ECONOMIC & INVESTMENT PERSPECTIVES

AUGUST: LEADING ECONOMIC INDICATORS SUPPORT CONSTRUCTIVE OUTLOOK

Figure 1: 8/31/2021 Returns (source: Bloomberg)
Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	Month	YTD	1YR	Current vs. 52-wk High	Current vs. 52-wk Low
US Aggregate Fixed Income	AGG	-0.2%	-0.8%	-0.1%	-2.4%	2.5%
Investment Grade Corp Bonds	LQD	-0.3%	-0.7%	2.2%	-2.3%	5.8%
U.S. Treasury Bonds	GOVT	-0.1%	-0.9%	-2.0%	-3.6%	3.0%
20+ Year Treasury Bonds	TLT	-0.3%	-4.8%	-6.9%	-11.0%	11.7%
Muni Bonds	MUB	-0.2%	1.1%	3.0%	-0.7%	2.0%
High Yield	HYG	0.6%	3.3%	8.3%	0.0%	6.7%
Non-US Corp Bonds	IBND	-1.0%	-4.0%	0.6%	-5.6%	3.1%
Emerging Markets Bond LC	EMLC	0.6%	-3.7%	3.7%	-7.0%	2.8%
Global Equity						
ACWI Global Equity	ACWI	2.2%	15.8%	28.6%	-0.2%	35.6%
United States	VTI	2.9%	20.6%	33.4%	-0.3%	43.2%
International Developed	EFA	1.4%	12.0%	27.0%	-1.8%	32.3%
Emerging Markets	EEM	1.6%	1.9%	19.4%	-10.1%	23.9%
Global Equity by Region						
United States	VTI	2.9%	20.6%	33.4%	-0.3%	43.2%
Europe	IEUR	1.8%	17.4%	31.5%	-1.0%	41.1%
Asia ex-Japan	AAXJ	1.1%	-0.7%	15.4%	-13.4%	20.0%
China	MCHI	-0.7%	-12.4%	-5.5%	-27.4%	7.4%
Japan	BBJP	2.0%	2.3%	19.7%	-4.3%	19.9%
Latin America	ILF	-0.4%	2.0%	36.9%	-9.0%	43.5%
US Equity						
US S&P 500	IVV	3.0%	21.6%	31.3%	-0.3%	41.4%
NASDAQ 100 QQQ	QQQ	4.2%	21.4%	29.6%	-0.2%	46.1%
US Large Growth	IWF	3.6%	21.0%	28.4%	-0.4%	42.2%
US Large Value	IWD	2.0%	20.2%	36.3%	-0.4%	43.6%
US Eqwt S&P 500	RSP	2.4%	23.5%	42.5%	-0.4%	51.0%
US Mid Cap	IJH	2.0%	20.3%	44.7%	-0.9%	56.3%
US Small Cap	VTWO	2.2%	15.7%	47.0%	-3.7%	59.0%

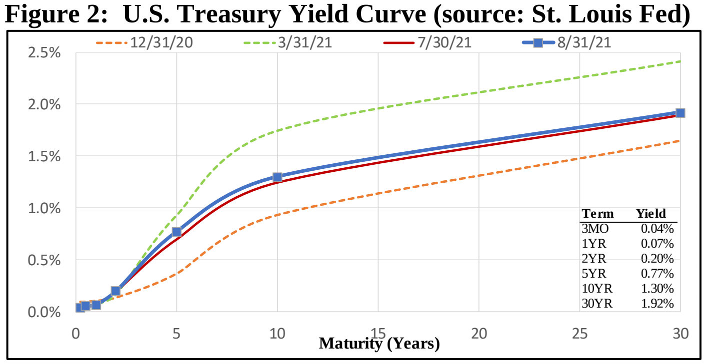
Interest rates vacillated in August but were roughly unchanged as inflation concerns offset worries over economic growth due to rising virus cases, hospitalizations and deaths in the U.S. and globally. Stocks still moved higher and closed at or near record levels due to strength in the U.S. Performance highlights for the month and 2021 year-to-date (YTD) are summarized below.

- Bonds: The U.S. Aggregate index (AGG) fell 0.2% this month (-0.8% YTD). Long-term Treasuries (TLT) fell 0.3% (-4.8% YTD); corporate bonds (LQD) were down 0.3% (-0.7% YTD) while high yield gained 0.6% (+3.3% YTD) as spreads narrowed. Non-U.S. bonds (IBND) lost 1.0% (-4.0% YTD), but emerging market debt (EMLC) rose 0.6% (-3.7% YTD).
- Global equity (ACWI): +2.2% this month (+15.8% YTD).
- U.S. Equity: The broad market (VTI) rose 2.9% in August (+20.6% YTD). The S&P 500 (IVV) was up 3.0% (+21.6% YTD); small stocks (VTWO) were up 2.2% (+15.7% YTD). Growth stocks led, with Nasdaq QQQ rising 4.2% (+21.4% YTD). At the sector level, financials (XLF) rose 5.1%, while energy stocks (XLE) fell 2.0%; both are up over 30% YTD.
- Non-U.S. Equity: Developed markets (EFA) gained 1.4% (+12.0% in YTD), led higher by Europe (IEUR) and Japan (BBJP). Emerging markets (EEM) rose 1.6% (+1.9% YTD), led by India (INDA), Indonesia (EIDO) and Mexico (EWW), while Brazil (EWZ), Korea (EWY), and China (MCHI) fell.

Interest Rates and the Economy

After moving steadily lower since March, interest rates rose slightly in August. Figure 2 graphs the U.S. yield curve, which plots yields (Y-axis) for various maturities (X-axis) of U.S. Treasuries. Short-term yields remain near zero indicating that despite higher inflation readings recently, investors do not believe that the Federal Reserve (Fed) will increase policy rates anytime soon. Longer term maturities rose modestly consistent with expectations that the Fed will likely begin to reduce monthly bond purchases incrementally in late 2021 or early 2022. The U.S. 10-year bond yield rose from 1.24% to 1.30% this month.

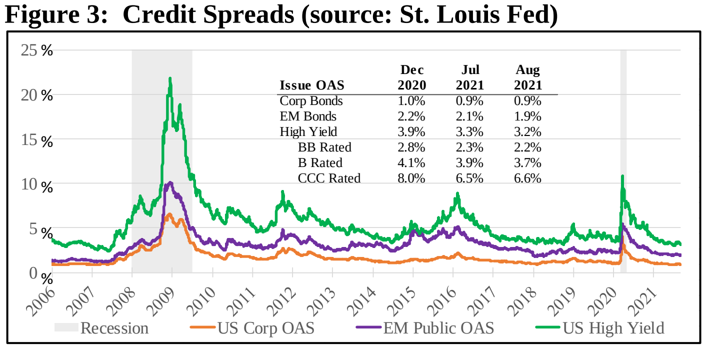
Figure 2: U.S. Treasury Yield Curve (source: St. Louis Fed)



For bonds other than Treasuries, we track the option-adjusted spread (OAS) between yields and Treasuries of comparable maturities. Low or narrowing spreads signal optimism while high or rising spreads signal fear. Spreads narrowed slightly this month on average and remain considerably below 2020 year-end levels.

- Investment grade corporate bond spreads were stable last month at +0.9% versus +1.0% at the 2020 year-end.
- High yield (non-investment grade) spreads narrowed to +3.2% and are well below year-end spreads of +3.9%. The riskiest bonds (rated CCC & below) yield +6.6% over Treasuries, up from 6.5% last month but well below the +8.0% at year-end.
- Emerging market bond spreads narrowed to +1.9% this month and remain below 2020 year-end spreads of +2.2%.

Figure 3: Credit Spreads (source: St. Louis Fed)

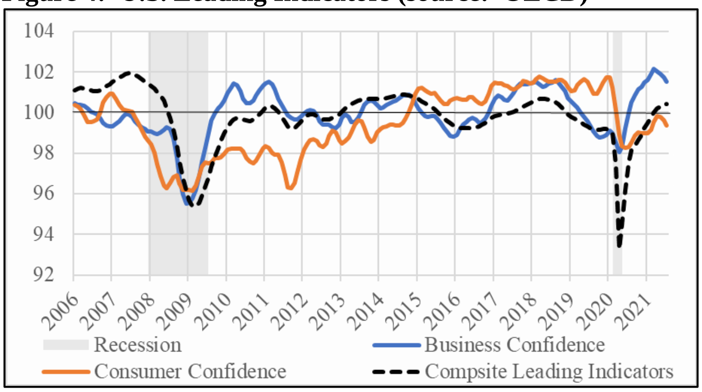


Leading Economic Indicators

With the U.S. and global stock markets near all-time highs, it makes sense to take stock of how far the markets have come and, more importantly, where they might be going from here. The stock market is forward-looking, with valuations based on expectations for future growth. There is no crystal ball to predict the future, but there are data and metrics than can guide forecasts.

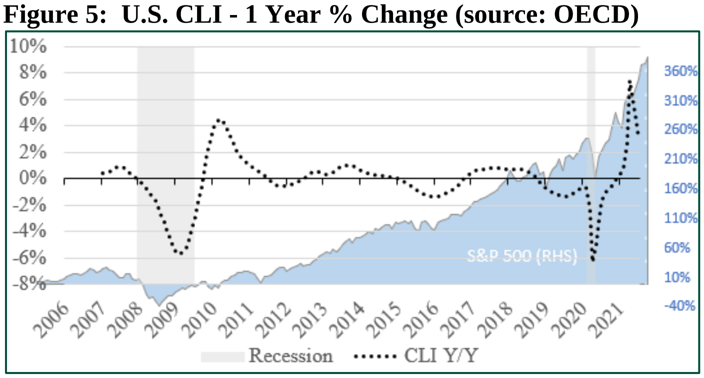
The Organization for Economic Cooperation and Development (OECD) is an international entity focused on data, analysis and best practices, fed by experts from 38 countries. Among other things, they track and publish a suite of indicators of economic activity across countries and regions. We focus on a subset of that data here, including consumer confidence, business confidence and the Composite Leading Indicator (CLI), which combines the confidence data with other factors (employment, housing starts, durable goods orders, interest rates and stock prices) to offer a comprehensive measure of economic performance. The data for the U.S. are plotted in Figure 4 (each normalized at 100).

Figure 4: U.S. Leading Indicators (source: OECD)



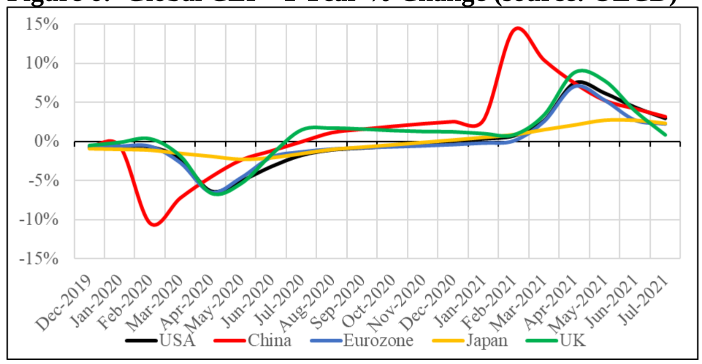
The graph illustrates the metrics across the last two recessions (the global financial crisis and the pandemic). Business and consumer confidence were hit hard on both occasions, impacting the production and consumption segments of the economy. Recent data indicates that while business confidence has fully rebounded, consumer confidence has lagged due to lingering employment and health concerns. Even so, the Composite Leading Indicator (CLI, dashed black line) is above 100, indicating a positive forecast for economic conditions. Figure 5 graphs the year-over-year percent change in the CLI versus the S&P 500 to illustrate the connection between the indicator and the stock market. When the CLI change is above 0% (below 0%) market performance tends to be positive (flat or negative). The market connection makes sense given that stock prices are included in the CLI.

Figure 5: U.S. CLI - 1 Year % Change (source: OECD)



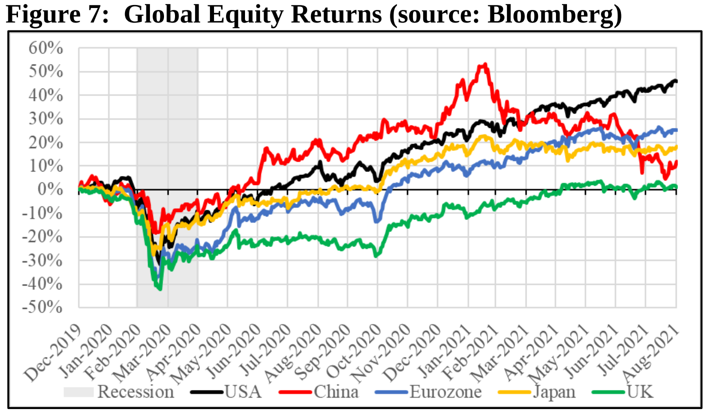
Based on this indicator, the outlook for the U.S. economy continues to be constructive. OECD also tracks and publishes similar data for the world's major economies. Figure 6 below tracks the year-over-year change in the CLIs during the pandemic era for the largest contributors to global GDP; together, these five countries/regions comprise roughly 70% of global GDP and over 80% of the investable stock market capitalization. (Note: Each country's CLI includes factors that are specific to that economy.)

Figure 6: Global CLI – 1 Year % Change (source: OECD)



China's economy was the first impacted by the pandemic, but given the draconian steps undertaken to stop the spread, they were also the first to recover. U.S. and European economies followed a similar path several months after China. Japan's economy did not suffer as much early on and, therefore, has not surged recently. Given that year-over-year change in CLI for all five remain above zero, the economic outlook for each remains constructive (U.K. bears watching). Figure 7 graphs the equity performance for the five countries/regions in the pandemic era. It makes sense that China's market was strongest early on (though regulatory changes have hurt performance recently). The U.S. stock market has led over all, while the U.K. has lagged.

Figure 7: Global Equity Returns (source: Bloomberg)



Bottom Line

Markets rise and fall based on investors' expectations regarding future economic growth and, therefore, the earnings potential of corporations. Leading indicators continue to be constructive regarding the economic performance and outlook for the major global economies, justifying the continued appetite for risk (equity), especially given historically low interest rates. But markets are likely to remain volatile as economic activity, employment, inflation and interest rates seek self-sustaining equilibrium, underscoring the value of a diversified investment portfolio.

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