

Equity and Bond Market Update

(as of October 12, 2021)

Index	YTD	1-Year
Dow Jones Industrial Average TR	+13.9%	+22.6%
S&P 500 Total Return Index	+17.1%	+27.0%
Russell 2000 Total Return Index	+14.0%	+37.8%
MSCI EAFE Index (net)	+7.6%	+20.7%
MSCI Emerging Markets Index (net)	-1.2%	+12.5%
Barclays US Aggregate Bond TR	-1.8%	-1.0%

Recent Economic Indicators

	Statistic	Data as of
Unemployment Rate	4.8%	Sep 2021
Gross Domestic Product (GDP)	+6.7%	Q2 2021
Consumer Price Index (CPI)	+0.3%	Aug 2021
Consumer Confidence (1985=100)	109.3	Sep 2021
30-year fixed mortgage rate	3.13%	10/12/2021
Housing Starts (single family)	1,076,000	Aug 2021
10-Year Treasury Yield	1.61%	10/8/2021

Inflation concerns, Federal Reserve tapering, and ongoing COVID-related jitters have taken a toll on recent equity and bond markets. Since early September, all foreign and domestic equity markets have pulled back, with small-caps retreating -3.0%, large-caps -4.1%, emerging markets -4.4% and foreign developed markets -5.0%. In addition to equity markets, bond prices have been under pressure with the US Aggregate Bond index down -1.3% since early September while the 10-year US Treasury rate jumped from 1.3% to its current 1.6%.

Over the last six weeks, the only sector of U.S. markets that has seen any advance was the energy sector which has gained over +15% during the period. All other sectors are anywhere from flat (financials +0.5%) to down over -8% (utilities -8.3%) since early September.

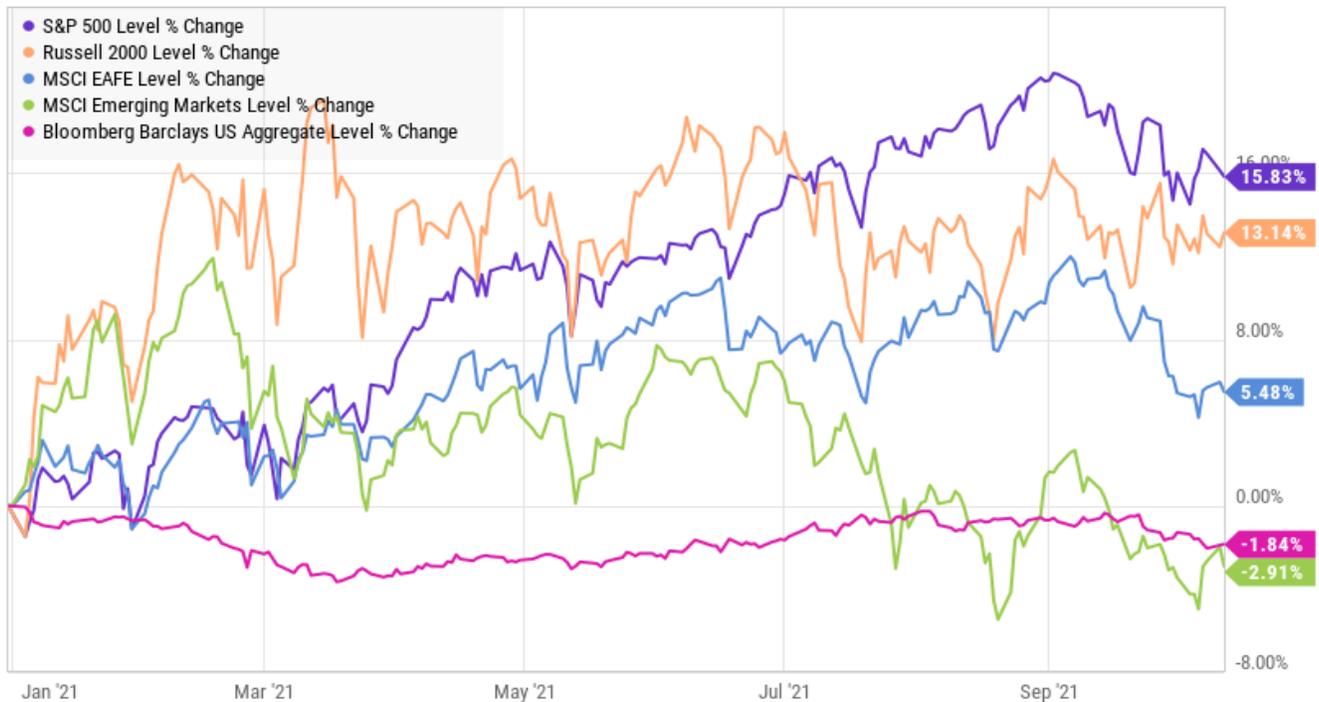
All of this should be taken with a broader view of markets and the economy in general. Although we have seen a slight pullback recently, most equity markets are still in the positive for the year and over the last 12 months. Currently, and through 2021, there has been a battle for leadership between large-cap growth (those with high P/E ratios) and value (those with lower P/E ratios) stocks. Currently, growth is in the lead year-to-date, but only by a margin of less than two percentage points. But this large-cap growth vs. value leadership has changed hands multiple times this year. Alternatively, small-cap value stocks have far outperformed small-cap growth stocks since late February, with a margin of difference over 22 percentage points.

This year has been out of the ordinary compared to historical standards when studying sector performance. Although it may be debated where we are in the economic cycle, most would consider us still in the early (or rebound) phases of the economic cycle after last year's flash recession and bear market. Typically, throughout the economic cycle, energy underperforms during the rebound phase of the cycle and outperforms during the late, or moderating phase. Since broad markets bottomed out in late March of last year, energy has been the best performing sector, bucking the historical trend. The second and third best performing sectors, financials and technology, however, have stuck with the historical trend of outperformance during the rebound phase of the business cycle.

There are many factors right now that are pulling markets in different directions – (1) the expansion of the economy as we ween our way out of COVID restrictions and getting back to normal, (2) federal policy due to the new administration taking power and reversing most of the policies put in place during the Trump administration (energy being probably the largest effected), (3) a Federal Reserve that has all but confirmed they will begin tapering bond purchases this quarter and continue reducing until mid-2022, and (4) inflation fears due much in part to the aforementioned factors, just to name a few.

The bottom line that we have touched on in the past are that equity market valuations over the long-term are based solely upon current and expected corporate earnings. Earnings season for the third quarter kicks off this week, and with record earnings expected, equity markets could see a welcome boost to valuations after the pullback we have seen over the last 6 weeks. Given this expected earnings growth, and a still very low interest rate environment by historical standards, this may be the catalyst to market valuation growth throughout the remainder of this year.

Major Market Indices Price Return (YTD through October 12, 2021)



Rather than being more focused on large vs. small-cap, growth vs. value, or foreign vs. domestic, we have shifted our more aggressive portfolios to take advantage of more theme-driven strategies. Those sectors and companies due to experience better than average growth in areas such as cybersecurity, water infrastructure, and the rollout of 5G networks globally have taken position in these portfolios. Also, industries that have benefitted from, and will continue to do so, by the earlier adoption of certain technologies such as cloud computing, robotics and artificial intelligence are being held through mutual fund and ETF positions. We anticipate these themes will rotate out over time as new themes emerge and drive economic growth.

Lastly, to meet the main mandate of price stability for this portion of more conservative portfolios, we are still focused at this time more on higher-quality, lower-duration bond holdings. Remember that in the bond universe, and especially in a low-rate environment, seeking higher yield means either (1) taking on credit risk through lower-quality, high yield instruments, or (2) holding instruments that do not provide diversification for volatility purposes from riskier stock holdings, such as convertible bonds.

Always keep in mind that fear, panic, and optimism are not investment strategies, but rather emotions that drive short-term markets.

Please contact Lifestyle Asset Management, Inc. at (281) 612-2035 or by email at pjackson@lsaminc.com should you have any questions or comments.

Sources:

S&P Dow Jones Indices website (us.spindices.com)
 MSCI Barra website (<http://www.msibarra.com>)
 The Conference Board (www.conference-board.org)
 Bureau of Economic Analysis (www.bea.gov)
 JP Morgan Guide to the Markets

FTSE Russell (www.ftserussell.com)
 Bankrate.com (www.bankrate.com)
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 United States Census Bureau website (www.census.gov)

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