WAYPOINT ADVISORS

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Market Perspectives **Third Quarter 2021**

A tidal wave of economic stimulus has sustained economies and lifted markets

A deluge of monetary and fiscal stimulus has buoyed economies and equity markets globally. We have seen equity markets roar back across the world since their nadir in March 2020 with U.S. and developed international equities returning 97.7% and 69.9% respectively through 9/30/2021.[1] As COVID vaccination rates have risen there has been a dramatic rebound in economic activity despite the spread of COVID-19 variants.

In 2021, the earnings of the S&P 500 grew 26.3%[2] and corporate profits in the US climbed 10.5% to a record high of $2.44 trillion in the second quarter of 2021.[3] Profit margins for the S&P 500 are forecasted to remain high through 2023 according to Yardeni Research, Inc.[4] Annualized US real GDP growth has gone from -35.7% in Q1 2020 to 6.6% for Q2 2021[5], an increase of over 42%! There have been similar recoveries around the world. The story going forward, however, will look more like 2019 than 2021 with developed markets growing less than 3% and China's growth below 6%.

GDP Growth & 2021 Forecast (%)[6]	2019	2020	2021
U.S.	2.3	-3.4	5.7
Eurozone	2.8	-2.7	5.1
China	5.9	2.3	8.0
World	2.5	-3.4	5.8

We have likely reached the high tide mark of monetary and fiscal support

The flow of support for economies is subsiding and we have reached peak monetary and fiscal support in many countries. We will continue to feel the effects of monetary and fiscal programs, but governmental support will fade back to pre-pandemic levels over the next 24 months. Equity markets, which are always looking into the future, have responded accordingly with slightly negative returns for the quarter, but valuations remain high. The Russell 3000 returned -0.10% and the MSCI EAFE index had net returns of -0.45% this past quarter. [7]

Covid stimulus for individuals, families and businesses is coming to a close

The fiscal story is somewhat complicated. Multiple bills, totaling $5.92 trillion, were signed into law to address pandemic related issues.[8] Approximately $4.68 trillion has been committed or disbursed, but a significant amount remains unspent, particularly monies allocated to support state and local governments.[9] Nonetheless, with a closely divided legislative branch, federal spending programs are expected to decline drastically especially if President Biden's American Jobs and American Families plans are not enacted.

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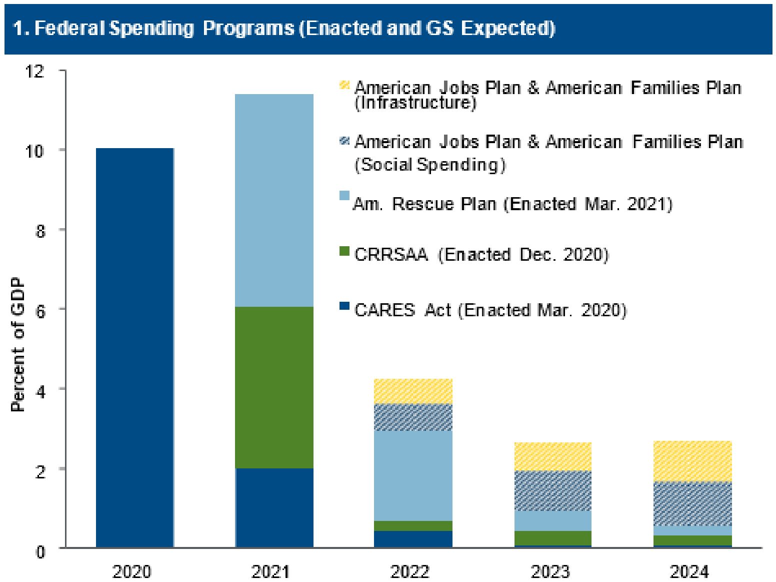
[1] Russell 3000 total return and MSCI EAFE net return.
[2] JP Morgan Asset Management, Guide to the Markets, 9/30/2021.
[3] https://tradingeconomics.com/united-states/corporate-profits, U.S. Bureau of Economic Analysis.
[4] https://www.yardeni.com/pub/yriearningsforecast.pdf, October 4, 2021.
[5] U.S. Bureau of Economic Analysis.
[6] Sources: S&P Global Ratings and Oxford Economics: https://www.spglobal.com/ratings/en/research/articles/210928-economic-outlook-q4-2021-global-growth-is-steady-as-delta-spurs-wide-regional-swings-12126694, United Nations Conference on Trade and Development, European Central Bank.
[7] Morningstar, Inc.
[8] Investopedia.com, https://www.investopedia.com/government-stimulus-efforts-to-fight-the-covid-19-crisis-4799723
[9] Committee for a Responsible Federal Budget, https://www.covidmoneytracker.org/explore-data/interactive-table.



Source: Goldman Sachs Global Investment Research

Though GDP growth has been high throughout 2021, many economists project declining GDP growth over the next three years. The Conference Board forecasts a decline in US real GDP growth to 5.5% for Q3 2021 and to 3.0% in 2023 and the Euro area real GDP is expected to grow by 5.1% in 2021 followed by more moderate growth of 4.5% and 2.1% in 2022 and 2023 respectively.[10]

As monetary and stimulus support wanes, more turbulence is expected

Ebb tides follow high tide bringing crosscurrents and uncertain waters trying to adapt to the change in the moon's pull. Likewise, as an economic ebb tide starts to take hold, uncertainty is expected to increase. We expect markets to become more volatile as non-pandemic related risks take on more importance and affect investor sentiment proportionally. Because monetary and fiscal support has played such an important role in mitigating the effects of the pandemic, the pace of their reduction has great import for markets – too slow or too fast and markets react negatively.

The Federal Reserve has increased its balance sheet over $4.1 trillion since the start of the pandemic through the monthly purchase of $120 billion in Treasury notes and mortgage-backed securities. Recent statements from Fed chairman Powell indicate that the Fed is planning to reduce its bond and mortgage-backed securities purchases, as early as November and stop purchases sometime in mid-2022. This timeline equates to a $15 billion reduction in purchases every month.[11] Equity and bond markets have taken these comments in stride, an indication that the pace of "tapering" is reasonable.

Markets have become increasingly concerned about inflation which has been below 3% in the US on an annual basis since 1992. In March markets began to take notice of potential inflation risks when personal consumption expenditures (PCE), the Federal Reserve's preferred inflation benchmark, ticked up above 5%. In fact, the Federal Reserve whose mandate includes managing inflation, spent significant time communicating a message about the transitory nature of the inflation numbers coming out. While its messaging has helped assuage inflation fears, inflation has remained high, 4% for August, and uncertainty about the Fed's new untested framework of inflation averaging has left room for jitters in the market.

[10] European Parliament Briefing - PE 645.716 - September 2021.
[11] CNBC. https://www.cnbc.com/2021/09/23/heres-what-will-happen-when-the-feds-tapering-starts-and-why-you-should-care.html

The possibility of new COVID variant outbreaks is a continuing risk to the ongoing economic recoveries. While new COVID variant outbreaks are possible, societies and governments are better able to handle outbreaks. Vaccination rates have risen, significantly reducing the possibility of variant genesis. Federal, state and corporate policies and procedures are in place to mitigate the economic impacts. And the adoption of new technology and work arrangements has actually increased productivity.

There are additional risks that could accelerate the ebb tide pulling on our current economic highs. These include the possibility of higher taxes in the US, continued supply chain disruptions, labor market dislocations and shifts in regulatory regimes such as those we see in China.

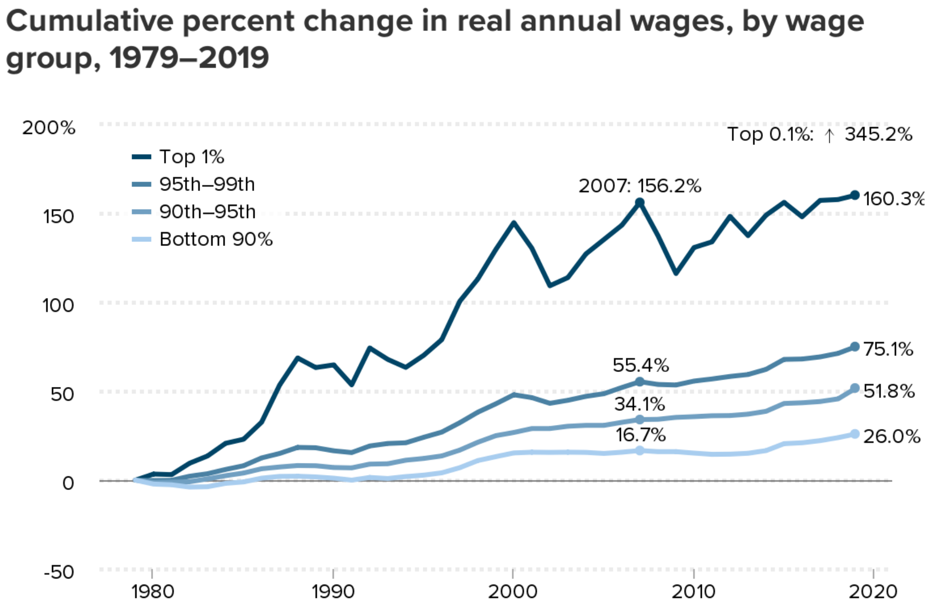
Labor market disruptions stir fears of wage inflation

The COVID pandemic brought significant disruption to the labor market. It accelerated the use of technology as many workers were forced to work virtually from home. Some grew to prefer working from home and productivity actually increased during this time. Parents had to adapt to children learning virtually from home at the same time, forcing many mothers to leave the workplace. Some older workers near retirement decided to throw in the towel and retire early. Some younger workers decided to abandon their big city jobs to buy homes and work remotely or to change jobs. Immigration also came to a screeching halt, partly due to restrictions by the Trump administration and partly due to COVID restrictions on travel. The hardest hit workers were the low to moderate income workers who lost jobs in the hardest hit parts of the economy – restaurant, hotel, laborers, and retail workers. Some of these workers found stimulus/unemployment checks to be higher than their paychecks, a discouraging predicament. Others, such as nurses and other front-line workers had to work harder and became exhausted from the stress and extra duties. Truck drivers, ship captains, dock and warehouse workers also had to work even harder once the economy started to open.

The bottom line is that some of these workers haven't returned to work, others have left permanently, and others have found better jobs. The labor force was already projected to decline before COVID due to reduced immigration, lower birth rates and baby-boomers passing into retirement. Covid exacerbated this, but also contributed to a shifting labor force and pockets of severe labor shortages which are driving wages up, particularly at the lower end of the pay scale.

While this is a risk to wage inflation, it is helping to correct a 40-year history of growing wage disparity in our country. In the chart below you will see the bottom 90% of wage earners grew wages 26% from 1979-2019 while the top 1% increased 160% and the top .1% increased 345%. The top 1% and .1% represent 2019 salaries of $521,794 and $2,888,192 respectively. [12] The wages of the bottom 5% actually declined when inflation is taken into account by approximately 5% during this time period. From 1979-2019, the slice of the total wage pie earned by the top 5% grew from 19.4% to 27.8%.[12]

[12] https://www.epi.org/blog/wages-for-the-top-1-skyrocketed-160-since-1979-while-the-share-of-wages-for-the-bottom-90-shrunk-time-to-remake-wage-pattern-with-economic-policies-that-generate-robust-wage-growth-for-vast-majority/



Source: Authors' analysis of Kopczuk, Saez, and Song (2007, Table A3) and Social Security Administration wage statistics. State of Working America Data library: **Wages for Top 1.0%, 0.1%, and Bottom 90%**. See Mishel and Kandra (2020) for details.

Source: Mishel, Lawrence and Josh Bivens. "Identifying the policy levers generating wage suppression and wage inequality." Economic Policy Institute, 13 May 2021.

Wage inflation is a particular concern to markets as wages make up the lion's share of corporate expenses, tend to be sticky, and could significantly erode profit margins. However, wage inflation may not contribute as much to overall inflation if there is some redistribution of wage growth from the very top to the bottom. Studies show that this would actually make the economic pie bigger, and all would benefit.[13]

The tide will ebb bringing slower growth and more sensitive markets

Though equity markets have absorbed the expiration of the $2.3 trillion CARES Act on September 5, 2021 and the portended Fed "tapering" with relative equanimity, high US equity valuations and low bond yields have made investors much more reactive to any uncertainty about either asset class leading to greater market volatility. The outlook for US bond markets is cloudy with inflation well above the Fed's 2% target and Fed rate hikes expected to start in late 2022 or early 2023. In our current environment markets are still sorting out where long-term interest rates will coalesce, but we expect it to be closer to 3%, particularly when international bonds are carrying negative yields.

While there is still growth potential in the short run from stimulus money still in circulation, many financial institutions project low single digit equity market returns over the next five years[14] as equity headwinds build. In an environment of high equity valuations, low bond yields, elevated inflation, COVID variants, and heightened trade competition, active management is poised to add value.

[13] The Economic Gains from Equity, Buckman, Choi, Daly, Seitelman, 9/9/2021.
[14] Northern Trust Asset Management, Goldman Sachs, BlackRock Investment Institute, Vanguard.