The *Philadelphia* Story

A Quarterly Commentary on the Economy & the Financial Markets October 2021

From: *Philadelphia* Investment Management Group

OVERVIEW

- ***The Federal Reserve's Monetary Stimulus Continues to Perform Key Functions in Promoting the Health of the Economy and Stability of the Financial System.*** *The question on the table now is when does the Fed begin to reverse these stimulus policies so as not to overshoot the excess liquidity going into the economy.*

- ***Inflation, Inflation, Inflation--We Read About It Every Day.*** *There has never been, in recent times, more controversy as to the expected outcome on prices resulting from the disjointed economy caused by the back side of the COVID crisis on business in general.*

- ***Because It is Critical that the U.S. Dollar Remains the Currency of Choice Throughout the World, It is Imperative that the Government Supports Other Forms of Transaction Payments.*** *In this regard, digital currency is becoming more than just a buzz word. Central banks around the world are looking into the potential benefits and risks of issuing a digital currency, and we cannot afford to be left behind.*

THE ECONOMY

As reported in the third quarter, U.S. real GDP increased 1.6% in the second quarter, putting it at 0.8% above its pre-pandemic fourth quarter 2019 mark. Consumer services are quickly recovering, thanks to mass vaccinations. Our expectation of a return to normal spending patterns over the next year continues the advance towards normal behavior within the business community. The supply side of the economy is the most pressing problem today as conditions mount for companies to raise prices as demand outweighs supply. Once supply needs are met and manufacturing returns to a normal demand/supply relationship, price increases should subside, which will temper inflation worries.

The economy added 194,000 jobs in September, the smallest gain since December 2020 and down from the upwardly revision of 366,000 jobs added in August. These figures add to evidence that fears about the virus and global supply constraints continue to hold back the economic recovery. The jobless rate remains higher than the pre-pandemic level of 3.5%.

And finally, the dollar has been on a tear lately, propelled by deepening jitters about global growth and rising U.S. bond yields. When the dollar strengthens, the value of money earned abroad shrinks. Emerging market companies also tend to suffer, because their large dollar-denominated debt becomes harder to pay off. Driving our currency higher may well cause the Federal Reserve to act earlier and more aggressively to remove pandemic-era stimulus. Supply chain snarls, disrupted industrial activity in markets, including China and the U.K., weigh on growth prospects.

We believe that the unwelcome jump in inflation this year, once relative price adjustments are complete and bottlenecks have unclogged, will in the end prove to be largely transitory. The Fed's view on monetary easing is that as long as the recovery remains on track, a gradual tapering of its asset purchasing will conclude around the middle of next year. Further, the Fed will have to decide whether it can keep rates near rock bottom while inflation is taking time to fade.

FINANCIAL MARKETS

EQUITIES

Global and U.S. equities both hit record highs at the start of September. But then the markets fell, and the decline erased index gains for the third quarter overall. As shown in the following chart, S&P 500 total returns for the quarter were pared back to 0.58% and to 15.92% year to date. The Dow Jones and NASDAQ were both lower for the quarter but still positive for the year to date. The Russell 2000 index of smaller companies fell the most in the quarter, down 4.36%, but finished with a year-to-date gain of 12.41%.

	Equity Returns*			
Index	**3rd Qtr**	**2nd Qtr**	**1st Qtr**	**YTD**
S&P 500	0.58%	8.55%	6.17%	15.92%
Dow	-1.46%	5.08%	8.29%	12.12%
NASDAQ	-0.38%	9.49%	2.78%	12.11%
Russell 2000	-4.36%	4.29%	12.70%	12.41%

*Total: price change + reinvested dividends

As reflected in the chart below, Financial companies had the best return in the quarter, ahead by 2.74%. With the exception of Energy, the sector's year-to-date return of 29.14% was ahead of the other S&P sectors by an appreciable amount, followed by Real Estate, which was ahead 24.38% for the year to date. Energy lost some steam in the third quarter, but still ended with the highest return for the year to date.

	S&P 500				
		Returns*			
Sector	**Weight**	**3rd Qtr**	**2nd Qtr**	**1st Qtr**	**YTD**
• Energy	2.7%	-1.66%	11.30%	30.85%	43.22%
• Materials	2.5%	-3.51%	4.97%	9.08%	10.49%
• Industrials	8.0%	-4.23%	4.48%	11.41%	11.48%
• Cons. Discretionary	12.4%	0.01%	6.95%	3.11%	10.28%
• Consumer Staples	5.8%	-0.31%	3.83%	1.15%	4.69%
• Health Care	13.3%	1.43%	8.40%	3.18%	13.45%
• Financials	11.4%	2.74%	8.36%	15.99%	29.14%
• Info Technology	27.6%	1.34%	11.56%	1.97%	15.29%
• Commun. Svcs	11.3%	1.60%	10.72%	8.08%	21.59%
• Utilities	2.5%	1.78%	-0.41%	2.80%	4.20%
• Real Estate	2.6%	0.88%	13.09%	9.02%	24.38%

09/30/21
*Price + income
Source: S&P Dow Jones

After enjoying a strong resurgence versus growth stocks in the first quarter, value companies underperformed in the second and third quarters. Growth led the market across the market cap spectrum. A factor overlooked by most market strategists in analyzing why growth would outperform value in a difficult economic environment is the clear fact that solid growth companies are not as vulnerable to change in the economic cycle.

FIXED INCOME

Barclay's Bond Index, which acts as a proxy for the investment grade bond market, increased by 0.1% in the quarter, as the small move higher in interest rates did not have a major impact on returns. Other areas of the bond market produced mixed results, including U.S. Treasury, corporate and municipal bonds, as reflected in the following chart.

Fixed Income Returns

Index	**3rd Qtr**	**2nd Qtr**	**1st Qtr**	**YTD**
Corporate/Govt.	-0.05%	2.57%	-4.43%	-2.02%
Int. Corporate/Govt.	-0.03%	1.03%	-1.80%	-0.82%
Long Corporate/Govt.	-0.11%	6.71%	-10.79%	-4.91%
U.S. Treasury	-0.03%	2.02%	-4.61%	-2.71%
- Intermediate	-0.07%	0.67%	-1.73%	-1.14%
- Long	0.11%	6.61%	-13.24%	-7.40%

Fixed Income Returns (cont'd)

Index	**3rd Qtr**	**2nd Qtr**	**1st Qtr**	**YTD**
Corporate	-0.06%	3.60%	-4.50%	-1.12%
- Intermediate	0.06%	1.76%	-2.06%	-0.28%
- Long	-0.26%	7.03%	-8.73%	-2.56%
- Quality				
- AAA	-0.42%	4.84%	-7.39%	-3.32%
- AA	-0.11%	3.74%	-5.29%	-1.87%
- A	-0.19%	3.36%	-4.91%	-1.90%
- BBB	0.06%	3.73%	-3.96%	-0.32%
Municipal	-0.38%	1.72%	-0.36%	0.98%
- Intermediate	-0.09%	0.65%	-0.25%	0.31%
- Long	-0.56%	2.42%	-0.43%	1.41%

Source: ICE BofA

Fixed income markets will continue to adjust to the inflation number as it eventually settles out, but we believe both short and long interest rates will change little from present positions. Municipal bonds will follow in the steps of governments and corporates. Stronger general obligation and revenue bond areas will continue to garner the greater support.

Comments on fixed income wouldn't be complete without mentioning the quantitative easing program of the Government. The Federal Reserve is still purchasing at least $80 billion in Treasuries and $40 billion in agency mortgage-backed securities per month. It will likely announce a plan to taper this program soon. At its latest meeting, Chairman Powell stated that "a moderation in the pace of asset purchases may soon be warranted and concluded around the middle of next year." While the easing helped save the economy from a major recession, now the economy is on the path of recovery and, to be expected, inflation pressures are mounting. We are of the opinion, as stated in our remarks in The Economy section above, that inflation will be contained to moderate levels.

****

In conclusion, our outlook is for an economy that will slowly return to pre-pandemic levels of activity. Businesses will find ample supply of goods and materials to meet demand; thus, end prices will reflect this better relationship of the two. Quantitative easing will moderate, and fixed income markets will accept this as positive news. Global support for our economy and our dollar will continue to gain support.

Philadelphia Investment Management Group
105 Clarke Avenue
Pocomoke City, MD 21851