REVIEW AND COMMENTARY
3rd QUARTER – 2021

As the last quarter of 2021 starts, equity market volatility remains elevated. As of the first four days of trading the Dow Jones Industrial Average had daily swings of anywhere between 1.3% and 2.09%. Historically, October has provided some dark days for investors. Daily market drops of over 20% in 1987, 14% in 2008 and over 11% each day on October 28th and 29th in 1929. However, according to recently published data from Yardeni Research Inc., from 1928 to the end of September 2021 October, on average, has returned positive results. In fact, on average, the 4th quarter is positive. September is by far the worst month by a considerable measure losing 1% on average and, with the exception of February and May, all other months are positive. We wish it was that simple.

Investors remain concerned with growing government deficits, U.S. debt ceiling limits, inflation, the affect and timing of a reduction of bond purchases by the U.S. Federal Reserve however there are a few new concerns facing investors this quarter. Certainly, the pending bond default by Evergrande, China's largest property developer, is the most notable at the time of writing. It is unclear whether the Chinese government will step in to re- assure debt holders however even if they do, this will be a drag on the recovery of the world's second largest economy. Another is the COVID delta variant which continues to surge worldwide, and the U.S. afflictions remain worryingly high as many US citizens remain unwilling to get vaccinated. This will impair the potential recovery of the world's largest economy. With these two economies strugglingly to cope with these issues (and others), it would appear that the U.S. economic recovery will take longer than widely expected only a few months ago. As discussed in our last quarterly, the uncertainly of the recovery will likely delay the tapering of bond purchases even further into next year.

Since February of 2020, the US money supply, as measured by the M2 index, has increased by approximately 33%. Under normal monetary policy, this would cause significant inflationary pressures as more money chases after a limited supply of assets. While this may be the case in some asset classes, in some jurisdictions, the velocity of money has not grown anywhere near the rate of money supply. In other words, money is staying put- at least on a relative basis. Corporate balance sheets are flush with cash which should bode well for future stock buybacks and increased dividends. However, eventually as liquidity is drained from the financial systems by the U.S. Federal Reserve and other Central Banks investors will have to remain cautious. If the tapering is done too quickly or the economies are unable to absorb the impact properly, it may have a negative impact on the stock markets globally.

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An increasing number of companies are blaming supply chain problems for earnings below expectations. Supply chain problems are a two- edged sword. On one hand, for as long as supply chain issues exist, growth will be less that expected. Two, those companies that are victim of it will not be able to function efficiently and therefore suppress earnings. Alternatively, this may dampen economic recovery temporarily which in turn may cause the US Federal Reserve to defer bond purchases even further. If the recent uptick in inflation remains temporary, as the head of the Bank of Canada and the US Federal Reserve believe, then the stock market should continue to provide positive returns. What would happen if supply chain matters were resolved? Most likely, a decent uptick in earnings as well as a significant rebound in jobs and the economy. That would be a more appropriate time to consider tapering.

Until then, with inflation appearing to be temporary, liquidity levels steady and cash accumulating in corporate coffers the only thing that may unhinge present valuations is either a massive default by Evergrande or some other entity. While it may be too early to tell about the former, it is hard to predict the latter so low interest rates and ample liquidity should limit any equity market pullback- if it happens.

We remain constructive on equities and wish you all a Happy Thanksgiving.