LOOK AHEAD

Q4 2021

DISCLAIMER

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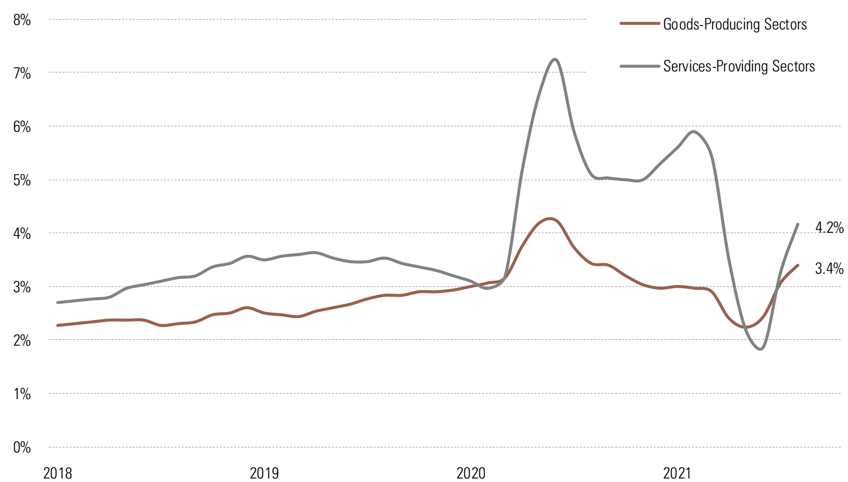
Jobs + Wages = Consumers

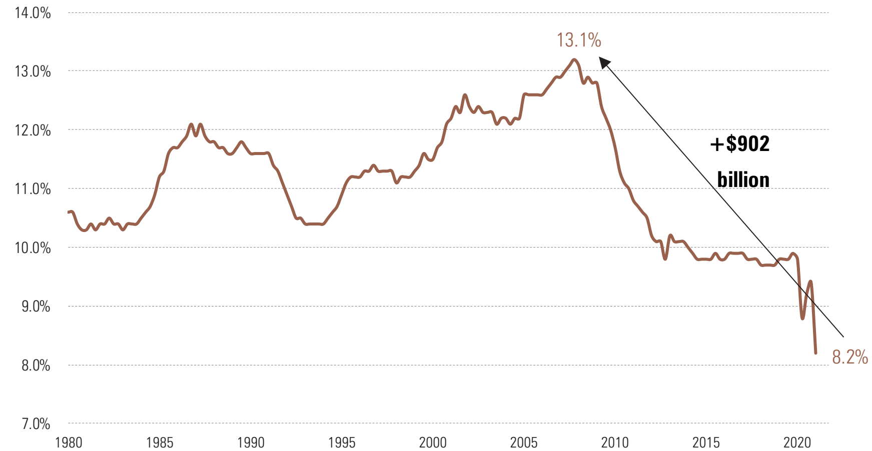
Rising wages, especially in the lower-wage service sector,
are continuing to put more firepower in the hands of consumers.

Wage Growth Goods-Producing & Services-Providing Sectors



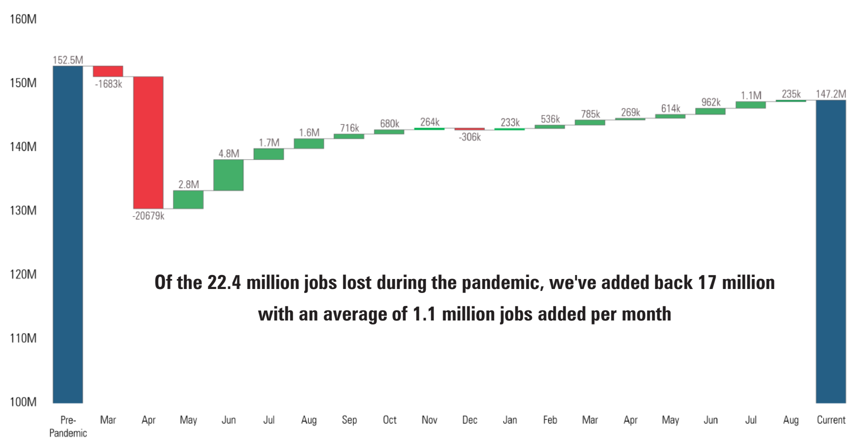
Consumer debt to disposable income remains at multi-decade lows.
If consumers returned to prior peak levels of debt service, it could total $902 billion or 4% of GDP.

Interest Payments as a % of Disposable Personal Income



Higher wages will pull more workers off the sidelines and fill the
unemployment gap which currently stands at 5.3 million jobs below pre-pandemic levels.

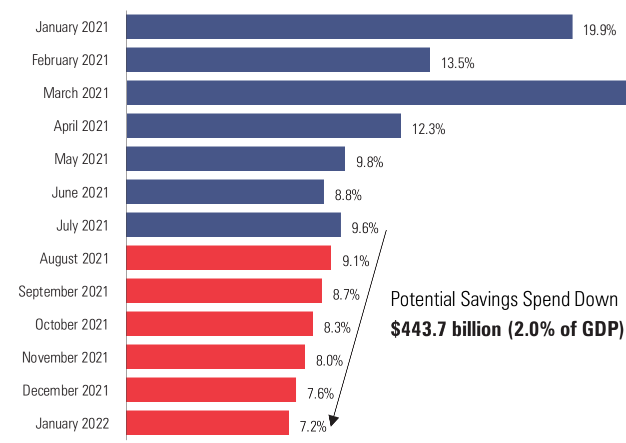
Total Jobs Change (thousands, SA)



The spend down of personal savings could also provide fuel to the consumption fire.
While the savings rate jumped back up to 9.6% in July, a potential spend down back to
pre-pandemic levels could add $443.7 billion, or 2%, back to GDP.

Potential Spend Down of Personal Savings

Savings rate as a % of disposable income



Data Sources: Bureau of Labor Statistics, St. Louis Federal Reserve

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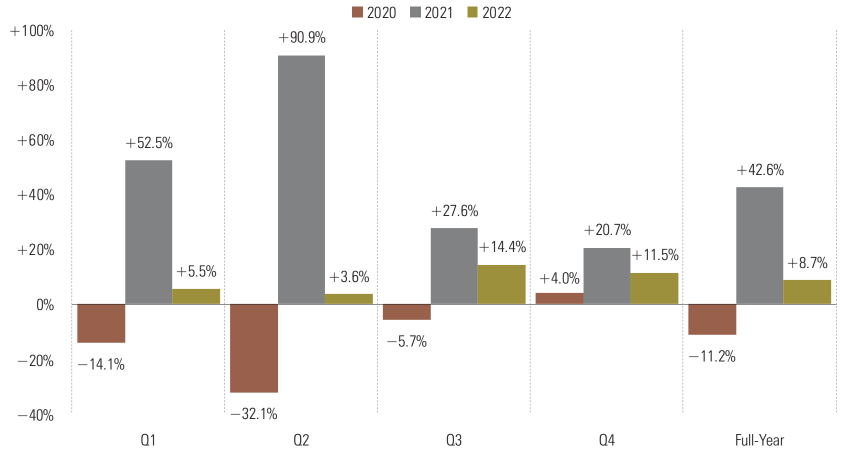
Earnings Crest – Base Effect Ending Soon

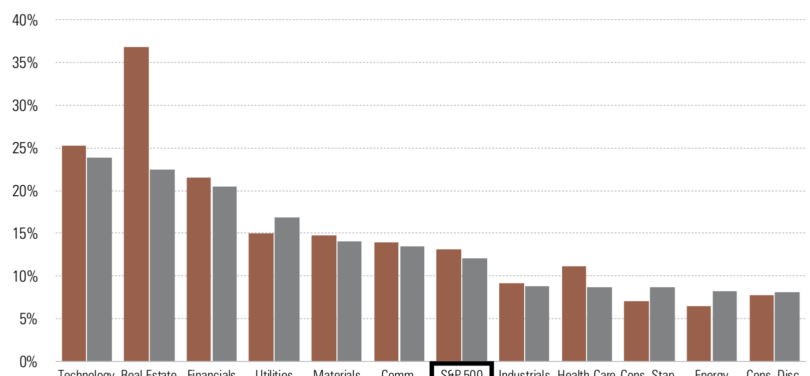
Are we at peak earnings growth?
Corporate earnings growth has been strong, and expectations for Q3 earnings are remarkable.
However, with the pandemic base effect waning, the path forward becomes more challenging.

S&P 500 Earnings Growth 2020 – 2022



Inflation looks to be pressuring corporate profit margins as we saw a small dip between Q2 and Q3.
Q4 might be more of the same.

S&P 500 Net Profit Margin Q2 2021 vs. Q3 2021



	Technology	Real Estate	Financials	Utilities	Materials	Comm.	S&P 500	Industrials	Health Care	Cons. Stap.	Energy	Cons. Disc.
Q2 '21	25.2%	36.8%	21.5%	15.0%	14.7%	13.9%	13.1%	9.1%	11.1%	7.0%	6.5%	7.7%
Q3 '21	23.9%	22.5%	20.4%	16.8%	14.0%	13.5%	12.1%	8.8%	8.7%	8.7%	8.2%	8.1%

Valuations on U.S. equities remain elevated.
Even with the recent equity market sell-off, valuations only fell modestly and are hardly anything to jump on.

S&P 500 Forward Price-to-Earnings

On a forward basis, the S&P 500 is currently trading **12%** above the 5-year average and **24%** above the 10-year average P/E ratio.

Data Sources: FactSet, Bloomberg

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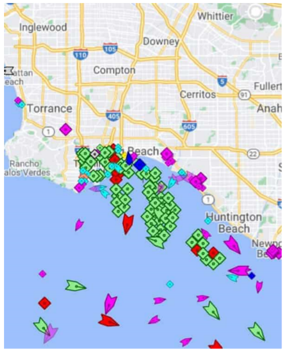
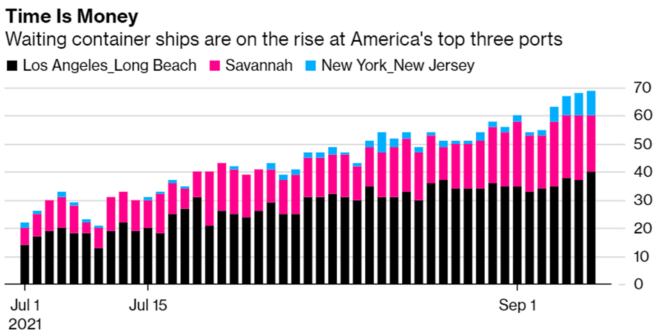
Inflation – Noise or Signal?

The base effect is still driving high inflation which is persistently running above the Fed's 2% target.

U.S. Inflation vs. Fed's 2% Target

As for goods producers, their supply chains continue to be constrained.
The backlog in the Port of Los Angeles is at record levels. In fact, most of the largest U.S. ports are experiencing record delays.

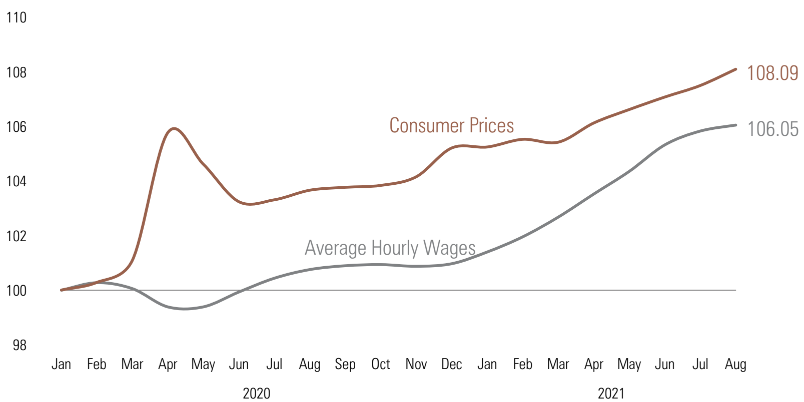




Wages have risen perhaps not in lock step with inflationary pressures; however, the net impact will be higher quality consumption for a larger population base. That should find it's way into corporate earnings in the coming years.

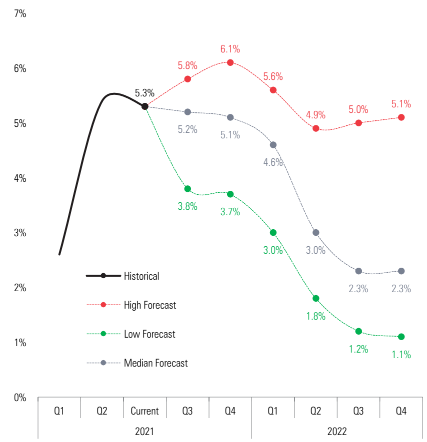
Wage Growth & Consumer Prices

January 2020 = 100

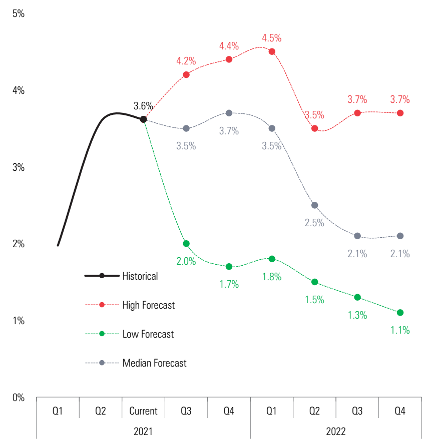


Equilibrium is coming.
CPI inflation and Core PCE inflation are expected normalize around 2% by the end of 2022.

U.S. CPI Inflation Expectations



U.S. Core PCE Inflation Expectations



Data Sources: Bureau of Labor Statistics, Bloomberg

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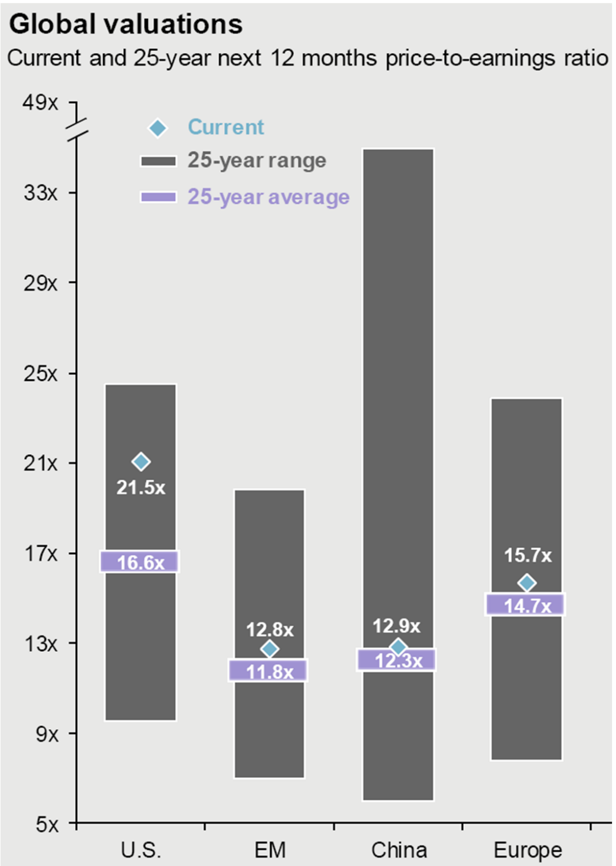
Valuations & Returns Around the World

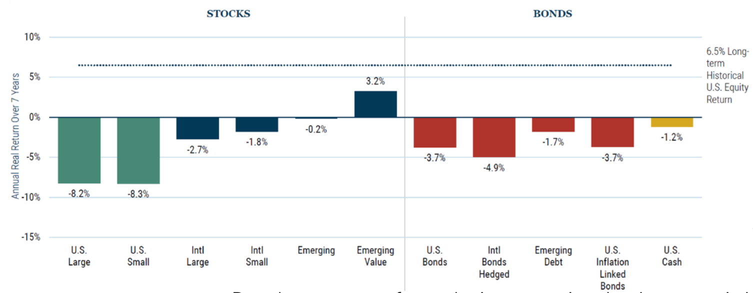
Higher valuations are driving more volatility and lower returns around the world and investors have few areas to invest.

Almost everything is overvalued with the exception of China.



With valuations at extreme highs, forward-looking returns look gloomy.

Famed investment house GMO exemplifies this point in their forward-looking real return forecasts (after adjusting for inflation).



Vanguard on the other hand forecasts more promising returns over a longer timeframe (10 years vs. GMO's 7 years).

Here are our current 10-year annualized return forecasts:

U.S. stocks: 2.4% to 4.4%; **Ex-U.S. stocks:** 5.2% to 7.2%.

U.S. bonds: 1.4% to 2.4%; **Ex-U.S. bonds:** 1.3% to 2.3% when hedged in U.S. dollars.

Euro-area stocks: 2.9% to 4.9%; **Ex-euro-area stocks:** 1.6% to 3.6%.

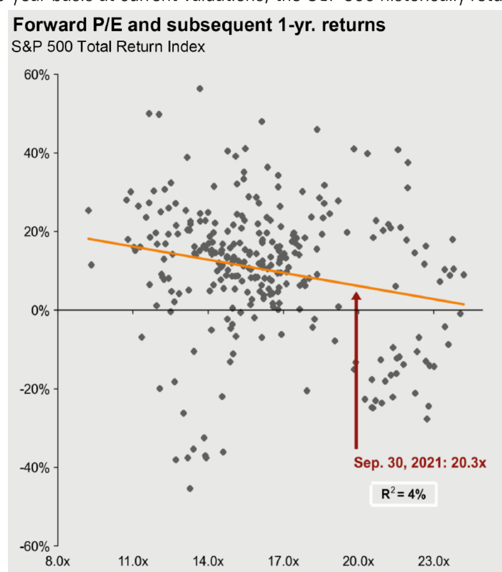
Euro-area bonds: –0.5% to 0.5%; **Ex-euro-area bonds:** –0.5% to 0.5% when hedged in euros.

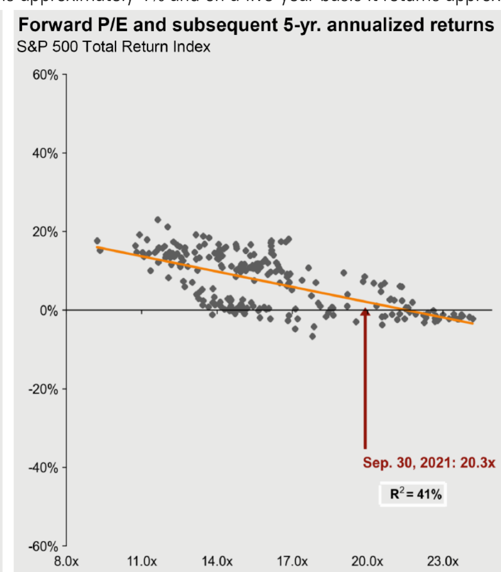
Chinese stocks: 5.1% to 7.1%; **Ex-China stocks:** 3.6% to 5.6%.

Chinese bonds: 2.8% to 3.8%.

Based upon current forward price-to-earnings levels, returns in U.S. stocks tend to look very muted.

On a one-year basis at current valuations, the S&P 500 historically returns approximately 4% and on a five-year basis it returns approximately 1%.





Opinions vary on returns however valuations generally dictate prospective results.
We should expect modest returns as we transition away from an economy driven by fiscal stimulus.

Data Sources: J.P. Morgan, GMO, Vanguard

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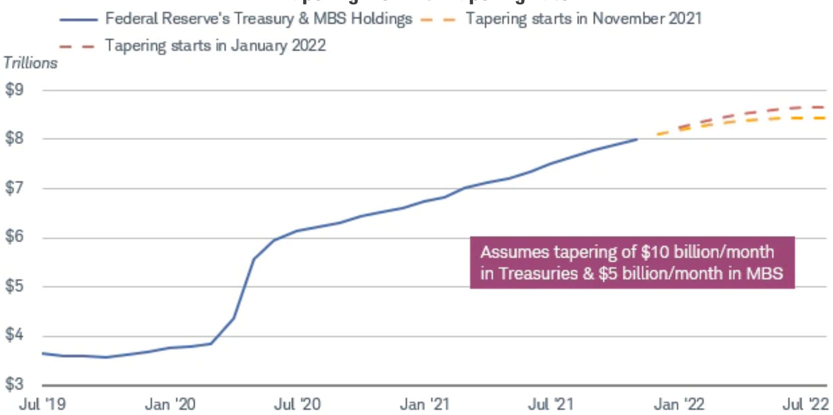
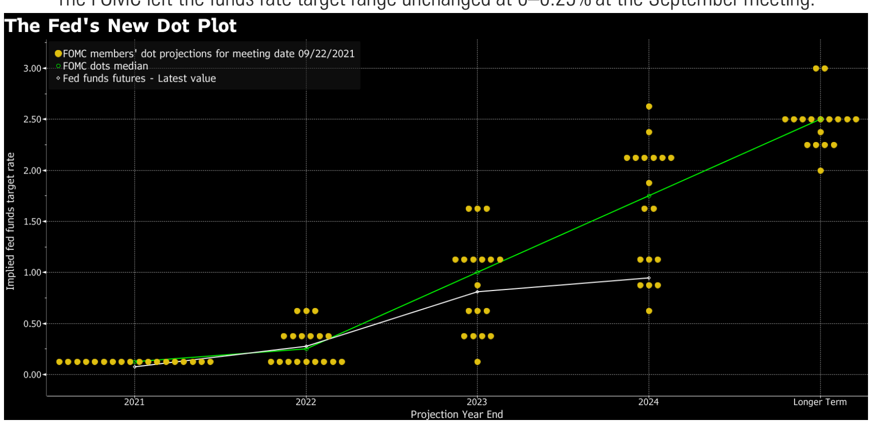
Federal Reserve

Tapering Now vs. Tapering Later



- The statement noted that a reduction in the pace of asset purchases "may soon be warranted," paving the way for the FOMC to announce the start of tapering at its November meeting.
- In 2014 when the Federal Reserve tapered for the first time, it did so by decreasing monthly purchases by $5 billion per month for Treasuries and MBS each.
- The full tapering process took 10 months to complete. This time there has been some indication from FOMC members that they would like to move more quickly, as the economy has bounced back so fast.

The FOMC left the funds rate target range unchanged at 0–0.25% at the September meeting.



What could tapering mean for the markets?

Treasury Yields

Tapering doesn't necessarily mean yields will spike higher.

In the previous period of tapering, yields rose prior to the onset of tapering in 2013 but then fell during the implementation period.

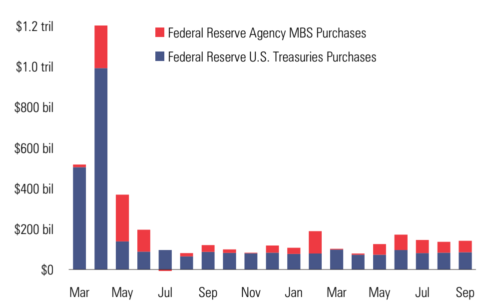
Mortgage Market

In 2014 when the Fed started tapering MBS purchases, MBS spreads narrowed, and yields declined.

The decline in yields and narrowing of spreads in the MBS market resulted from the general improvement of the housing market more so than the Fed tapering QE.

Although MBS spreads could rise slightly this time around, it is likely that the tapering of MBS purchases will have a minor impact on the MBS market.

Pace of Federal Reserve Securities Purchases



Average 30-Year Mortgage Rate

Data Sources: Schwab, Bloomberg

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Rates, Deficits, & Debt

The current "human infrastructure" proposal will create another $800 billion in unfunded debt and low rates will be needed to fund this debt without throwing us into an interest rate-induced recession.

$4.4 trillion Gross Total Cost – **$3.6 trillion** Gross Deficit Reductions = **$800 billion** Net Total Cost (Unfunded Liabilities)

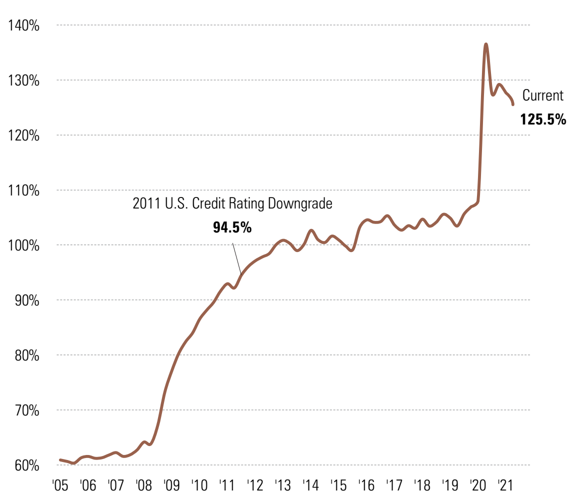
Another piece of the puzzle might be the need to pass legislation to raise the debt ceiling.

The last time the United States was in the crosshairs of a debt default was just over 10 years ago.

Much of the downgrade was driven by politics and not credit, which is similar to today's environment.

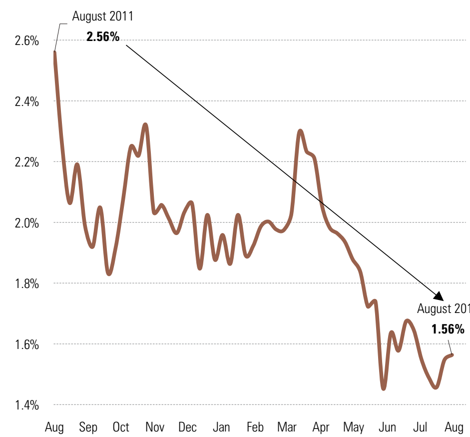
What is not similar is our Debt to GDP in 2011 compared to 2021.
It's hard not to panic when you think about the $28.5 trillion in debt we are sitting on.

U.S. Debt to GDP

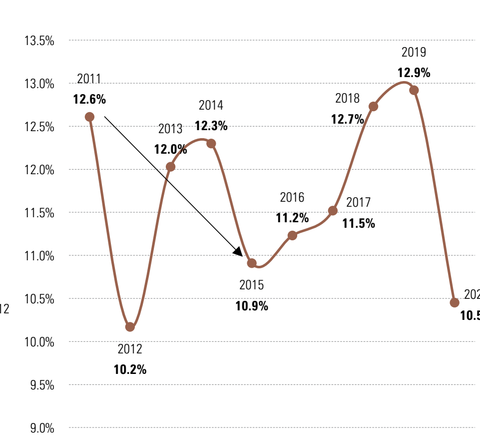


Something counterintuitive happened after our credit rating was cut in 2011: Interest rates fell.
Further, the average interest rate paid on federal debt dropped post-credit downgrade.

U.S. 10-Year Treasury Yield after U.S. Credit Rating Downgrade



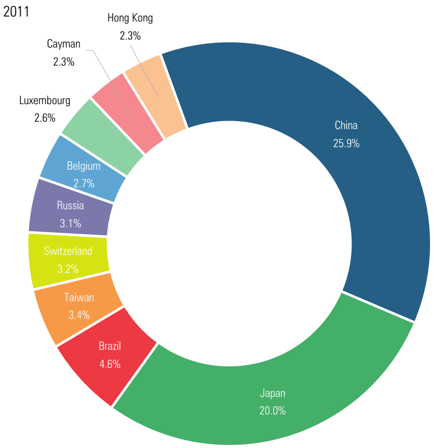
U.S. Federal Interest Costs as a Percent of Federal Budget



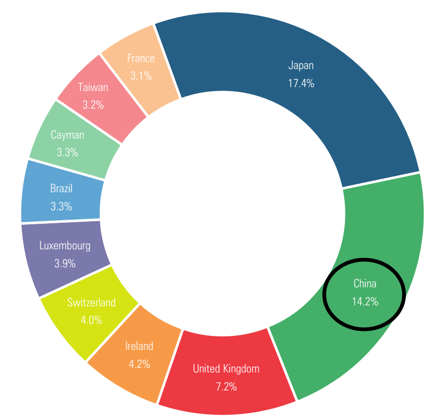
As was the case in 2011, it appears there are plenty of foreign buyers for our debt.
Note that China owns 14.2% of our debt currently.

Will they continue to buy our debt with so much anti-China rhetoric?
While the U.S. dollar is a stable currency, everyone has their limits.

Top Foreign Owners of U.S. National Debt
2011



Top Foreign Owners of U.S. National Debt
2021



Data Sources: Congressional Budget Office, St. Louis Federal Reserve, Bloomberg

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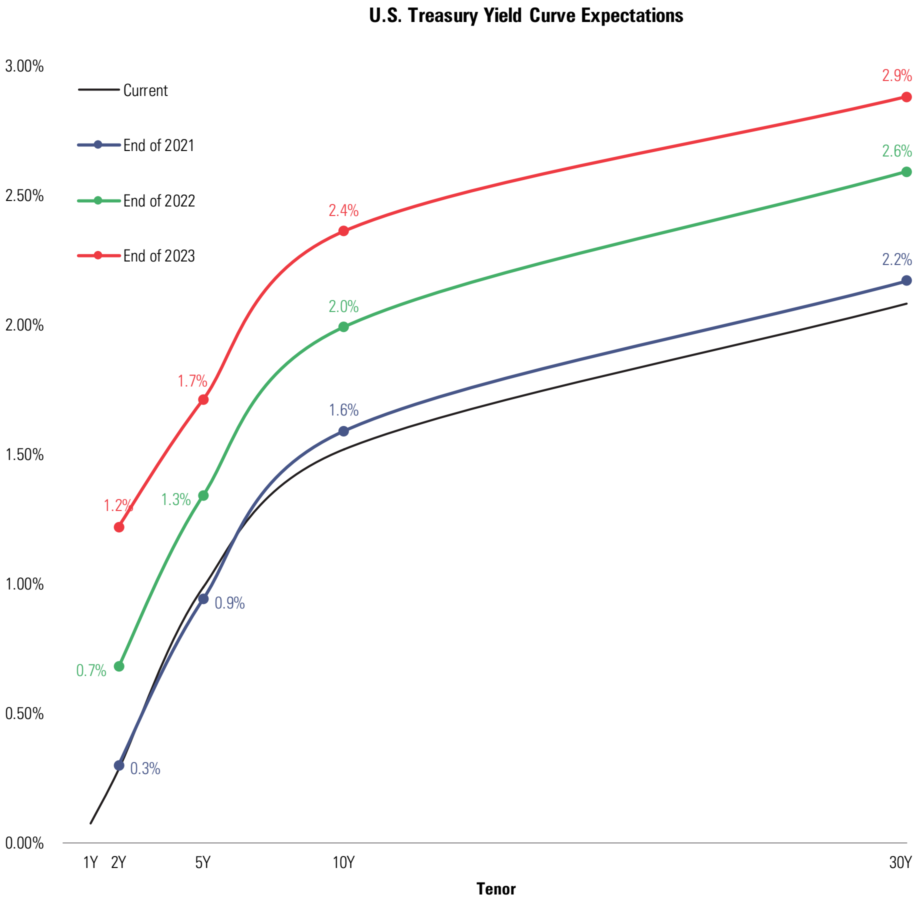
Fixed Income – It's Still Risky



It is still tough to find total return in Fixed Income, as shown by the steep year-to-date declines for longer-dated Treasury ETFs.

Hardest Hit Areas of Fixed Income Year-to-Date

Ticker	Name	Price	Yield % Current	Yield % End of 2020	Return 2021 YTD	Duration (years)
EDV	Extended Duration Treasury Bonds	135.53	2.08%	2.02%	−10.10%	24.57
TLT	20+ Year Treasury Bonds	144.32	1.52%	1.25%	−7.55%	19.46
TLH	10-20 Year Treasury Bonds	147.07	1.62%	1.05%	−6.75%	14.97
BLV	Long-Term Bonds	102.33	2.80%	2.88%	−4.55%	16.08
IEF	7-10 Year Treasury Bonds	115.22	0.84%	0.73%	−3.44%	7.98
VCLT	Long-Term Corporate Bonds	105.58	3.15%	3.01%	−2.97%	15.02
EMB	Emerging Markets Bonds	110.06	3.76%	4.09%	−2.62%	8.21
LQD	Investment Grade Corporate Bonds	133.03	2.30%	2.43%	−2.21%	9.96
BIV	Intermediate-Term Bonds	89.44	1.85%	2.02%	−2.08%	6.58
BND	Total Bond Market	85.45	1.83%	2.00%	−1.83%	7.17
AGG	Core U.S. Aggregate Bonds	114.83	1.88%	1.27%	−1.67%	6.74
IEI	3-7 Year Treasury Bonds	130.17	0.68%	0.78%	−1.64%	4.65

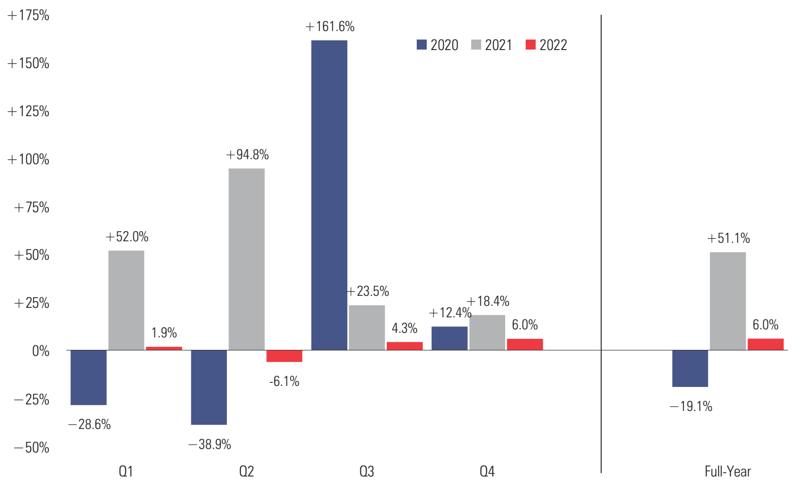
- Active management could help reduce some of the risk as we transition to steeper yield curves in the coming year. Managing duration and credit quality will be critical.

- We continue to focus on shorter duration higher quality credits.

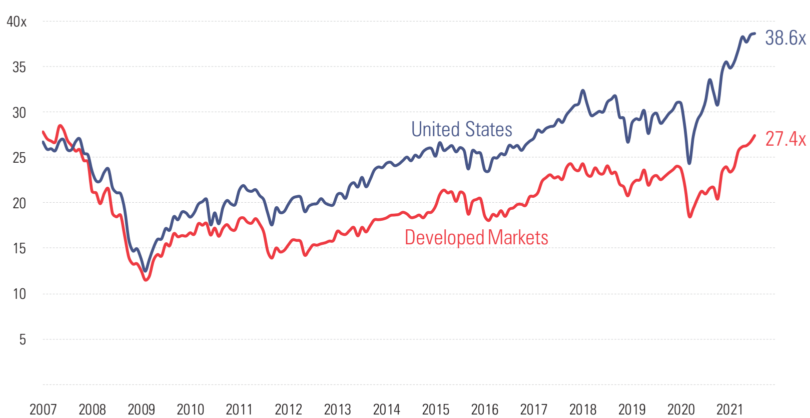
Developed Markets

Earnings growth for Q3 and full year 2021 will continue to improve. Valuations, while not as elevated as US companies, are still well below emerging markets companies.

MSCI EAFE Earnings Growth: 2020 vs. 2021



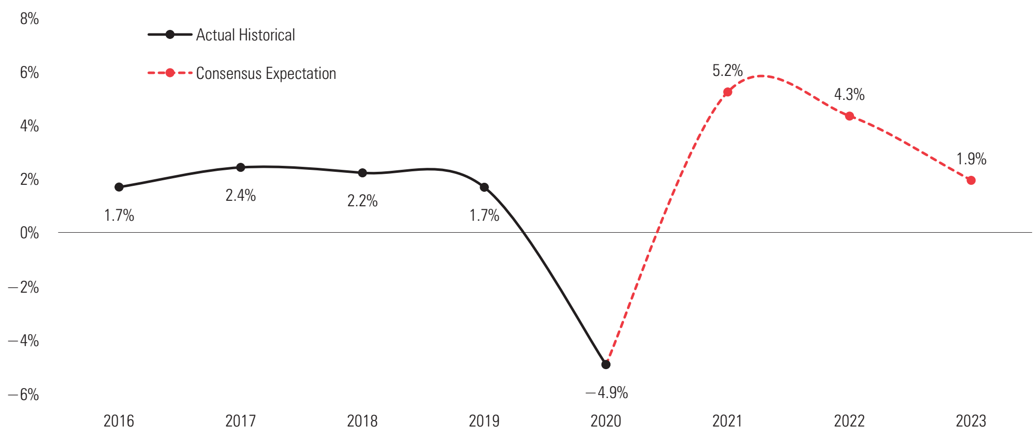
Historical CAPE Ratio Developed Markets & United States



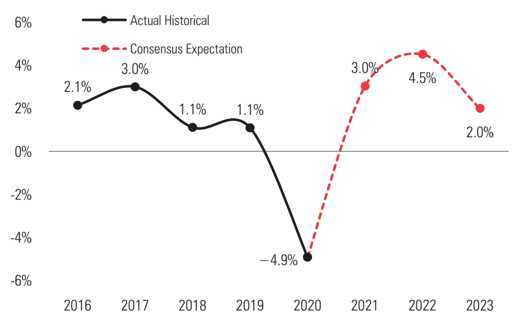
Developed Markets are currently trading at a 29% discount to the U.S.

Economic activity could remain subdued heading into Q4. A return to more structural, slow growth in developed economies will be on the horizon as fiscal support and temporary inflationary pressures both wane.

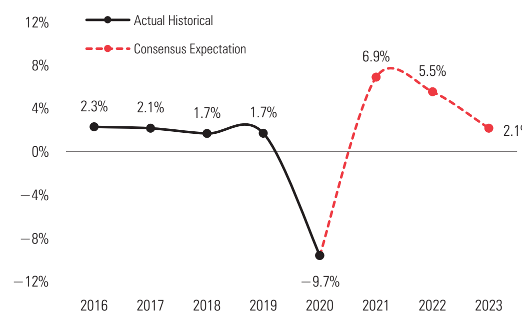
EAFE GDP Growth



Germany GDP Growth



United Kingdom GDP Growth



Data Sources: Bloomberg

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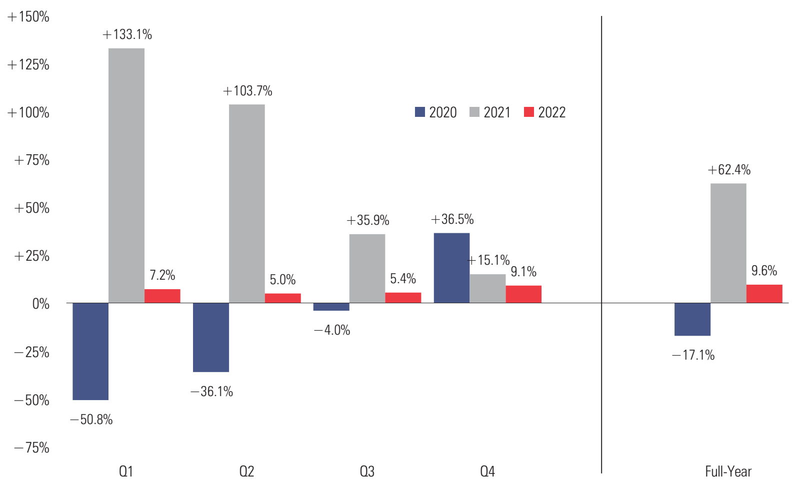
Emerging Markets

From an earnings growth and valuation perspective,
emerging markets remain favorable within the broad spectrum of equity investing.

MSCI Emerging Markets Earnings Growth: 2020 vs. 2021

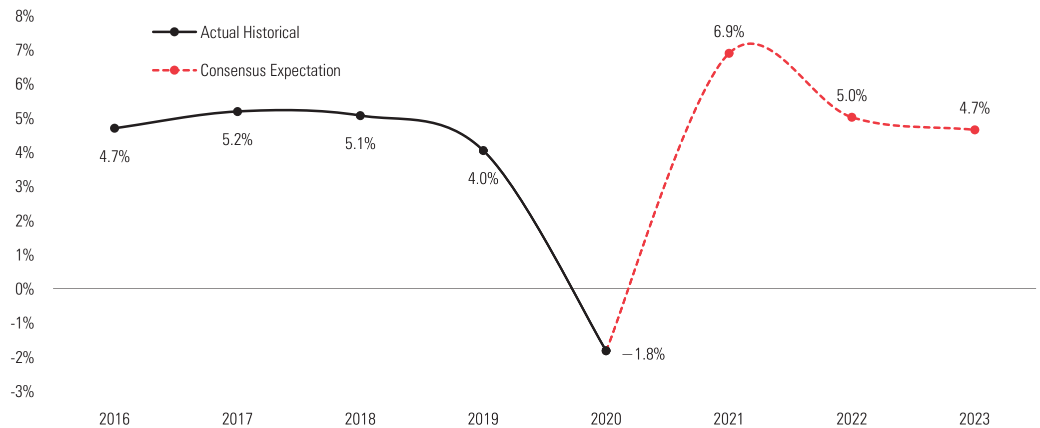


Historical CAPE Ratio Emerging Markets & United States

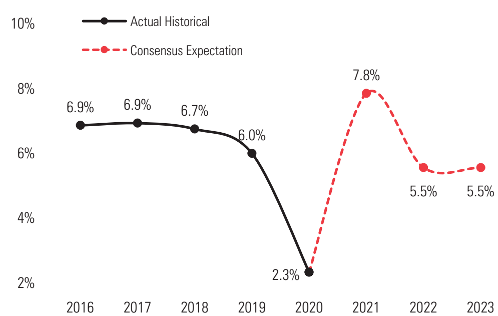
Developed Markets are currently trading at a 43% discount to the U.S.

While GDP growth in emerging markets moderate around the 5% level,
China and India will present stronger growth in 2022 and 2023.

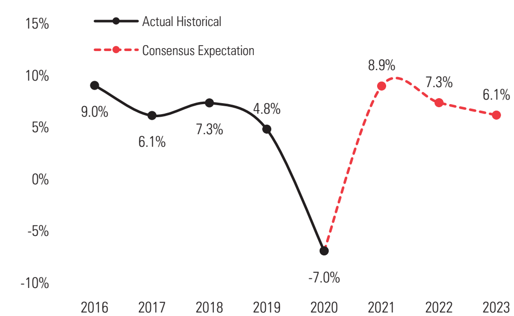
Emerging Markets GDP Growth



China GDP Growth



India GDP Growth



Data Sources: Bloomberg

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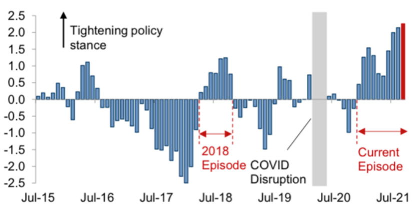
China

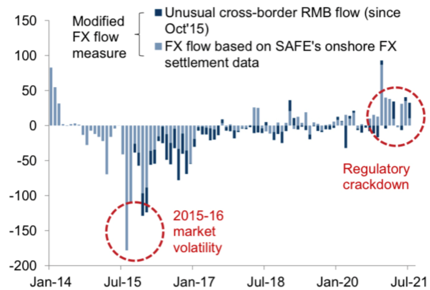
The latest regulatory tightening cycle in China is unprecedented in terms of duration, intensity, and scope.

POE (privately owned enterprise) regulation proxy, z-score



Despite market volatility and regulatory crackdowns, FX inflow into China have remained resilient.

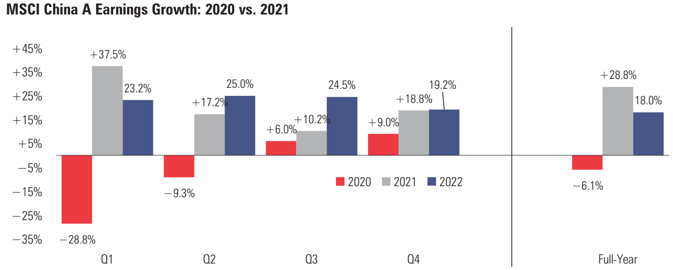
Modified FX flow measure, $bn



The A-share market took a tumble in Q3 out of fear the CCP would move unilaterally against various industries.

While the pandemic base effect is waning, corporate earnings expectations remains strong.

MSCI China A Earnings Growth: 2020 vs. 2021

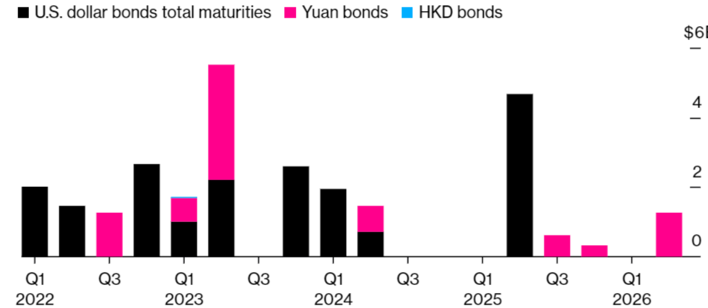


An area of uncertainty that has developed recently revolves around the Chinese property market and one of China's largest developers, Evergrande, struggling to make interest payments on outstanding debt.

However, that hype was quickly dispelled when the company made interest payments to their domestic bondholders.

Coming Due

Evergrande needs to repay some $7.4 billion of maturing bonds next year



China's economic growth has slowed this year, primarily driven by the impact of supply-side cuts to energy-intensive production and slightly less support from fiscal policy.

These factors led Goldman Sachs to revise down their Q3 and Q4 sequential growth forecast.

China Real GDP forecasts

		New YoY%	Previous YoY%	New QoQ%, SAAR	Previous QoQ%, SAAR
2020		2.3	2.3		
2021		7.8	8.2		
2022		5.5	5.6		
2019	Q4	5.8	5.8	6.1	6.1
2020	Q1	-6.8	-6.8	-30.5	-30.5
	Q2	3.2	3.2	46.4	46.4
	Q3	4.9	4.9	11.7	11.7
	Q4	6.5	6.5	12.6	12.6
2021	Q1	18.3	18.3	1.6	1.6
	Q2	7.9	7.9	5.3	5.3
	Q3	4.8	5.1	0.0	1.3
	Q4	3.2	4.1	6.0	8.5
2022	Q1	4.4	5.2	6.5	5.7
	Q2	4.8	5.2	7.0	5.6
	Q3	6.4	6.3	6.0	5.5
	Q4	6.3	5.5	5.8	5.4

Data Sources: Bloomberg, Goldman Sachs

Our View & Recommendations

Our View

- Inflationary pressures will moderate in the coming quarter and supply chain and employment issues abate.
- The base effect in U.S. corporate earnings is largely passed and hurdle rates for corporations get exceedingly harder in the quarters ahead.
- Federal Reserve will begin to ween investors off easy monetary policy, driving more volatility in rates.
- Emerging markets will continue to provide the best valuation and growth opportunities, especially China. Investors must take a long view on China to capture their growing middle-class consumer.
- Anti-China rhetoric will dampen as the U.S. government realizes China is a critical global partner in supporting economic growth.
- Fiscal support from the tax and spending bills coming out of the current Administration will add uncertainty to equity markets in the coming quarter.
- The U.S. Consumer will continue to spend down precautionary savings as the jobs picture rapidly improves.
- Possible start to a secular bull market in base metals.

Recommendations

- Maintain policy weightings in US Equites yet prepare for excessive volatility in the coming quarter. Buy the Dips!
- Continue to hold a slight policy weighting toward base metals as a hedge on inflation and more important access to copper which is under a severe supply/demand imbalance.
- Continue to actively manage fixed income, as yield chasers increase, defaults across the credit markets will have greater impact.
- Overweight Emerging Markets as a best global price-to-growth opportunity.
- Specific overweight to China domestic equities.
- Consider some exposure to industrial commodities as a weak dollar and recovering global economies will push prices and profits higher.

Mean Reversion Dashboard

Style Forward P/E as a % of 20-Year Average

Style

Size	Value	Blend	Growth
Large	122.3%	136.7%	167.4%
Mid	118.6%	134.5%	186.9%
Small	119.2%	134.0%	153.7%

Regions & Countries Forward P/E as a % of 20-Year Average

Regions

World	Developed Markets	Emerging Markets
127.7%	111.1%	95.9%

Countries

United States	Germany	United Kingdom	China	Brazil	India	Russia
145.6%	101.1%	87.0%	109.9%	63.2%	148.5%	47.3%

Sector Forward P/E as a % of 20-Year Average

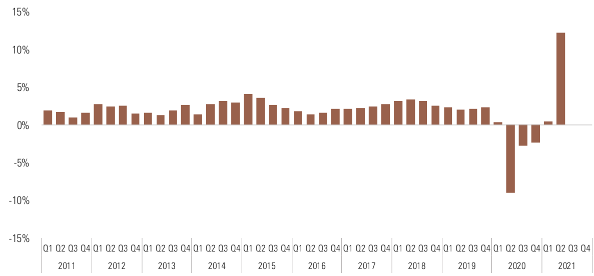
Sectors

Energy	Materials	Industrials	Consumer Discretionary	Consumer Staples	Health Care	Financials	Technology	Telecom	Utilities	Real Estate
84.0%	90.3%	117.5%	152.0%	103.1%	85.8%	71.5%	133.2%	108.8%	90.1%	254.2%

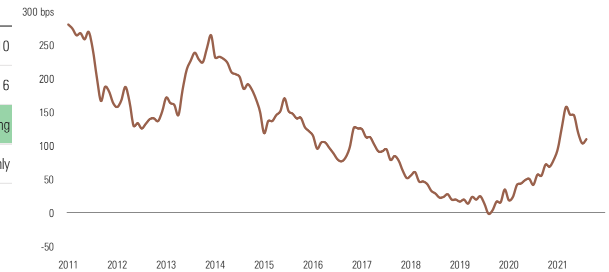
Data Sources: Bloomberg

Economic Dashboard

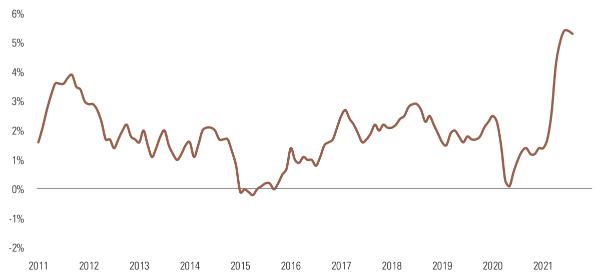
U.S. GDP Growth (YoY %)	
Latest Level	12.20%
Change from Prior Quarter	11.80%
Latest Direction	Expanding
Frequency	Quarterly



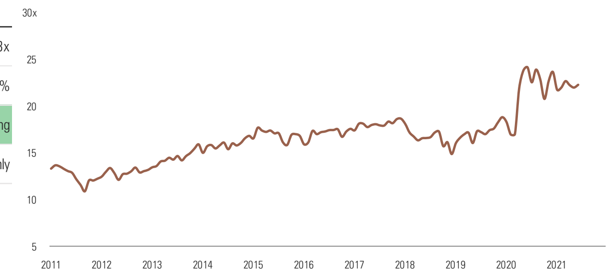
U.S. Treasury Spread (10 Yr vs. 2 Yr)	
Latest Level (basis points)	110
Change from Prior Month	6
Latest Direction	Steepening
Frequency	Monthly



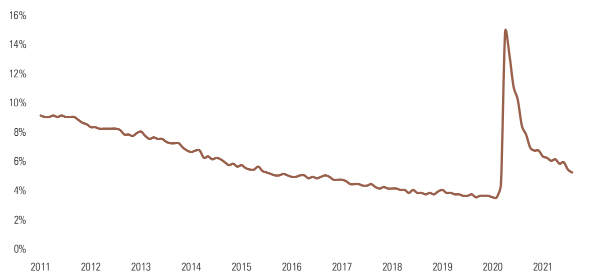
U.S. Inflation (YoY %)	
Latest Level	5.30%
Change from Prior Quarter	0.69%
Latest Direction	Falling
Frequency	Monthly



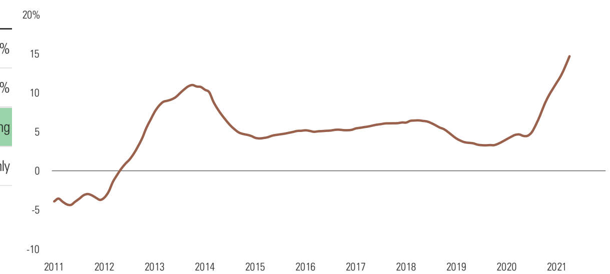
S&P 500 Forward P/E Ratio	
Latest Level	22.3x
Change from Prior Month	1.35%
Latest Direction	Increasing
Frequency	Monthly



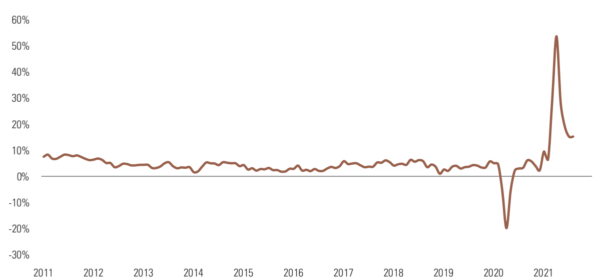
U.S. Unemployment (YoY %)	
Latest Level	5.20
Change from Prior Month	-0.20
Latest Direction	Falling
Frequency	Monthly



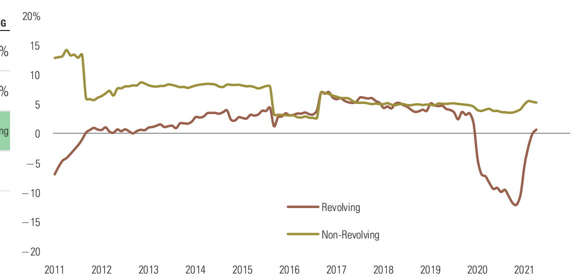
Case-Shiller Home Prices (YoY %)	
Latest Level	14.58%
Change from Prior Month	1.58%
Latest Direction	Increasing
Frequency	Monthly



Retail Sales (YoY %)	
Latest Level	15.10
Change from Prior Month	-3.80
Latest Direction	Decreasing
Frequency	Monthly



Consumer Credit (YoY %)	REVOLVING	NON-REVOLVING
Latest Levels	+0.6%	+5.3%
Change from Prior Month	+0.6%	+0.3%
Latest Direction	Increasing	Increasing
Frequency	Monthly	



Data Sources: Bloomberg

Phillips & Company
Wealth Strategies | Vested

THANK YOU

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www.phillipsandco.com

Data Sources

Slide 2	**Job + Wages = Consumers** https://www.bls.gov/news.release/empsit.nr0.htm https://fred.stlouisfed.org/series/PSAVERT https://fred.stlouisfed.org/graph/?g=Dho7
Slide 3	**Earnings Crest –Base Effect Ending Soon** https://insight.factset.com/
Slide 4	**Inflation –Noise or Signal?** https://www.bls.gov/news.release/empsit.nr0.htm https://www.bloomberg.com/news/articles/2021-09-10/port-congestion-index-shows-u-s-import-rush-clogging-trade-hubs
Slide 5	**Valuations & Returns Around the World** https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/guide-to-the-markets/ https://www.gmo.com/ https://advisors.vanguard.com/advisors-home
Slide 6	**Federal Reserve** Bloomberg https://www.schwab.com/resource-center/insights/content/fomc-meeting
Slide 7	**Rates, Deficits, & Debt** Bloomberg https://www.cbo.gov/
Slide 8	**Fixed Income – It's Still Risky** Bloomberg
Slide 9	**Developed Markets** Bloomberg https://indices.barclays/IM/21/en/indices/static/shiller.app
Slide 10	**Emerging Markets** Bloomberg https://indices.barclays/IM/21/en/indices/static/shiller.app
Slide 11	**China** Bloomberg https://research.gs.com/
Slide 13	**Mean Reversion Dashboard** Bloomberg
Slide 14	**Economic Dashboard** Bloomberg