Legacy Financial Strategies

Market & Economic Review 3rd Quarter 2021

- *September was the first negative month for stock returns since January.*
- *“Pandemic fatigue” has caused consumer confidence to plunge.*
- *COVID cases rolling over and declining in many U.S. states.*
- *Inflation still appears to be “transitory.”*
- *Corporate profits have surprised to the upside in Q1 and Q2…Q3 earnings are up next.*
- *Tax legislation, interest rates, COVID and bond tapering will likely drive volatility.*

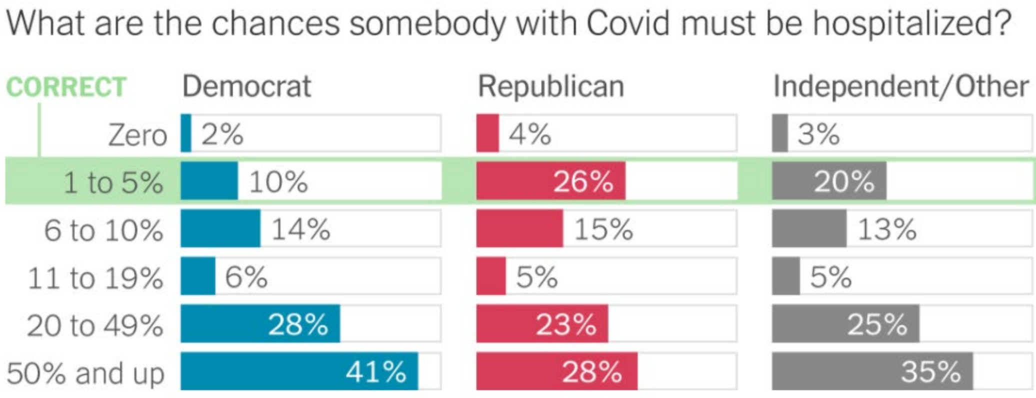
I am starting to think that our investment committee is getting bored with my presentation in the monthly meeting. Many of the economic and market concerns have lingered throughout the year so the narrative has been a bit repetitive. COVID still carries much of the weight in economic sentiment and the markets have continued to focus on fundamentals such as corporate earnings and interest rates. Recently however, Washington has generated some political theater courtesy of the debt ceiling debate and proposed spending/tax legislation. Additionally, the sizable drop in consumer confidence has been a head-scratcher. Neither of these concern me much but I will spend some time on each as I don’t want to bore you too….

Consumer Confidence Crisis

The University of Michigan consumer sentiment survey in August delivered the worst reading in 10 years and the 5th worst drop in 45 years. It is now lower than anytime during the COVID-19 pandemic including April 2020 when we were in full lockdown. Why now? Last spring, COVID had no known cure, no vaccine was on the horizon, mortality rate was 1 in 12 confirmed cases or 8% and took a severe toll on the elderly. Economically, job losses were staggering, annualized GDP dropped more than 30%, the U.S. entered a recession and corporate profits disappeared from many large and small businesses. Today, over 70% of adults in the U.S. are vaccinated and the mortality rate is thankfully lower. GDP has surpassed the 2019 high and growth is continuing. S&P 500 company profits have recorded a new record high, unemployment has fallen and household net worth-to-income ratio is at an all-time high. With 10.4 million jobs[1] available, opportunities exist. Throw in unprecedented government stimulus and much more confidence is warranted. Drops in the U of M survey are typically followed by positive stock market returns. My glass is half-full on this one.

COVID Credentials?

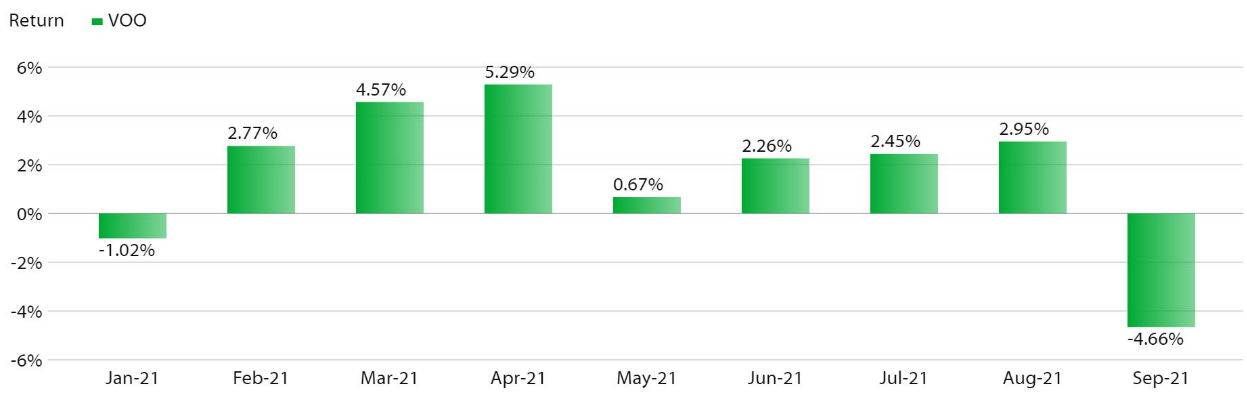
Even after millions of “Facebook PhD’s” have been minted since the pandemic began, there is a partisan misunderstanding about the severity of COVID, likely contributing to low consumer confidence. A person contracting COVID has an estimated 1-5% chance of being hospitalized. In a 2020 survey, more than half of respondents believed there was a 20%+ chance of hospitalization of which 1/3 on average believed chances were higher than 50%. That exaggerates reality anywhere from 5-50x. Rather than pointing across the political aisle, we should point and click on the CDC and health department websites for the data.



By The New York Times | Source: Franklin Templeton-Gallup Economics of Recovery Study

Climbing the Wall of Worry

I have said for years: "there is always a reason to not invest." The more you listen to the media (or even friends and family), the more reasons you will find. This year, the ongoing concerns have been inflation, interest rates, equity valuations and an impending market correction. The broad stock market on average, experiences one 10% or greater peak-to-trough correction each year. The S&P 500 has fallen 5% only once in 2021 despite averaging about three per year. Every small pullback has been "bought" allowing prices to recover. The two charts below show the YTD and calendar months return of the Vanguard S&P 500 ETF (VOO)[2]. The mountain chart illustrates the "dips" in the market and subsequent recovery. The drop on the top right peaked on September 6 and we are about 2% below that level at the time of this writing. Investors Intelligence, a survey of writers and advisors reported that the number of stock market "Bulls" is at 40%. That is the lowest level since April 2020. This indicates that 60% have a neutral or negative opinion on the stock market. Based on this chart, negativity has been very short-lived.



Unlike your mortgage payment, stock market corrections are never DUE as many in the financial media like to say. Corrections are impossible to accurately predict, but looking ahead, we see a few catalysts (or excuses) that could spook investors and cause some heightened market volatility:

- The debt ceiling debate in Washington could certainly lead to short-term weakness. The U.S. will default on its debt only if we choose to do so. It is an excuse for politicians to finger point and grandstand, but they all understand that it will not happen. Anyone else for term limits?
- Proposed tax legislation to increase rates for the wealthy are anticipated or planned but any unforeseen surprises or last-minute changes to the bill are a risk.
- Inflation is higher than the long-term average. We think this is transitory due to a few outliers and are cautiously watching for data suggesting sustainable inflation.
- Interest rates as measured by the 10-year US Treasury Yield have crept higher in 2021. A substantial increase would provide challenges for bonds, stocks, and mortgage rates.
- In the last four post-recession stock market recoveries since 1980, the market has traded sideways or experienced a correction the following 12-24 months. This is not a "reason" but a function of all possible or unforeseen risks.

Dash to the end…

The general sentiment is glass half-empty. I worry about our clients' worrying but I feel confident about the future. Stock returns are positive 73% of calendar years since 1926[3]. Stocks have delivered 10% annualized returns in the last century while facing a depression, inflation, rising rates, commodity shocks, world wars, a technology sector collapse, a housing market bubble, political and socioeconomic uncertainty, and several viral outbreaks. My glass is half-full but I always have one eye open. As always, we strive to invest your money in a manner consistent with your tolerance for risk. We believe our clients benefit from time in the market, not timing the market.

As always, we genuinely appreciate the trust you place in your financial advisor and our firm.

Chris Proctor
Chief Investment Officer

Sources:
[1] Bureau of Labor Statistics; [2]Kwanti Portfolio Analytics; [3]Morningstar