NOVEMBER 2021 MARKET COMMENTARY

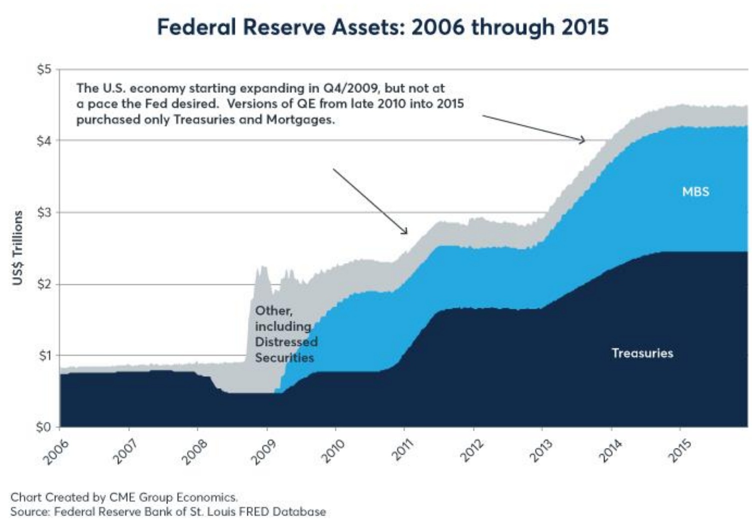
Markets broadly rebounded in October after a seasonally weak September that saw a spike in volatility mainly on political headlines out of Washington as Congress played "political chicken" with the Debt Ceiling and a looming government shutdown. All domestic, European, and Asian, equity indices are positive for the year. Commodities remain strong performers for the year (excluding precious metals) due to the inflationary effect we have seen in food, materials, and energy prices.

The Federal Reserve signaled during their September meeting that they could begin tapering their monthly asset purchases (support of the market through quantitative easing) as early as mid-November. In the summary released in October, they expanded upon that sentiment defining their tapering as up to $10 billion per month of Treasury securities and $5 billion per month of mortgage-backed securities. They also eased up on their quelling of inflation concerns indicating that inflation may last longer than they previously assumed. The minutes sparked a lot of headlines and speculation around a repeat "Taper Tantrum," or spike in Treasury yields, like the markets saw in 2013 when the Fed announced they would begin tapering purchases from the 2008 Financial Crisis.

But what does this all mean, and is it a reason to worry? _In short, we do not believe this is a reason to worry, and we are not making meaningful adjustments within client portfolios, at this time._ Please read on for a background on Quantitative Easing and our rationale.

What is Quantitative Easing? Quantitative Easing, or QE, is an unconventional form of monetary policy in which a central bank, in our case The Federal Reserve (Fed), purchases long-term securities from the open market. In doing so, they create money. With a larger supply of money, and increased liquidity available to banks, it encourages lending and investment. The Fed's purchasing of these securities creates increased demand for the available supply, which in turn increases prices and lowers interest rates (making the borrowing of that money available for lending and investment more attractive).

In 2008, the Fed purchased assets at an unprecedented rate and from 2006 through 2015 their balance sheet ballooned from around $1 trillion to nearly $4.5 trillion. You will see in the chart to the right that eventually the Fed curtailed (tapered) their purchase of asset classes and the size of their balance sheet grew at a slower rate, eventually leveling off.



At the time, the 2008 Financial Crisis created a QE asset purchase program of unprecedented size and scope. The COVID-19 pandemic brought about a swift and expansive response by the Fed. For reference of the size and speed of those QE actions, in 2020 the Fed expanded its balance sheet in a matter of months the same amount that took five years during the 2008 Financial Crisis. The below chart puts this in perspective.

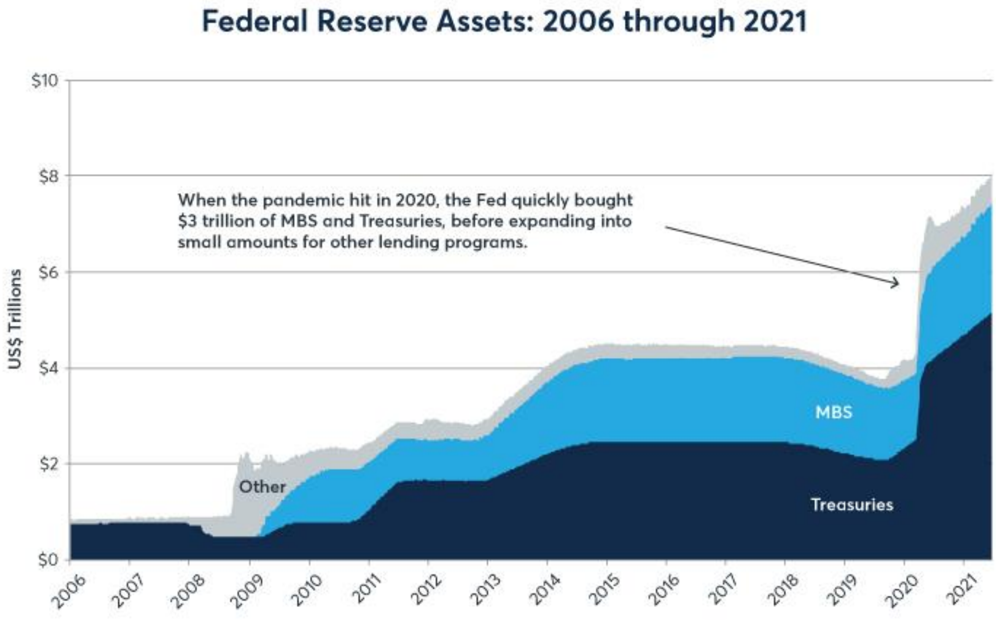


Chart Created by CME Group Economics.
Source: Federal Reserve Bank of St. Louis FRED Database

While Quantitative Easing in the simplified explanation above seems like a miracle drug for an ailing economy, and has proven an effective short-term solution, there are possible negative unintended side effects:

- First and foremost, for QE to work, banks need to lend the money that is made available in the system, and borrowers need to take loans to invest and spend. While the Fed can make the money available, the market participants (banks and borrowers) need to participate. If they do not, QE will be ineffective at spurring economic growth.
- When the available money supply is increased, and more money is available to purchase goods, it can create inflation or an upward movement in prices.
    - If inflation is created and the economy is growing, the inflation can be healthy if it doesn't run away. If you experience inflation without the intended economic growth this is called stagflation.
- QE can also devalue the dollar. This can help domestic manufacturers and businesses as it makes their goods and services appear cheaper in the global market (spurring economic activity, exports, and growth)—but it can also hurt the consumer and add to inflation as imports become more expensive.

This is why the Federal Reserve sets monthly limits to their support of the markets, monitors the economic data, and makes adjustments as necessary. It is also why the Fed eventually sets an expiration date for QE.

So, what happens when the Fed stops supporting the economy with QE? When a child learns to ride a bike there is a logical progression where a toddler will move from a tricycle, to a bicycle with training wheels, to a bicycle with an adult running behind holding the seat, and finally the child looks back and no one is holding the seat. If you put a toddler on a bicycle, the result would likely be quite a few bumps, nicks, and bruises. The same rings true to an economy that is being supported with massive unconventional stimulus.

The Federal Reserve has been extremely transparent in telegraphing their every move well in advance. In 2013, Fed Chairman Bernanke said that at some undetermined point in the future, the Fed would begin to curtail their

QE program. The market, having a dependency on ongoing Fed support, reacted swiftly and it created volatility in asset prices and a spike in interest rates. This is referred to as the "Taper Tantrum." It is important to note that the Fed had not slowed their purchase of assets, nor had they began reducing their balance sheet by selling assets. The Taper Tantrum had no basis in market fundamentals but was purely a negative shock to expectations of investors and market participants.

It is also important to note that the Fed, much like a parent teaching their child to ride a bike, didn't move right from a tricycle to a bicycle with no training wheels or assistance. The Fed tapered—they slowed their purchase of assets rather than stopping their purchases all together overnight. They curtailed support of the markets gradually as the market got its legs and continued with direction. Indeed, the stock market continued higher during the entire tapering process. From the day of Bernanke's testimony that the taper would start the market (as measured by the Standard and Poor's 500 Index) moved 10.67% higher and during the actual tapering the market moved 10.16% higher.

While history doesn't always repeat itself, it often rhymes. The Fed has remained committed to economic growth, adjusting policy as needed, and has been extremely transparent in telegraphing their every move.

So, what are we monitoring and when might we make changes? We are closely monitoring a few areas of the market. First and foremost, we are monitoring inflation and jobs data. We anticipate that inflation will likely remain elevated throughout 2022, especially the first half, as we continue to see weakness in the global supply chain. We are not rattled by a slightly elevated inflation as long as jobs data continues to improve—not only jobs created but wage growth and asset growth that keeps up with inflation to preserve purchasing power. Interest rates—while short-term rates are set by the Fed, long-term rates can be more volatile as it is set by market conditions. We are also closely monitoring credit conditions as the credit markets are often a leading indicator. Defaults are running well below historical averages and liquidity is ample.

We remain tactical and selective with our fixed income allocations for clients to not only find yield, but to preserve capital and purchasing power. Periods of rising rates can have adverse effects on asset prices, if not managed. We note that like tapering, rising rates are not always a negative for the stock market. Indeed, from December 2015 to December 2018 the Fed raised rates 9 times and the market, as measured by the Standard and Poor's 500 Index, returned just shy of 21%.

We remain positive about the long-term and urge clients to continue to tune out "market noise" as much as possible. Our clients have a financial plan and are invested for the long-term—their financial future. As such, we do not take sudden action in response to short-term market movements. We monitor the markets and our clients' financial plans; we adjust as needed and for now view any short-term pullbacks in the market as long-term opportunities.

As always, should you have any questions, please contact our office.

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Data sources: Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation); U.S. Department of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services). Performance: Based on FactSet data. News items are based on reports from multiple commonly available international news sources (i.e. wire services) and are independently verified when necessary with secondary sources such as government agencies, corporate press releases, or trade organizations.