Retirement Market RECAP Q3 2021

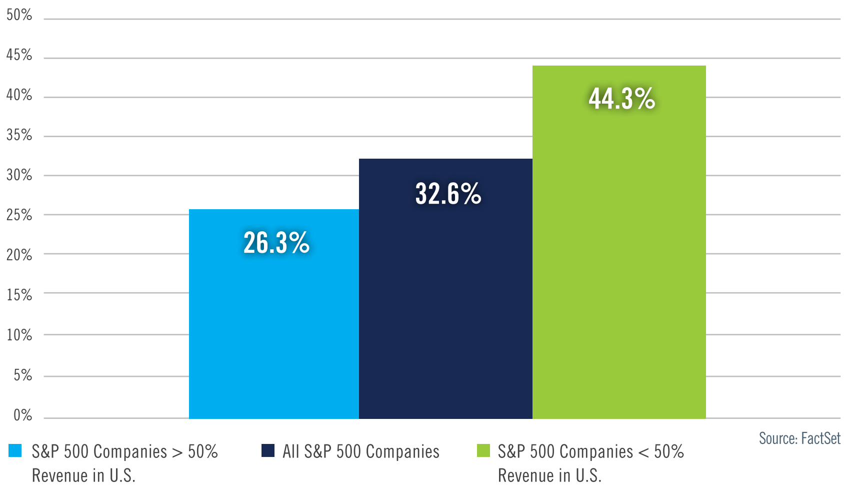
HANYS Benefit Services

U.S. and developed international markets flat in Q3 while emerging markets struggled

As the third quarter of 2021 came to a close, the immediate threat of COVID-19 plateaued in the U.S. and other developed economies, based on lower hospitalization rates. Despite the economic headwinds caused by the Delta variant, U.S. stocks eked out a small 0.58% gain, with the S&P 500 Index posting its seventh consecutive quarterly gain since the first wave of COVID-19. The Index ended the quarter on a weak note due to concerns about lowered economic growth expectations, inflation and global supply chain logjams. U.S. equities outpaced international developed equities by 103 basis points (MSCI EAFE Index) and emerging market equities by 867 basis points in the quarter. Emerging markets (–8.1%) reversed sharply as mounting regulatory uncertainty in China across the for-profit education sector and a liquidity crisis at one of the country's largest property developers, China Evergrande Group, pressured the broad market.

Within the S&P 500 Index, all sectors performed within a historically tight range. Top performance was in financials (+2.7%) and utilities (+1.8%), with industrials (-4.2%) and materials (-3.5%) lagging. The energy sector (-1.7%) began to outperform late in the quarter as supply constraints and long-range weather forecasts for a cold heating season in parts of the northern hemisphere drove higher prices for natural gas and oil – Brent Crude in particular.

S&P 500 Earnings Growth: Q3 2021



Fixed income returns disappointed in the quarter mainly due to concerns about rising interest rates, with the Bloomberg US Aggregate up a scant 0.05%. Bond investors were rewarded to a degree for committing to longer maturities (Bloomberg Long Term US Treasury Index, +0.47%) or accepting higher risk (Bloomberg High Yield Corporate Index, +0.89%). Investors showed renewed interest in inflation-hedging investments. The Bloomberg US Treasury US TIPS Index returned 1.75%. Real estate is another traditional inflation hedge that all HBS clients include in their retirement plan investment menu. The S&P United States REIT Index gained 0.97% for the quarter and has bounced back in the trailing one-year period at +37.03%.

Investor concerns about rising interest rates are valid for two reasons. As prices for goods and services rise, interest rates must eventually follow suit. Otherwise there is an arbitrage opportunity to accelerate the consumption of goods and services on borrowed money. Secondly, The Federal Reserve has clearly signaled its intention to begin tapering back quantitative easing (bond buying program) in November and to end it by mid-2022. Tapering could temporarily push bond prices lower. The Fed's median expectation for changes to the Fed Funds Rate, currently at a target rate of

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0.00%-0.25%, is one hike (of 25 basis points) in 2022 and three hikes in 2023 and in 2024. The bond market disagrees, pricing in a 75% probability of at least two rate hikes in 2022.

Continuation of the Fed's accommodative monetary stance is predicated on expectations for a slowing economy. Their most recent estimate for 2021 GDP growth is +5.9%, down from their July estimate of +7.0%. Fed models show the economy continuing to slow toward pre-pandemic levels: +3.8% growth in 2022 and +2.5% in 2023. Their models also indicate that inflation pressures will ease as the economy slows. Fed projections for year-over-year inflation are 4.2% in 2021, then falling to back to 2.2% in 2022 and 2023. (Federal Open Market Committee Projections, Sept. 22, 2021)

Weak links in the supply chain hamper global growth

- The current problem is based on unusually high imbalances between supply and demand. Pre-COVID-19, the supply chain had evolved into an efficient system supporting synchronized commerce on a global scale. The pandemic and resulting fiscal and monetary stimulus caused significant and largely unpredictable swings in demand. For manufactured goods, there is a natural lag in keeping up with soaring demand, and a natural increase in prices.
- World purchasing manager monthly surveys indicate delivery times for raw materials and components have risen to record levels. Higher input costs and production delays drive up costs, which manufacturers will pass along the supply chain, given sufficient demand.
- Sectors most heavily impacted include autos/transportation, construction, computers and other electronics and industrial machinery. The auto industry is specifically challenged by the severe global shortage of semiconductors, reducing unit sales volume and increasing prices.
- Asian governments' zero tolerance policy for viral infections has resulted in shutdowns of factories and shipping ports; 38% of global manufacturing is based in the Pacific region.
- How are supply chain inefficiencies affecting U.S. companies' third quarter corporate earnings? Surprisingly, of the S&P 500 companies that have reported earnings as of Oct. 25, 2021, those that generate more than 50% of sales outside the U.S. report an average year-over-year earnings increase of 44.3%, versus 26.3% for companies with more than 50% of sales inside the U.S. (See FactSet Chart).
- A full reopening of the economy would support a rebalancing of consumer spending back to services and away from goods, providing some relief for manufacturers, shippers and other links in the supply chain.

Investors who stayed the course during the fear-driven market in the first wave of COVID-19 have been rewarded with remarkably resilient markets. COVID-19 will continue to be the main influence in U.S. economic activity until public health conditions begin to improve. While it is unlikely that the high level of infections and hospitalizations will derail the economic expansion, the path of the pandemic will influence the growth rates in spending, output and employment in the important holiday shopping/travel season and into the New Year.

EQUITY INDICES	3 MO	YTD	1 YR	3 YR	5 YR	FIXED INCOME AND RETIREMENT INDICES	3 MO	YTD	1 YR	3 YR	5 YR
S&P 500 TR USD	0.58%	15.92%	30.00%	15.99%	16.90%	ICE BofA 3M US Trsy Note TR USD	0.01%	0.08%	0.09%	1.24%	1.18%
Russell 3000 TR USD (Broad Market)	-0.10%	14.99%	31.88%	16.00%	16.85%	ICE BofA 1-3YR US Trsy TR USD	0.06%	-0.02%	0.03%	2.64%	1.63%
Russell 1000 TR USD (Large Cap)	0.21%	15.19%	30.96%	16.43%	17.11%	Bloomberg Long Term US Trsy TR USD	0.47%	-7.49%	-10.27%	9.22%	3.31%
Russell Midcap TR USD	-0.93%	15.17%	38.11%	14.22%	14.39%	Bloomberg US Aggregate Bond TR USD	0.05%	-1.55%	-0.90%	5.36%	2.94%
Russell 2000 TR USD (Small Cap)	-4.36%	12.41%	47.68%	10.54%	13.45%	Bloomberg US Treasury US TIPS TR USD	1.75%	3.51%	5.19%	7.45%	4.34%
MSCI EAFE NR USD (Int'l Equity)	-0.45%	8.35%	25.73%	7.62%	8.81%	Bloomberg High Yield Corporate TR USD	0.89%	4.53%	11.28%	6.91%	6.52%
MSCI Emerging Markets NR USD (E.M. Equity)	-8.09%	-1.25%	18.20%	8.58%	9.23%	Bloomberg Global Aggregate TR USD (Global Bond)	-0.88%	-4.06%	-0.91%	4.24%	1.99%
S&P United States REIT TR USD	0.97%	22.89%	37.03%	9.92%	6.61%	Morningstar Lifetime Mod 2020 TR USD	-0.29%	5.24%	14.14%	9.71%	8.58%
						Morningstar Lifetime Mod 2040 TR USD	-0.89%	9.89%	25.71%	11.17%	11.69%

ICE BofAML – Intercontinental Exchange Bank of America Merrill Lynch; S&P 500 - Standard & Poors; MSCI – Morgan Stanley Capital International
Sources: Morningstar as of Sept. 30, 2021

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