

PDS WEALTH MANAGEMENT



Quarterly Investment Report – Q3 2021

Welcome to the second edition of the PDS Wealth Management Investment Report. In the report, we cover the events of Q3 and highlight several issues likely to impact markets going forward. As usual, we refrain from predicting the future, but seek to raise relevant, identifiable issues. If any topic herein leads to any questions or concerns, don't hesitate to reach out to us to discuss. Thank you and all the best as we close out 2021!

Market Review

Stocks

The US stock market continued its upward climb in July and August before sliding in September. The S&P 500 finished Q3 up 0.2% following a 4.8% decline in September and now stands +15.9% for the year through September 30th. The Dow Jones Industrial Average and Nasdaq Composite fell 1.9% and 0.38%, respectively, during Q3 and ended the quarter with year-to-date gains of 10.8% and 12.1%.



Source: FactSet

As we write this summary in the first week of October, the S&P is in the midst of its largest decline of 2021, currently 5.8% off the highs of early September. As mentioned in our previous edition, since 1980, the market has suffered average intra-year declines of 14.3%.

At the end of Q2, value stocks were outperforming growth stocks by ~2.3%. That disparity widened modestly to 3.6% at the end of Q3. The Vanguard Value Index ended Q3 with a 15.8% year-to-date gain compared with a 12.2% rise for the Vanguard Growth Index.

On a sector basis, most cyclical sectors gave back some ground while financials led to the upside with a 2.7% gain. Industrials were the worst performers, losing 4.2% in Q3, followed by Materials (-3.5%) and energy (-1.7%). Technology, healthcare, and utilities all rose between 1-2%. Energy remains the year-to-date standout with a 43% gain, followed by financials (+29%) and real estate (+24%). Consumer Staples and Utilities, typically viewed as “safe haven” sectors, are the relative laggards with gains between 4-5% to date in 2021.

The small-cap Russell 2000 Index lost ground in the third quarter, falling 4.6%, and ended the quarter +12.5% for the year. International markets fell - the FTSE All-World ex-US Index dropped 2.6% in the quarter and stands +6.7% for 2021.

Bonds

The yield on the 10-year treasury note started the year at 0.93%, reached a year-to-date high of 1.78% on March 30th, and closed out Q3 at 1.53%, up 7bps in the quarter. The recent uptick in rates, as seen in the below chart, followed the Fed’s September meeting when they alluded to beginning the tapering of asset purchases in the near future, though they did not specify a date.

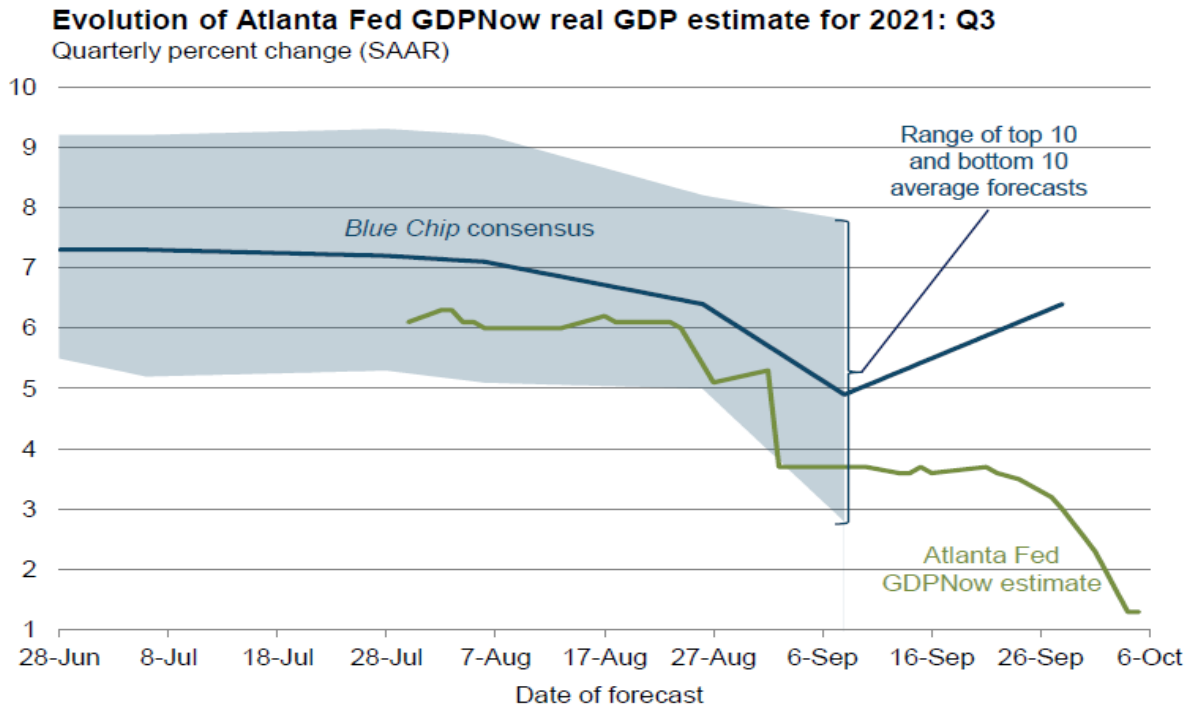


Source: FactSet

The US Aggregate Bond Index is down 1.6% on the year through September 30th. The S&P 500 Investment Grade Corporate Bond Index fell 1.35% through the end of Q3 and currently yields ~2% with a duration of 8.3 years. The S&P 500 High Yield Corporate Bond Index returned +3.5% through Q3.

Economic Review

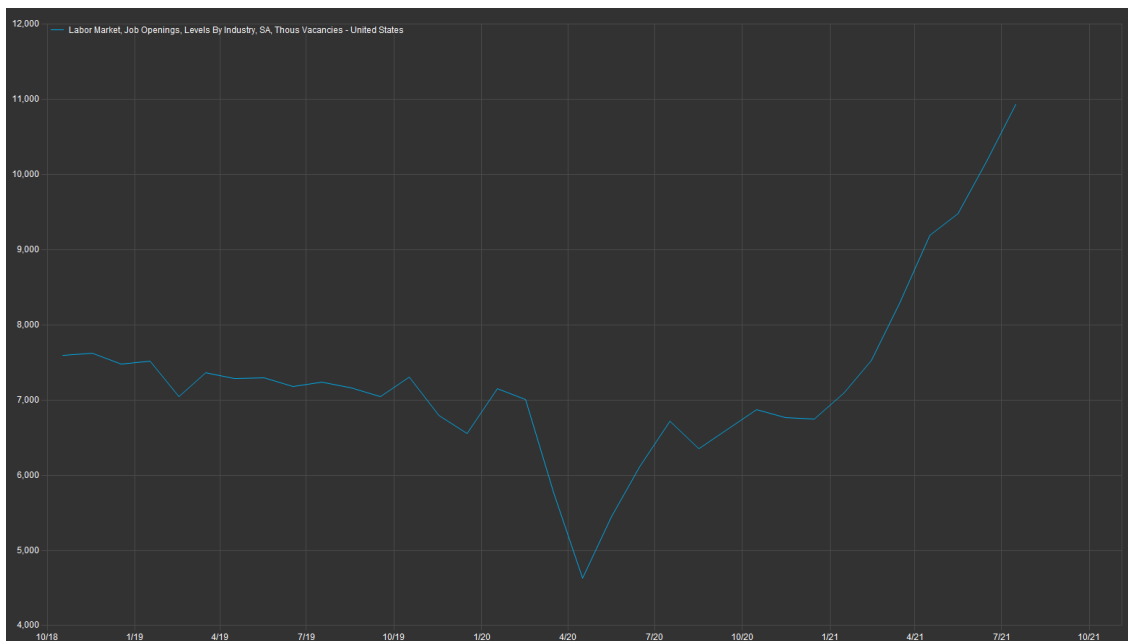
The US economy continues to enjoy robust growth coming out of 2020's extreme COVID-induced decline. The rate of growth, however, is currently under pressure as logistics bottlenecks are limiting the supply of goods flowing through distribution networks. Labor issues are also gumming up the works. Job openings remain elevated, but companies report a difficult time hiring qualified workers and are having to pay up when they find them. Below is a chart showing the evolution of the Atlanta Federal Reserve Bank's Q3 Real (inflation-adjusted) GDP estimate. Expectations were above 6% for most of August and are now just 1.3%.



Source: Federal Reserve Bank of Atlanta

Employment

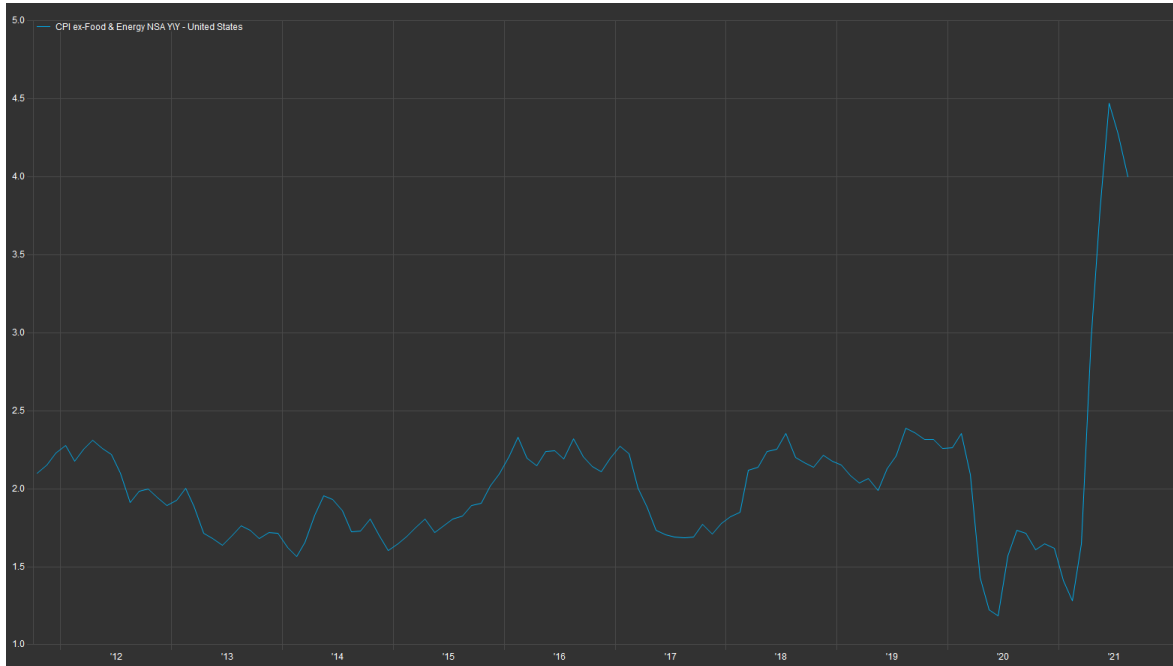
As mentioned above, job openings remain plentiful, as indicated by the below graph of JOLTs which shows nearly 11 million job openings as of the end of July.



Source: FactSet

Inflation

Inflation continued to heat up during the quarter and remains above the Fed's long run 2% target. The Fed continues to view rising prices as "transitory." It is unclear at what point a new term may be necessary. The most recent core (excluding food and energy) Consumer Price Index (CPI) reading showed prices rising 4% year over year, down slightly from 4.5% in June and 4.3% in July.



Source: Factset

Outlook

As we finish out 2021, there are a plethora of questions for which we are seeking answers. Here are a few of them:

Geopolitics/Global Issues

- What are the repercussions of the disastrous Afghanistan withdrawal? Do countries take advantage of perceived American overseas weakness? (i.e., China/Taiwan)
- Do COVID variants continue to emerge, evading vaccinations and leading to further lockdowns?
- When, where, and who will the next cyberattack target?

Economic

- Is Jerome Powell appointed to a second four-year term as Fed President?
- Who replaces Fed presidents Kaplan and Rosengren, who recently resigned over ethics issues?
- How long does inflation persist before it can be described as something more than "transitory"?
- Does tapering begin before the end of the year, as expected; does persistent inflation pull forward rate hikes or does slowing growth push them out?

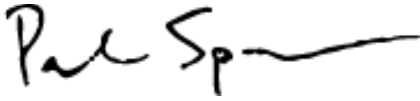
Corporate Fundamentals

- Q3 earnings are forthcoming; how will they compare with expectations, which have been coming down in recent weeks?
- How much are margins squeezed by higher input costs (labor, commodities, etc.) vs. ability/inability to pass through price increases?
- Do the troubles at Chinese property developers (Evergrande) lead to bigger issues domestically and/or abroad?

Political

- Does the debt ceiling get raised and when?
- Will the infrastructure bill pass the House and how much of Biden's \$3.5 trillion spending plan is ultimately achieved and what tax hikes will pay for it?

All the best for the rest of 2021!

A handwritten signature in black ink that reads "Paul Sp" followed by a long, horizontal flourish.

Paul Spencer, CFA®

Director

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