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Economic Review and Outlook

Marcia Peters, CFA, Chief Investment Officer

Third Quarter 2021

Third Quarter 2021 Highlights

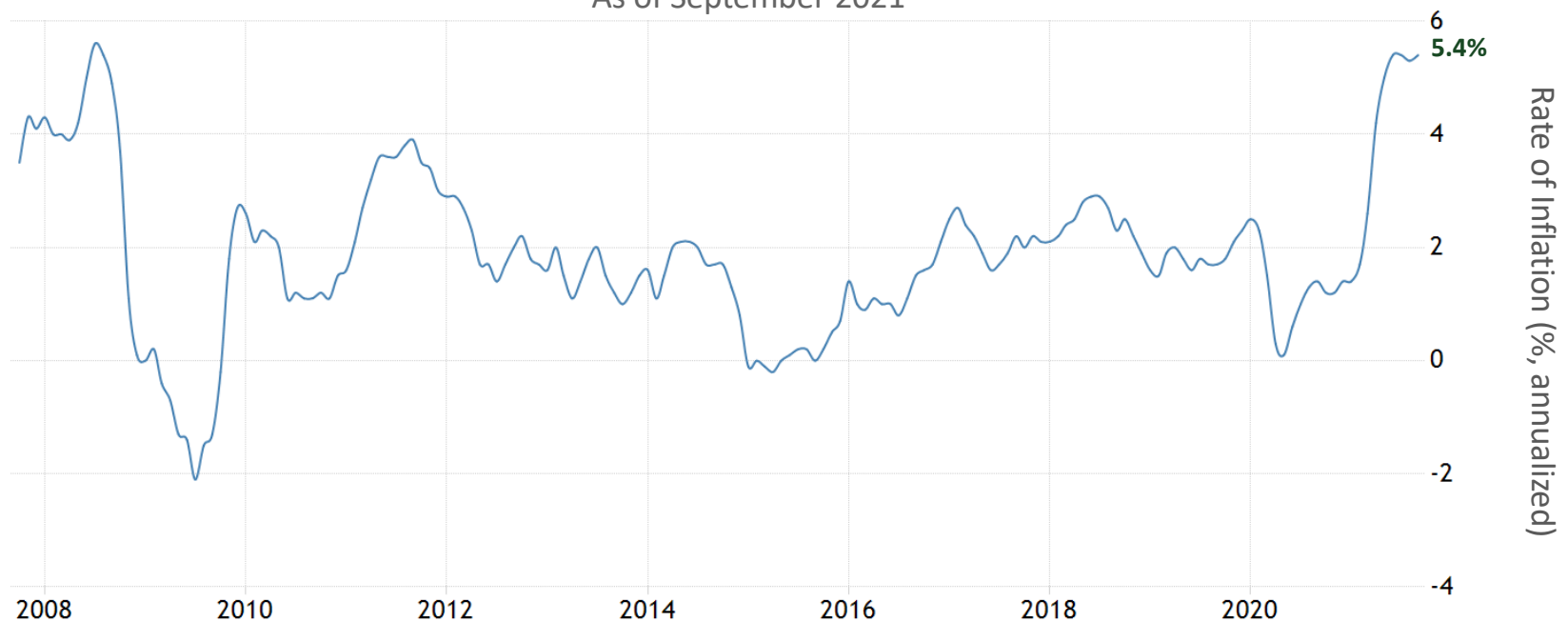
- ▲ Third quarter economic progress proved to be challenging due to the highly contagious Delta variant, as consumer confidence waned, and some pandemic mandates were reinstated. Third quarter real GDP expectations are between 1% - 3%, annualized, and below the previous quarter's 6.7% pace.
- ▲ Also contributing to the slower growth were supply chain disruptions driven from excessive demand and backlogs at major ports. September's Retail Sales index was up 13.9% year over year, after equally high levels in July and August. Meanwhile, shortages of semiconductor chips severely constrained auto manufacturing and significant demand for labor went unfulfilled.
- ▲ Extended federal unemployment benefits ended in September, but jobs data indicated hesitancy to return to work. Surveys cite continued concerns over the virus, childcare issues, and a re-evaluation of career goals. While the unemployment rate ended the quarter at 4.8%, a reduced labor force participation rate and the lack of applicants for a record number of job openings are vexing problems for policy makers. Businesses looking for help have offered signing bonuses and other incentives, in addition to wage increases, which are 4.6% higher than a year ago.
- ▲ Powerful supply and demand imbalances contributed to concerns about inflation. Supply side constraints (including labor) and pent-up demand has caused upward pressure on not only wages, but also on real estate, auto, commodity, and food prices. The September inflation rate was 5.3% (annualized), which was a thirteen year high and well above the Fed's average target of 2%. As of now, analysts generally agree with the Fed that these imbalances will prove to be transitory; inflation is expected to be lower and around 2.5% by the end of 2022.
- ▲ Globally, the recovery is progressing. EU growth is expected to end this year around 5%, while Covid-related shutdowns and regulatory changes in China slowed the annual growth rate to 4.9% from 7.9%. As the Delta variant subsides, the peak in global growth is expected during the first half of 2022. Beyond that point, growth is expected to subside to the pre-pandemic trend, as both fiscal and monetary policy become less accommodative.

Economic Review and Outlook

U.S. Inflation at Thirteen Year High

- The Consumer Price Index was up 5.4% for the year ending in September. Food prices were 4.6% higher on the year, while energy and used auto prices were up over 24%.
- Global central bankers and many economists say the surge in inflation is transitory; a temporary, albeit painful, result of surging demand. In recent weeks there are signs the Covid-related distortions are easing and some prices are stabilizing. However, even the Fed's projections acknowledge the process could take up to 2 years.
- Long-term, supply chain disruptions could exist for extended periods and rising oil prices and wages could lead to an upwards spiral. However, offsetting demographic trends such as an aging population and continued advances in technology and healthcare could support moderate inflation over the long-term.

U.S. CPI Inflation Rate, Including Food and Energy
As of September 2021



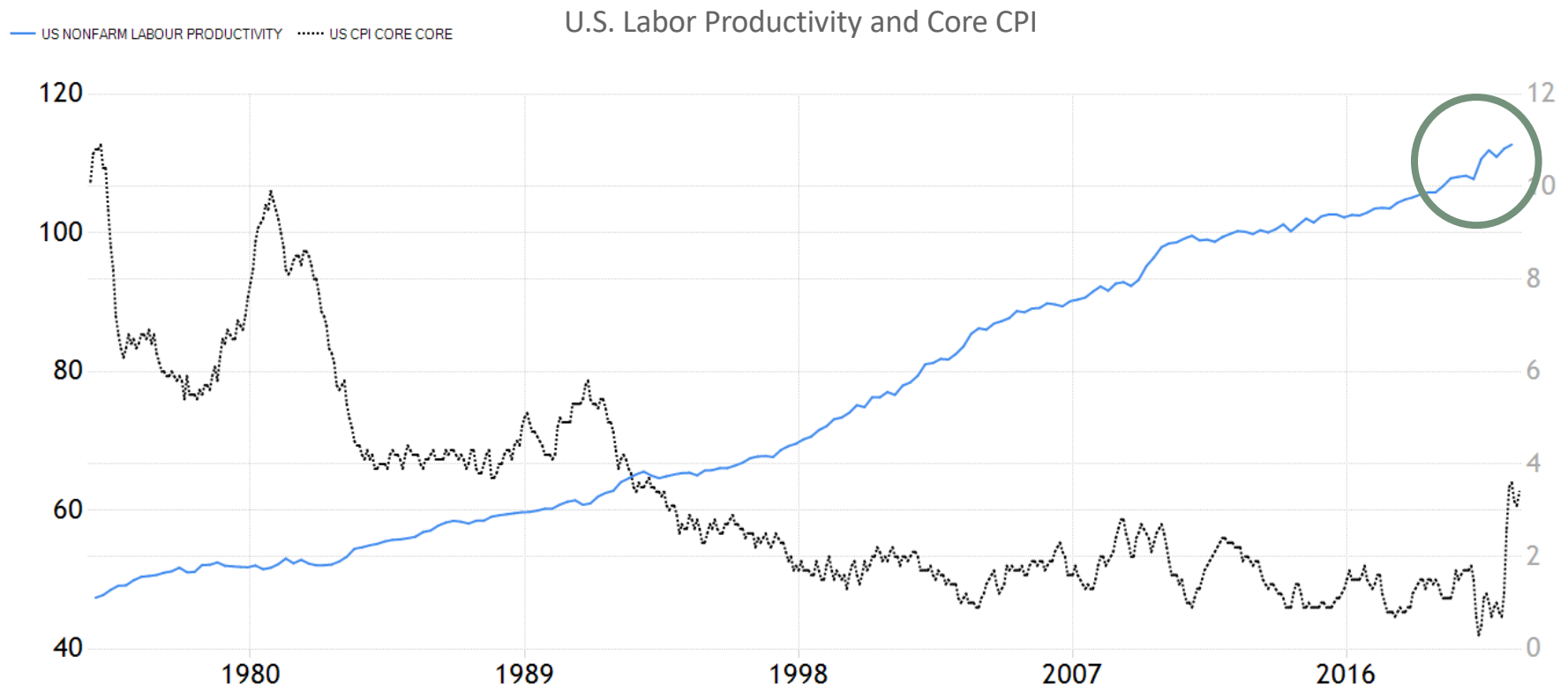
Source: U.S. Bureau of Labor Statistics, Trading Economics, October 2021



Economic Review and Outlook

The Long-term Outlook: Productivity and the Post-Pandemic Economy

- ▲ Rapid technology adoption since the start of the pandemic has fueled a jump in worker productivity. Work-from-home platforms, e-commerce, and online banking were in place prior to the pandemic, but have become structurally embedded over the last 18 months.
- ▲ When considering advances in robotics, artificial intelligence, and biotechnology, higher productivity estimates for the balance of the decade are behind a long-term, favorable economic outlook.
- ▲ Another benefit of increasing productivity; it tends to drive inflation lower. This is an important consideration for the Federal Reserve, especially if post-pandemic productivity stalls.



Source: U.S. Bureau of Labor Statistics, Trading Economics, October 2021



Monetary Policy

Policy action will dictate the next steps in economic growth. Monetary policy will remain supportive to growth for the foreseeable future. Proposed fiscal expansion, while significant, will be spread over 10 years, and amount to annualized levels below that seen during the pandemic. Interest rates will rise, but are expected to remain at historically low levels, which will counter the impact of the elevated level of US debt.

- The September FOMC meeting revealed a growing concern about inflation and an accelerated timetable for the first interest rate increase. Projections for short-term economic growth were scaled back.
- Chairman Powell indicated tapering could begin as early as the end of this year and the pace of tapering will bring asset purchases to zero by mid-2022.
- Most analysts foresee the first interest rate hike by the end of 2022 or early 2023, followed by 3-4 additional rate increases in 2023.

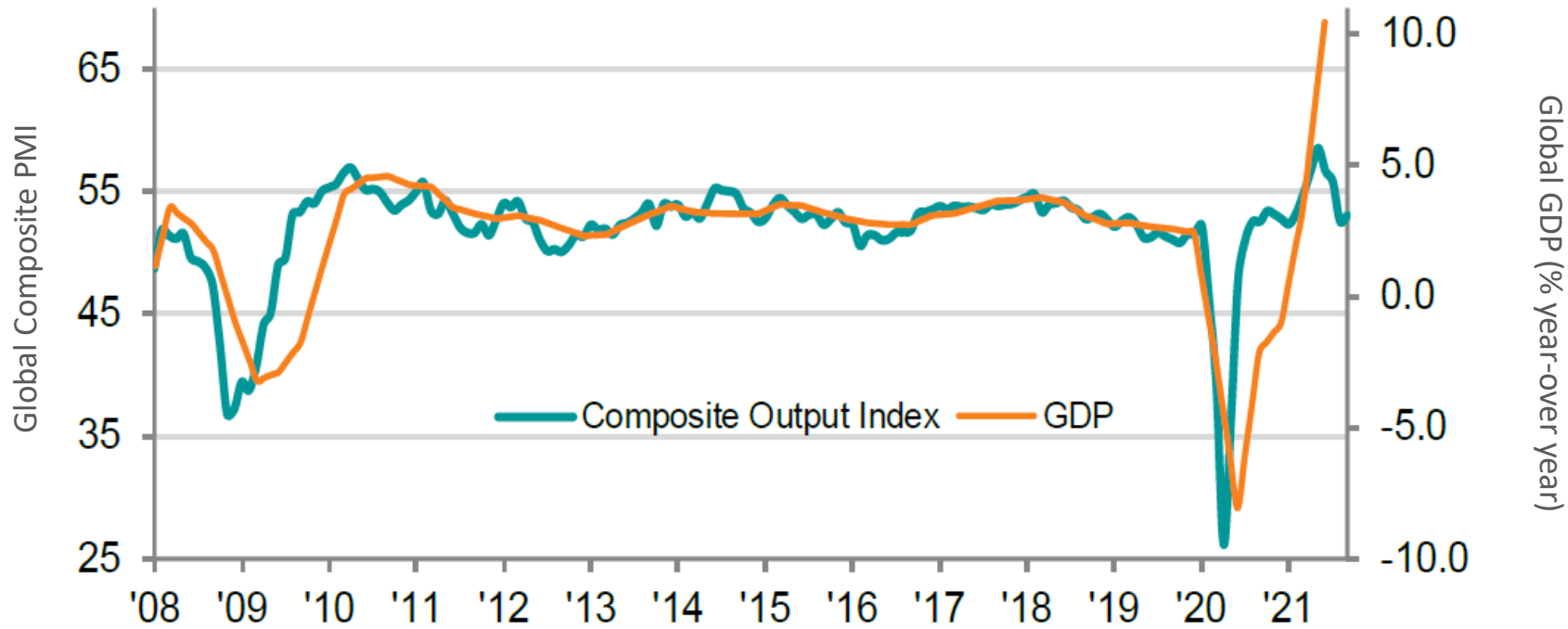
Fiscal Policy

- The ten-year, \$3.5T reconciliation bill (aka the American Families Plan) is still being negotiated in both houses of Congress. Included in the bill is an increase in the debt ceiling, which was temporarily expanded until December 3, 2021.
- To gain support from moderate Democrats, corporate tax increases and climate-related projects may be paired back, reducing the bill to \$2-\$2.5T.
- Approval for infrastructure spending, which has bi-partisan support, is tied to the reconciliation bill timing.

Economic Review and Outlook

A Quick Look at the Status of the Global Economy

J.P. Morgan Global Composite (Manufacturing and Services) PMI and Global GDP
As of September 2021



Economic Review and Outlook

China Policy, Growth, and Evergrande

- ▲ China's GDP reached 12.7% in the first half of 2021, as the economy quickly recovered under that country's zero-tolerance Covid policy.
- ▲ The government used that opportunity to institute regulations to achieve "common prosperity" and improve the standard of living across all segments of the population.
- ▲ To constrain excesses in certain industry sectors, regulations were applied to:
 - Environmental and energy consumption, to curtail emissions
 - Technology/data protection, to address privacy concerns
 - Private education, to constrain spiraling college preparation costs and "for profit" education
 - Property development, to reduce speculation causing rising property prices
- ▲ Government regulations are expected to slow economic growth closer to the target 6% level. While not expected to have widespread contagion, global economic headwinds will need to be monitored.

A Note about Evergrande

- Industry regulations were imposed on property developers to address rising debt levels and real estate affordability for the middle class.
- Regulations are intended to restrict speculation by limiting credit creation. Evergrande, a highly leveraged property company, has been adversely impacted and defaulted on recent debt payments.
- Most analysts think this will not be a "Lehman-type" event and point to other examples where the government provided support in similar situations. Financial markets have been supported on expectations of restructuring and government assistance to small lenders, if necessary, although that viewpoint has not been verified.

Looking beyond the quarter, continued vaccinations and boosters contributed to an increased ability to combat serious illness. The waning Delta variant and a global reopening that is building momentum present the forces for above-trend growth over the next couple of quarters. Inflation is projected to stabilize to targeted (or in the U.S., slightly higher) levels once supply chains and production capacity normalizes in 2022.

Real GDP Projections (year on year)

	2021	2022
World	5.7%	4.5%
US	6.0%	3.9%
Euro area	5.3%	4.6%
Japan	2.5%	2.1%
UK	6.7%	5.2%
China	8.5%	5.8%

Inflation Projections (year on year)

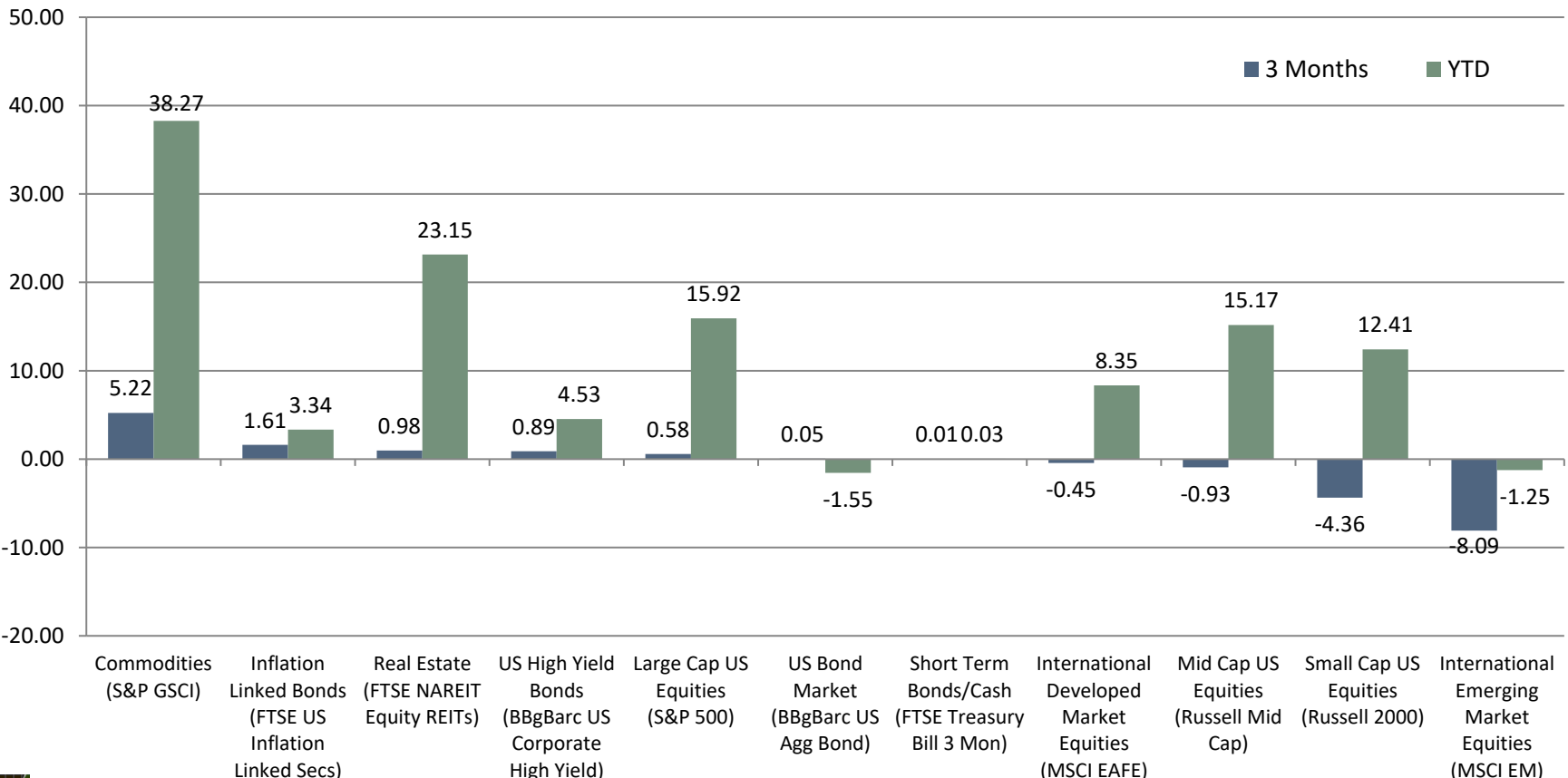
	2021	2022
World	-	-
US	3.6%	3.1%
Euro area	2.1%	1.9%
Japan	-0.4%	0.5%
UK	2.3%	3.1%
China	1.2%	2.2%

Economic Review and Outlook

Asset Class Performance

- ▲ Commodities continue to be the best performing asset class for both the quarter and the year. Ongoing supply chain disruptions and extraordinary global demand in the energy sector kept pressure on commodity prices.
- ▲ Elevated inflation and inflation expectations benefited TIPs and real estate, but higher bond yields and concerns about tighter Fed policy weighed on other risk assets.
- ▲ Emerging markets were adversely influenced by imposed regulations designed to slow certain sectors of China’s economy and the fallout from the property company, Evergrande.

Trailing Performance as of September 30, 2021



Economic Review and Outlook

Financial Market Performance

Trailing Performance (% annualized) as of September 30, 2021

DOMESTIC EQUITY

	Index	3 Mos.	YTD	1 Year	3 Year	5 Year	10 Year
Broad Market	DJ Industrial Average	-1.46	12.12	24.15	11.00	15.68	14.72
	S&P 500	0.58	15.92	30.00	15.99	16.90	16.63
	NASDAQ Composite	-0.23	12.66	30.26	22.67	23.37	20.93
	Wilshire 5000 Total Market	0.14	15.62	32.35	16.19	17.01	16.66
Large Cap	Russell 1000	0.21	15.19	30.96	16.43	17.11	16.76
	Russell 1000 Growth	1.16	14.30	27.32	22.00	22.84	19.68
	Russell 1000 Value	-0.78	16.14	35.01	10.07	10.94	13.51
Mid Cap	Russell Mid Cap	-0.93	15.17	38.11	14.22	14.39	15.52
	Russell Mid Cap Growth	-0.76	9.60	30.45	19.14	19.27	17.54
	Russell Mid Cap Value	-1.01	18.24	42.40	10.28	10.59	13.93
Small Cap	Russell 2000	-4.36	12.41	47.68	10.54	13.45	14.63
	Russell 2000 Growth	-5.65	2.82	33.27	11.70	15.34	15.74
	Russell 2000 Value	-2.98	22.92	63.92	8.58	11.03	13.22

Source: Morningstar

INTERNATIONAL EQUITY

	Index	3 Mos.	YTD	1 Year	3 Year	5 Year	10 Year	
Developed	MSCI ACWI	-1.05	11.12	27.44	12.58	13.20	11.90	
	MSCI ACWI Ex USA	-2.99	5.90	23.92	8.03	8.94	7.48	
	MSCI EAFE	-0.45	8.35	25.73	7.62	8.81	8.10	
	MSCI EAFE Growth	0.07	6.88	20.87	11.91	11.41	10.06	
	MSCI EAFE Value	-0.97	9.61	30.66	3.04	5.96	5.97	
	MSCI EAFE Small Cap	0.90	10.02	29.02	9.05	10.38	10.73	
	MSCI Europe	-1.55	10.07	27.25	7.81	8.85	8.15	
	MSCI Europe Ex UK	-1.91	9.45	26.14	9.61	10.23	9.19	
	MSCI Pacific Free	1.55	5.50	23.14	7.33	8.85	8.08	
	MSCI Pacific Free Ex Japan	-4.40	4.78	25.80	6.75	7.74	7.40	
	MSCI Japan	4.56	5.90	22.07	7.54	9.36	8.35	
	Emerging	MSCI EM	-8.09	-1.25	18.20	8.58	9.23	6.09
		MSCI BRIC	-11.28	-6.57	7.68	8.53	9.77	6.06
MSCI EM Latin America		-13.26	-5.55	27.34	-1.36	1.85	-1.08	
MSCI EM Europe		7.70	23.28	50.96	10.31	10.64	3.08	
MSCI EM Asia		-9.59	-4.15	13.93	10.00	10.73	8.52	

Source: Morningstar

FIXED INCOME

	Index	3 Mos.	YTD	1 Year	3 Year	5 Year	10 Year
	BBgBarc US Agg Bond	0.05	-1.55	-0.90	5.36	2.94	3.01
	BBgBarc US Government	0.08	-2.42	-3.20	4.88	2.26	2.21
	BBgBarc US Credit	-0.03	-1.30	1.45	7.10	4.37	4.60
	BBgBarc US Govt/Credit Interm	0.02	-0.87	-0.40	4.63	2.60	2.52
	BBgBarc US Govt/Credit Long	0.07	-4.57	-2.97	10.12	5.21	5.76
	FTSE US Inflation Linked Secs	1.61	3.34	5.06	7.65	4.44	3.21
	BBgBarc EM USD Aggregate	-0.55	-1.14	3.31	5.94	4.13	5.69
	BBgBarc ABS	0.05	0.23	0.59	3.50	2.36	2.13
	BBgBarc US MBS	0.10	-0.67	-0.43	3.85	2.17	2.41
	FTSE Treasury Bill 3 Mon	0.01	0.03	0.06	1.14	1.13	0.60
	ICE BofAML 1-3Y US Trsy	0.06	-0.02	0.03	2.64	1.63	1.16
	BBgBarc US Corp Aaa	-0.34	-3.34	-1.91	8.10	4.61	4.15
	BBgBarc US Corp A	-0.12	-2.06	0.11	6.95	4.08	4.51
	BBgBarc US Corp Baa	0.11	-0.45	3.52	8.05	5.23	5.44
	BBgBarc US Corporate High Yield	0.89	4.53	11.28	6.91	6.52	7.42
	BBgBarc US HY Caa	0.75	8.00	18.71	3.15	6.10	7.92

Source: Morningstar

STABLE VALUE & MONEY MARKET

	Index	3 Mos.	YTD	1 Year	3 Year	5 Year	10 Year
	Median Taxable Money Market Fund	0.00	0.01	0.01	0.88	0.83	0.41
	Average Stable Value Fund	0.42	1.32	1.84	2.22	2.14	2.02
	Consumer Price Index	0.58	4.92	5.00	2.68	2.51	1.88

Source: PEI

REAL ASSETS

	Index	3 Mos.	YTD	1 Year	3 Year	5 Year	10 Year
	FTSE NAREIT Equity REITs	0.98	23.15	37.39	10.01	6.83	11.27
	Bloomberg Commodity	6.59	29.13	42.29	6.86	4.54	-2.66
	S&P GSCI	5.22	38.27	58.30	-1.49	3.64	-4.83

Source: Morningstar





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