Portfolio Manager Commentary

September 3, 2021

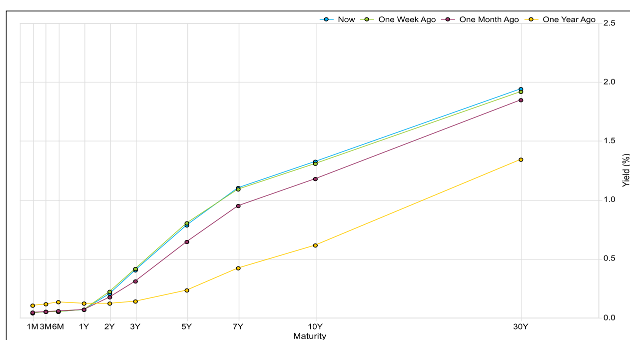
Economic Outlook

U.S. Pending Home Sales were down 1.8% in July following a 1.9% drop in June. The Case-Shiller Home Price Index was up 18.6% on an annualized basis in June, after having been up 16.8% in May. The Chicago Purchasing Manager's Index came in at 66.8 in August versus 73.4 in July, both strongly expansionary. The U.S. Purchasing Manager's Index and the ISM Manufacturer's Indexes came in at 61.1 and 59.9, respectively, for August. The ISM Services Index was 61.7 for August, and the PMI Services Index was 55.1 for the same month. Finally, the U.S. Unemployment Rate was 5.2% in August, down from 5.4% in July. Average Hourly Earnings were up 0.6%.

Fixed Income

It looks like it is going to take a little bit longer for things to liven up again in the $22 trillion U.S. Treasury market. Ten-year note yields were little changed last week after a weak jobs report lowered expectations that the Federal Reserve will being its bond tapering program sooner than later. The release of last week's jobs report comes after Fed Chair Jerome Powell made it clear to bond market traders that any tapering of its asset purchasing program didn't necessarily mean short-term interest rates would be pushed higher by raising the Fed Funds target. Many bond-market veterans including Bill Gross have sounded the alarm about the risk of surging yields, while the spread of the coronavirus delta variant is helping hold back the Fed on any taper efforts. The result is that the market has defied doomsday predictions and traded in a very narrow range as of late. It has been six months since the ten-year yield has posted a weekly move significantly greater than ten basis points, and measures of volatility are cratering. A popular trade did emerge last week where traders are wagering that ten-year yields will remain between 1.05% and 1.60% through the end of November. "The Treasury market will remain in this sort of lull," said Bill Herrmann, founder and managing partner at investment firm Wilshire Phoenix, LLC. "The labor data points to fears of delta, which all may turn out to be just fears, but we can only go on the data that we are presented with. It's looking really likely that the Fed is going to be handcuffed against normalizing policy at all until delta is contained." Last Friday had loomed as a day of reckoning for bond traders, should a robust jobs figure spark bets on a more hawkish Fed stance at policymakers next meeting later this month. But the addition of 235,000 jobs in August was well short of forecasts, even as hourly wages rose twice the median estimate. The jobs report is all but certain to push the Fed to delay considering a move to scale back asset purchases until at least its November meeting, according to several economists. The yield curve did steepen last week as the spread between two-year and ten-year notes now stands at 111 basis points. Several Fed governors and board members will be speaking this week so market watchers will be closely listening to any hints of the Fed's upcoming plans.

Change in Treasury Yield



Current Generic Bonds Yields

Treasuries		Agencies		Corporates		Municipals	
3 mo.	0.03%	3 mo	-0.05%	3 mo	0.16%	3 mo	0.15%
6 mo	0.04%	6 mo	-0.03%	6 mo	0.17%	6 mo	0.15%
1 yr	0.06%	1 yr	0.02%	1 yr	0.20%	1 yr	0.16%
2 yr	0.21%	2 yr	0.21%	2 yr	0.32%	2 yr	0.17%
5 yr	0.78%	5 yr	0.63%	5 yr	1.05%	5 yr	0.55%
10 yr	1.32%	10 yr	1.40%	10 yr	1.85%	10 yr	1.09%
30 yr	1.94%	30 yr		30 yr	2.72%	30 yr	1.69%

Equity

U.S. Equity finished the week higher as the S&P 500 Large Cap Index rose 0.63%. Factset Research Systems notes there was not much behind the upside for the week though there seemed to be a spillover from the dovish takeaways from Powell's Jackson Hole Speech Last week. In his speech, Powell distinguished between tapering and liftoff and reiterated a transitory view of price pressures.

Value took a hit this week as Energy (-1.40%) and Financials (-2.38%) lagged its sector peers the most while Health (+1.65%), Consumer Staples (+1.46%) and Utilities (1.42%) saw the biggest bumps. Year-to-date, growth (+24.04%) is outperforming Value (19.23%) by roughly 5%.

Index Returns	Last Week	YTD
Dow Jones Industrials	-0.12%	16.96%
S&P 500 (LCap)	0.63%	21.89%
S&P 400 (MCap)	-0.24%	19.68%
Russell 2000 (SCap)	0.65%	16.06%
NASDAQ Composite	1.55%	19.21%
MSCI EAFE (Int'l)	1.70%	14.00%
iShares Real Estate	3.83%	31.04%

Source: FactSet Research Systems

Asset Allocation

Current Sentiment

Cash	Favorable
Short FI	Neutral
Intermediate FI	Neutral
Inflation-Adjusted FI	Neutral
High Yield FI	Unfavorable
International FI	Unfavorable
Equity Income	Neutral
Large Cap Equity	Favorable
Mid Cap Equity	Neutral
Small Cap Equity	Unfavorable
International Equity	Unfavorable
Emerging Markets Equity	Unfavorable
Real Estate	Neutral
Commodities	Unfavorable

Summary below - Current stance on most asset classes:

Cash - Overweighting due to market volatility and uncertainty from Covid-19.

Short Term Bonds - Relative to Intermediate Bonds, the reduced duration is preferable given the oversold long-end of the curve.

Intermediate Term Bonds - The current trading range of intermediate bonds warrants a neutral position with limited upside potential. Some opportunities still remain in certain sectors.

Inflation-Adjusted Bonds - Low inflation expected in near-term providing zero real return.

High Yield Bonds - Spreads are rising given the market turbulence and exposure to unnecessary credit risk when compared to Treasuries would not be advised.

International Bonds - Foreign bonds offer good diversification qualities and higher yield opportunities, however, risks have been elevated recently and investment should be made cautiously.

Equity Income - High quality and higher-dividend-paying companies remain attractive for long-term investors given their favorable risk-adjusted profile and current yield curves.

Large Cap Stocks - A favorable weighting is recommended. Growth continues to be a more favorable style and should continue to be overweighed versus Value.

Mid Cap Stocks - Mid cap exposure remains neutral - more attractive than small caps but not as attractive as large caps.

Small Cap Stocks - In broad market corrections, small cap stocks will suffer most with increased volatility. Underweight until a clearer picture of recovery ensues.

International Stocks - Given most foreign investment is in developed markets and European countries, until sovereign debt concerns are alleviated, an underweight is recommended.

Emerging Market Stocks - Stronger balance sheets, less debt, and better growth potential make emerging markets more fundamentally attractive than developed countries longer-term. However, trade uncertainty and dollar strength provide a headwind for EM in the near term.

Real Estate - Pricing has begun to stabilize and long-term valuations appear attractive. Real Estate should continue to be a strong alternative to other asset classes.

Commodities - Global demand should support higher prices if the global recovery remains on track. Volatility will be higher, and commodities will be susceptible to short-term price shocks, however, if used in conjunction with other asset classes, risk can be reduced substantially within a diversified portfolio. Used alone though is not recommended

Sources of statistical information are Bloomberg and Ned Davis Research.

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