Q3 2021

MARKET VIEW QUARTERLY

Philip Blancato, Chief Market Strategist, Advisor Group

The first half of 2021 was characterized by optimism and positive momentum in both markets and the economy as the Coronavirus Pandemic's effects faded in the U.S.; however, the third quarter saw a slight slowdown in that momentum as the Delta Variant emerged and threatened to slow down growth globally. While the Delta Variant has caused a spike in cases late in the summer, cases seem to have plateaued, and the global economy is continuing to get back on track. As an example, the United States will reopen in November to air travelers from thirty-three countries including China, India, Brazil, and most of Europe who are fully vaccinated against COVID-19. GDP growth came in above expectations in the second quarter, rising at a 6.6% annual rate, and is expected to rise 5% in the third quarter. The labor market has also proven to be resilient with the U-3 unemployment rate at 5.2% as of August, down from 5.9% to begin the quarter. Fears of rising inflation have remained at the forefront of investors minds, as they try to anticipate whether the Federal Reserve will be forced to raise interest rates sooner than anticipated. The Consumer Price Index (CPI) is up 5.3% year-over-year as of August, slightly moderating from earlier in the year, but still well above long-term averages. While a pickup in inflation is typical in a recovering economy, questions remain about the long-term effects of the extraordinary levels of stimulus seen in the last year and a half. While we expect economic data to moderate in the months ahead, we believe the recovery will remain strong in the coming quarters as loose monetary policy and a strong consumer should propel the economy forward.

DOMESTIC EQUITIES

After climbing higher for seven straight months through August, its longest winning streak since January 2018, the S&P 500 reversed course and declined -4.65% for the month of September. Still, stocks finished the third quarter slightly higher, returning +0.58%. Strong earnings were the main catalyst pushing stocks higher. Corporate profits rose by 92% year-over-year in the second quarter, the highest year-over-year earnings growth rate reported by the index since Q4 2009 (109.1%). The market pullback in September was not surprising as the month historically has built in calendar risk. According to CFRA, the S&P 500 has been positive just 45% of the time in September going back to World War II. The average September performance during that time is -0.56% and is the worst of all months. A myriad of headline risks also caused equity volatility during the final month of the quarter, including fears that Chinese real estate developer, Evergrande Group's, possible default on multibillion-dollar debts might send shockwaves through global financial markets. Similarly, the Federal Reserve acknowledged that they may start to slow their bond buying program which has helped to support markets and the broader economy through the pandemic over the past 18-months. As we move along in the expansion investors have continued to pile back into growth stocks, believing that these may do well in comparison with the economically-sensitive value names as we see a slower rate of economic growth in the second half of the year. Similarly, despite spiking at the end of September, yields remained relatively subdued throughout the quarter. As a result, the Russell 1000 Value index returned -0.78% for the third quarter versus 1.16% for the Russell 1000 Growth index[1]. Small caps continued to lag their larger cap peers during the third quarter, over concerns regarding their relatively high valuations and persistent inflation, stoking fears that small companies won't be able to pass rising costs on to customers. Small caps returned -4.36% for the third quarter versus -0.93% for mid-caps and 0.21% for large cap equities. We acknowledge that there are concerns over a slowdown in growth, inflation pressures, and the Fed dialing down stimulus, however, we believe that markets will continue to climb the wall of worry as the fundamentals of the economy remain strong. Therefore, we would consider any market volatility as a buying opportunity and remain bullish on US equities over the longer-term.

INTERNATIONAL EQUITIES

International developed equities and emerging market equities returned -0.33% and -8.03% for the third quarter, respectively, both lagging the S&P 500. The developed international equity market (mainly Europe and Japan) is much more value-focused than the U.S. market, based on the MSCI EAFE Index and the S&P 500 Index. As the market regime shifted in favor of growth stocks, it was no surprise to see international equities underperform domestic equities. However, moving forward we could see strong performance from the international space. According to FactSet, Europe is now on the front foot this earnings season, with earnings growth for the quarter increasing a remarkable 248%, more than twice as fast as its American counterparts. Similarly, an acceleration on Coronavirus vaccination rates could spur a recovery in travel and consumer spending in the eurozone which would be a tailwind for international stocks.

Emerging market equities were again hit particularly hard this quarter over concerns about the Chinese government's regulatory crackdown on Chinese firms. China makes up more than one third of the emerging market index, therefore, any volatility in Chinese markets is going to be a drag on emerging market stocks overall. However, as pressures surrounding Chinese equities ease, we remain optimistic that a resilient global economic upswing, continued demand for many natural resources and stretched valuations elsewhere could help emerging markets recover.

FIXED INCOME

The fixed income market, as measured by the Bloomberg Barclays US Aggregate Bond Index, returned +0.05% during the third quarter. This was due to a reversal in long-term interest rates to end the quarter, as market participants re-evaluated the path of the Federal Reserve and the staying power of inflationary pressures. The 10-year U.S. Treasury yield sits at 1.49% as of quarter end, up from 1.47% to start the quarter, an increase of 0.02%[1]. As short-term rates remain anchored by the Federal Reserve, the difference between long and short-term rates decreased to 1.21% as the yield curve began to steepen[1]. Though the Federal Reserve has indicated that they are not going to raise interest rates in the near term, they did note that they are likely to announce a tapering of their bond-purchasing programs in upcoming meetings. While the announcement of tapering has had an adverse impact on markets previously, we believe the clear communication of their intentions may help the market to digest this change in monetary policy. We believe the projected path for interest rates is up from here, as an economy with above-trend growth, inflation, and an improving labor market may force the Fed's hand in the medium term. Moving forward, we believe fixed income securities will provide diversification benefits to equities but may be under pressure if rates continue their upward path on the year.

ALTERNATIVES

Alternative assets have continued their climb from Q2 into Q3 as investors weigh the effects of higher inflation expectations. WTI Crude prices reached new highs, however it was a volatile quarter, as WTI prices started the quarter at $72.05 a barrel before falling as low as $61.84, before recovering and ending the quarter at $75.03 a barrel[1]. Continuing vaccinations across the United States and easing restrictions have led to an uptick in the demand for petroleum products. MLPs and similar investment vehicles may see tailwinds moving forward if the Fed does indeed taper its asset purchasing program potentially moving interest rates higher. Hedge Fund-like alternatives moved lower on the quarter, down -0.54%, as measured by the Morningstar Diversified Alternative index[2].

REAL ESTATE

The Federal Reserve's asset purchasing program has served as a tailwind for real estate. With interest rates anchored near zero, home buyers have been eager to take advantage of low mortgage rates. However, as home prices continue to rise, more and more buyers are being pushed out of the market and are moving towards renting. According to the St. Louis Fed, the median price for a new home sold reached a record of $390,900[3]. Single family home starts decreased by -2.8% month-over-month in August pointing to a possible slowdown in demand with home prices at current levels. The decrease in permits may also be reflective of the increased pricing pressures effecting producers as inputs such as lumber, and copper have increased. Consequently, the increases in input costs and home prices may ultimately offset some of the benefits that the current low borrowing costs are offering. In the near to intermediate future for the residential market, if the Fed begins to taper its asset purchases, interest rates could move higher, which may slow demand.

CONCLUSION

As the United States brings the Delta Variant under control, potential growth has been pushed from the present into the future, extending the runway for the current economic recovery. Though we have witnessed moderation in economic data, we remain optimistic on the ability for the US economy and the markets to continue moving higher. As an example, corporate profits are still expected to grow by 22% for the full year of 2021, well above average growth that is indicative of the strength of the recovery so far. Inflationary pressures have become a real concern in the near term as supply chain disruptions remain unresolved, however, investors should take comfort in the fact that the labor market has more room to recover before the Federal Reserve alters their stance on short term interest rates. As the recovery continues, we don't expect data to be as strong as it has been, but there are still tremendous levels of pent-up consumer demand that should allow the United States to continue on its path to a robust recovery.

Economic Definitions

GDP: Gross domestic product (GDP) measures the final market value of all goods and services produced within a country. It is the most frequently used indicator of economic activity. The GDP by expenditure approach measures total final expenditures (at purchasers' prices), including exports less imports. This concept is adjusted for inflation.

Unemployment Rate: The unemployment rate tracks the number of unemployed persons as a percentage of the labor force (the total number of employed plus unemployed). These figures generally come from a household labor force survey.

CPI (headline and core): Consumer prices (CPI) are a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.

Housing Starts: Housing (or building) starts track the number of new housing units (or buildings) that have been started during the reference period.

Index Definitions

S&P 500: The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

Russell 1000 Value: Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.
Russell 1000 Growth: Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.

Russell Mid-Cap: Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

Russell 2000: The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. The real-time value is calculated with a base value of 135.00 as of December 31, 1986. The end-of-day value is calculated with a base value of 100.00 as of December 29, 1978.

MSCI EAFE: The MSCI EAFE Index is a free-float weighted equity index. The index was developed with a base value of 100 as of December 31, 1969. The MSCI EAFE region covers DM countries in Europe, Australasia, Israel, and the Far East.

MSCI EM: The MSCI EM (Emerging Markets) Index is a free-float weighted equity index that captures large and mid cap representation across Emerging Markets (EM) countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

Bloomberg Barclays US Agg Bond: The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

Bloomberg Barclays High Yield Corp: The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded.

Morningstar® Diversified Alternative Index: The Morningstar® Diversified Alternatives Index is designed to provide diversified exposure to alternative asset classes in order to attempt to enhance risk-adjusted portfolio returns when combined with a range of traditional investments. The index consists of a diversified set of ProShares alternative exchange traded funds that employ alternative and nontraditional strategies such as long/short, market neutral, managed futures, hedge fund replication, private equity, infrastructure, or inflation-related investments.

Disclosures

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[1] *Bloomberg as of 9/30/21*

[2] *Morningstar Direct as of 9/30/21*

[3] *Median Sales Price for New Houses Sold in the United States (MSPNHSUS) | FRED | St. Louis Fed (stlouisfed.org)*