# Economic and Market Overview

Third Quarter 2021

ENVESTNET PMC

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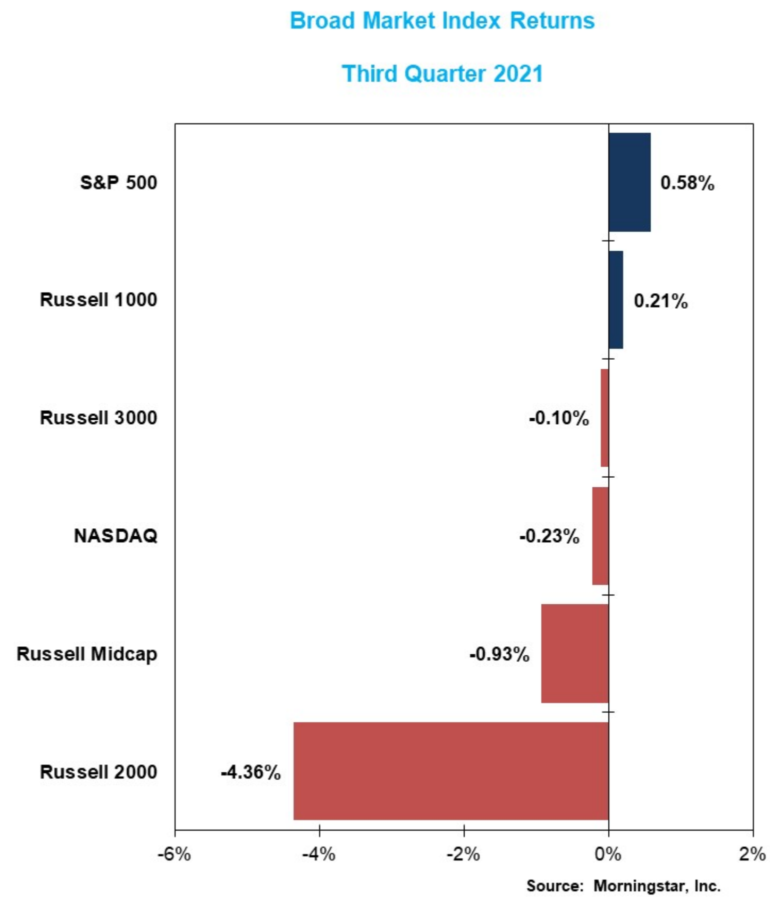
*The following commentary summarizes prior financial market activity, and uses data obtained from public sources. This commentary is intended for **one-on-one use with a client's financial advisor only,** as a resource to manage assets and evaluate investment portfolio performance.*

## The Economy

The US economy posted slowing but above-average growth in the quarter, supported by the dual tailwinds of accommodative monetary policy and historic fiscal stimulus. Lockdowns that had defined the early stages of the pandemic have for all intents and purposes ended, but there remain supply chain disruptions causing bottlenecks for many goods. Within this context, the Bureau of Economic Analysis released the third estimate of the second quarter 2021 real GDP, a seasonally adjusted annualized increase of 6.7%, slightly higher than the prior estimate, and an improvement over the 6.3% increase in the prior quarter. The employment situation also improved, but the most recent gains were less than expected. The August report showed that employers added 235,000 jobs in the month, and that the unemployment rate fell to 5.2%. The Federal Open Market Committee (FOMC) maintained its supportive monetary policy response to the pandemic, leaving the funds rate target range of 0% to 0.25% unchanged. However, the central bank provided advance notice that it would begin tapering its $120 billion monthly asset purchases, perhaps starting in December. The FOMC's "dot plot," a forecast of future rate changes, turned somewhat more hawkish, indicates the committee now expects the first interest rate hike to occur sometime in 2022.



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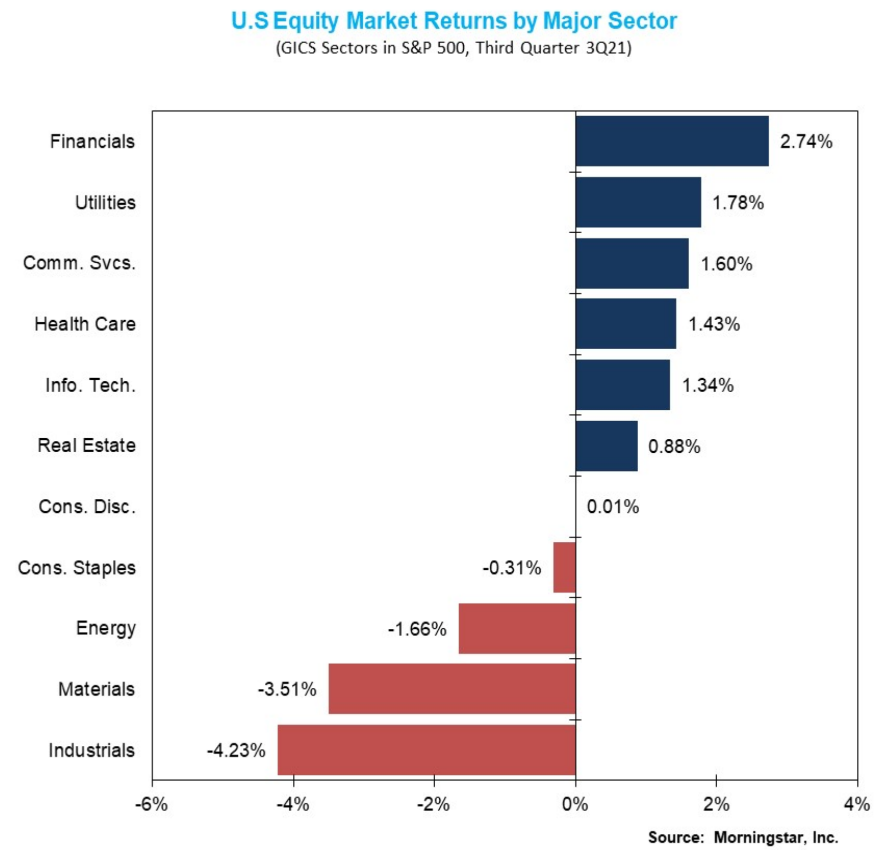
## Highlights and Perspectives

### GROSS DOMESTIC PRODUCT (GDP)

In the latest data available, the Bureau of Economic Analysis released the third estimate of the second quarter 2021 real GDP, a seasonally adjusted annualized increase of 6.7%, a notch better than the prior estimate, and an improvement over the 6.3% increase in the first quarter of 2021, as the economy continued to make up ground lost during the pandemic. As has been the case for most of the rebound, strength was especially strong in consumer segments, as consumers continue to benefit from the unprecedented fiscal stimulus coursing through the economy. Business investment was another segment that contributed positively. Inventories and trade were offsets. Corporate profits rose by 9.2% (not annualized) during the quarter after having risen 5.1% in the prior period. Inflation spiked, rising the fastest since the early 1980s.




### HOUSING

The housing segment continued to improve in fits and starts, as low supply and high home prices have made it difficult for potential homebuyers to purchase a home. Existing-home sales for August (the latest monthly data available) rose to an annualized rate of 5.9 million units, about 2% lower than the results from July, and also down about 2% from year-ago levels. The inventory of existing homes was approximately 2.6 months of supply, lower than levels of the prior year. Existing-home prices in August increased 15.6% from August 2020. In the new-home segment, the NAHB Housing Market Index, a measure of homebuilding activity, ended the quarter at 76, up slightly from a reading of 75 in the prior month, and lower than its cycle high of 90 in November 2020. Analysts believe the housing market remains in solid condition, even if mortgage rates were to rise from current levels.

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## EMPLOYMENT

The August employment report (the latest data available) showed a modest slowing with respect to the jobs situation, as new variants of the virus have dampened travel and leisure activities. In addition, the effects of the vast amounts of fiscal stimulus in the system have begun to dissipate. Employers added 235,000 jobs during the month, far lower than the consensus expectations of a gain of 750,000. The mining and manufacturing industries experienced the strongest gains, while losses in leisure/hospitality were the main reason for the overall slowdown. Economists indicate that employment will continue to trend higher such that the economy reaches full employment sometime in 2022. The unemployment rate in May declined to 5.2%, and the labor force participation rate remained level at 61.7%.

## FEDERAL RESERVE POLICY

The FOMC made no change to the federal funds rate target range of 0% to 0.25%, but did provide the long-awaited advance notice of its plans to begin tapering the $120 billion of monthly asset purchases. Analysts believe the tapering could begin in December. The committee modified the language regarding inflation in the communication following its most recent meeting, stating that prices remain “elevated.” The FOMC’s “dot plot” – the forecast of the fed funds rate – now signals that the federal funds rate may be raised in 2022, whereas in prior statements the expectation was 2023. The median projection of committee members is that the fed funds rate will be 1% in 2023 and 1.8% in 2024.

## INTEREST RATES

Fixed income securities’ prices on balance were lower (and yields higher) in the quarter as the economic rebound continued and inflation began to pick up steam. Inflation was a concern to bond investors, and even though growth slowed from prior quarters, yields were firm. The upcoming negotiations in Congress over raising the debt ceiling and passing an infrastructure bill could create heightened volatility for bonds in the coming weeks. As mentioned above, the FOMC made no change to its policy stance, but indicated that it sees the fed funds rate rising in 2022, earlier than had previously been expected. The FOMC is expected to maintain the target federal funds rate range at between 0% to 0.25% for the next several quarters.

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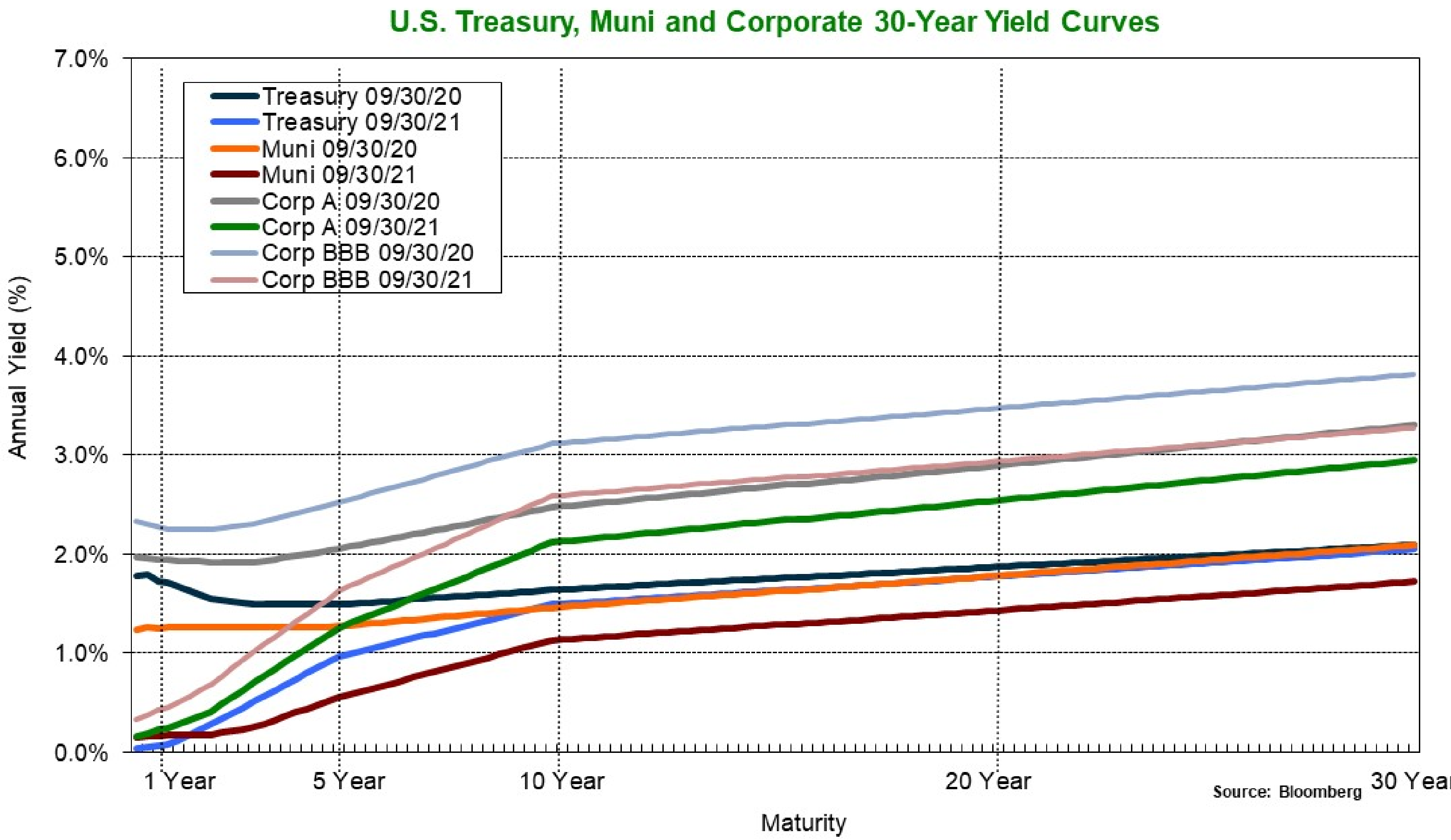


The shape of the Treasury yield curve remained similar to that at the end of the second quarter. Yields on the shortest-term maturities rose a mere 10 basis points, while yields in the intermediate- and long-term segments of the curve were essentially flat. By the end of the quarter, the yield on the benchmark 10-year US Treasury note was higher, ending at 1.49%, compared to 1.47% on June 30.

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The yield on the 10-year Treasury trended lower at the outset of the quarter, from a high of 1.47% near the beginning of July to a low of 1.17% in early August as economic growth cooled. However, yields marched higher from that point as investors began to worry that the elevated inflation was not going to be merely transitory, as the FOMC had previously indicated. Against this backdrop, the yield on the 3-month Treasury Bill settled at 0.04% at the end of the quarter, of the same as the previous quarter. The yield on the 5-year Treasury Note ended the quarter at 0.97%, compared to 0.89% on June 30, and as mentioned above, the yield on the 10-year Treasury Note was higher at 1.49%, compared to 1.47% over the same period. The yield on the 30-year Treasury Bond was little changed, ending the period at 2.05%, compared to its beginning level of 2.09%. Inflation expectations were also somewhat lower, with the Fed's gauge of five-year forward inflation expectations below the level of 2.24% on June 30.

Total returns on fixed income securities were mixed during the quarter. The Bloomberg Barclays Treasury 5-7 Yr. Index declined by -0.1% for the quarter. The Bloomberg Barclays US Credit Corporate 5-10 Yr. Index edged up by +0.04% during the three months. High yield securities, which often follow the performance of equities, edged higher, posting a return of +0.9%. Municipals posted moderately lower results in the quarter, as the Bloomberg Barclays Municipal Bond Index inched down by -0.3% during the quarter. Prices of non-US fixed income securities were lower in the quarter, as the Bloomberg Barclays Global Aggregate ex-US Index dropped -1.6%. Emerging markets bonds gave up recent gains, with the JPM EMBI Global Index lower by -0.5%.

## EQUITIES

Stocks finally encountered some headwinds after generating consistent positive monthly returns since March. Broad-based indices posted their sixth consecutive quarter of gains, but heightened inflation and rising yields created higher volatility later in the quarter. The S&P 500 rose steadily from the beginning of the quarter through early September, at which time it had gained 5.9%. However, seasonal influences, looming debt ceiling negotiations, and the aforementioned concern about inflation caused investors to take a portion of their profits. When the quarter ended, the S&P 500 Index had advanced +0.6%, and has gained +30% over the past 12 months.

Performance of eight of the 11 primary economic sectors was positive during the quarter. Financials, Utilities, and Communications Services were the strongest performers on a relative basis, generating returns of +2.7%, +1.8%, and +1.6%, respectively. The Industrials, Materials, and Energy sectors were the poorest relative performers, posting returns of -4.2%, -3.5%, and -1.7%, respectively.

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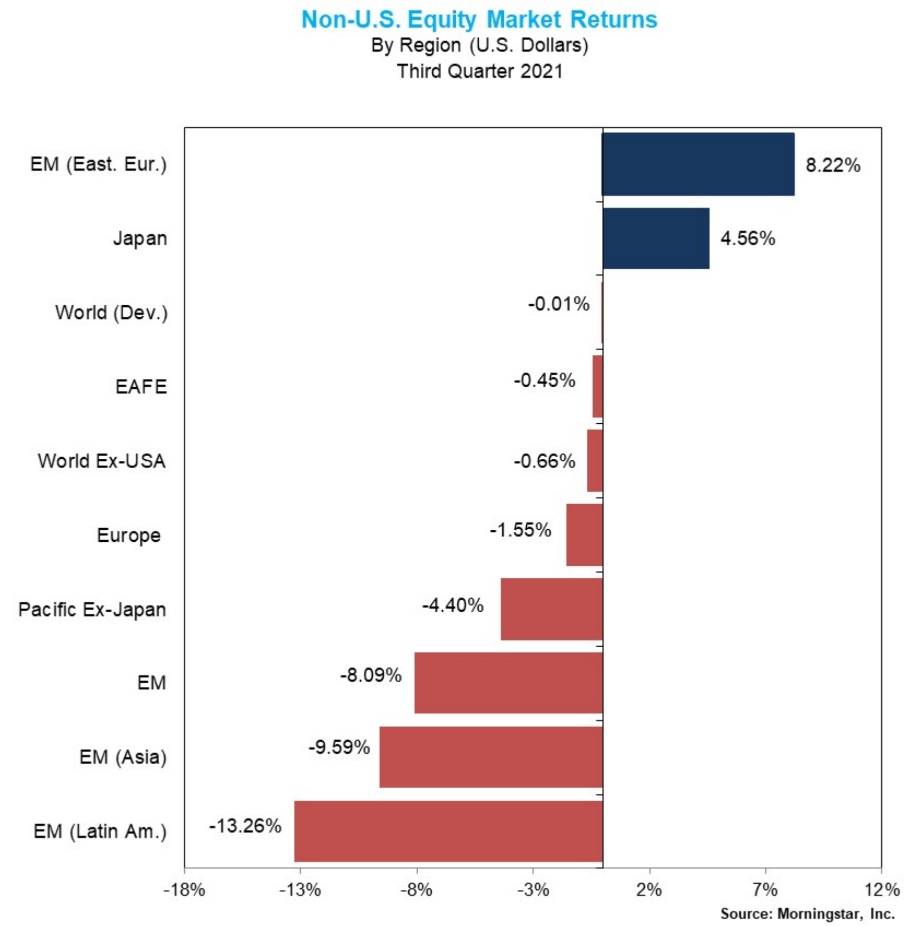
The Russell 1000 Index of large capitalization stocks generated a +0.2% total return. Within the large cap segment, growth stocks outperformed value stocks. Small cap stocks, as represented by the Russell 2000 Index, underperformed large caps, and finished the quarter with a total return of -4.4%. Small cap value outperformed small cap growth. The NASDAQ Composite, dominated by information technology stocks, finished the quarter with a modest loss of -0.2%. The Dow Jones Industrial Average of 30 large industrial companies declined by -1.5%.

Real Estate Investment Trusts (REITs) were higher during the quarter, with the DJ US Select REIT Index up +1.3%. Commodities also posted solid gains, with the Bloomberg Commodity Index adding +6.6% for the quarter.

International stocks also generated mixed results during the quarter, and generally performed in line with US equities. The MSCI ACWI Ex-USA Index, which measures performance of world markets outside the US, slumped by -3.0%. The MSCI EAFE Index of developed markets stocks eased by -0.5%. Regional performance was generally negative for the quarter. Eastern Europe was the strongest performer on a relative basis, with a return of +8.2%. China was the poorest relative performer, declining -18.2%. Emerging markets performance was very poor, as the MSCI Emerging Markets Index was lower by -8.1%.



## Outlook

The global economy is moving forward in fits and starts, with varying results in different regions of the world. Covid-19 continues to be somewhat of a headwind for the economy, with the Delta variant raising concerns over a rise in new cases. At the same time, questions about the long-term efficacy of vaccinations, and debates about vaccine and mask mandates are causing increased societal polarization. In the US, growth has been resilient, but expectations have been moderated in recent weeks due to the impact of the Delta variant. The euro zone is faring better than expected from the perspective of economic prospects, with analysts forecasting 4% growth in 2022. In Asia, lower vaccination rates have caused governments to re-impose restrictions, putting a damper on economies. Economists are increasingly focusing on consumer sentiment, because as the effects of fiscal stimulus fade economies will need to rely on positive expectations about the future in order to sustain growth. Supply chain disruptions also remain a hurdle. Since Asia is a critical player in the supply chain, economists argue that improvement in supplies will be slow to come until the region sees a drop in Covid cases. In terms of central bank throughout the world, the expectation is that many will begin tapering soon, and that they will begin to raise rates in 2022, assuming growth is positive and inflation remains elevated. Despite stumbling into the end of the quarter, stock prices are not far off all-time highs, and still have valuations that are also near record levels. Historically, when valuations have been close to where they currently stand forward returns have been muted.

Brandon Thomas, *Co-Founder* and *Chief Investment Officer,* Envestnet

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**INDEX OVERVIEW**

The **Dow or DJIA** (Dow Jones Industrial Average) is an unmanaged index of 30 common stocks comprising 30 actively traded blue chip stocks, primarily industrials, and assumes reinvestment of dividends. The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **DJ US Select REIT Index** is a subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities (The Dow Jones US Select Real Estate Securities Index (RESI) represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the US). The **Bloomberg Commodity Index** is a broadly diversified commodity price index that tracks prices of futures contracts on physical commodities on the commodity market, and is designed to minimize concentration in any one commodity or sector. The **MSCI EAFE Index** is recognized as the preeminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia, and the Far East. The **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization index that is designed to measure equity market performance in the global emerging markets. The **MSCI ACWI Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging markets country indices. The **MSCI Emerging Markets (EM) Eastern Europe Index** captures large and mid cap representation across four emerging markets (the Czech Republic, Hungary, Poland, and Russia) countries in Eastern Europe. With 52 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. The **MSCI EM (Emerging Markets) Latin America Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of emerging markets in Latin America. The **MSCI ACWI Ex-US Index** is a market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI China Index** captures large and mid cap representation across China H shares, B shares, Red chips, and P chips covering about 85% of this China equity universe. The **Bloomberg Barclays Municipal Bond Index** is an unmanaged index comprising investment-grade, fixed-rate municipal securities representative of the tax-exempt bond market in general. The **Bloomberg Barclays Global Aggregate ex-US Index** is a market-capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most US-traded investment- grade bonds are represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The Index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in the US. The **Bloomberg Barclays US 5-10 Year Corporate Bond Index** measures the investment return of US dollar-denominated, investment-grade, fixed-rate, taxable securities issued by industrial, utility, and financial companies, with maturities between 5 and 10 years. Treasury securities, mortgage-backed securities (MBS), foreign bonds, government agency bonds, and corporate bonds are some of the categories included in the Index. The **Bloomberg Barclays Capital US 5-7 Year Treasury Bond Index** is a market-capitalization-weighted index, and includes Treasury bonds issued by the US with a time to maturity of at least 5 years, but no more than 7 years. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index (which comprises the 3000 largest US companies). The **Russell 2000 Index** is an unmanaged index considered representative of small cap stocks. The **Russell 3000 Index** is an unmanaged index considered to be representative of the US stock market, and measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The **Russell Midcap Index** is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The **Housing Market Index** (HMI) is based on a monthly survey of **NAHB** members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. The **JPMorgan Emerging Market Bond Index** (EMBI Global) tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million. The **CBOE Volatility Index** (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index.

**DEFINITIONS**

The **Federal Open Market Committee** (FOMC) is the monetary policymaking body of the Federal Reserve System. The **federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **European Central Bank** (ECB) is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power, and thus price stability, in the euro area. The euro area comprises the 19 European Union countries that have introduced the euro since 1999. The **Gross Domestic Product** (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The **Bureau of Labor Statistics** (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the US government in the broad field of labor economics and statistics, and serves as a principal agency of the US Federal Statistical System. The **Bureau of Economic Analysis** (BEA) is an agency in the US Department of Commerce that provides important economic statistics, including the gross domestic product of the US. It is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the US Congress, other Federal agencies, state and local governments, business, and labor representatives. The **PCE (Personal Consumption Expenditure) Index of Prices** is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data, including US Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures, and is essentially a measure of goods and services targeted towards and consumed by individuals. Sector performance is represented by the **Global Industry Classification Standard (GICS)** sectors, developed by Standard & Poor's and MSCI Barra.