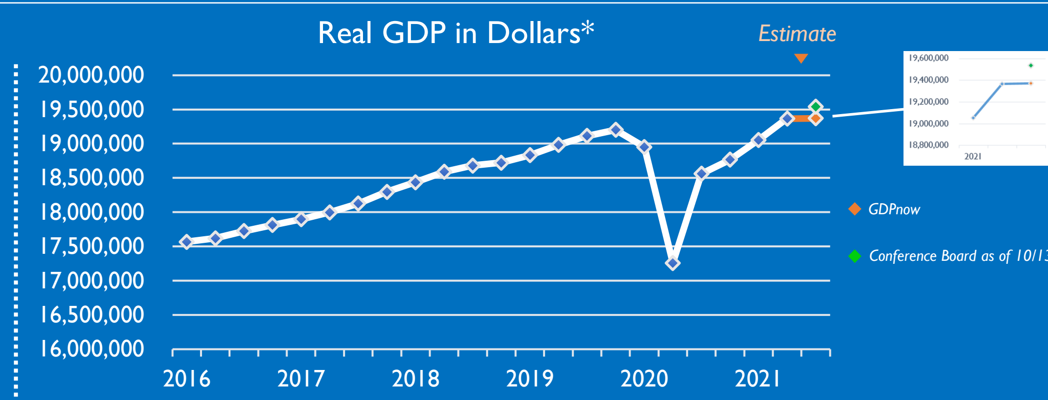
Economic Commentary

As of September 30, 2021

Other Indicators

	CPI	Unemployment	Sentiment	Crude Oil
Q3: 2020	1.4%	7.9%	80.4	$40
Q2: 2021	5.3%	5.9%	85.5	$77
Q3: 2021	5.4%	4.8%	70.3	$78

Real GDP in Dollars*



*Billions

GROWTH

There are differing forecasts for Real GDP. The GDPNow model estimate for Real GDP growth is 0.5% (annualized rate) in the third quarter of 2021. The Conference Board forecasts that US Real GDP growth will be 3.5% percent (annualized rate) in the third quarter of 2021. Both sources downgraded from their September outlooks due to the larger-than-expected impact that the COVID-19 Delta variant has had on the US economy. Consumer spending will be a key driver of growth in Q4 2021, but recent declines in consumer confidence may mute expectations. Sentiment varies by income group, as the bottom-third of the income distribution was more optimistic about the economic outlook. However, the top two-thirds of the income distribution have a more pessimistic view of the economy.

INFLATION

Recent economic reports and price action in commodities markets continued to lean in favor of longer-lasting inflation, which runs counter to the central bank's 2% target. Supply-chain disruptions that have held back industrial output in the past few months have persisted. Shortages of gas and coal are triggering extra demand for oil products from the power market. Food prices also climbed 2% after a 2.9% increase the month prior. The Fed and economists both predict that year-over-year inflation rates will likely continue to remain high, with high energy prices keeping inflation from falling more rapidly over the winter months. However, it is likely that the intensity and momentum of month-over-month price increases will begin to decline. We expect the Fed to start tapering, however they have yet to commit to a time frame. Most economists believe it will start sometime in the next year.

EMPLOYMENT

Both unemployment and the labor force shrank in September. There are five million fewer people working than before the pandemic began, and three million fewer even looking for work. The health crisis is still making it hard or dangerous for some people to work, while savings built up during the pandemic have made it easier for others to turn down jobs they do not want. That economic activity and incomes have held up so much better than jobs is testimony to the contradictory nature of the pandemic recession, which effectively bypassed sectors of the economy that didn't require in-person interaction. Much of the information technology sector, including software, gaming and most internet enterprises, continued to grow. Lower-wage workers seem to have borne the brunt of the pandemic's employment declines because their jobs did require in-person interaction.

Third Quarter Market Review

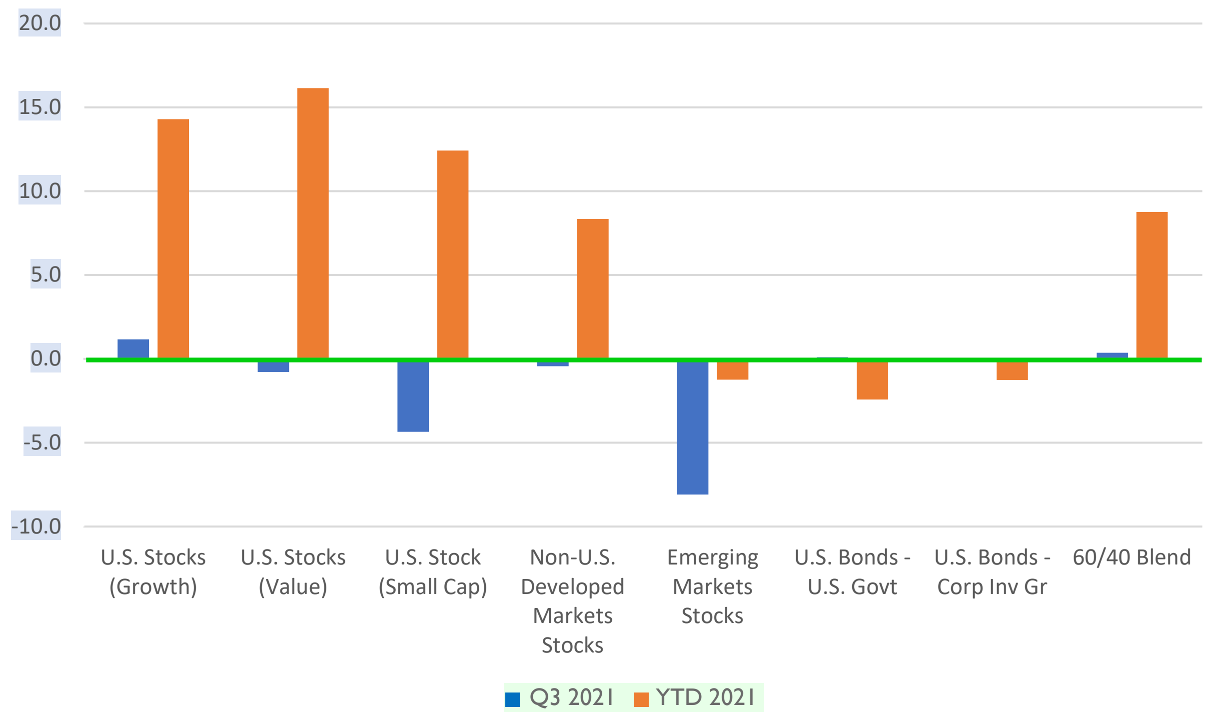
U.S. stocks registered a modestly positive third quarter, with the S&P 500 closing at 4307.54, up from 4297.50 on June 30, but off its all-time high close of 4536.95 on September 2. The index returned 5.49% over July and August, and then declined 4.65% in September.

Behind the S&P 500 price was a mixed story, however, with large cap value and small cap stocks declining.

The top performing sectors in the S&P 500 were Financials and Utilities, while Industrials, Materials and Energy lagged.

Among stocks, the top contributors to the index return were the large technology-related stocks – Alphabet (Google), Microsoft, Tesla, and Apple. Detractors included Amazon, PayPal, and Facebook (contribution incorporates the effects of both price change and weight).

- In the U.S., large cap growth stocks had a small positive return, while large value and small cap were negative.
- Outside the U.S., developed markets declined modestly, while emerging markets declined far more. Within the emerging markets, the Hong Kong-based China 50 Index fell 15.7%.
- Within U.S. fixed income markets, interest rates on U.S. Treasury bonds rose slightly, creating near zero total returns for investment grade securities. Active core fixed income managers continue to outperform the negative return of the U.S. Aggregate Index this year.



Asset class returns are represented by the following indexes: Russell 1000 Growth and Value, and Russell 2000 Index (U.S. Stocks), MSCI EAFE Index (Non-U.S. Developed Stocks), MSCI Emerging Markets Index (Emerging Market Stocks), Bloomberg Barclays U.S. Government Index (U.S. Bonds - Govt), and Bloomberg Barclays US Corporate Bond Index (U.S. Bonds – Corp IG). The Blend is 60% S&P 500/40% US Aggregate.

Drivers of Capital Markets Returns

- Fixed income investments are debt instruments typically issued by governments and corporations. They generally pay a periodic fixed amount of interest until maturity, at which time the principal is repaid. Investors in fixed-income instruments are **lenders**.
- Corporations can also raise capital by selling shares, also known as equity. Equity investors share in a company's success or failures over time. Investors in equity are **owners**.

The price of the S&P 500 Index as of September 30, 2021, was 4,307.54.

Returns to Lenders

Inflation ➡ 5.4%

- June's CPI level of 5.4% persisted through September. Energy prices were a big contributor; the core rate was 4.0%, lower than June, but still above recent trends.

Interest Rates ⬆ 0.07%

- The yield of a 10-year U.S. Treasury bond rose from 1.45% on June 30 to 1.52% on September 30.

Credit Spreads ➡ 0.03%

- The yield spread of a generic BBB-rated corporate bond rose 3 basis points to 132 basis points. The yield spread measures the yield of 10 – 15-year corporate debt compared to U.S. Treasury Bonds of equivalent maturity.

Returns to Owners

Growth (GDP)

2Q: 2021	3Q: 2021
6.7%	0.5%*

- Second quarter real growth of GDP reflected the continued reopening of many areas of the U.S. economy. The current third quarter estimate from the Atlanta Fed's GDPnow model shows sharply lower growth, reflecting an estimate of a 0.4% real increase in consumer spending.

Profitability

2021E	2022E	%Change22E
$200.54	$219.13	9.3%

- The consensus estimate of 2021 earnings for the S&P 500 rose 5.0% during the third quarter. The estimate for 2022 was 9.3% above 2021.

Valuation

2021E P/E	2022E P/E
21.5	19.7

- On September 30, the price of the S&P 500 was 21.5x its estimated 2021 earnings – lower than the multiple on June 30 as the estimated earnings rose and the price was nearly unchanged.

** October 19, 2021 – Atlanta Fed GDPNow estimate*