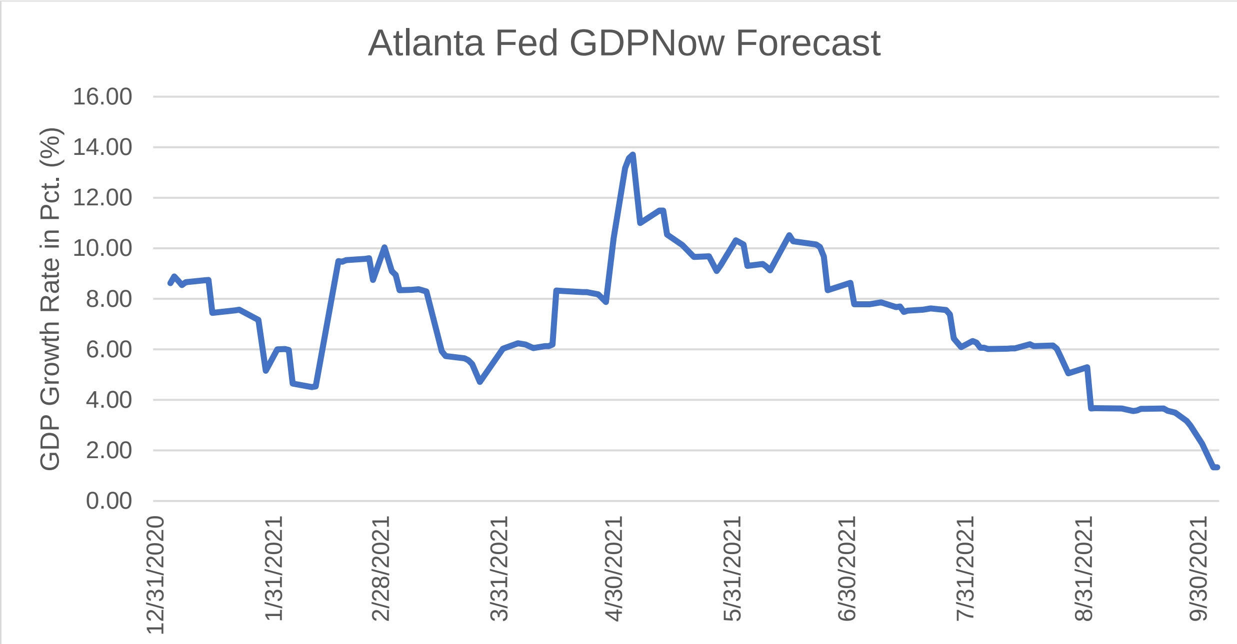
# AndCo's Monthly Market Update

*October 2021*

## THE ECONOMY

*"The trend is your friend." – Martin Zweig*

Much as in life, spotting a trend can increase the probability of success, especially when investing. With the end of the 3rd quarter behind us, there are a few trends that we believe are both notable and material. Most importantly, the US economy is decelerating. After having experienced a rapid recovery following the onset of the pandemic last year, the pace of US economic growth more than likely slowed during the quarter which precipitated an increase in market volatility. While the third measurement of the 2nd quarter's GDP growth was re-affirmed at 6.7%, the Conference Board is forecasting that the US economy will grow at a slightly less rapid pace of 5.5% during the most recent quarter.[1,2] That forecast stands in stark contrast to the Atlanta GDPNow model which is estimating that the economy slowed to 1.3% growth during the period.[3] There are a number of factors which likely contributed to the slowing growth including continued concerns related to the Delta variant, rising US interest rates, rising energy prices, signaling by the Federal Reserve Bank (the Fed) that it will begin tapering asset purchases in the near future, and concerns related to fiscal policies in Washington. However, the more likely scenario is that as the recovery matures, the economy is reverting to its long-term growth trend of roughly 2%.[4] With this in mind, we are looking to confirm the trend of positive economic growth remains intact, albeit at a less robust pace.

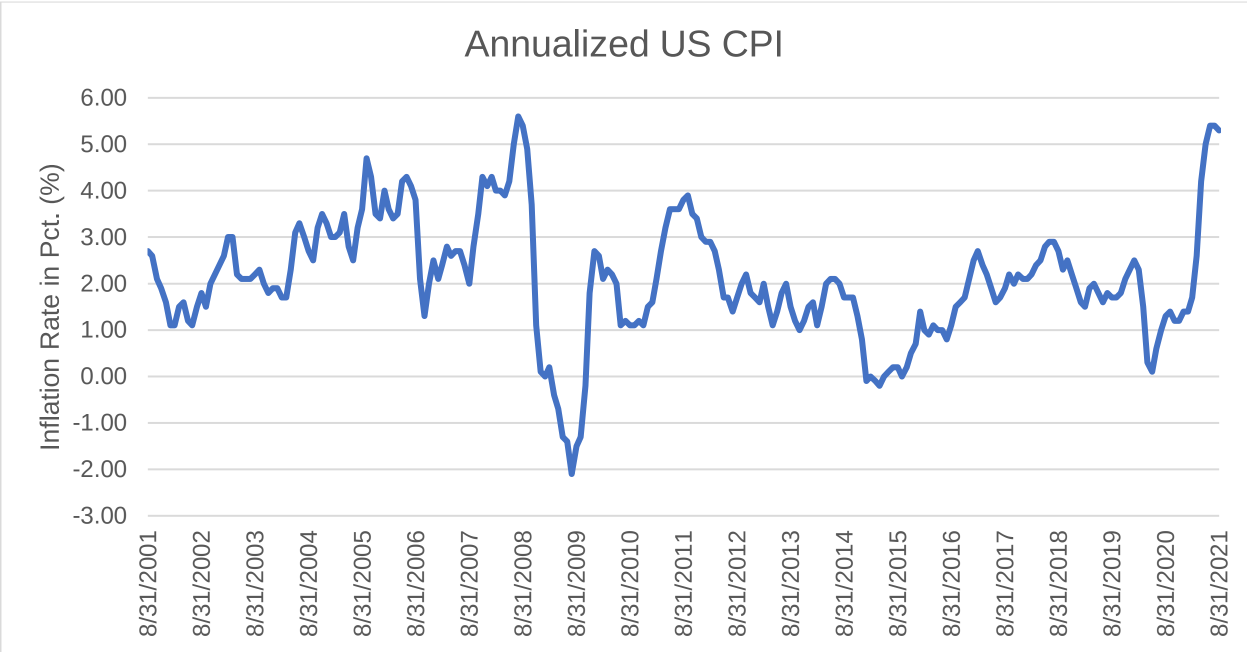



***Source:*** Bloomberg as of October 5th, 2021

As we would expect during a period of slowing growth, certain data points we monitor such as the health of labor markets, housing, and consumer sentiment, showed signs of slowing during the month of September. Regarding the labor market, while the trend of a lower unemployment rate remains intact, as evidenced by the August rate of 5.2% versus 5.4% for July, the Nonfarm Payroll data was far less than expected with only 235 thousand new jobs created during the month as opposed to expectations of 733 thousand new jobs.[5] Importantly, the weekly initial jobless claims reported during September were consistently above expectations. While the market's expectations for both the unemployment rate and new jobs created are expected to show improvement in September, due mainly to the expiration of unemployment benefits related to the pandemic which expired early in the month, it is possible we could see a temporary uptick in unemployment as those individuals begin searching for work.[6]

Housing has been a consistent source of strength for the economy since the recovery began last year. This can be seen in the S&P CoreLogic Case-Shiller composite which has risen roughly 20.0% year-over-year as of July.[7] However, the trend for strong price appreciation may be showing signs of slowing. While the data between pending and existing homes sales diverged, with the former rising 8.1% and the later falling by -2.0% during August, mortgage applications fell during the month primarily due to rising US interest rates.[8] Historically, the housing market has taken a breather during the 4th quarter of the year due mainly to seasonality. That said, the overall supply in the market remains tight which should be supportive to the market. Our concern is the potential for higher interest rates to further reduce housing affordability as borrowing costs increase, which could result in slower price appreciation in the future.

Consumer sentiment has historically been a volatile indicator and predicated on a number of underlying economic conditions, most notably the strength of the job market. The thinking here is if you feel good about your job prospects, you likely feel comfortable spending on things such as electronics and durable goods like home appliances. For the month of September, the University of Michigan Consumer Sentiment Index rose to 72.8, which was a slight improvement from the August reading of 70.3.[9] While one month does not make a trend, it is important to recognize that the August reading was the lowest since December of 2011.[10] The likely contributors the recent decline in sentiment can most likely be attributed to are the fact that inflation has far outpaced the Fed's average target of 2.0%, and the fact that wages have not risen fast enough to offset the increase in prices.[11] For August, the Consumer Price Index rose 5.3% year-over-year.[12] We are watching closely for any signs that consumer sentiment is trending lower. Given that the consumer spending accounts for roughly 70% of economic activity, any such pullback could have a ripple effect across the economy.[13]

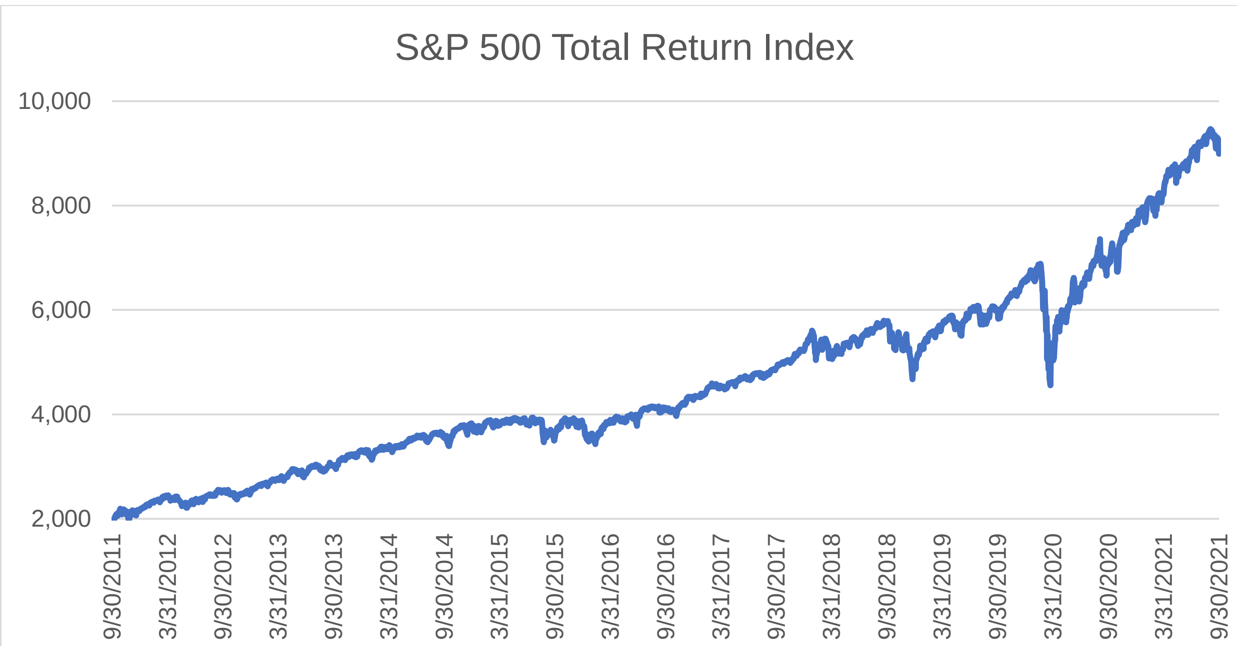



***Source:*** Bloomberg as of September 30th, 2021

In summary, we think it is likely that the positive growth trend in the US economy will remain intact in the near-term. Given the magnitude of the recovery and its rapid pace, any deceleration should be considered normal. Moving forward, we will be watching for events and economic indicators that could suggest growth is slowing below the long-term trend.

## EQUITIES

Equity returns were broadly lower in September across styles, market capitalizations, and geographies. September is historically a challenging month for equity returns with the market declining on average -1.0%.[14] For the month, the market was led lower by the S&P 500 Index which dropped by -4.7%.[15] This was the largest monthly decline in stocks since the onset of the pandemic in March 2020.[16] Large cap growth stocks had a particularly difficult month with the technology-heavy Russell 1000 Growth Index falling -5.6%.[17] In contrast, value stocks outperformed across market capitalizations led by the Russell 1000 Value Index which declined by only -3.5%.[18] Factors that drove the decline in stocks include the Fed's announcement regarding the future path of interest rates, the continuing problems related to disruption in the global supply chain, and concerns about declining margins due to rising inflation. From a sector perspective, the lone bright spot was Energy which benefited from the continued rise in oil prices.[19] For the month, Energy was up 9.4% while in contrast, the Communication Services sector was down -6.6%.[20]

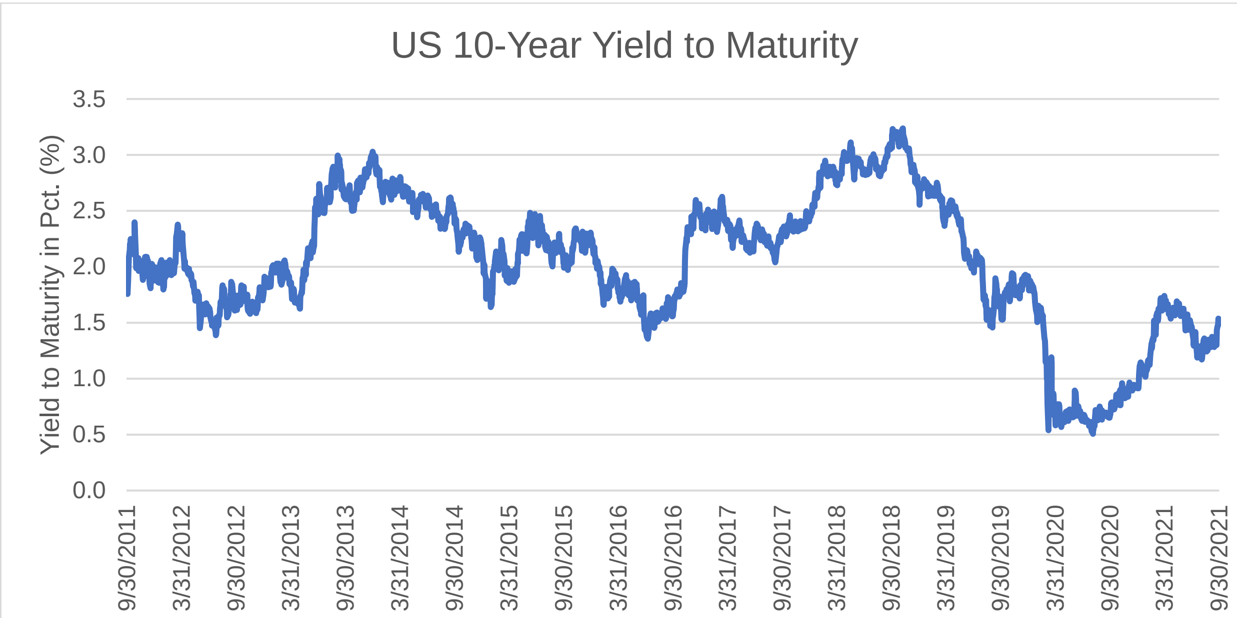



***Source:*** Bloomberg as of July 31st, 2021

Overseas markets didn't fare much better with the developed market MSCI EAFE Index declining by -2.9% and the emerging market MSCI EM Index falling by -4.0%.[21] Similar to their counterparts in the US, several companies in developed markets cited supply chain disruptions and rising inflation as headwinds to growth. Eurozone inflation is estimated to have increased by 3.4% in September, the highest level since 2008 and well above the European Central Bank's 2.0% target.[22] Energy prices are primarily to blame for the recent rise in inflation as evidenced by the 17.4% spike in German energy prices during the month.[23] Emerging markets were hit hard by the news out of China regarding the potential default by real estate development giant Evergrande. As of the end of September, China makes up roughly 34% of the MSCI EM Index.[24] Despite the attempts to raise capital, the company's shares were halted in trading on Hong Kong's exchange, casting doubt about the company's viability going forward.[25]

## FIXED INCOME

Fixed income markets broadly declined in September as US interest rates rose at their fastest pace since March of this year.[26] The US 10-Year Treasury bond yield ended the month at 1.49%, up from 1.31% in August.[27] The recent move higher in rates is likely tied to the Fed's recent comments related to its expected tapering of asset purchases, which was largely anticipated. The bank signaled that it expects to begin raising interest rates sometime in late-2022 with the short-term Fed Funds rate eventually rising to roughly 1.75% by the end of 2024.[28]




***Source:*** Bloomberg, September 30th, 2021

Despite concerns about rising interest rates, credit issues generally did better than higher quality government bonds during the month. As evidence, the Bloomberg US Aggregate Bond Index returned -0.9% while the lower quality Bloomberg US Corporate High Yield Index returned -0.0%.[29] The fact that corporate bonds generally have larger coupons and shorter overall duration profiles largely drove performance during the period. Importantly, credit spreads were largely unchanged across the credit continuum during the month for both investment grade and high yield bonds.[30]

As previous mentioned, emerging markets faced headwinds in September due to China, and more specifically, issues at Evergrande. The company is one of the largest real estate developers in the country and failed to make a scheduled interest payment during the month.[31] The company, with more than $300 billion in debt outstanding, has sought to raise capital in recent weeks by selling off several valuable subsidiaries including a property management division valued at $5 billion.[32] The question investors may be asking is: why is this important? China has been attempting to reform its economy and the country's real estate market to reduce speculation. The challenge is that Evergrande is a conglomerate with many business lines including wealth management and manufacturing. In the event of a formal default, foreign bond holders will likely suffer significant losses. The concern is the event may have a spillover effect into emerging market corporate bonds and potentially sovereign debt. Investors are anxiously watching to see if the Chinese government will step in and bail out the company to stave off a liquidation and avoid a global contagion.

## APPENDIX


1. Bloomberg, September 2021
2. https://www.conference-board.org/research/us-forecast#:~:text=The%20Conference%20Board%20forecasts%20that,year%2Dover%2Dyear).
3. Bloomberg, September 2021
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13. Bloomberg, September 2021
14. https://www.spglobal.com/spdji/en/commentary/article/us-equities-market-attributes/
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