Cambridge Advisors inc.
Investment Managers

Investment Perspective | *September 2021*

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Market Commentary

Stock returns were mixed this quarter. Large cap stocks in the S&P 500 gained about 5% before giving up most of those gains to end the quarter with only a slight gain of 0.58%. Their year-to-date return is 15.92%. Small cap stocks were down during the entire quarter. The Russell 2000 lost -4.36% during the period bringing its year-to-date return to 12.41%. International stocks in developed markets also had gains for most of the quarter but ended the quarter down -0.45% thereby reducing their year-to-date return to 8.35%. Emerging market stocks erased their 2021 advances with a -8.09% loss for the quarter which resulted in a year-to-date loss of -1.25%. Bond yields fluctuated but ended with the Barclays U.S. Aggregate Bond Index up 0.05% for the quarter but still down -1.55% so far this year.

The best performing industries this quarter were financials followed by utilities and communication services. Industrials, materials and energy lagged.

Second quarter GDP growth was 6.7% which although outstanding for a "normal" quarter, was well below the 9%-10% that analysts had originally been projecting. The Delta variant uprising, continued supply chain bottlenecks, and labor shortages were blamed for the dampened growth. Looking ahead, David Kelly, chief strategist with JPMorgan, expects third quarter GDP growth to slow to 2% because the supply chain bottlenecks have not been resolved but he thinks that it could increase to 6% in the fourth quarter assuming that the Delta variant continues to wane. Next year, the government will not be helping the economy as much as it has recently so he expects GDP growth to start the year strong but slow to 2% by the end of 2022.

2021 Benchmark Rates of Return

Index	Third Quarter	YTD
S&P 500	0.58%	15.92%
Russell 2000	-4.36%	12.41%
International	-0.45%	8.35%
Fixed Income	0.05%	-1.55%
JPMorgan Diversified*	-0.66%	8.02%

*25% S&P 500 large cap stocks,10% Russell 2000 small cap stocks, 15% MSCI EAFE international stocks, 5% MSCI EME emerging market stocks, 5% REITs, 25% Barclays US aggregate bonds, and 5% each in short term Treasuries, high yield global bonds, and commodities.

In September, daily reported COVID cases peaked and are now declining. Hospitalization and death rates lag but are expected to follow daily reported cases lower. Adults who wanted a vaccination have received it and vaccinations for children five and older are likely to be approved in the next few months. David Kelly and other analysts report that around 85% of the US has some form of immunity either through vaccination or because they had COVID. As a result, businesses and restaurants have almost fully reopened while sporting events and concerts have live audiences again. Some modifications have been made as people and businesses adapted to this new normal but economically speaking, COVID's impact is diminishing.

Unemployment is now 5.2% and is expected to be 4.5% by year end. Next year it is projected to be back below 4%. Businesses are already finding it difficult to attract the number the employees they need to run at full capacity. Some businesses are having to turn potential customers away by restricting open hours or services. Others are turning to technology to outsource or automate more functions. Many are paying more to attract and retain employees. Wage growth was 5.2% in August and has been above the long term average of 4% for the past two years.

The US inflation rate in August was 5.3% year-over-year. Although the Federal Reserve has repeatedly stated that higher inflation is transitory, more analysts are pondering whether it is more sticky. Brian Wesbury, economist with First Trust, cites that housing rents are likely to rise sharply now that the eviction moratorium has lapsed. Since rents are 30% of CPI, they have a large impact on the inflation rate. He also thinks the 33% increase in money supply since the pandemic began will eventually lead to inflation. More money from the increased money supply and higher wages are chasing the same number or fewer goods due to supply chain bottlenecks which is placing upward pressure on prices. The Fed continues to repeat that it does not intend to raise short-term rates to combat inflation even though it is above their 2% target which means inflation could stay higher for longer. However, they may begin

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to taper their bond purchases by year end which would be a step in reigning in the money supply.

After falling -13.0% in 2020, corporate earnings have surged in 2021 now that the economy has reopened and is getting back to normal. Profits for the S&P 500 were up 95% in the second quarter compared to second quarter a year ago when the economy was mostly shut down. According to Zack's, third quarter earnings are expected to be up 26.1% and profits for the full year of 2021 are projected to be 42.7% higher versus 2020. In dollar terms, JPMorgan projects the S&P 500 Index will reach a new high of $200 per share of earnings in 2021. In 2022, earnings could be impacted by slower economic growth along with higher wage costs, interest rates and taxes.

At the time of this writing, Congress is still working through issues surrounding the debt ceiling, a large spending package, budget reconciliation and higher tax policies. The spending will not likely have as big an impact as recent spending bills because the dollar amount will be spread out over 10 years. Meanwhile, the tax policies are focused on corporations, investors, and higher income earners so may have a more significant affect on our clients.

For several years, analysts have been pointing out that international stocks have not had the same run up in prices and valuations that US stocks have had. More attractive valuations paired with a declining dollar and the more cyclical nature of international stocks versus US stocks has resulted in analysts encouraging investors to include foreign stocks in their allocations both for diversification and because of possible future outperformance. Although the dollar has actually increased recently and international stocks have continued to lag, David Kelly of JPMorgan still believes investors should include an allocation to international stocks. Vanguard also projects that international stocks will outperform US stocks over the next decade with returns of 5.1% to 7.1% per year. Vanguard is projecting US stocks to earn between 2.4% and 4.3% on average over the same period.

With a low Fed Funds rate, money market funds will continue to earn near 0%. The yield curve has steepened as long-term yields have risen even though short-term rates did not. The 10-year Treasury bond yield rose from 0.91% at the end of 2020 to a high of 1.76% during the first quarter before falling to 1.44% at the end of June. In the third quarter, the yield continued to fall to a low of 1.15% before ending the quarter slightly higher than it began at 1.53%. JPMorgan has a target 10-year Treasury yield of 1.75% for year end. Low but rising yields would continue to pressure bond returns. Over the next decade, Vanguard expects US aggregate bond returns to only average 1.3% to 2.3% per year. Their expectation for inflation is 1.4% to 2.4% which means bonds may not provide any real return.

Analysts continue to favor stocks over bonds but mostly because bond returns are likely to remain muted. Volatility is higher with stocks, though, so more risk averse investors will still want to include bonds in their allocations because they are less correlated to stocks than most alternatives. We continue to explore opportunities in newer asset classes. "target outcome" or "buffer" ETFs allow investors to take part in stock market appreciation but also provide some protection if stock prices fall. Digital currency is growing in popularity and becoming more accepted both as a currency and an investment. Structured products may provide opportunities to earn a higher income stream than available in bonds to investors who can withstand some risk.

We continue to encourage investors not to try to time the market or chase returns but to align your investment portfolio with your risk tolerance. We use Riskalyze software to help us measure your risk tolerance so we can help ensure you have the appropriate risk in your investments. We compare your risk score to the risk score of your investment portfolio to see if adjustments might be necessary. If you are unsure about the risk in your portfolio or have any questions, please talk to your advisor.

CAMBRIDGE ADVISORS NEWS

Thank you again for the trust you have placed in us. A recent survey by Schwab of 401k plan participants showed that 61% think they need professional advice for their financial situation. We appreciate your referrals of family and friends who may be part of this group that would benefit from our investment management and financial planning services.

As a reminder, Cambridge Advisors is fully open and meeting with clients in person. We can also participate in video chat meetings with clients who do not feel comfortable coming into our office. We can share our screens and conduct review meetings easily for our clients who wish to meet virtually. We also have a client portal where you can view your accounts on our system as well as past reports. If you need help accessing the client portal or would like to initiate a logon, please let your advisor know.

Each year, we are required to offer you the most recent version of our From ADV Part II which describes our business and how we work for our clients. When you first became a client, you received a copy. Each year in April, we send you a report of anything that has changed on our ADV Part II. If you would like to receive a complete copy, please give us a call. A copy of our Proxy Voting Policy is also available upon request.