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THIRD QUARTER 2021 ECONOMIC AND FINANCIAL MARKETS REVIEW

Despite increased volatility, the stock market continued this year's uptrend during the third quarter as concerns regarding the COVID Delta variant and rising inflation were offset by massive government stimulus and strong corporate earnings. Recently, the Delta variant harmed the economy by slowing consumer spending on travel and leisure. It has also slowed the shipment of supplies needed by corporations to make products. This supply chain problem resulted in rising prices of consumer goods and needs such as cars, food, and other merchandise. However, stock market investors looked past the economic slowdown and rising prices and focused more attention on the Federal Reserve Board's highly accommodative monetary policy. Stock investors also appreciate that Congress intends to continue fiscal stimulus packages to support American citizens and businesses. As a result of stimulus and better-than-expected corporate earnings, the S&P 500 Index ended the third quarter up 14.68% year-to-date, while the Dow Jones Industrial Average gained 10.58%. The Bloomberg Barclays U.S. Intermediate Government/Credit Bond Index declined .87% year-to-date as of September 30, 2021.

The Delta variant has caused a spike in COVID cases, resulting in many states reintroducing restrictions that have threatened economic activity once again. While it is likely that a reversion back to last year's long shutdown measures will be avoided, it remains to be seen how seriously COVID variants will impact the global economy and corporate profits in the future. Consumers and businesses remain reluctant to spend during periods of rising COVID cases, further jeopardizing economic growth.

Another concern for the stock and bond markets is inflation. The COVID pandemic has led to product shortages and higher costs for finished goods, which are being passed on to consumers. This reduction in the supply of goods and higher product costs has created the highest level of inflation in decades. Although moderate inflation is not necessarily a bad thing, high inflation erodes consumer purchasing power. Inflation also causes investors to worry about a potential adverse reaction in the bond market. Rising inflation typically leads to increasing interest rates on bonds because investors demand higher interest rates to compensate for rising prices. When interest rates rise, bonds' values typically decline and bond investors lose principal. Rising interest rates also reduce economic activity because borrowers are less likely to seek higher-interest loans for major purchases such as homes and cars.

Despite these inflationary and interest rate concerns, the Fed continues to print money and keep the interest rates that they control near zero. In fact, the Fed recently stated that they believe the rise in inflation is "transitory" and they do not plan to reduce the amount of money they are printing until later this year. They also do not intend to raise interest rates for a long time. As long as interest rates remain near zero, investors will likely continue to buy stocks to attempt to earn a reasonable rate of return on their money.

In addition to the Fed's accommodative monetary policy, the U.S. government continues to launch expansive fiscal stimulus. The federal government has spent trillions of dollars on programs designed to help individuals and businesses weather the storm of the COVID pandemic. Although this has caused the U.S. to take on more debt and run a record budget deficit, it has also helped to boost the economy, corporate earnings, and stock prices in the short term. Additional fiscal policy by way of a potential massive infrastructure bill may provide even further stimulus to the economy. Like monetary stimulus, continued fiscal stimulus is positive for corporate earnings that have generally not shown any signs of slowing despite the recent COVID variant outbreak.

So long as the Fed and Congress continue their massive monetary and fiscal stimulus programs, the problems and uncertainties that would otherwise concern stock market investors may continue to be overshadowed. In fact, bad economic news may actually prove to be good news for the stock market because it may delay the Fed's decision to raise interest rates and encourage Congress to spend more money.

Healthy stock market corrections are not uncommon during bull markets. However, we do not foresee a more significant, drawn-out bear market decline until the Fed begins raising interest rates or if the economy weakens severely due to existing or future potential COVID variants. Nevertheless, with all of these crosscurrents in mind, we continue to favor larger company domestic stocks over riskier smaller company stocks. We recommend short-term bonds rather than longer-term bonds because short-term bonds are less sensitive to rising inflation and interest rates. Finally, gold should benefit if inflation persists or the economy struggles further with COVID variants.

As always, we will continue to monitor ongoing economic and financial market conditions. In the meantime, please contact us if you have any questions regarding your investment portfolio or the financial markets in general.

* *Index returns were obtained from the Wall St. Journal and Bloomberg Barclays on October 1, 2021.*