HB RETIREMENT®

FINANCIAL MARKET SNAPSHOT

September 9, 2021

While labor markets continue to improve, they did experience a Covid related slowdown in August.

U.S. equity indexes hit new highs, bucking the historical trend that August is one of the worst-performing months for stocks. For the month of August, the S&P 500 index posted 12 new closing highs in its 22 trading days. The S&P 500 has now climbed higher for seven straight months, its longest winning streak since January 2018. Despite inflation concerns, supply-chain constraints, labor shortages and the spread of the coronavirus Delta variant, the market moved higher during the month, closing up 2.90% in August.

Speaking during the Jackson Hole symposium last week, Fed Chair Jerome Powell's made dovish comments that helped spurred equities higher. Powell emphasized that the Federal Open Market Committee "remains steadfast in [its] oft-expressed commitment to support the economy for as long as is needed to achieve a full recovery." Chair Powell also suggested tapering may start sometime before year's end if "substantial further progress" on inflation measures cooperate, economic momentum continues, and employment numbers continue to see "clear progress." Although data from the Bureau for Labor Statistics showed that August's unemployment rate continued to improve, falling 20 basis points to 5.2%, there was some unanticipated softness in current hiring data.

While there was job growth in August, but it was woefully weaker than the job growth seen in July. In fact, August nonfarm payrolls increased by 235,000 (vs. consensus 750,000). The question is, will the Fed be willing to see through the disappointment as a short-term effect of the Delta variant on hiring or will it potentially delay the tapering of its $120 billion monthly purchases of Treasury and mortgage-backed securities?

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Table 1: Notable Returns / Yields / Spreads. Data as of September 8, 2021.
Source: Bloomberg
Note: BBG Barc = Bloomberg Barclays; 10Yr Treasury Yield figures as of the end of the month/quarter

	Ticker	Q1-21	Q2-21	Q3-TD	'21 YTD
S&P 500 Total Return Index	SPXT	6.2%	8.5%	5.3%	21.4%
Russell 1000 Growth Index	RLG	0.9%	11..9%	7.4%	21.4%
Russell 1000 Value Index	RLV	11.2%	5.2%	2.1%	19.6%
MSCI EAFE Index	MXEA	3.7%	5.4%	3.8%	13.3%
MSCI Emerging Markets Index	MXEF	2.2%	5.1%	-3.8%	3.4%
BBG Barc. US Agg Bond Index	LBUSTRUU	-3.4%	1.8%%	0.8%	-0.8%
10-Year Treasury Yield	USGG10YR	1.74%	1.47%	1.33%	1.33%

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Powell's remarks also included a long section on lessons from history, weighing the dangers of acting too soon, and too late. Powell pushed back against notions that the Fed's 2020 adjustment to the policy framework is no longer suited to current conditions. That shift emphasized shortfalls from maximum employment and allowed for temporary overshoot of the 2% target. Powell noted the following historical lessons:

- The Fed's takeaway from the 1950s was that responding to temporary factors may do more harm than good. In the current environment, well short of full employment, that would harm progress for many within an uneven recovery.
- The lesson from the high-inflation 1970s was that central banks cannot always take transitory factors for granted, particularly if they feed through to higher inflation expectations. Consistent with our read of the June meeting and July minutes, Powell noted the committee will be scouring the data for evidence that contradicts the critical transitory inflation assessment.

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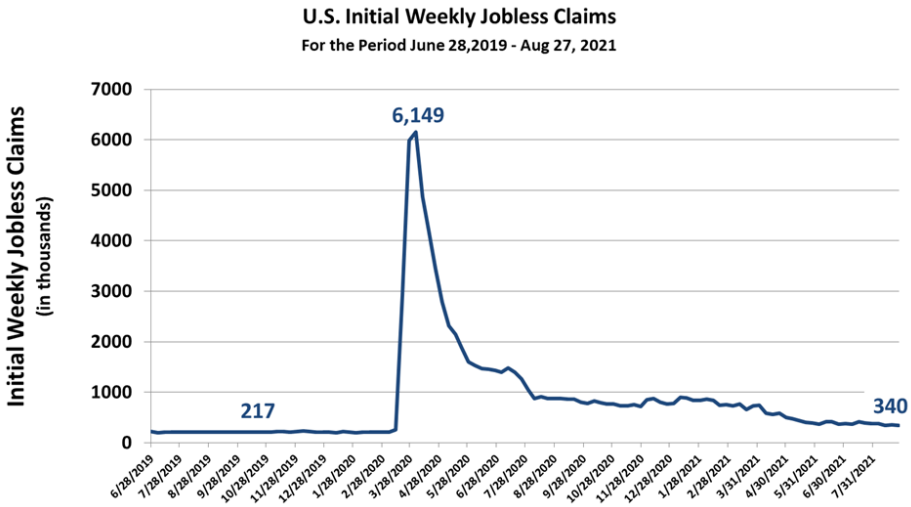
Initial Weekly Jobless Claims Reach Pandemic-Era Low

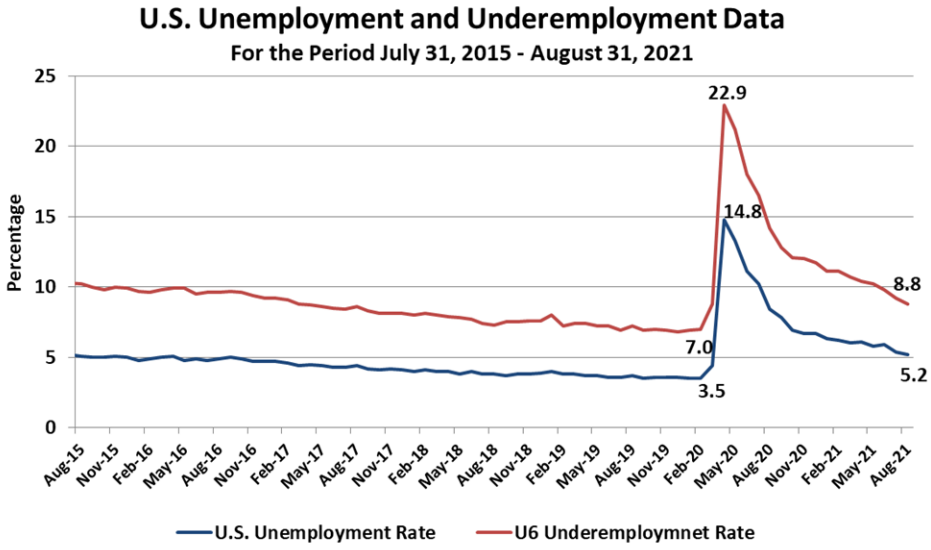
The U.S. economy added far fewer-than-expected new jobs last month, the Labor Department said Friday, as hiring slowed amid a surge in Delta-variant infections and supply chain disruptions in manufacturing and housing. Initial unemployment claims in regular state programs fell 14,000 to 340,000 in the period ended Aug. 28. The median estimate in a Bloomberg survey of economists called for a slight decrease to 345,000 new applications. The DOL noted that hourly wages were up 0.6%, and 4.3% on the year, to $30.73 per hour, with both figures coming in ahead of Street forecasts. However, the DOL revised its July jobs addition estimate up to 1,035,000 from its original estimate of 943,000.



Source: U.S. Department of Labor

The employment claims figures come amid the last period before the expiration of pandemic-triggered unemployment benefits are set to expire for around 10 million people around the country. Some 3 million will lose extended benefits this weekend, with a further 7.5 million facing the cut-off for emergency jobless benefits from the 26 states that are still paying them. The expiration, as well as the return to full classroom learning for millions of schoolchildren nationwide, could trigger massive changes in job creation over the final months of the year, given that unfilled positions are sitting at an all-time high of 10.1 million.

The level of continuing claims, the measure of ongoing benefits, was 2.75 million, a decrease of 160,000 from the previous week's revised level and is also the lowest level since March 14, 2020.. The decrease in the number of continuing claims also represents the lowest level for insured unemployment since the Covid era began.



Source: Bureau of Labor Statistics

The Bureau for Labor Statistics said on Friday that the unemployment rate also dipped further to reach a pandemic-era low of 5.2%, while holding above the 50-year low of 3.5% from early 2020. Moreover, the number of long-term unemployed (those jobless for 27 weeks or more) fell in August to 3.2 million, but is 2.1 million higher than in February 2020. These long-term unemployed accounted for 37.4% of the total unemployed in August, according to the DOL.

According to the DOL, so far this year, job growth has averaged 586,000 jobs per month. And while employment has risen by some 17 million since April 2020, the economy is still down about 5.3 million jobs from its pre-pandemic level in February 2020 – when the unemployment rate was at a historic low of 3.5% prior to COVID -19 walloping the labor market.

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Slowing U.S. Labor Market Data Could Impact Fed Taper Timing

The abrupt slowdown in job growth last month could derail the Federal Reserve's plan to start unwinding its easy-monetary policies at its September policy meeting amid signs the highly contagious Delta variant is weighing on the labor market's recovery from the pandemic.

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Fed officials, including Chair Jerome Powell, have emphasized the importance of the monthly employment reports as a guiding metric for the timing of when to begin reducing its asset purchases. The disappointing report reinforces the central bank's data-driven approach to the timing of tapering.

Economists blamed the job growth drag on the Delta variant, noting that net job growth in leisure and hospitality – which includes bars, restaurants and hotels – was zero, a sign that Americans were pulling back on spending as the virus spreads nationwide.

Many economists had pointed to September as the month when those factors would have largely abated, but the Delta variant has pushed back that timeline. Uncertainty remains over the path of the virus. While hospitalizations are starting to fall in recent hot spots, there is concern about it spreading to other parts of the country.

At the Federal Open Market Committee's July meeting, "most" officials agreed it would probably be appropriate to begin reducing asset purchases before the end of the year, according to minutes from the gathering. While a handful indicated that it's best to wait until 2022, other officials have suggested they want to make a move as soon as next month.

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Powell hinted an announcement on tapering bond purchases could come as soon as next month during the virtual Jackson Hole conference, but with the lackluster August jobs report, most experts expect the U.S. central bank to delay until at least November as they assess the status of the labor market. We note that there are three more scheduled Fed policy-setting meetings this year: Sept. 22, Nov. 3 and Dec. 15.

Rate Hikes are Not Imminent

As for interest rates, Powell reiterated the Fed's framework includes a "different and substantially more stringent test." Powell said that "the timing and pace of the coming reduction in asset purchases will not be intended to carry a direct signal regarding the timing of interest rate liftoff, for which we have articulated a different and substantially more stringent test."

Powell noted that rate hikes are not imminent as there is still "much ground to cover" before the economy hits full employment. Paired with the rest of the speech, which included doubt about whether pre-pandemic disinflationary trends are truly behind, and the juxtaposition of low unemployment and low inflation before the pandemic, the remarks are consistent with analysts' views that an initial rate hike will likely have to wait until 2023.

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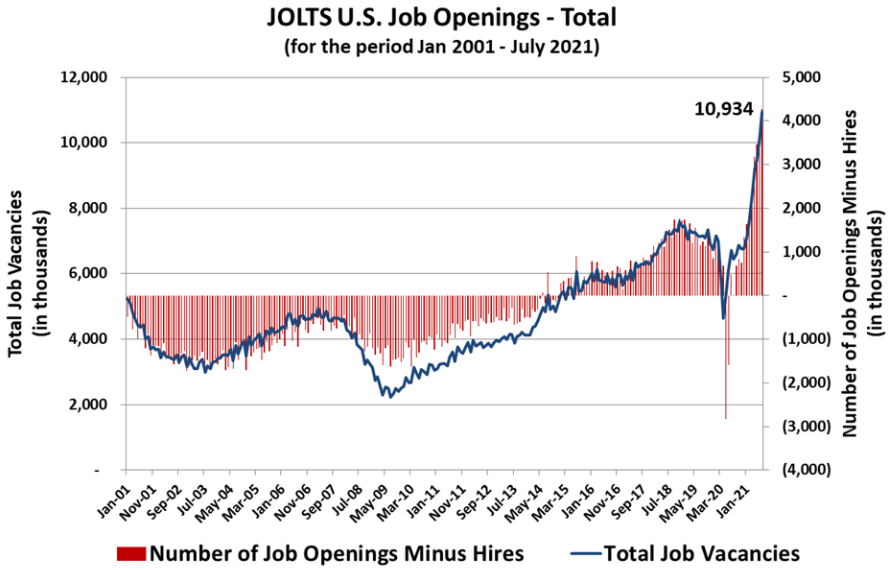
U.S. Job Openings Rose to a Record 10.9 Million in July

U.S. job openings rose to a fresh record high in July, illustrating the lingering staffing shortages that are making it challenging for businesses to meet demand. The Labor Department's Job Openings and Labor Turnover Survey, or JOLTS, showed that the number of available positions rose to 10.93 million during the month from an upwardly revised 10.2 million in June. Economists in a Bloomberg survey had called for openings to remain little changed at 10 million.



Source: Bureau of Labor Statistics

After shedding millions of workers from payrolls last year, the rapid snapback in economic activity has left many businesses severely short-staffed. "Help Wanted" signs can be seen in the windows of businesses across the U.S., and many restaurants have limited their hours of operation. Employers have offered incentives to attract applicants – like higher wages and one-time bonuses – but the pool of available workers remains constrained by pandemic-related factors.

The number of vacancies exceeded hires by 4.3 million in July, the most since data dating back to 2000. The number of people who voluntarily left their jobs rose to 4 million in the month, and the quits rate was unchanged at a near record 2.7%.

The largest increases in openings were in health care and social assistance; finance and insurance; and accommodation and food services. Total hires eased to 6.7 million in July, most notably in sectors like retail and manufacturing. The hires rate decreased to 4.5%. Layoffs and discharges picked up slightly.

The JOLTS figures trail the government's monthly jobs data. That report, out last week, showed payrolls rose by just 235,000 in August – trailing all economists' estimates – as the spread of the Delta variant paired with ongoing hiring challenges weighed on job growth.

Separate figures last week showed half of small-business owners said they had vacant positions they could not fill in August, a record in the National Federation of Independent Business survey. Meantime, the share of consumers who said jobs were "plentiful" in the Conference Board's survey last month hovered near a two-decade high.

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Implications for Our Portfolios

From a portfolio management perspective, we remain cautiously optimistic on equity capital markets as we progress into the back half of 2021. While we are tracking the impact of the delta Covid variant on the economy, we are hopeful for a relatively quick burnout of new cases post the initial spike in infections.

Overall, we expect equity market returns in the second half of the year to be more muted, with S&P 500 price targets implying mid-single digit returns over the next six months. We believe that this expectation is supported by the potential for sustained earnings growth, driven by the continued reopening of the economy.

We believe that the continuation of a "catch-up" trade into the back half of 2021 is likely, and that value equity could outperform growth equity over this time period. Consequently, we believe that as the economy reopening accelerates in the second half of the year, the rally could broaden to economically sensitive investments that have lagged, including cyclical sectors, small-cap stocks and international equities.

We also continue favor high-quality asset classes (US large-cap and mid-cap) and remain constructive in tilting the portfolio in that direction. While we like Technology, Communication Services, Consumer Discretionary longer-term, we believe that incremental exposure to select segments within the Industrials, Financials and Materials sectors is currently warranted given our belief that they will potentially benefit from a broadening economic recovery.

We continue to watch inflation trends very closely, and believe that inflation has both a transitory and a structural component to it. Furthermore, we believe that the transitory causes will begin to abate in the latter half of the year driven by: easy comparables dropping out of the data, supply chain constraints being resolved and the labor market conditions continuing to improve.

We also believe that inflation has both a transitory and a structural component to it. Furthermore, we believe that the transitory causes will begin to abate in the latter half of the year driven by: easy comparables dropping out of the data, supply chain constraints being resolved and the labor market conditions continuing to improve. Consequently, we believe that this expectation supports our preference for equity over fixed income as well as corporate and securitized debt over government debt.

At Henderson Brothers, we remain committed to our disciplined and repeatable investment process, which is based both on top-down, macro analysis coupled with bottom-up, fundamental research. As such, we intend to follow the data and adjust our outlook and portfolios accordingly. Consequently, at the present time, we are staying the course with regard to the asset allocation—favoring value over growth. Unprecedented times such as these not only validate but mandate a disciplined investment process!

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Our judgement or recommendations may differ materially from what may be presented in a long-term investment plan. Investors should consult with an investment advisor to determine the appropriate investment strategy and investment vehicle. Investment decisions should be made based on the investor's specific financial needs and objectives, goals, time horizon and risk tolerance.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against market risk.

Stock investing involves risk including loss of principle.

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The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Precious metal investing involves greater fluctuation and potential for losses.

Government bonds and Treasury bills are guaranteed by the US government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

High yield/junk bonds (grade BB or below) are not investment grade securities and are subject to higher interest rate, credit, and illiquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

The MSCI EAFE Index is a free float –adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.

The MSCI EM (Emerging Markets) Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of the emerging market countries of the Americas, Europe, the Middle East, Africa and Asia.

The S&P 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing the major sectors of the U.S. economy.

The Bloomberg Barclays U.S. Aggregate Bond Index is an index of the U.S. investment grade fixed-rate bond market, including both government and corporate bonds.

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