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Capital Markets Review and Outlook

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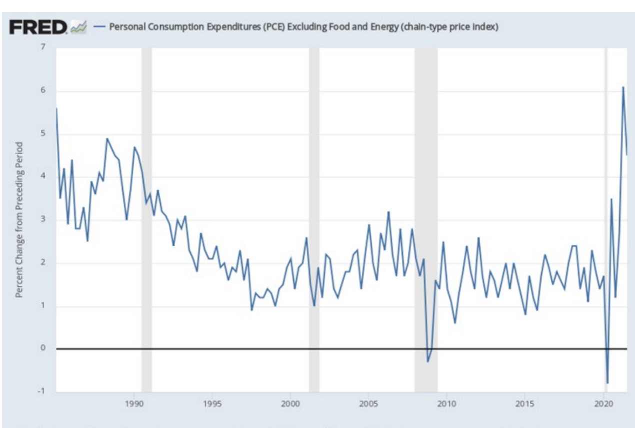
Economy and Outlook

Over 5 million deaths globally have now been reported from the Covid-19 pandemic with almost 250 million confirmed cases. As grim as these statistics are, the light is getting brighter at the end of the tunnel we are in. Total vaccinations administered worldwide are now over 7 billion with half the world's population receiving at least one vaccine dose, a remarkable feat considering that vaccinations began less than a year ago. Also, infection rates and mortality rates are both on a declining trend. Additionally, several countries have started or are considering booster vaccine shots, especially for the vulnerable segments of their populations. These actions will help further prevent the severity of the disease if contracted. On the economic front, third quarter U.S. GDP growth slowed down to a 2% annualized pace following the strong rebound in the first half of the year after the pandemic-induced economic decline in 2020. The rise in coronavirus Delta-variant cases over the summer and supply chain disruptions were behind the economic slowdown. The underpinnings for the economy, however, remain firm. The October employment report showed a gain of 531,000 jobs with the unemployment rate falling to 4.6%. Weekly jobless claims have declined to the lowest level since the pandemic began, while the number of job openings remain near a record high of 10 million. Supply chain bottlenecks continue to play a major role in both slower sales growth as well as rising prices. Auto manufacturers, for example, are hampered by the shortage of computer chips which, in turn, has caused a significant decline in vehicle shipments and higher car prices. In addition to rising prices for commodities and finished goods, wages have also been increasing at a rapid pace as companies struggle to find and retain workers. The chart on the left shows that the Federal Reserve's preferred gauge for inflation, the core personal-consumption-expenditures (PCE) price index, is increasing at the fastest rate in over 30 years. While the Fed has been of the opinion that these inflationary pressures are transient, there now appears to be a subtle shift in this stance as evidenced by the central bank's recent decision to begin tapering its massive quantitative easing (QE) program. The Fed will reduce its bond-buying by $15 billion each in November and December which could completely phase out the $120 billion monthly purchase program by June of 2022 if the Fed, as expected, continues the monthly reduction in bond purchases. Despite the dialing back of monetary stimulus, the fiscal spigot is at full throttle.



While the White House's original $3.5 trillion climate and social spending proposal has now been cut by almost half, in an effort to get it passed by Congress, even the lower figure together with the approximately $1 trillion infrastructure bill will provide a very high level of fiscal support for the economy. The backdrop of a less accommodative central bank combined with massive government spending programs are likely to continue the upward pressure on interest rates and volatility, especially for risk assets.

Equity Markets

Equity markets rebounded strongly in October after the September slump. For the month, the broad domestic equity market represented by the Russell 3000 index notched its biggest monthly gain for the year, rising +6.8%. This brought the return for the 10 months of the year to a strong +22.8%. Strong corporate earnings reports bolstered the markets as a significant majority of companies reporting earnings in October handily beat forecasts. Investors were also reassured by the declining rate of Covid-19 infections, a firm economic backdrop, and a further reopening of the global economy. In the market rebound, there was a reversal from the prior month in performance by capitalization as Large Cap (+6.9%) outperformed both Mid Cap (+5.9%) and Small Cap (+4.3%). Year-to-date, Large Cap is now firmly ahead of the other two capitalization categories after having lagged in the first half of the year. In October, there was also a reversal in performance by Style as Growth outperformed Value across all capitalizations, especially Large Cap where the outperformance was +360 bp. In contrast, the outperformance in Small Cap was +90 bp. For the year, however, Value continues to dominate Growth in performance especially in Small Cap where the outperformance is a huge +20 percentage points. All 11 of the major S&P 500 sectors were in the green in October. As is typically seen in strong up months, Cyclicals stood out with Consumer Discretionary (+10.9%) the best performer compared to Consumer Staples (+3.9%), the second worst relative performer. Energy was the 2nd best sector performer in October with a gain of +10.4% as energy prices continued to climb higher with the benchmark price for domestic crude oil (WTI) closing above $80 a barrel. Compared to a year ago, the Energy sector is up a remarkable +111%. International equity markets also rebounded in October though not as strongly as the U.S. markets. The MSCI Developed Markets equity index rose +2.5%. Strong performers were Canada (+7.6%) helped by the continued rise in energy prices, Italy (+5.2%) and France (+4%). After its strong rebound in September, Japan (-3.4%) resumed its decline. The MSCI Emerging Markets index rose +1% for the month. While China (+3.2%) rebounded after its weak performance over the past few months, Brazil lost -9% in October widening its loss for the year to almost -20%. For the year, the Developed Markets Index (+11%) is well-ahead of the Emerging Markets index which is fractionally lower at -0.3%.

Fixed Income Markets

Expectations for the Federal Reserve to begin tapering its bond-purchase program propelled interest rates higher in October. Short and intermediate maturities once again bore the brunt of the increase in yields with 2-year and 5-year maturity Treasury yields jumping 20 bp each to end the month at 0.48% and 1.18% respectively. The increase in the 10-year Treasury note was a more muted 3 bp to 1.55%. On the other hand, the yield on the 30-year Treasury bond dropped sharply by 15 bp to 1.93%. As a result, the Treasury yield curve flattened significantly with the yield differential between the 2-year and 30-year Treasury narrowing by 35 bp for the month to +145 bp. At the end of the 1st quarter of this year, the 2-year/30-year Treasury yield spread was steeper at +225 bp. Unlike the rally in the equity markets, the investment grade corporate bond sector modestly underperformed with the sector's option-adjusted spread (OAS) widening by 3 bp to +82 bp. However, performance was flat versus duration-matched Treasuries due to coupon yield. For the third consecutive month, the credit quality curve flattened as the BBB-rated sector outperformed the Single-A sector by +10 bp in excess return. The credit curve also flattened with the long maturity sector outperforming the short and intermediate sectors by an average of +39 bp. With the continued rise in energy prices, the best performing sector for the 2nd consecutive month was energy-related with +76 bp of excess return for Oil Field Services. Railroads (+47 bp), Transportation Services (+46 bp) and Airlines (+44 bp) were other strong performing sectors in October. The laggards included Tobacco and Wireless both of which underperformed by -35 bp. Despite the credit index's spread widening in October, the investment grade credit sector rose +0.2% for the month due to the decline in long maturity yields. For the year, the index is now down -1.3%. Unlike its investment grade counterpart, the OAS of the high yield index narrowed by 2 bp to +287 bp in October. Also, unlike the investment grade sector, the high yield quality curve steepened with the Ba-rated sector generating a total return of -0.14% while the corresponding return for the Caa-rated sector was -0.21%, and distressed issuers rated Ca and below lost -5.7%. The best performing sectors included Airlines (+49 bp) and Oil Field Services (+48 bp), while Cable Satellite (-103 bp) and Restaurants (-80 bp) were among the underperformers. For the month, the High Yield sector lost -0.2% as the sector's high coupon was more than offset by the sharp rise in short and intermediate Treasury yields. Year-to-date, the index is up 4.4%. Changes in yields in international government bond markets were mixed with yield changes and curve reshapings in Europe mirroring those in the U.S. while in other countries such as Canada, long maturity yields rose. The value of the U.S. dollar was also mixed, rising strongly against the Japanese yen, and declining versus other currencies including the euro and the Canadian dollar. The result of these cross currents in yield and currency differentials in October was the FTSE non-US World Government Bond Index (WGBI) declining -0.7% for the month, underperforming the U.S. government bond index which declined -0.1%. Year-to-date, the underperformance of the international government bond index (-8.5%) versus the U.S. government bond market (-2.5%) has worsened.

			Returns as of 10/31/21 (In %)			
		Month	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	6.8	22.8	43.9	21.6	18.9
Russell 1000®	US Large Cap Equity	6.9	23.2	43.5	22.0	19.2
Russell 1000® Growth	US Large Cap Growth	8.7	24.2	43.2	29.4	25.5
Russell 1000® Value	US Large Cap Value	5.1	22.0	43.8	13.9	12.4
Russell Midcap®	US Mid Cap Equity	5.9	22.0	45.4	19.9	16.5
Russell Midcap® Growth	US Mid Cap Growth	7.0	17.3	39.4	26.2	21.9
Russell Midcap® Value	US Mid Cap Value	5.3	24.5	48.6	15.0	12.3
Russell 2000®	US Small Cap Equity	4.3	17.2	50.8	16.5	15.5
Russell 2000® Growth	US Small Cap Growth	4.7	7.6	38.5	18.6	17.9
Russell 2000® Value	US Small Cap Value	3.8	27.6	64.3	13.4	12.6
MSCI ACWI ex-US	Global Equity ex-US	2.4	8.4	29.7	12.0	9.8
MSCI EAFE	Global Developed Mkts Equity	2.5	11.0	34.2	11.5	9.8
MSCI EM	Emerging Mkts Equity	1.0	-0.3	17.0	12.3	9.4
Bloomberg/Barclays US Agg	US Core Fixed Income	0.0	-1.6	-0.5	5.6	3.1
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	-0.4	-1.2	-0.6	4.4	2.5
Bloomberg/Barclays US Credit	US Corporate Bonds	0.2	-1.1	1.9	7.7	4.6
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	-0.2	-0.9	-0.6	4.0	2.2
Bloomberg/Barclays US Corp HY	US High Yield	-0.2	4.4	10.5	7.4	6.4
FTSE Non-US WGBI	Global Fixed Income ex-US	-0.7	-8.5	-4.3	3.2	1.6

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