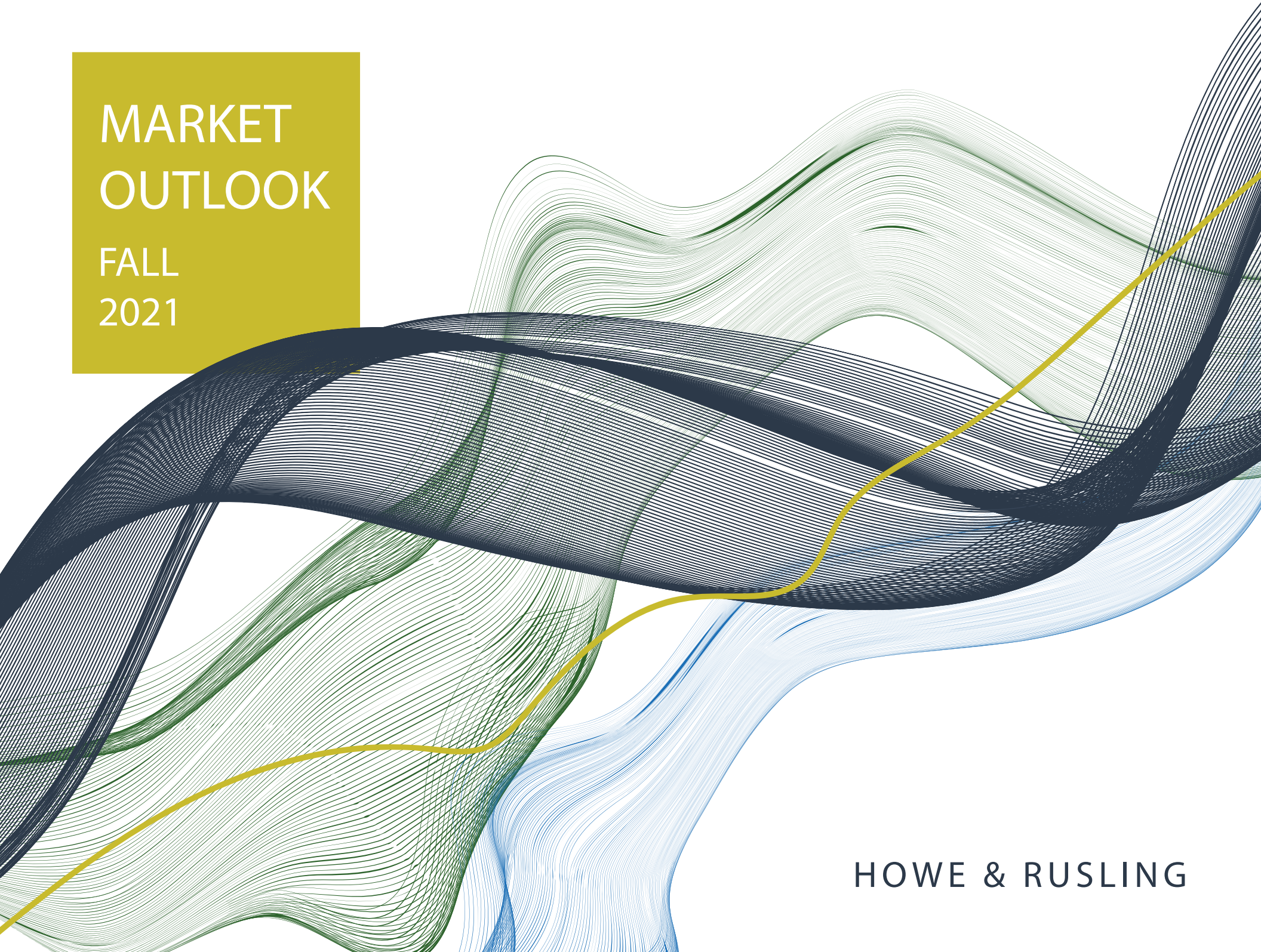
MARKET OUTLOOK

FALL 2021



HOWE & RUSLING

ON OUR MINDS

Fortitude: strength to face the unknown, knowing pain is part of the equation, but pressing on.

Throughout history, events of consequence (like wars, famine, depression, uprisings, or now a pandemic) seem to have some type of symbolic noun or adjective describing the effect of the event on the people. Words like grit, courage, selflessness, brave, resourceful, strong, enduring, and so on describe how people make it through the trying time.

When we consider the past 20 months, not only the people of the world, but also the markets, have displayed considerable fortitude.

Given this is an economic outlook for the coming quarter, we will focus on the markets (versus people), and how they have advanced despite the continuing endless barrage of pandemic related influences. Besides the challenges of a pandemic, the markets must endure political hearsay, as well as endless speculation from bulls and bears. However, in the end, the markets press on.

Take something as simple as an ice-cold Pepsi. Pepsi has bounced back despite numerous setbacks from the pandemic. Just like virtually every stock, it lost its fizz during March 2020, diving 30% in 30 days. However, Pepsi, and associated products, are frequently enjoyed when going out to a restaurant, a sporting event, or a theater. We do not need to tell you the woes of these industries over the past 20 months and the continued stress these industries endure with ever-changing social gathering requirements. Talk about fortitude. However, despite all these challenges, Pepsi has found some way to press on, to continue to return value to its shareholders, and hit all-time highs this year. It (via its leaders, distributors, customers, and investors) has known the pain, but instead of being crushed like a tin can in a compactor, displayed fortitude.

While I said this was going to be about the markets, it really comes down to people, and how we all have adapted and met the challenge. For this reason, markets have advanced, and while not every company has been able to press on and display fortitude, most of our economy has, and continues to move forward. We, as stewards of capital, continue to take that Pepsi challenge and find companies that display fortitude today and into tomorrow. We are ever so thankful for your belief in our services, and on behalf of the Macroeconomic Team here at Howe & Rusling, please enjoy our Fall Market Outlook.

Greg Farrell, VP, Senior Portfolio Manager & Macroeconomic Team Chair

THE PAST GUIDES THE FUTURE

THE MARKETS AND INFLUENCERS

FIXED INCOME

Fortitude is likely a good noun for this year's fixed income markets. Since the start of the year, every day, on every business channel and in every publication, you have heard that "rates are going up." It happened a bit in the winter, and now again, but in the winter, everyone was convinced rates were going to keep pressing higher. Well, that did not happen, and in fact, they retreated. Predicting rates is like timing the stock market; it is virtually impossible. However, rates are everything, and it is the reason we open our Outlooks with a discussion of Fixed Income, as the fixed income market has a domino effect on the entire economy.

So, back to rates going up. In a way, that is a logical assumption given that rates, as controlled by the Federal Reserve, are zero. But while everyone is predicting rates will go up, the real question is when, and by how much?

We believe the commentary coming directly from the Fed is a foundation for assumption. Hence, we want to focus on the Fed's recent September commentary, along with its estimates of key economic indicators such as GDP, unemployment, and inflation.

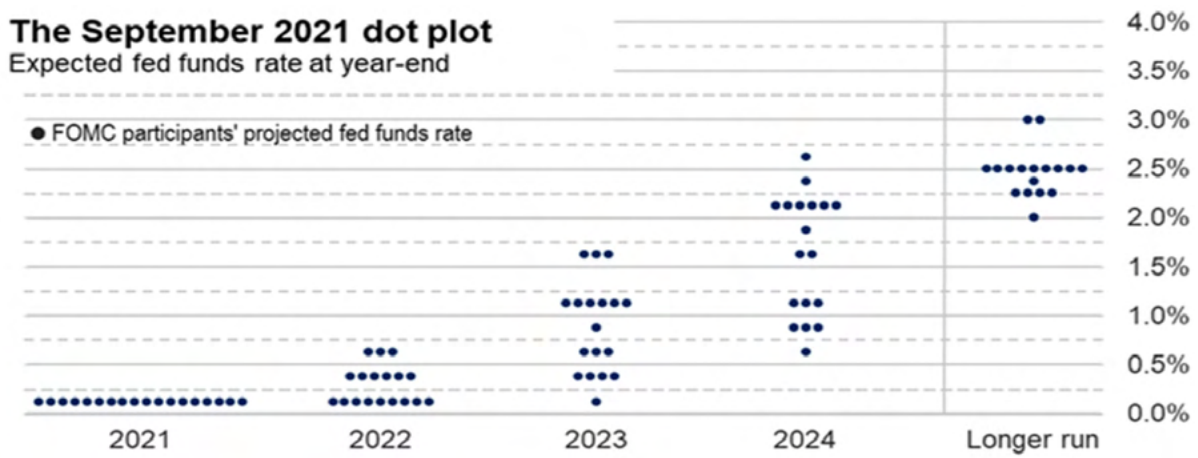
As expected, the FOMC made no changes to the various interest rates it controls. The statement took a further step toward taper this year (taper being buying less bonds).

- In July, the FOMC said, "…the economy has made progress toward these goals, and the Committee will continue to assess progress in coming months."
- In September, this evolved to, "…the economy has made progress toward these goals. If progress continues broadly as expected the Committee judges that a moderation in the pace of asset purchases may soon be warranted."

By the statement "made progress toward these goals," the FOMC is referencing its overarching goals of full employment and price stability in the marketplace. By virtue of its comment about progress and the pace of asset purchases (less bond buying), the markets instantly put these words to work, and the 10-year Treasury made upside movement in yield, a positive sign for the economy, despite the ramifications of slightly higher debt payments. If conditions change, the Fed will likely slow the taper, which is an easy fix. In our view, the challenge for the Fed is longer-term, whereas too slow or too fast of actions can have lasting effects on the economy for years to come.

FED RATE OUTLOOK

When the FOMC gathers, all the Committee members (18) provide their estimates of where they believe rates will be in the coming years. They have this luxury of predicting rates, as for them it is not fully a guess because they are the ones setting the target federal funds rate (average rate for overnight borrowing between banks). During the September meeting, the Committee had diverse views among its members, so the future target is not as clear-cut as one would assume. While the Fed has indirectly stated it will start the taper (via less bond purchases in the nearer term), we can see below it will not be raising rates until at least 2022 (and only half the Committee members make that estimate).



Note: Each dot represents the expectations of one FOMC member. Median projection is 0.125% for 2021, 0.375% for 2022, 1.0% for 2023 and 1.875% for 2024. The longer run median is 2.5%. One member did not submit projections for the longer run.

While this is helpful, we need to remember that these are estimates, and that it is very hard to predict rates. After the Great Recession, every banker, analyst, and commentator was predicting rates would rise soon (post mid-2009). It was not until the end of 2015, or 7½ years later, that rates moved off zero. Talk is talk but actions speak.

While it may introduce volatility, rates likely need to move up sooner rather than later given the larger money supply from both monetary and fiscal policies, adding to inflationary pressure (more on this later). However, an axiom of macroeconomics is that while credit is easy (low rates), economic growth is usually expected for the next 12 months. Our view is the 10-year Treasury should retest the highs from March 2021 at 1.75% and will likely move towards 2.00% in the second quarter of 2022.

STRATEGY

Laddered bond portfolios are an excellent way to avoid predicting rates and dollar cost in yield, especially in a rising market.

RATES AND THE STOCK MARKET

Consider this past January through March when the 10-year Treasury (the trading barometer of the economy), climbed 87% in 3 months from 0.93% to 1.74% (see chart below). While this is not a big number by any means, the pace of the ascent had market participants a bit nervous. While the rate was increasing, growth stocks were tracking in the opposite direction (see chartreuse line showing S&P growth stocks). The same is happening with the move of rates recently, escalating again, as growth stocks are moving lower.

Growth stocks do not particularly like rising interest rates for several reasons: first, and most important in investing, is that investors look to future cash flows to determine if the investment makes sense to purchase today. They take several factors into consideration, one being a discounted cash flow. In this analysis, an interest rate is used in the denominator of the equation. In basic math, when the denominator rises, the result is lower (2/1=2; 2/2=1). This means the company needs to generate more revenue growth (the numerator), which then makes the investment more uncertain given all the variables around revenue growth. Less certainty translates to a lower value (of the stock price).

RISING RATES V. GROWTH STOCKS

Another (simpler) reason why growth stocks, or any stock, do not like rising rates is this will increase their cost of doing business in years to come, which makes innovation more costly and in turn reduces profitability—the very profitability that present day investors have banked on in their purchase. Granted, all firms and consumers suffer when rates go up, but growth firms feel the pinch a bit more given their constant need to grow, and when expenses rise, this means they must work double-time to expand.

Another tidbit regarding market movement has been the conversation about a correction. Markets "correct" when a 10% decline has happened from the high, principally when investors believe prices have risen too fast, or there is some outside influence on the market (such as interest rates, taxes, or a pandemic).

While everyone is on edge for the 10% correction to the indexes, little press has been given to just how volatile the markets have been in 2021, as there have been sector rotations in virtually every category. Through October 4th, consider the following:

- 91% of the S&P 500 companies had over a 10% correction, with the average decline being 17%
- 90% of the Nasdaq had a 10% correction or more, with the average decline being 38% (the Nasdaq is symbolic with growth stocks)
- 98% of the Russell 2000 had at least a 10% correction, with the average decline being 38%

Hence, there have been massive corrections under the hood. The reasons for these are:

- As we mentioned, the rise in the 10-year Treasury, which caused a sizable shift out of technology stocks (growth companies)
- Broad-based correction related to COVID, specifically Delta, and worldwide lockdowns/reopening
- Inflationary fears—with rotations to energy, materials, and defensive stocks

Just as social media has made millionaires out of everyday people (a high number being very young people) by giving them a platform to show their expertise in some area and "influence" others, the economy is filled with all kinds of influencers (or indicators) which help form decisions for investing.

STRATEGY

Do not time the market; instead move with a structured thesis to seek dislocations in the longer range outlook while staying invested.

THE FED'S UPDATED ECONOMIC FORECAST

Continuing with our monitoring of the Fed's comments from its September meeting, on a quarterly basis, the Fed provides estimates of key economic indicators, including GDP, unemployment, and inflation. It likewise provides the reference points from the prior meeting (June 2021), making it easy to see how the Committee might have changed its view of the economy.

The current estimates were adjusted in September with unemployment and inflation higher and consequently GDP being lowered. This is no surprise given the advancement of COVID, via the Delta variant, in the summer.

FEDERAL RESERVE ECONOMIC FORECAST

Sep '21	Median					Central Tendency**				
Variable	2021	2022	2023	2024	Longer run	2021	2022	2023	2024	Longer run
GDP	5.9%	3.8%	2.5%	2.0%	1.8%	5.8%-6.0%	3.4%-4.5%	2.2%-2.5%	2.0%-2.2%	1.8%-2.0%
June Projection	*7.0%*	*3.3%*	*2.4%*		*1.8%*	*6.8%-7.3%*	*2.8%-3.8%*	*2.0%-2.5%*		*1.8%-2.0%*
Unemployment rate	4.8%	3.8%	3.5%	3.5%	4.0%	4.6%-4.8%	3.6%-4.0%	3.3%-3.7%	3.3%-3.6%	3.8%-4.3%
June Projection	*4.5%*	*3.8%*	*3.5%*		*4.0%*	*4.4%-4.8%*	*3.5%-4.0%*	*3.2%-3.8%*		*3.8%-4.3%*
PCE inflation	4.2%	2.2%	2.2%	2.1%	2.0%	4.0%-4.3%	2.0%-2.5%	2.0%-2.3%	2.0%-2.2%	2.0%
June Projection	*3.4%*	*2.1%*	*2.2%*		*2.0%*	*3.1%-3.5%*	*1.9%-2.3%*	*2.0%-2.2%*		*2.0%*
Core PCE inflation*	3.7%	2.3%	2.2%	2.1%		3.6%-3.8%	2.0%-2.5%	2.0%-2.3%	2.0%-2.2%	
June Projection	*3.0%*	*2.1%*	*2.1%*			*2.9%-3.1%*	*1.9%-2.3%*	*2.0%-2.2%*		

*Longer run projections for core PCE inflation are not collected
** The central tendency excludes the three highest and three lowest projections for each variable in each year

- The FOMC revised 2021 GDP revisions substantially lower in September. The June median was 7%, and the September median is 5.9%. The entire range shifted lower; this revision was not driven by a few people with radically different views.

- 2022 GDP median rose from 3.3% to 3.8% with a tighter distribution. This move up seems to point to confidence the present recovery is just delayed slightly from summer Delta outbreaks but will pick up more steam in 2022.

- The unemployment forecast is a little higher, reflecting the recent slowdown in hiring.

- The 2021 inflation forecast jumped, as the median of PCE inflation (also known as headline inflation) rose from 3.4% to 4.2% while Core rose from 3.0% to 3.7% (Core does not include food and energy). However, the 2022 forecast is only a little higher.

- Thirteen FOMC members say they are worried about upside inflation risks, as inflation is already well above target; however, they truly believe the pressures are supply driven and hence will resolve themselves over time (we will dive deeper in a moment).

GDP

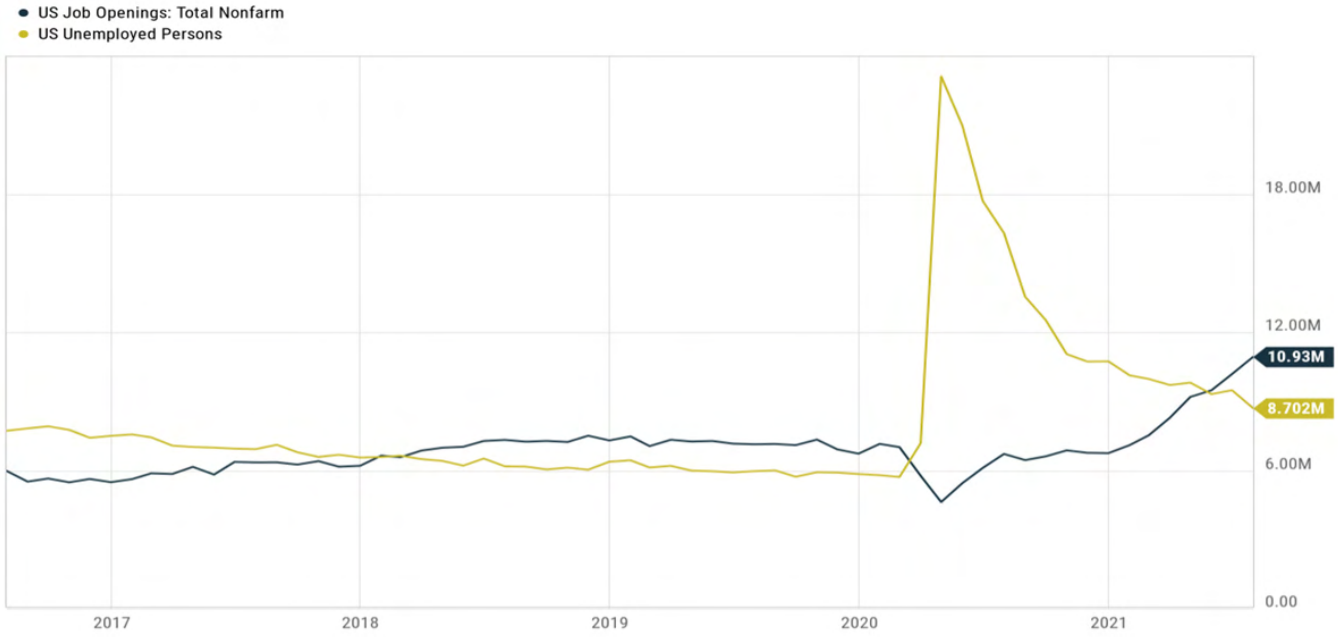
While the summer started with an air of optimism, sadly the Delta variant had other ideas and spread quickly in many parts of the country. Given the US never reached herd immunity, this left a sizable part of the population at potential risk. With the heightened outbreaks, many people reverted to peak pandemic habits of limiting public interface, which therefore resulted in reduced economic activity. This caused the Fed to lower estimates for GDP.

Considering all available information, we believe Delta peaked the second week of August and since then has been in a steady decline. As the media starts to bring this message to the masses, activity will hopefully resume in time for holiday spending. The CDC reported new COVID-19 cases fell 36% from Sept. 1- Oct. 1. Granted, there was a significant peak in cases in November 2020 (and again in January 2021) which some fear will repeat itself. We believe those fears might not be as bad as imagined, as this year we have a significant portion of the population vaccinated (compared to zero last year). Furthermore, we also have a fair number of individuals with some residual antibodies in their system from contracting COVID-19. While this virus will presumably never go away, as a country, we are much further along than a year ago.

EMPLOYMENT

Employment is a goal of the Fed, as this is part of its monitoring of inflation pressure. Despite all efforts, we only have 0.8 people per job opening, and the Fed had to raise its 2021 unemployment projection. Therefore, we have a hot labor market.

JOB OPENINGS V. UNEMPLOYED
(7/13/2016-7/31/2021)



This hot labor market has a lot to do with the cash in the system, unemployment policies, early retirements, and the challenges of childcare. While we will delve much deeper into inflation later, a hot labor market is never good for keeping inflation in check as it typically means people are getting paid more—which is why the Fed watches employment very carefully. This is especially true at the lower wage earner segment of the market, which is where the hottest part of the labor market is at present, as this segment tends to spend. Additionally, across all segments of the market, quitting a job is at an all-time high, as people are strongly believing they will get a higher paying job. All of this translates to higher wages and a continued inflation threat, and as such is a significant influencer to the markets. Higher wages translate to higher operating costs for companies which can translate to lower profit margins and lower projections for future growth—the foundations for investing.

While we believe this hot labor market will heal itself somewhat in the months to come as several fiscal policy unemployment benefits have lapsed and children are attending school in person, there has been a paradigm shift in the labor market. As the saying goes, once you give someone something, it is very hard to take it back. This is especially true with remote work.

Prior to the pandemic, only 2% of the workforce was remote. We all know what happened during the peak of the pandemic in the spring of 2020, in which everyone who could be remote was remote. While American workers proved they could be productive off-site, a fair number of larger, publicly traded firms took note, especially as they looked to the future with expense control (rent, in-office perks, time management). Hence, the latest projections show that approximately 25% of the workforce will be remote post-pandemic. Many very large firms now have a percentage of their employees fully remote, as well as a percentage who have hybrid work arrangements with a few days in the office and the rest remote. These cost efficiencies, if sustainable, could offset wage pressure.

Finally, regarding the labor force, besides all the above reasons for less workers, there has been a shift to gig workers. These are individuals who have decided they do not want to be employed by one specific firm but instead have become independent contractors. They typically work from home, do contract work for large firms, and for the most part they can set their own hours provided they fulfill the demands of the contract. Hence, they might play during the day and work in the evening or early morning. Many got a taste of remote work when the economy shutdown, and instead of going back to work for someone else, they decided they liked the lifestyle and could support themselves with piecemeal jobs on their schedule. This paradigm change has left employers looking to different models and has added to the labor shortage.

INFLATION

While we all would enjoy a low-rate environment, rates play a very critical role in the economic macrocosm, especially as it relates to the control of inflation. If rates stay low, this means most of the economy has more money to spend, as debt costs are lower. Less debt expense means the saved cash from those lower interest payments is going to buy something else, which then usually causes inflationary pressure; and we all know runaway inflation is the villain of any economy.

During the September FOMC meeting, the Committee changed its assessment of inflation from "has risen" to "is elevated." The Fed still blames transitory factors.

This assessment by the FOMC is of no surprise to the average American. From lumber to cars to semiconductors (which virtually run the economy in every aspect given our dependence on electronics in this digital era) to higher wages and energy costs, every person and industry is starting to feel the pinch of higher prices.

One of the principal factors in the supply shortage has to do with the supply chain. The supply chain relies heavily on the shipping and trucking industries to get products to store shelves (or online retailer warehouses). Given the high level of imported goods, ports throughout the country are extremely congested. A congested port means goods are not getting on shelves. All ports today have a few keys issues in common which have resulted in subsequent supply chain issues:

- Where's the container? – Containers are what all goods are loaded in and shipped across the seas, and for now, there is a shortage. With lockdowns, shipping was at a standstill, and containers were stuck in all parts of the world and have not made their way back.
- Port truck chassis shortage – a chassis is the underframe and wheels on which a shipping container rests and gets moved. This shortage has been ongoing, as prior to the Great Recession, steamship liners carriers (SSLs) provided a chassis as part of their unloading. The recession forced them to sell these to help the bottom-line.
- Consolidation of SSLs – mergers at the shipping carrier level have fostered cost efficiencies with the result being larger ships capable of carrying more containers. Hence, larger ships mean unloading time exponentially increases, which results in more ships sitting at sea (and more containers tied up in voyage—which is 14 days from Shanghai to LA).
- Peak season – call it a perfect storm, but to get goods by the holiday season, peak shipping months are now. Ships waiting to be called into port are averaging 12 days (Port of LA), and once called into port, the average unloading is 7 days. Hence, a full month is spent traveling and unloading, and the goods still need to be transported to stores by truck, rail, or air.
- Trucks – there just are not enough, nor are there enough truckers.

Multiply all this by every port and it is easy to see why we have supply-induced inflation.

Additionally, due to massive lockdowns, the product manufacturing cycle virtually stopped. Consider this very simple example of a cotton shirt, as it requires a lot more than just turning on the factory lights. It involves thousands of hands from one group of cotton farmers exclusively growing cotton to be made just for seed, selling the seed to another set of farmers to raise the cotton for clothing (and the entire distribution chain for both), shipping the cotton to a mill for conversion to cloth, shipping to the apparel company for manufacturing (don't forget the button manufacturer is out there too with its own set of chains), plus the plastic wrap and cardboard manufacturers, the marketing firms, the shipping firms, the retailer, the worker, the gasoline to drive trucks and your car to shop, and so on. Close one of these, let alone all, and chaos is sure to follow... and we wonder why we have supply shortages!

Remarkably, as complex as the above example sounds, the economies of the world are adapting, and it has been nothing short of spectacular and a true display of fortitude. So, supply side inflation is real, as the supply of any good is a very large and complex web.

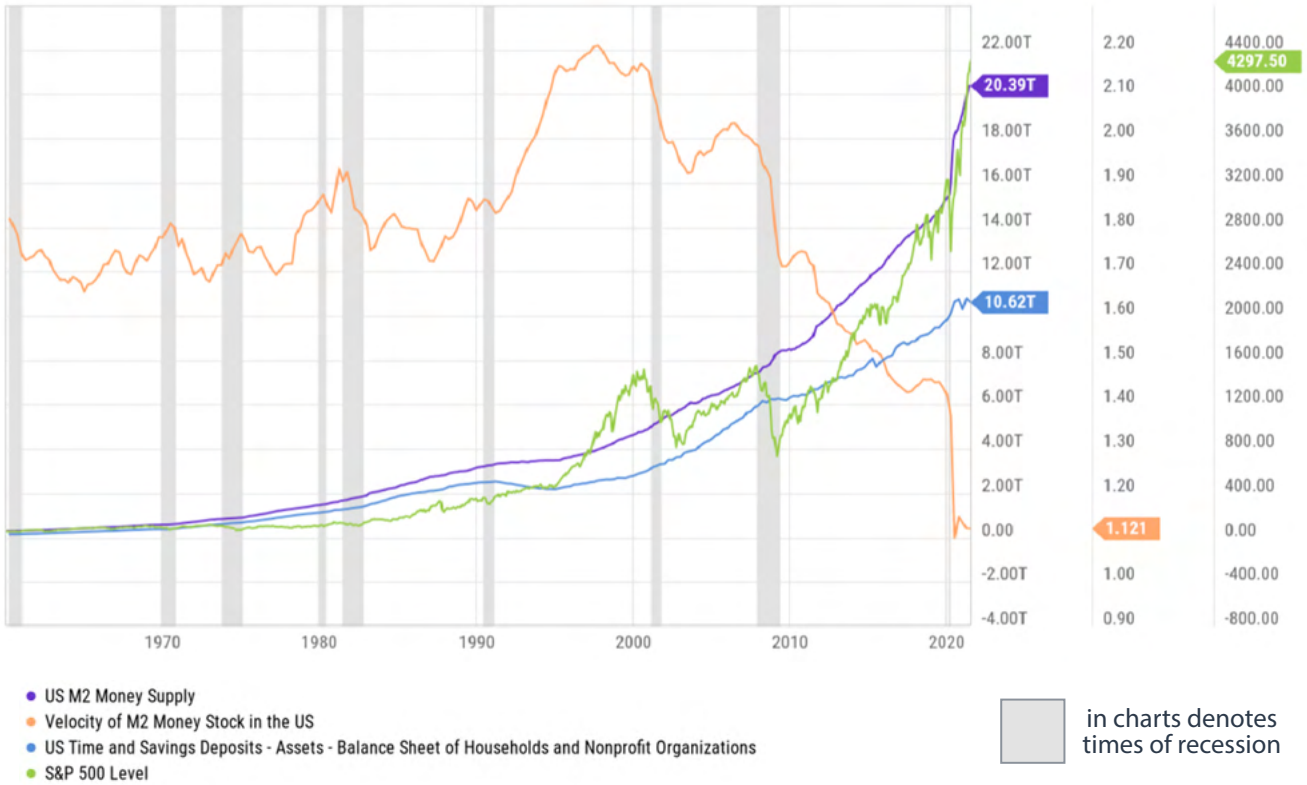
Going deeper into the inflation story, as we have said many times, inflation is too much money chasing too few goods, which therefore creates the opportunity to raise a price. We are not going to reveal any breakthrough here, but on top of the supply chain issue, Americans have a bit of extra cash in their accounts.

First, Uncle Sam has been aiding the average American via fiscal policy stimulus payments. We all know of the multiple stimulus checks in 2020, but extra programs adding cash to the system have been:

- The recent frontloading of the childcare credit. Granted, this only applies to those with children, but that segment of the population spends money. Plus, discussions are in the works to extend this benefit through year-end.
- For those living in California, an additional stimulus went to about two-thirds of the state residents in September, and given the size of California, this accounts for 7% of all Americans.
- Amended tax returns. Many who collected unemployment benefits in 2020 filed tax returns before the government decided to make a portion of this tax-free. Those individuals have been filing amended returns all summer and have been getting refunds.

While extra cash can surely promote inflationary pressure, especially coupled with supply issues, we wanted to go a bit deeper in our analysis by looking at the money supply, how it turns in the system, and other factors to know if a crisis is at hand or if the inflation is in fact transitory.

MONEY, SPENDING, SAVINGS, & THE S&P 500



The chart above depicts many things at once to give perspective. Money in the system continues to be elevated at $20.39T (M2; purple line). M2 includes household funds in savings, most CDs, checking accounts, money market funds, and hard cash. While $20.39T is a huge number, given normal progressions and trends, the number would be around $16.5T today if we did not have stimulus related programs. Hence, the system is supporting roughly $4.0T extra in readily available cash, or 25%, from the pandemic fiscal and monetary policies.

However, in fairness, money is not being spent as fast as stories might report, and it also might not be dumped into the system as other theories purport, so this provides a time-out moment for the runaway inflation theory. The Velocity of M2 (orange line) shows what has been happening with money in the system: it is not being spent, at least since the start of the present century.

Savings are happening and have been on the rise for years. The savings line (blue) is trending close to the supply of money (as it should since M2 includes savings). So, believe it or not, Americans are saving.

Another quiet reason for higher M2 might be the Baby Boomers. Twenty years ago, in 2001, the upper end of the Boomers were about 55 years old, and they were starting to think about retirement. As is natural, people approaching retirement tend to be more conservative with their stockpiles. Furthermore, this generation did not have the pensions their parents enjoyed; instead, most had retirement funds in self-directed plans which made them more frugal as they feared running out of money.

Coincidentally, at the same time, the economy was in recession and the stock market had taken a big hit (see green line). Given these folks had to manage their own money for the rest of their lifetime, versus a pension, money stayed in their cash accounts. To make matters worse, and instilling more fear, a significant recession occurred just six years later, and with millions more Boomers retired at this point, cash, instinctively, was kept much closer.

Additionally, per adult population projections from the US Census, retired Americans will be an ever-increasing percentage of the population, which therefore can lead to more cash in accounts. Currently, about 17% of the population is over 65, but by 2030, it will be 21%.

Also, the value of the S&P has risen with the money supply. While M2 does not include retirement funds, nor investments in the stock market, it does include mutual fund money markets which are in the stock market (estimates are mutual fund money markets are close to $4.0T, which is sizable).

Therefore, even though cash is high, there seems to be legitimate reasons for such, which could support the supply-related inflation theory.

ENERGY COSTS

While energy is not in core inflation numbers, individuals and companies still feel this expense. As we outlined in our cotton shirt example, energy is embedded in every part of that cycle, and if energy rises (which it currently is), all costs rise—hence inflationary pressure.

As with so many examples we have given of the interconnectedness of all products produced, energy producers, just like lumber, were managing profitability before the pandemic, which included cutting back on supplies and plants. Add in the strong drive for renewable energy and politicians across the globe disincentivizing fossil fuel businesses, and an unexpected disaster was brewing.

Take Europe as an example: with high hopes of wind energy being their main alternative, many nuclear and coal-driven electricity plants have closed. However, no one considered doldrums on the North Sea and the energy-producing wind plants having no output. On top of no wind, Europe relies heavily on Russia for natural gas, to the tune of over 40%, and Russia limits supply to cover its own needs. This puts Europe at the mercy of the market to find energy, and we all know where the price will go (Russia has agreed to supply Europe, but no one is reporting the pricing).

Here in the states, government policies with multiple interests disrupt the free flow of the energy market, for good and bad, but opening a pipeline or turning a plant back on once disrupted takes a long time to ramp up to meet demand. Hence, at least in the states, we become more dependent on energy imports, specifically from OPEC+, who have no issue with supply shortages (as they control supply), and shortages translate to higher profitability at the mercy of demand.

This inflation thing will have some growing pains for a while. That said, no one was complaining when gasoline was under $2.00 a gallon. We all need to develop some strong fortitude for the next six months or so. Things will ease up. The silver lining is that when times are harder, innovation is strong. The cash will work through the system, maybe spending more on energy and some basics, but soon enough the playing field will level out.

The good thing to remember is the stock market is made up of companies. In other words, while people are spending, and aiding in the inflationary pressures, companies are being rewarded with sales. Granted, they might have less inventory for now, but if they raise their prices just a bit (over higher input costs), they have improved profit margins. All of this bodes well for a strong 4th quarter (GDP-wise) as consumers should have some cash to spend.

Remember: never in history had an entire economy been shut down before, so no Federal Reserve has ever been under this type of pressure before.

STRATEGY

Have patience with the supply chain as pressures will dissipate; strategically invest in strong, innovative, firms which posses a dose of growth yet have reasonable forward earnings projections.

FINANCIAL PLANNING – NAVIGATING WASHINGTON

Financial planning is a balance of the future with the present. We all have dreams, yet it takes today's efforts, along with the set of rules governing investment holdings, to strategically plan for them. At the mere mention of Washington, debate opens not just on the halls of Congress, but sadly in families, among friends, and surely among opposite position holders. As investors, we stay away from the rhetoric because in the end, earnings and interest rates move markets. Earlier we mentioned that talk is talk, but actions speak. When it comes to the role of government, and how it influences investment decisions, endless speculation will only cripple action. Government is important, but every election cycle we typically see change, and yet companies continue to endure, and the markets invest in companies.

We could go on with endless dialogue about taxes, spending plans, deficits, debt ceilings, and shutdowns, but in the end, we must work off actions. While taxes (principally capital gains) have an impact on portfolios, at the end of the day, gains are still gains, and only a portion of the gain amount is the tax portion. Yes, under today's rules, some higher-earning investors can have federal gains taxes up to 24.7%, but for other investors, the gain could be free (in 2021, married couples with taxable income up to $80,000 pay no gains tax).

Congress has a proposal on the table for keeping the gains tax at 15% for those with incomes under $400,000 but raising it from 20% to 25% (plus surcharges which we will not discuss here to keep it simple) for those with more than $400,000 in income. This proposal, if approved, would be retro-effective to September 13, 2021, on any sales after that date. The key here is "if approved"—anything can happen until a law is a law, so investors need to work within known law.

Debate also surrounds the present "step up" in cost basis at death which erases gains at someone's passing. Most observers believe taxing investments at passing could be impossible, and could have severe market effects, but let us not discount the creative ways Congress has changed laws. The SECURE Act (Setting Every Community Up for Retirement Enhancement) is a great example. Inside this act, the way a retirement account (IRA) could be passed at death totally changed. Before, if someone inherited an IRA, they could effectively stretch that investment over their lifetime, with the only requirement being an age-adjusted required minimum withdrawal. This created a nice annuity of sorts. The problem with the prior method of stretching was it also allowed for the stretching of taxes paid. With ever increasing deficits, Congress needed to find a way to get revenue in the door faster. Hence, within the SECURE Act, the flow of funds (tax revenue) accelerated, as inherited IRAs now need to be totally distributed within 10 years. This is additionally significant because a good share of those inheriting could be at their maximum earning years, and hence in a higher tax bracket, which will make the tax revenue from the inherited IRA even more enhanced. The bottom line is never underestimate the creativity of Congress.

We mention the creativity of Congress, but we all understand the politics involved with wrangling a deal. So far under the present administration, not much has happened in terms of legislation besides executive orders. Since before the election, we have heard nonstop about infrastructure, but nearly a year later, nothing has happened.

On another more recent discussion on the debt ceiling, as well as government shutdowns, the fact is that markets tend to brush these off.

A discussion of estate taxes has also gained traction. As it stands currently, the estate tax exemption is $11.7mm per person (or $23.4mm per couple). This means no federal estate tax for much of the population. The discussion at hand is to lower this figure, presumably to cut it in half or even bring back to a $3.5mm level per person. Again, for most, these figures represent a lot of funds, but if you add in life insurance to an estate (which you must), the value of a home, and all other estate holdings, the numbers can add up quickly.

Since predicting the moves of Congress seems harder than winning the Powerball lottery, prudence is required. Perhaps only for the ultra-high net worth does it make sense to consider any deep estate planning, as regardless of what Congress does in the near term, the higher exemption level sunsets (disappears) at the end of 2025 and will revert to the $5.0mm level (adjusted for inflation).

While government has its role, and tax, fiscal, and monetary policies have economic impact, we must always remember the markets are compositions of companies that adjust to policy and endure with fortitude, and history has always proven this.

MEDIAN RETURN V. S&P 500 (%)

AROUND GOV SHUTDOWNS SINCE 1980

Sector	Week before	Week after
Consumer Discretionary	0.3 pp	0.6 pp
Information Technology	(0.9)	0.4
Health Care	0.6	0.3
Materials	(0.4)	0.2
Utilities	0.1	0.2
Industrials	0.1	0.2
Financials	(0.4)	(0.1)
Real Estate	0.4	(0.1)
Consumer Staples	0.4	(0.3)
Communication Services	0.8	(0.5)
Energy	(0.5)	(0.8)
S&P 500 return	**0.4 %**	**0.4 %**

STRATEGY

Understand the importance of goverment; however, refrain from altering investment decisions until facts are law.

While we would all like to move on from our endless state of adaptation, the world has changed in a mere 20 months. Some of the change has been for the good: knowing businesses can go on despite having to execute on their business contingency plans; knowing employees can be trusted to perform their jobs while not under the eye of management; knowing government can likewise react when absolutely needed.

Companies have found efficiencies in client contact, improved their online presence, and prioritized costs. They have streamlined operations, found new alliances or vendors who could adapt as they were adapting, and focused on revenue that was beneficial. They've expanded their awareness to employees, customers, and society. While displaying extraordinary fortitude, they have positioned themselves for a new world and have placed an emphasis on the ability to be nimble. These companies will be the winners in the future.

But some of the change has been for the bad. Solitude has its downfalls, and one of them can be the loss of the ability to interact with others with politeness. Obviously, this is not everyone, but we now observe people acting rudely to others, using vulgar language regardless of the setting, ignoring traffic rules, demanding attention if they do not get what they desire at a store or public event, behaving aggressively on planes, and so on. Violent crimes are escalating again after a steady drop from highs in the 1990s. We have seen friendships and families broken over vaccines. None of this is a random observation; it has been reported in all types of media, and frankly, it is sad, especially during a time of peril which typically brings us together.

We favor the more positive changes, and we believe there are far more good things than bad. And in the marketplace, we believe change has ignited a new era for investing. While the titans of tech were untouchable during the pandemic, as frankly they got us through the pandemic (Alphabet, Amazon, Apple, Facebook, Microsoft, and Netflix), the world has changed, and new opportunities are starting to come into focus. Yes, the titans will still be huge, but as the world is progressing towards new attitudes about employee engagement, environmental stewardship, and digital presence, new titans will emerge. This has happened faster than predicted, but we are embracing this change as we move forward and build portfolios.

The role of our Macroeconomic Committee is to assess all of the factors explored above in order to act in the best interest of our clients. For our clients with a mix of equites and fixed income, we are still holding a 5% overweight to equities given the ongoing recovery and current rate environment. We believe Q4 will be a bit rocky as some companies reporting their Q3 earnings could report less revenue from supply limitations or COVID related slowness. In turn, we likely will see lower future guidance which will translate to some market volatility. One might wonder why the overweight, given that this is not the rosiest of pictures and equities are expensive historically speaking. The raw fact is that equities are extremely inexpensive to interest rates. Compared to bonds still facing some upstream challenges, a slight equity overweight to equities is prudent. The recovery is still far from over, and while delayed, monetary policy supports equities at the present.

end.

MACRO TEAM

TODD ARTWELL
DIRECTOR OF
FIXED INCOME

GREG FARRELL
VICE PRESIDENT,
SENIOR PORTFOLIO MANAGER

BRIAN LESTER, CFA
DIRECTOR OF EQUITIES

ELIZABETH PERRY
PORTFOLIO OPERATIONS
MANAGER

DYLAN POTTER, CFP®
VICE PRESIDENT,
PORTFOLIO MANAGER

SARAH SWAN
VICE PRESIDENT,
PORTFOLIO MANAGER

MARK THOMPSON
EQUITY ANALYST

JOHN TRENTACOSTE
SENIOR FIXED INCOME
ANALYST

Registration with the SEC should not be construed as an endorsement or an indicator of investment skill, acumen or experience. Investments in securities are not insured, protected or guaranteed and may result in loss of income and/or principal. Diversification does not eliminate the risk of market loss. A long-term investment approach cannot guarantee a profit. While H&R believes the outside data sources cited to be credible, it has not independently verified the correctness of any of their inputs or calculations and, therefore, does not warranty the accuracy of any third-party sources or information. This communication may include opinions and forward-looking statements. All chart data has been sourced from YCharts, Bloomberg Professional Services, Federal Reserve Board of Governors, Charles Schwab, Goldman Sachs Global Investment Research, and Federal Reserve Bank of St. Louis. All statements other than statements of historical fact are opinions and/or forward-looking statements (including words such as "believe," "estimate," "anticipate," "may," "will," "should," and "expect"). Although we believe that the beliefs and expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such beliefs and expectations will prove to be correct. Various factors could cause actual results or performance to differ materially from those discussed in such forward-looking statements. All expressions of opinion are subject to change. You are cautioned not to place undue reliance on these forward-looking statements. Any dated information is published as of its date only. Dated and forward-looking statements speak only as of the date on which they are made. We undertake no obligation to update publicly or revise any dated or forward-looking statements. Historical performance is not indicative of any specific investment or future results. Views regarding the economy, securities markets or other specialized areas, like all predictors of future events, cannot be guaranteed to be accurate and may result in economic loss of income and/or principal to the investor. Investment process, strategies, philosophies, portfolio composition and allocations, security selection criteria and other parameters are current as of the date indicated and are subject to change without prior notice. This communication is distributed for informational purposes, and it is not to be construed as an offer, solicitation, recommendation, or endorsement of any particular security, products, or services. Nothing in this communication is intended to be or should be construed as individualized investment advice. Unless stated otherwise, any mention of specific securities or investments is for illustrative and informational purposes only. Adviser's clients may or may not hold the securities discussed in their portfolios. Adviser makes no representations that any of the securities discussed have been or will be profitable.

DISCLOSURES