

FALL 2021

The exuberance of the early summer regarding the reopening of the economy and the surging stock market has given way to a more clear-headed view of the challenges faced as we enter the final quarter of 2021. The continuing threat of the Delta variant and the ever-present intransigence in Washington are but two of the issues concerning investors. Additional worries about inflation, higher interest rates and the reduction in the stimulus activities of the Federal Reserve, have all dampened the enthusiasm of the summer.

These concerns, among others, may have prompted the retreat in the market as measured by the Standard & Poor's 500 (S&P 500) in September. The S&P 500 declined by 4.8% in September and as of Monday, October 4th is 5.0% below the all-time high set on September 2, 2021. While this is the worst monthly performance since March of 2020 it is hardly akin to the precipitous decline experienced at the start of the Covid crisis. And, despite the difficult September, the S&P 500 has returned 15.9 % year to date. Over the last 12 months the S&P 500 has a total return of 30.0%, so some sort of pause or pull back was not unexpected.

Other market indices suffered in September as well with the Dow Jones Industrial Average down 4.2% for the month while the NASDAQ Composite declined 5.3%. Both the Dow, up 12.1%, and the NASDAQ, up 12.7%, remain solidly ahead year to date. With many large technology company market leaders like Apple and Amazon down more than 10% from their 52-week highs, the Russell Growth Index lost more in September, -5.6%, than the Russell Value Index which was down 3.5%. Year to date, the Russell Value Index has outperformed the Russell Growth Index, up 16.1% versus 14.3%.

The year-to-date outperformance of "Value" relative to "Growth" stocks can be seen in the financials such as J.P. Morgan, up 31.5%, and energy, like ExxonMobil, up 49.1%, versus technology stocks such as Apple, up 7.1% year to date, and Amazon, up 0.9%. While Amazon is part of the Consumer Discretionary sector, it is often viewed as one of the big cap technology stocks.

The point in singling out J.P. Morgan and ExxonMobil is that both stocks could continue to outperform in an inflationary environment with rising interest rates. Banks can make more money on the spread between deposits and loans with higher interest rates while oil companies benefit from rising energy costs. Conversely, many growth stocks, particularly those with very high price/earnings (P/E) ratios, might have more difficulties in times of rising interest rates. Investors may be less willing to tolerate high P/E ratios for the promise of earnings growth well into the future.

Opinions vary significantly about the threat of inflation and the potential effects on the financial markets. The Federal Reserve has announced a gradual reduction in their stimulus efforts (tapering) and their projection for inflation by 2022 remains at 2.0%. Many believe this conclusion is too conservative and feel inflation will be higher and the Fed will be forced to take more dramatic action. If this is the case, interest rates will rise faster and higher than expected with negative ramifications for both stocks and bonds.

The Consumer Price Index (CPI) rose 5.3% for the 12 months ending on August 31, 2021. While this is obviously well ahead of the Fed's 2.0% target, the 5.3% CPI number reflects the rapid recovery from the pandemic decline and other factors the Fed believes to be transitory. Not all agree however, as noted Professor Jeremy Siegel of the Wharton School stated in a recent CNBC interview, he believes inflation will be a problem and that it will pressure the Fed to accelerate their tapering process. He believes this may cause further volatility in the stock and bond markets and lead to a continuance of the outperformance of value stocks, particularly dividend payers, versus more traditional growth stocks.

These concerns are valid, and both the stock and bond markets remain vulnerable to a more meaningful correction. We are comfortable, however, with a diversified mix of growth and value stocks in client portfolios as appropriate to each's individual objectives. We believe stocks with good earnings and dividend growth records throughout varying economic environments will withstand whatever dislocations may be ahead for the markets.

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