Market **Insights**

Economy | **Capital Markets**

Q3
2021

Economy

"New beginnings are often disguised as painful endings," is a famous and appropriate quote relevant to today's economic and social environment. Although we desperately try to move on from the pandemic, we are constantly reminded of its grip on our lives. Cases are stubbornly rising again in many parts of the country, particularly among the unvaccinated, and we are still counting deaths, a realization that seems unfathomable this far into the crisis. Still, the economy has roared back to life, with tremendous help from the government and Federal Reserve. Collectively, we are settling into our new reality with a bit more clarity and appreciation for what lies ahead. Our world has been forever altered because of this experience. Hopefully, for the better. Already these changes have had a profound impact on our lives, including how we work, shop, learn and use technology. Not to mention, the adoption of new safety and cleanliness protocols throughout our businesses, schools and entertainment venues. Dramatic changes in life tend come with newfound opportunities, and we are starting to witness this in both the economy and capital markets.

On the economic front, the major trends continue to point to robust growth with strong end-user demand for both products and services. The recent manufacturing industry report showed growth in 15 of 18 sectors with broad production gains, an increase in new orders and higher backlogs. Yet, the industry continues to struggle with a combination of global supply-chain slowdowns, higher input costs and trouble hiring qualified workers. These and other persistent problems are expected to last well into 2022. The services part of the economy has also benefitted from a surge in demand as consumers attempt to return to normal activities. However, the lack of workers along with higher commodity prices and increased regulations has pressured profit margins and left many businesses struggling to keep afloat. The housing market remains another bright spot in the economy. The number of single-family houses under construction rose to 689,000, the most since 2007. Further, annual housing starts are expected to hit 1.6 million, a pace last witnessed nearly 15 years ago, as demand is expected to remain elevated. Still, as homebuilders grapple with limited availability of land, labor and materials, home prices are expected to rise modestly in the years ahead.

While still unprecedented in modern history, the tremendous financial support by the Federal Reserve and the U.S. government is expected to wane a bit in the months ahead. Already, the government has ended both the additional unemployment payments to individuals and the eviction moratorium. However, new benefits have started, such as the child tax credit payments, which should help buoy the finances of many families. At the same time, the Federal Reserve has indicated that its massive monetary support to the credit markets throughout the crisis is not infinite. In the recent commentary by the committee, it started the process of discussing a timeline to reduce asset purchases and return to a more normal operational environment at some point. While this could ultimately take years to accomplish, it is difficult to determine how disruptive these actions by the government and Federal Reserve could be on the financial markets.

During the quarter, investors struggled with a rise in Covid cases, even as vaccine rates increased, and concerns that waning support by the Federal Reserve would negatively impact the economy and capital markets. Still, corporate earnings grew about 90 percent for S&P 500 companies in the latest quarter and are expected to top 20 percent over the next few quarters. Higher earnings should bolster stocks, even as overall valuations remain high. For the quarter, the S&P 500 Index returned 0.58% percent, while mid- and small-cap stocks declined -1.76% percent and -2.85% percent, respectively. Growth stocks came roaring back, relative to value, as investors cooled a bit on the reopening story. In bonds, interest rates declined modestly, which helped produce slightly positive results for most areas of the bond market.

Looking ahead, the economy and financial markets face several obstacles that could either help or hinder growth and market returns. The recent surge of economic activity brought along higher inflation, supply bottlenecks and a lack of qualified workers. These conditions are not easily resolved and could restrain economic activity over the next few years. Further, investor expectations of unlimited support by the Federal Reserve will be tested over the next few years. Finally, although massive deficit spending by the U.S. government helps support growth in the short-term, the long-term ramifications of this high debt load is likely to hinder growth. While we expect some additional volatility in the capital markets as we work through these issues, we suspect corporate earnings growth will remain strong, which should bring down currently lofty valuations, and interest rates should remain historically low. With stocks up substantially already for the year, we expect more muted returns over the next few quarters. In bonds, higher consumer inflation and better economic growth will likely impact returns. We continue to work diligently to analyze the environment and make strategic investment moves in client accounts as appropriate.

As always, investing in capital markets comes with some risk and uncertainty. We thank you for your continued support of our investment process as we work hard to deliver positive risk-adjusted portfolio returns to our clients. Should you have any questions, please do not hesitate to reach out to your financial adviser.

Capital Markets

Investors became a bit concerned about higher inflation and waning support by the Federal Reserve. Most areas of the stock and bond markets produced lackluster results for the quarter.

Disclosure: It is not possible to invest directly into an index. The indices listed above are unmanaged and are not affiliated with the Advance Capital Companies.

Market Index Performance (%)

As of Sept. 30, 2021

	3rd QTR	YTD	1 Year	Annualized 3 Year
S&P 500	0.58	15.91	29.98	15.93
Dow Jones Industrial	-1.46	12.12	24.15	10.97
Nasdaq Composite	-0.22	12.67	30.33	22.66
Barclays Aggregate Bond	0.05	-1.55	-0.90	5.34
FTSE USBIG Corporate	0.11	-0.97	2.02	7.61
MSCI World	0.10	13.45	29.41	13.72

Economy from a Historical Perspective

	Latest	Average*	Definition	Comments
U.S. Unemployment Rate	5.93%	6.08%	Represents the number of unemployed persons as a percent of the labor force	Steadily declining
Consumer Price Index	5.30%	4.00%	Represents changes in prices of all goods and services purchased for consumption	Sharply higher
U.S. Capacity Utilization	76.44%	80.01%	The greatest level of output that a plant can maintain within the framework of a realistic work schedule, accounting for normal downtime	Low, but improving
Gross Domestic Product+	6.70%	2.80%	Total value of all goods and services produced indicates strength or weakness of the economy	Historicallly high
10 Year Treasury Yield	1.49%	6.10%	Yield on the current 10 year treasury bond	Historically low
Annual Housing Starts	1,615,000	1,432,000	New privately owned housing unit starts annualized rate	Trending higher

*Average from 1966 to Present + Annualized Source: Bloomberg