap US stocks fell less, at -2.9% for September, and -4.3% on the quarter. Emerging markets lost 3.8% on the month, and -8.6% on the quarter. This generally flat to negative quarter was anticipated this Spring as economic indicators began to roll over before Q2 was over. A 7-10% correction should set up a good buying opportunity going into year end. Year to date gains remain solid. After this correction completes, I am optimistic for a solid end to the year.

Growth in the economy is still with us, however, at a slower pace than had been hoped for earlier in the year. Economic data points to a levelling out of growth. Current GDP, **for Q2 2021 is 6.5%,** and current expectations for Q3 are just under 5%. Our real GDP is still a few percent below 2019 levels. Employment has gained over 2020, but growth in employment has flattened, compared to 2020, as wages rose. New orders for manufacturing have been level all year after the huge rebound in 2020.



The levelling off growth, and perhaps the Covid surge in the South this summer, has reduced Consumer Expectations. The elevated growth compared to 2019 is purely backfilling the Covid recession. I expect the US to work through the supply chain issues and to add workers at a modest pace over the next year. Counterintuitively, that may mark the end of this growth cycle as wage pressures and prices decrease, which are dis-inflationary. That period would be characterized by slowing growth but increasing profits. That's still a couple years out though.

Wages were growing at 1% month over month in January 2021, slowed to a negative .43% in March, and picked back up in June at +.43%, and September at +.56%. **Wages are rising at about 5.5% annual rate. Number of hours worked** at 34.7/wk, is **the same** as it was in January. 2021 is seeing slightly higher hours worked than 2020 (34.6), but much higher than 2019 (34.4). Finally, the number of employed persons in the US is at 153.15 million. This is down from 2019 average of 157.62million. While our population has grown over the past 2 years, there are **4.5 million fewer people working**. What we have is fewer people working a similar number of hours throughout 2021 for higher wages.

If employment and wages continue to gain, we could see persistent inflation. The core of the current inflation is supply chain issues, simply a lack of goods pushing prices higher. In addition, the nature of the past recession had a much smaller impact on higher income earners. There was little displacement of white-collar workers, and thusly, demand for homes and other big-ticket items never receded while factories were idled across the globe. Prices are higher while less 'stuff' is out there, **stagflation.** Regardless, interest rates have risen and should **remain elevated, but may not rise too much further,** especially if we see these supply chains get back in line. The reversal of a trend, like the amount of supply chain chatter in the press, often comes when everyone fully expects the trend to endure. **Don't be surprised if factories suddenly come back to life early 2022.**

How will solid, but slowing growth and tempered interest rates **affect the stock market**? Probably in a positive manner. As long as expectations or hope of increased profits and backfilling the GDP gap from the recession persist, investors will take on risk, and stock prices should climb. Its when we have 'fixed' the last problem AND investors are highly optimistic that actual market risk is around the corner.

Finally, a couple thoughts on the status of Covid 19. The summer surge we saw in the South and Florida is ending. Cases and hospitalizations are down dramatically from this recent super peak. The concern now is for the rest of the country. Fortunately, a by-product of a Covid surge is that more people get vaccinated and take precautions. Also, the rest of the country already has a higher level of vaccinations. While there will be a lot of cases as the weather cools, **hospitalizations and deaths should be much lower** than we saw in Florida. As we enter the 'living with Covid' era this topic should fade from the headlines. Schools back in **session should allow for more people to go back to work** since they wont need childcare as much. On the other hand, the level **of influenza**, given we saw almost none last year has scientists concerned that there is lessened resistance to this year's strains. Since there is no appetite for large scale closures, anticipate a heightened awareness of flu/covid symptoms and continued efforts to wear masks and social distancing. If we can have an idea on what to expect, when it happens, it won't be that much of a disturbance.

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