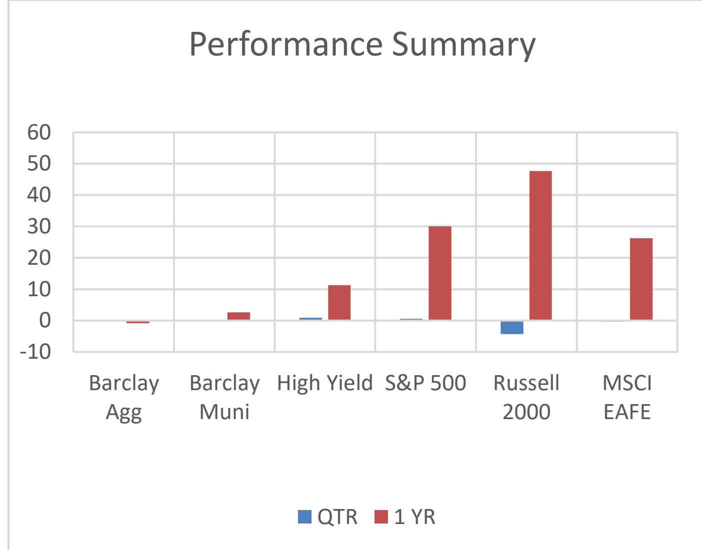
A September sell-off stalled the third-quarter stock rally and left most indices with flat or negative returns for the three-month period. Higher inflation, hawkish language from central banks, the U.S. debt ceiling standoff, and the potential collapse of one of China's largest property developers contributed to September's weak markets. Treasury bond yields rose in September, leading to a bond sell-off and negative returns in September. For the quarter, bond returns were close to flat.



- After declining nearly 5% in September, the S&P 500 index finished the quarter with a slight gain. September's decline marked the first monthly loss for the index since January.
- The U.S. economic environment generally remained favorable, though elevated inflation created headwinds. Economic growth has peaked, but at a high level.
- A sharp decline in September pushed European stocks lower for the quarter. Japan's August stock market rally continued, and the country finished the third quarter with a robust gain.
- A debt crisis at Chinese property giant, Evergrande Group, triggered worldwide market volatility in late September, and steep losses in the emerging markets.
- In September, the Fed hinted they would start tapering bond purchases by year end and rate hikes may begin in 2022. This led to higher yields and a bond sell-off in September.

Below we touch on several topics relevant to investors: Is the Great Moderation Over?; Rotation (Again)?; and Strategy In Pictures.

Is the Great Moderation Over?

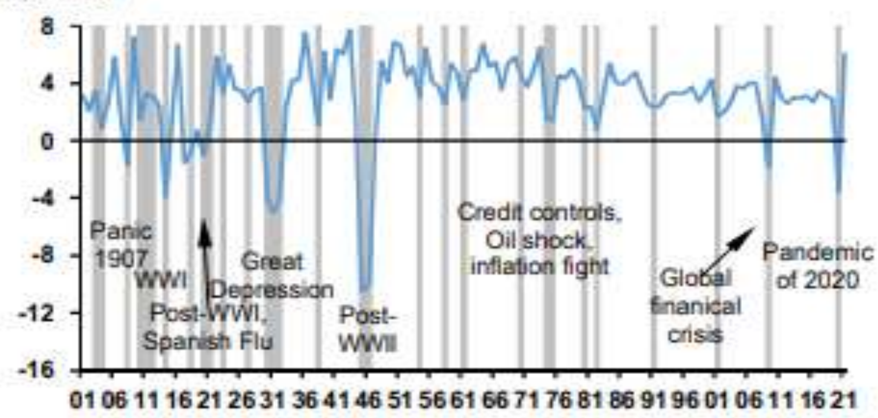
The Great Moderation (GM) is generally defined as the period since 1984 till now, when the economy experienced low inflation and economic growth with less volatility, longer economic expansions, and shallower recessions. The GM was driven by policy and financial liberalization that led to 35+ years of lower inflation and interest rates, less frequent recessions, and creating an ideal environment for both stocks and bonds. Visually you can easily see the impact of the GM in the chart on the next page, with less volatility in the economy and fewer recessions on the right side of the chart.

However, the GM has also left us with weaker economic growth, high debt burdens, vast inequality in wealth distribution and very low-interest rates that offer poor future returns for bonds. New macro policies to boost growth and reverse inequality are raising the risk that we are entering a period of higher inflation, even bigger deficits, greater economic volatility, and more frequent recessions. All of which will limit the future return potential of stocks and bonds and will (should!) impact how investors allocate assets in the future.

Rotation (Again)?

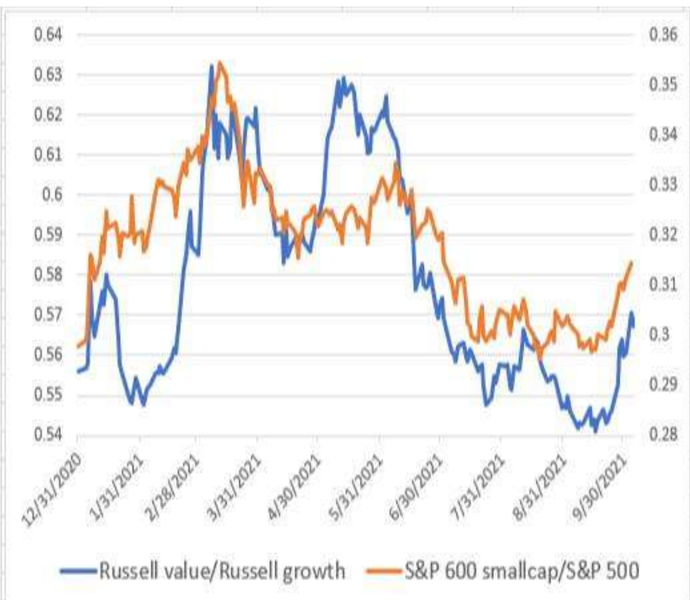
Performance in the stock market this year has been dominated by the 'tug of war' between value and growth stocks. When economic growth has been (or perceived to be) weak, growth stocks outperformed and when economic growth accelerated, value stocks outperformed. The chart below illustrates the relative performance of value vs. growth, and small-cap vs. large-cap stocks, which are also impacted by economic growth.

Figure 2 Real global growth since 1900



Source: J.P. Morgan, Angus Maddison data.

The significant rotation between investment styles is clear, however the past couple of weeks indicate the market may be rotating towards another stretch of value and small-cap stock outperformance. Here are a few reasons why we expect value, small-cap, and economically sensitive strategies to outperform:



- Economic growth has peaked, but at very high levels, and the economy should remain at above-trend levels
- Continued progress on vaccinations and therapeutics, have lessened the risk that the delta variant will shut down the economy
- Continued accommodative monetary and fiscal policies
- Household balance sheets are healthier, and savings are way up, which should lead to plenty of pent-up demand
- Value and small-cap stocks are trading at much better valuations than growth stocks
- Higher interest rates and regulation threats are potential headwinds for growth and tech stocks

Strategy In Pictures

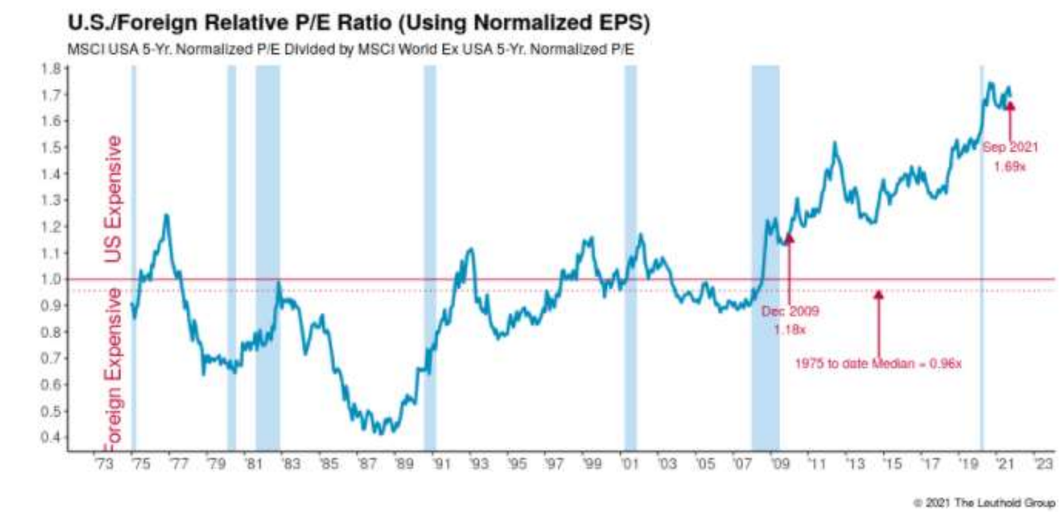
Below we highlight several charts that illustrate the investment case for overweighting: value, small-cap, economically sensitive, and foreign stocks in portfolios. We've added short comments for each chart, otherwise, the charts are mostly self-explanatory.

Economic growth will remain well above the long-term trend, a positive for cyclical stocks.

Valuations still matter and at some point there will be an extended period of value outperformance.

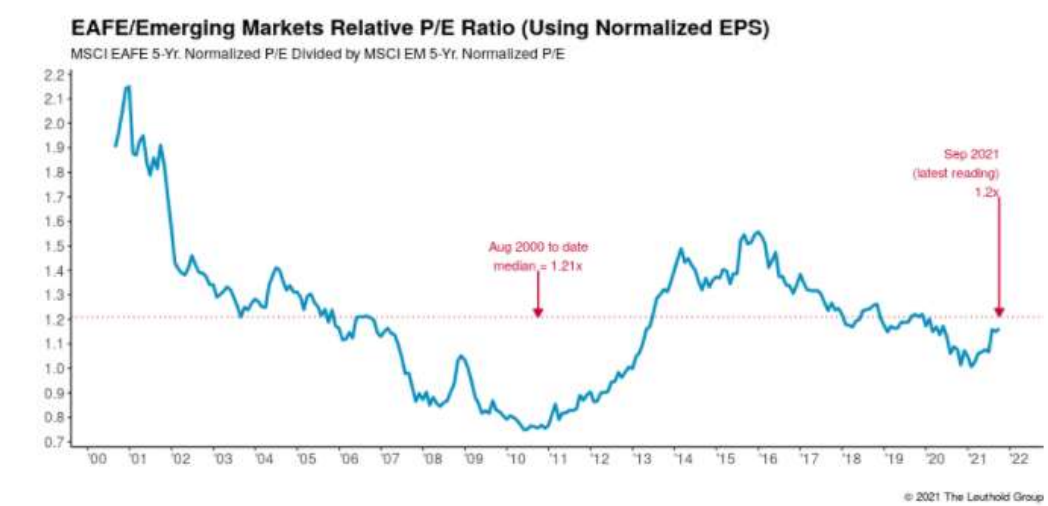
Ditto for small-caps relative to large-cap stocks.

U.S. vs Foreign Relative P/E Ratio



Foreign stocks are inexpensive compared to U.S. stocks. A rotation into value should benefit foreign stocks.

EAFE/Emerging Markets Relative P/E Ratio (Using Normalized EPS)



Emerging market stocks are relatively inexpensive and should perform well in an above trend economy.

We also recommend holding real return assets that can hedge against higher inflation, and in portfolios that can tolerate higher volatility, we would underweight exposure to bonds. Please give us a call if you have any questions on this commentary or investment strategy.

Asset Class		* ↔ Neutral weight ↓ Underweight ↑ Overweight
Equities	***View****	***Comments***
U.S. Large Cap	↓	We are optimistic about stocks relative to cash and bonds. However, we are underweight large-cap stocks and favor small-cap and foreign stocks due to more attractive valuations. We also favor cyclical and value stocks over growth stocks.
U.S. Small/Mid Cap	↑	We are overweight small/mid-cap stocks. Economic growth may have peaked but is still well above potential. Valuations are relatively attractive and above-average economic growth should provide a tailwind.
International Developed	↑	Valuations are attractive relative to U.S. stocks, and they are a little behind the U.S. in the economic cycle. This suggests there is more room for economic growth to increase. We like broad exposure to the foreign markets and would overweight dividend-paying and value stocks in this environment. Above trend growth and a weak dollar should be a tailwind.
Emerging Markets	↑	Valuations are attractive for the long term. Emerging markets tend to be volatile and are always susceptible to further selloffs, but in a global economic recovery with low rates, a declining US dollar, and ample liquidity they should outperform.

Fixed Income		
Investment Grade	↓	With the 10- year treasury yield near 1.5% and real yields negative, we remain under weight core bonds. We recommend keeping some exposure for disciplined risk management and diversification purposes. We are adding the difference to alternative asset classes.
High-Yield Bonds	↓	High-yield bonds may continue to outperform as the economy recovers. However, investors should recognize valuations are high, and risk may be more like stocks if the economy slows. With credit spreads at all-time lows, we are cautious.
Municipal Bonds	↔	We are neutral on municipal bonds relative to Treasury bonds; however, they remain attractive for high tax bracket investors.
TIPS	↔	TIPs are a hedge for higher inflation, we would hold positions in tax-deferred accounts as a long-term hedge against inflation and would favor them over traditional treasury bonds.
Floating-Rate Loans	↔	Similar to HY bonds, FRLs are likely to outperform core bonds in a strong economy. However, in a weak economic environment, there is downside risk, we like small positions as a hedge against higher rates.
Emerging Markets	↔	This asset class can be volatile but also provides opportunity. Interest rates in many EM markets are higher than in the U.S.; we get some exposure thru our core bond managers and don't anticipate buying any direct positions.

Alternatives		
Absolute-Return/Alternatives	↑	We like this asset class and have raised our rating to overweight earlier this year, given the strong rally in stocks and bonds. We like alternative funds as a way to hedge volatility, provide real returns, and improve the risk vs reward in portfolios. We favor simple and low-cost strategies like hedged equity and global macro.
REITs	↔	We are neutral on REITs. There are diversification benefits from owning REITs, however, we recognize REITs may be structurally impaired in the future as a result of shifts in work habits and technology caused by the pandemic.
Commodities/Gold	↑	We view commodities as an effective way for long-term investors to diversify their portfolios and hedge against higher inflation. Commodities have performed well and should continue to do well as the economic recovery continues. As the economy reached full employment, we will likely reduce exposure to commodities. Gold and silver have underperformed YTD, however, we still like small positions in portfolios as a hedge.

U.S. Stocks
Market Performance, Third Quarter 2021

Index	Q3 2021	1 YR
S&P 500	0.55%	30.00%
Russell 1000	0.21%	30.96%
Russell 1000 Value	(0.78%)	35.01%
Russell 1000 Growth	1.16%	27.32%
Russell Midcap	(0.93%)	38.11%
Russell 2000	(4.36%)	47.68%

Source: Morningstar

- Stocks sold off sharply in September which left returns for the quarter close to flat. Growth outperformed value by close to 2% for the quarter, however, we've seen a recent shift to value stocks outperforming.
- We believe this economic cycle has further to run and expect investors to rotate back into cyclical and value stocks.
- Small-cap stocks lagged during the quarter; however, valuations are attractive, and we expect relative performance to improve going forward.

International Stocks
Market Performance, Third Quarter 2021

Index	Q3 2021	1 YR
MSCI EAFE	(0.35%)	26.29%
MCSI EME	(7.97%)	18.58%
MSCI BRIC	(11.21%)	7.90%

Source: Morningstar

- Foreign developed markets were down slightly for the quarter. Longer-term valuations look more attractive than US stocks, and investors should maintain an overweight.
- Emerging market stocks were the biggest loser for the quarter as fears about a China slowdown weighed on markets. Valuations are relatively attractive, and investors should stay structurally overweight in the face of volatility.

Fixed Income

Market Performance, Third Quarter 2021

Index	Q3 2021	1 YR
Vanguard Total Bond Index	0.08%	(1.02%)
Barclays Muni Bond	(0.27%)	2.63%
Barclays US Corp High-Yield	0.89%	11.28%
JPM GBI- EM Global Diversified	(3.10%)	2.63%
iShares TIPS Bond	1.71%	4.82%
BofA Merrill Lynch 3-month Treasury Note	0.01%	0.07%

Source: Morningstar

- Core bonds sold off in September in the face of rising treasury yields and finished the quarter flat. We expect core bond's returns to be low, but they still play a role in providing diversification and risk management.
- High-yield bonds were up slightly for the quarter. We view high-yield as very overvalued and there is substantial downside risk when the next recession arrives. In our opinion, the risk is more comparable to stocks than bonds and the upside is limited.

Alternative Assets

Market Performance, Third Quarter 2021

Strategies	Q3 2021	1 YR
AQR Diversified Arbitrage	(0.16%)	20.89%
BNY Mellon Global Real Return	(1.10%)	9.64%
JPMorgan Hedged Equity	(0.16%)	14.04%
PIMCO All Asset	(0.59%)	25.61%
Vanguard REIT	0.68%	33.49%

Source: Morningstar

- Alternatives make a lot of sense in this environment of low-interest rates and rising inflation. We are selectively bullish on alternatives and believe they can add substantial value to portfolios. We view bonds as a source of funds. Commodities were the big winner for the quarter.
- We like alternative assets as a strategic way to reduce risk and increase absolute returns in portfolios. We expect alternatives to significantly outperform bonds over the full market cycle. We view real return, commodity, precious metal, and alternative strategies in general as an effective way to hedge against higher inflation.

Appendix:

Benchmark Definitions

U.S. Equity		Description
S&P 500	Index	The index includes 500 leading US companies and captures approximately 80% coverage of available market capitalization.
Russell 1000	Index	The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe and includes approximately 1000 of the largest securities. The Russell 1000 represents approximately 92% of the U.S. market.
Russell 1000 Value	Index	The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values.
Russell 1000 Growth	Index	The Russell 1000 Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.
Russell Midcap	Index	The Russell Midcap Index measures the performance of the mid-cap segment of the U.S. equity universe. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership.
Russell 2000	Index	The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.
International Equity		**Description**
MSCI EAFE	Index	The EAFE (Europe, Australasia, Far East) index consists of 21 developed market country indexes, excluding the US & Canada. It is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets.
MCSI EME	Index	The index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets and includes 23 emerging market countries in the index.
MSCI BRIC	Index	The index is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of the following four emerging market country indexes: Brazil, Russia, India, and China.

Fixed Income		Description
Vanguard Total Bond Index	Index Fund	This index measures a wide spectrum of public, investment-grade, taxable, fixed income securities in the United States—including government, corporate, and international dollar-denominated bonds, as well as mortgage-backed and asset-backed securities, all with maturities of more than 1 year.
Barclays Aggregate Bond	Index	The U.S. Aggregate Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The index includes bonds from the Treasury, Government-Related, Corporate, MBS (agency fixed-rate and hybrid ARM pass-through bonds), ABS, and CMBS sectors.
Barclays Muni Bond	Index	The U.S. Municipal Indices cover the USD-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.
Barclays US Corp High-Yield	Index	The index covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market and excludes Emerging Markets debt.
JPM GBI- EM Global Divers	Index	The index tracks returns for actively traded external debt instruments in emerging markets. Included in the index are US-dollar denominated Brady bonds, Eurobonds, and traded loans issued by sovereign entities.
iShares TIPS Bond	ETF	The iShares TIPS Bond ETF seeks to track the investment results of an index composed of inflation-protected U.S. Treasury bonds.
BofA Merrill Lynch 3-month Treasury Note	Index	The 3-month US Treasury Note Index is comprised of a single issue purchased at the beginning of the month and held for a full month. At the end of the month, that issue is sold and rolled into a newly selected issue.
Alternative Assets		**Description**
PIMCO All Asset All Authority	Mutual Fund	The investment seeks maximum real return, consistent with preservation of real capital and prudent investment management. The primary benchmark for the fund is the S&P 500, with a secondary objective of Consumer Price Index +650 basis points.
AQR Diversified Arbitrage	Mutual Fund	The investment seeks long-term absolute (positive) returns. It invests in a diversified portfolio of instruments, including equities, convertible securities, debt securities, loans, warrants, options, other types of derivative instruments.
JPMorgan Hedged Equity	Mutual Fund	The investment seeks to capture the majority of the returns associated with equity market investments while exposing investors to less risk than other equity investments. The fund invests in a broadly diversified portfolio of common stocks, while also selling index call options and purchasing index put options.

Alternative Assets		Description
Vanguard REIT	ETF	The investment seeks to provide a high level of income and moderate long-term capital appreciation by tracking the performance of a benchmark index that measures the performance of publicly traded equity REITs.
BNY Mellon Global Real Return	Mutual Fund	The fund allocates its investments among global equities, bonds, and cash; and generally, to a lesser extent, other asset classes, including real estate, commodities, currencies, and alternative or non-traditional asset classes and strategies, primarily those accessed through derivative instruments.