October 19, 2021
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Todd Asset Management

Grand Re-Opening 2.0

Todd Asset Management Q3 2021 US Market Review and Outlook

	3Q 2021	YTD	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
S&P 500	0.6%	15.9%	30.0%	16.0%	16.9%	14.0%	16.6%
Russell 1000 Value	-0.8%	16.1%	35.0%	10.1%	10.9%	9.3%	13.5%

* *Annualized Total Returns.*

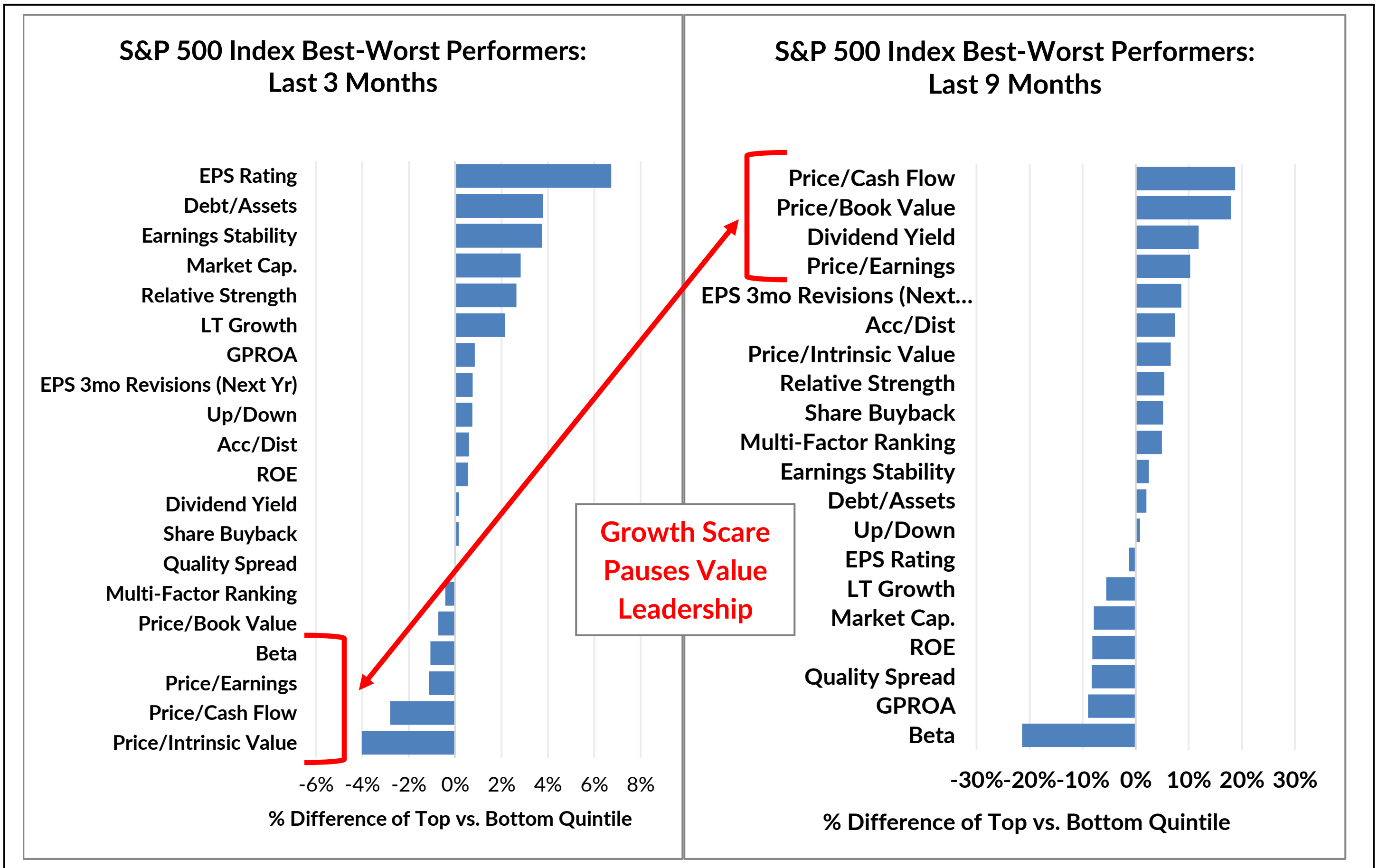
The S&P sagged on a growth scare in September, but still posted a positive result for the quarter. Concerns that weighed on markets included Washington turmoil, a hint of Fed tapering, Covid and general markdowns of expected economic growth on supply chain disruptions into year end. Interest rates rose and yield curves steepened late in the quarter as the thought of a reduction in Fed Buying coupled with an inflation pick up caused bond investors to balk. Higher rates and better sentiment about growth reaccelerating caused growth stocks to roll over. Higher rates do imply the growth scare of the summer is giving way to expectations of a Grand Re-opening 2.0, which should be supportive of stocks going forward.

Items of note during the quarter included:

- **A Growth Scare erupted on supply chain issues and labor shortages**, causing fears of weaker growth. We would point out demand remains very strong, and companies relying on broken supply chains are starting to fix them. Demand is deferred, but not destroyed.
- **Washington uncertainty was center stage.** The Afghan withdrawal was disorganized and hurt our international image. Stimulus/budget negotiations are dragging on. We believe compromise is likely, but the longer the drama drags on, the harder it will be to do a deal.
- **The Fed opened the door for a November announcement of tapering,** and bond yields rose on that news. This bolsters the case that economic recovery is continuing and still early in the process.
- **Commodity prices have hit the highest levels since 2015** on re-opening demand and an energy surge. China, the UK and Europe have seen energy shortages for various reasons, driving oil and natural gas prices higher. As cold weather is just beginning, higher prices are probably with us for some time. Inflation probably remains higher than estimates.

We are closely watching forward guidance in upcoming earnings season to see if margin compression is occurring. Economic growth sagged during Q3 but should recover as Q4 progresses. Weaker indicators included retail sales worldwide over the summer and many PMIs in Asia. Lockdowns and supply chain disruption were at the core of these concerns. With the news last week of Merck's breakthrough Covid treatment, we believe markets may begin to react like they did after the announcement of the vaccine last November. Call it the Grand Re-opening 2.0 if you want, but the Delta Variant led to a markdown in growth estimates and an effective treatment could reverse that. If economic growth recovers and rates continue to rise, the rotation to value factors probably resumes.

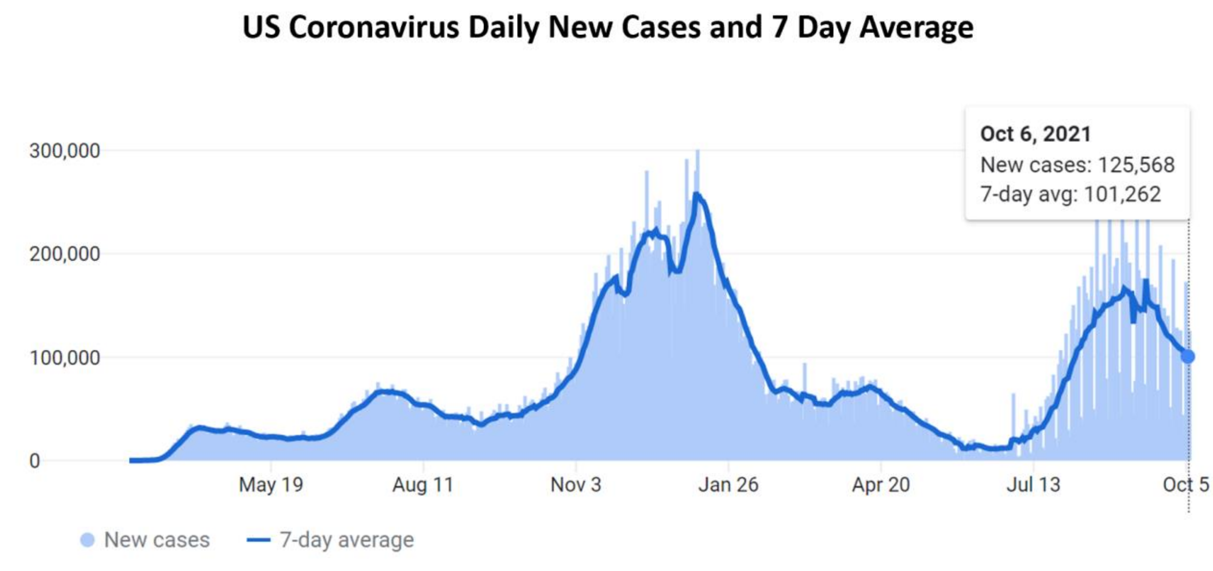
Factor Analysis



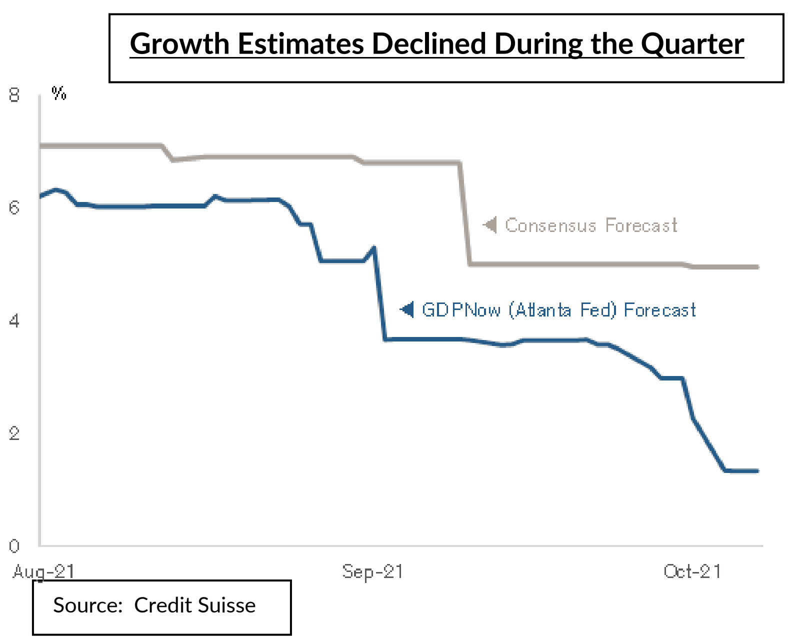
Source: Bloomberg, William O'Neill + Co. and Todd Asset Management

Our customary factor analysis is presented above, which compares performance between the best and worst 20% of the S&P based on the respective factors. Data for the quarter are presented on the left, and for the YTD period are on the right. Quality and visibility led for the quarter, as value came under pressure. This is in stark contrast to the YTD period, and we think it comes back to the growth scare we mentioned earlier. Since the Federal Reserve noted there has been progress made on the economy in late September, value factors have come back into vogue, and investors believe economic visibility is better.

Interesting Charts We Saw This Quarter



This chart, from the NY Times, is self-explanatory, but good to keep an eye on. New cases have rolled over, and fear of Covid seems to be waning. New treatments have been announced, namely a pill from Merck that treats mild to moderate covid and appears to help patients avoid hospital time. This could be a game changer as an effective treatment should allow a fuller Grand Re-opening 2.0.



GDP estimates declined during the quarter. Continued Covid Restrictions, labor shortages and supply chain issues are to blame. Most of those issues are expected to be worked out over the coming quarters and should not derail the current economic recovery we are experiencing.

TODD
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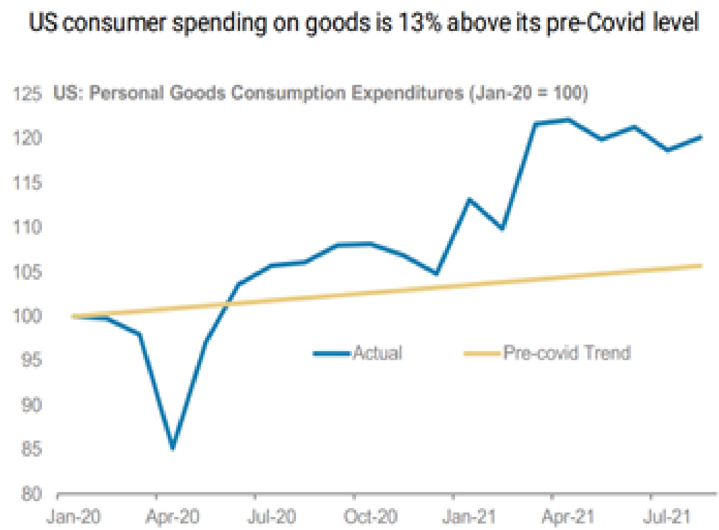
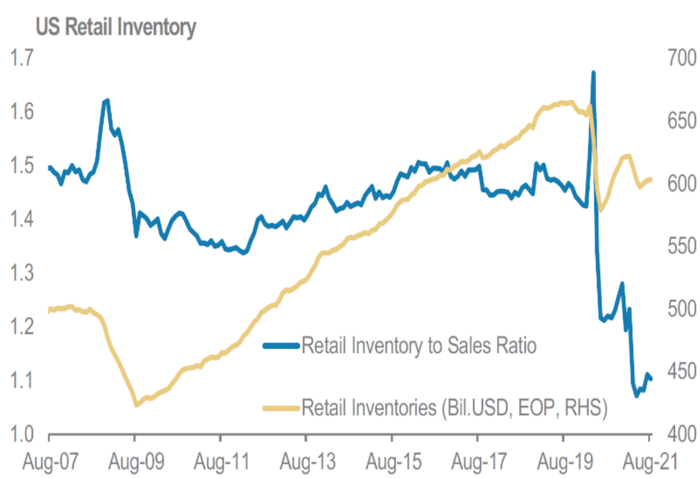
Demand looks great! Supply… Less So.



Source: Haver Analytics, Morgan Stanley Research
Note: The pre-pandemic trend is based on average %M for the five years prior to Feb-20.

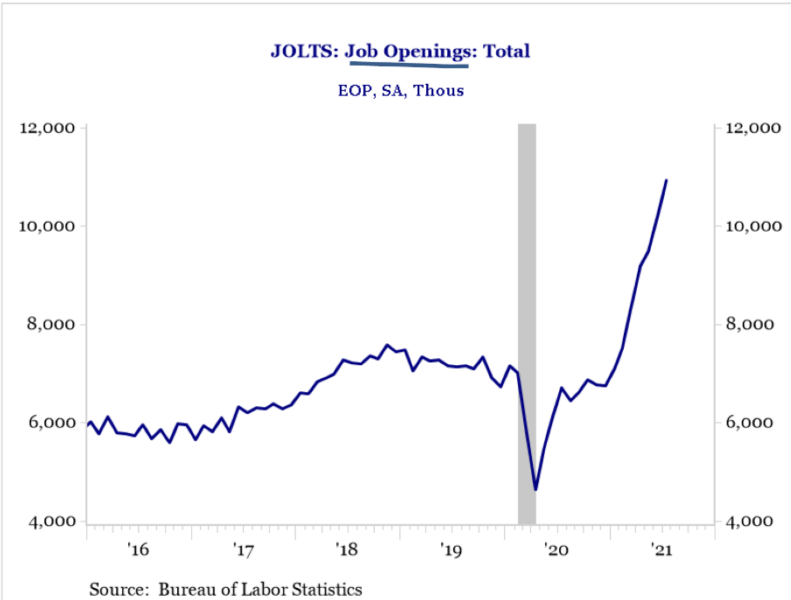
These charts, compliments of Morgan Stanley, illustrate consumer demand (top chart) versus the pre-pandemic average, and the US Retail Inventory to Sales ratio.   As the chart shows, demand is very robust, as consumers have savings and are willing to spend. That is encouraging.



Source: Morgan Stanley

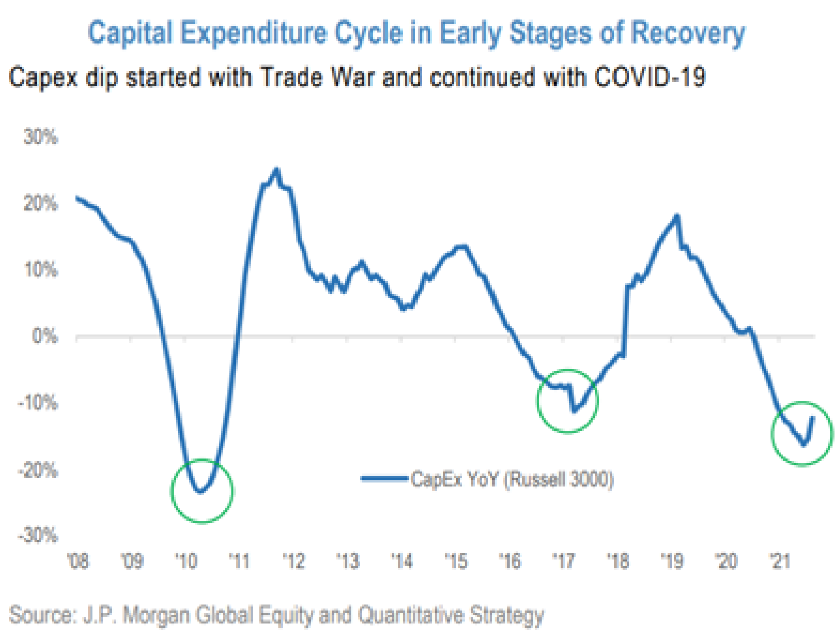
Supplies chains have seized up as covid restrictions have slowed production and bottlenecks are prohibiting retail inventory restocking. While shelves may be bare, there is a silver lining. Supply chains concerns are starting to be solved, and **inventory rebuilding should bolster the recovery over the coming years.** If demand remains firm, supply usually finds a way to satisfy that demand.

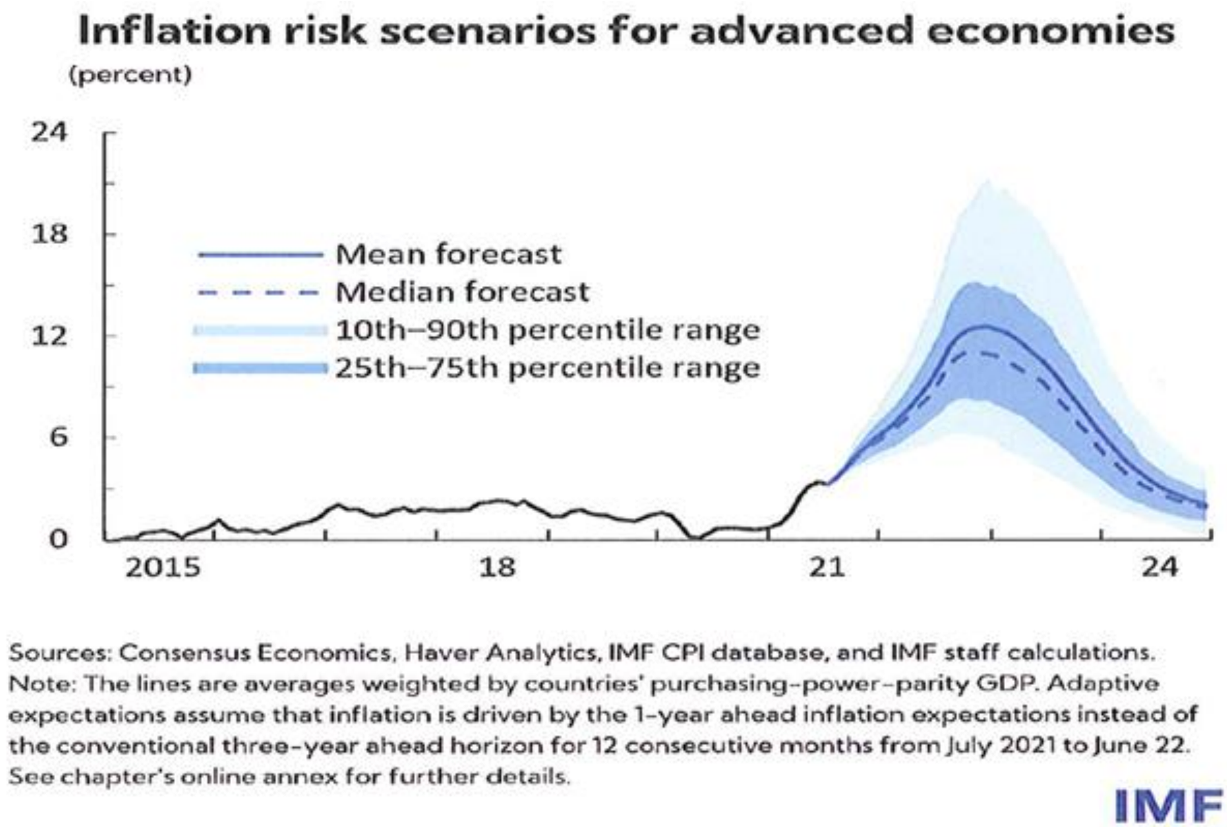
Jobs are Plentiful, Workers… Less So.



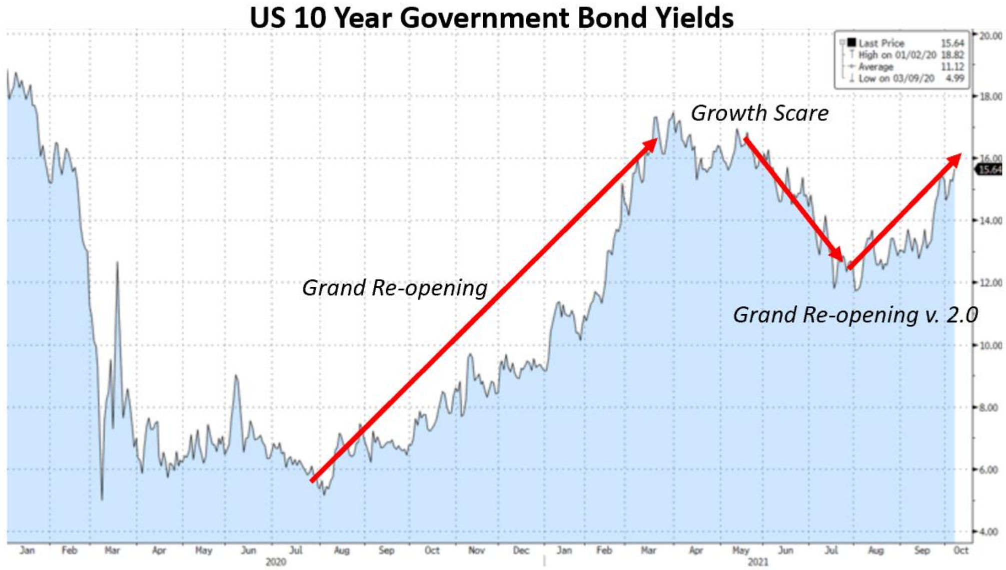
The good news? Job openings are plentiful. The bad news, workers are not applying for them. A combination of Pandemic worries, early retirements, school closures, and expanded jobless benefits have caused workers to be pickier about which jobs they will apply to. As with the supply chain issues, this is a factor that should extend the recovery as a strong job market draws worker back.

One upshot from the issues we noted above is that capital spending is likely to be boosted for some time to come. If restaurants, trucking companies, railroads, ports, and factories cannot get the workers they want, more capital spending is likely in store, which should enhance productivity. Another point to consider is the Government Infrastructure program would add to any recovery in private sector capital spending.





According to the IMF, higher inflation is likely to be with us through the beginning of 2023 and should then start to ease up. Commodity prices are where we are seeing this most vividly, but wages are seeing a boost as well. Consumers appear willing to accept higher prices according to the research we are seeing. The Fed is still viewing this as transitory. Our sense is that with CPI levels above 5% in the US, pressure is building for them to begin stepping away from the extraordinary stimulus they provided for the Pandemic.



Source: Todd Asset Management, Bloomberg

Bond yields have been an excellent indicator of investor sentiment. As you can see from the chart above, yields spiked during the first Grand Re-opening, declined during the Growth Scare, and now are rising again on the Grand Re-opening 2.0. Within equity markets, re-opening beneficiaries led during the initial rate spike, but then FANGMA bounced during the growth scare. The re-opening beneficiaries are leading again as rates are rising.

ARK CONTINUES TO TRACK THE NASDAQ MARCH 2000 ANALOGUE

Our final chart for this report, from Strategas, highlights performance of the ARK Innovation Fund. This fund is very concentrated in the highest multiple growth stocks. Performance has been tracking the peak and subsequent rollover of the NASDAQ bubble from 2000. We believe a durable rotation to value oriented stocks is beginning as economic visibility is the highest in a decade in our opinion. As part of that, the old growth darlings of the market have to give up the lead. This chart illustrates that rotation.

In summary, the economic recovery is continuing and should benefit from the Grand Re-opening 2.0 we have highlighted in this report. Consumer demand remains firm, capital spending is starting to recover, and anyone who wants a job should be able to get one. There are some issues slowing the recovery, notably a lack of workers, inflation concerns and supply chain breakdowns. The good news is that most of these issues are addressable and should contribute to a longer economic recovery as demand has been deferred not destroyed. There are likely to be bumps along the way as the market shifts from the aggressive growth-oriented leadership of the past five years to a more value-oriented leadership. We still believe we are in the second half of a secular bull market that has years to run. The rotation and better economic visibility are probably what powers the second half of that secular bull.

As always, if you need any additional information, please feel free to contact any of us.

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10/19/21
S&P 500 – 4520
Russell 1000 Value – 1611

Refer to the following page for more information on the commentary presented. This is pertinent to this letter and should not be reproduced or duplicated without this disclosure.

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Russell 1000 Value Index is a widely recognized index of market activity based on the aggregate performance of common stocks from the Russell 1000 Index, with lower price-to-book ratios and lower forecasted growth values. The performance data was supplied by Frank Russell Trust Company.