



It has been a year and a half since the Covid Crash.

A 6-week violent, cyclical Bear Market came to an end in March of 2020, allowing the secular Bull Market to yet again ascend. Ever since its birth, amidst the ashes of the Financial Crisis, this Bull Market has charged higher in the face of so much adversity. That's the character of this Bull. Nothing has gotten in its way over the decade-plus in pursuit of record highs, something it achieved over 50 times in 2021.

The past 18 months saw the fastest recession in American history, followed by the quickest recovery. There was a crash down and a crash up. Employment and economic output fell more in that brief period of 2020 than all of 2008, during the Financial Crisis. US Gross Domestic Product is already back to its pre-pandemic level and may be back to its pre-pandemic path by year-end. Modern medicine is a marvel. The vaccine came to the rescue. That triggered the turn.

The subsequent recovery and reopening of America brought a surge in spending, a surge in earnings and a surge in asset prices. Pent-up demand exploded. Surge is definitely the word. The Stock Market and Real Estate reflect the growth. It's been quite remarkable and easy to lose sight of the extent of the damage and recovery. Those were some dark, dark days in March 2020; Days we will not soon forget. The World Changed.

THE FED MOVED FAST



Here's a reminder of how the Market got here. The pandemic-induced lockdown and subsequent recession in early 2020 led to unprecedented asset purchases by the Federal Reserve as emergency measures to save the Economy from falling off a cliff. The Fed went big; Bigger than it's ever gone before. The central bank took interest rates to zero and has been buying \$120 Billion in assets every month for a year and a half. The Fed's balance sheet thus expanded from \$4 Trillion to over \$8.44 Trillion today. This has provided massive amounts of liquidity in the system.

The Fed did whatever it took. They wasted no time and went big. Congress, in collaboration, followed suit. At least at first. Much of the aggressive response was purely experimental. Fortunately, the lessons learned should lessen the toll of future recessions. By depositing cash directly into household bank accounts, Treasury has learned how, with Congressional approval, to deliver stimulus almost as quickly as the Fed.

Asset prices have responded big time, as evidenced by the Stock Market and Housing. Even though the Market and US Economy are no longer in need of emergency methods, the Fed seems terrified of being the cause of another economic slowdown not to mention a Stock Market decline. But the test for tapering has been met. The official taper announcement is expected in November. It could start before January. The test for liftoff in rates is much higher and yet to be completed. Even with a taper, the Fed will still be injecting large quantities of liquidity into the system. That's what the Market likes.

RIISING RATES

Interest rates have moved higher since Summer. The initial move is always fast. The Market has been recalibrating. The speed of the move in rates is what seems to be causing the greatest friction in the Stock Market heading into Fall. The greatest pain has been felt in Tech. Conversely, Energy and Financials experienced another resurgence. The price of Oil hit a 3-year high to close out September. Natural Gas reached levels not seen in nearly a decade. It's happening ahead of the Winter heating season. Higher interest rates mean more profits for the Banks. High Beta stocks have caught another bid while Tech takes a breather. There's been a rolling correction throughout 2021. We see more of this activity in Q4.



As a refresher on Investing 101, the value of an investment should equal the sum of its discounted future cash flows. Interest rates are the cost to borrow. In other words, they're the price of money. To that end, as interest rates rise, so should the discount rate for future cash flows. The implication is that stocks should be worth less with rising rates. That's especially the case with fast-growing companies yet to turn a profit. Those are considered long-duration assets because payouts are pushed out to the future. You find a lot of those in Tech.

Taking it a step further, higher rates also tend to slow the Economy. Economic slowdowns impact earnings and cash flows. It's the Fed's cooling mechanism. But since a rate rise is coming off the zero level, there is plenty of cushion ahead before any threat to growth occurs. The Fed has been in emergency mode for 18 months. It's the change that's causing some disruption. It was inevitable.

TAPER

The Fed tripped down on its belief that the current rate of inflation is temporary and not a lasting issue. The Fed also pulled forward rate-hike expectations. The Taper refers to the slightly

reduced buying of monthly asset purchases. The Fed is still expected to remain highly accommodative. Even with the Fed reducing its \$120 Billion monthly asset purchases by \$15 Billion per month, it will end up adding over \$400 Billion in liquid assets to the financial system through mid-2022. This would still far exceed anything Ben Bernanke did with his QE! The liftoff from zero interest rates could occur after that.



MID-CYCLE PAUSE

Where are we in this recovery? It seems like the end of Summer brought a Delta-led mid-cycle pause. It provided a serious reality check for the Market and the Economy. It also exposed once again how divided the nation is. Like the virus, the American people seemed to have mutated. Living with the virus has become a theme. Many Americans have gone back to normal or have gotten used to what's increasingly becoming the new normal with a hybrid model. Others are still spooked and continue to tread lightly. It's quite a process. Time is needed. Not everyone exercises patience. That's evident too.



The next stage of rising rates should be slower moving. The Market is simply getting ahead of the Fed. It always does. That should be supportive of growth. Most importantly, it will start the removal of dependence from the central bank. The Market will operate more naturally. The forecast is 1 rate hike in 2022 and 3 in 2023. Keep in mind, that's a long time from now. Anything can happen in that wide window.

RE-ACCELERATION AHEAD

There are signs that the spread is slowing, and the worst of Delta is behind us. There's definitely a big risk with another Winter spread as the cold weather sends people back indoors. The US Economy could see 6% growth in Q4 with another reopening, post-Delta, heading into the holiday season. That's when Americans really open their wallets. There's a great deal of seasonal activity. Vaccines for 12 and under by Halloween should help too. Pent-up demand and historic high savings rates are the fuel for increased spending. Demand is still very strong. It's the supply side that has been hampered. That's triggered inflation. Prices have risen.

Get those shopping lists ready. The supply chain slowdown will definitely impact Santa this year. Goods are still sitting on cargo ships offshore from ports. Delays mount. Department stores and warehouses are pulling out all stops in efforts to hire seasonal workers. Companies are raising pay for people and increasingly seeking out robotic solutions to navigate the aisles. Online shopping and delivery were already in irreversible trends. The pandemic simply accelerated the activity as stay-at-home consumers loaded up their digital shopping carts. Artificial Intelligence and Robots are increasingly the solution for inefficiencies.

INFLATION

There's still that issue of inflation. The Fed calls it transitory. The Market thinks it's longer-lasting. Inflation likely stays elevated but starts to slow as supply chain issues get resolved. But prices are unlikely to go back down to pre-Covid levels. The price of housing, rents and higher wages should keep things elevated. Limited supplies of semiconductors make items like computers, phones and cars prized possessions. Those prized possession prices are higher if you can even find them. Unemployment should continue to slide as benefits have been reduced and the virus spread shrinks. Sub 4% unemployment seems likely early in 2022. That is, if unemployed Americans want to work.

Loose Fiscal policy helped ignite inflationary pressures too. Stimulus checks and extra unemployment acted like spending fuel. Congress funneled more demand into a supply-constrained Economy, exacerbating the inflation problem. It's an easy trap for both political parties to fall into. There is a clear divide in wealth in this nation. There's a clear divide in politics too. It is so politically appealing to give voters freebies. The problem is, once it's done, it's very easy to overdo. That's a major issue that permeates the Capitol building presently.

HUGE DEBT & DIVIDED GOVERNMENT

The costs of doing whatever it takes are mounting. The money had to be borrowed. Federal debt spiked from 3/4 of GDP at the end of 2019 to nearly 100% today. It's now pushing \$30 Trillion. What's more, there is no credible plan to pay it back. It's been a manageable chore to service the debt with interest rates near zero. But future interest rates will not stay at zero. This is the time to refinance and get the Fiscal House in order. Unfortunately, that is not politically popular. If it were, finding common ground on how to do it would be beyond complicated. We're not sleeping on this issue. There's going to be a time where it matters. It's going to be a big deal.

One of the biggest risks the Market faces is self-inflicted by our own government. Congress has trouble keeping the government open, let alone passing an infrastructure bill or raising the debt ceiling. The Legislative Branch was able to cut a deal to keep the Federal Government open, at least for 2 more months. The can got kicked down the road again. It's still unclear what will be the fate of the debt ceiling and infrastructure as internal disagreements persist. The stress of uncertainty spilled into October. Even though very unlikely, a default or a rating downgrade cannot be ruled out. When it comes to today's Washington, we always expect 11th-hour action. It's stressful. Unfortunately, it's become our government's way.

One very important point of clarity: Bond yields are not going up because of growing default risks. They're going up as inflationary pressures build, relative to demand growth with tight supplies, ahead of the Fed taper. Commodities are going higher. Rents are higher. Labor costs are higher too.

RECORD EARNINGS

The Market cares less about Washington and more about Earnings. Corporate America has never been more profitable. Earnings growth has been fast. Q3 S&P 500 earnings, which will be reported starting in October, are expected to increase nearly 28% year-over-year. The S&P 500 is expected to earn roughly \$200 per share this year, shattering the previous record of \$163 in 2019, pre-Covid. That's what's led the S&P 500 to all-time highs in 2021. Cheap money and buybacks have certainly helped.



Some question if this is as good as it gets. The growth rate will certainly shrink. Higher costs have trickled back in recently with inflationary pressures. But Corporate America has been running very efficiently. Software and systems have allowed the office to become virtual. Employee productivity has improved. These are themes that should keep Corporate America humming and keep a bid under the Stock Market.

INVESTMENT THEMES



The Digital Revolution continues. There is no way our Economy could come back this quickly without the innovative solutions of Science and Tech. Vaccines and remote working make it happen. Online purchases, electronic payment and home delivery, are the way. It's very investable. These investment themes continue to be a focus of ours. Cycles just get bumpier. We have to toggle between the short-term and the long-term. That's what risk managers do.

We continue to see investment opportunities in Biotech and DNA sequencing. Innovation reigns. The current environment is also ripe for Cybersecurity and Defense. Geopolitics are on the rise and space travel has gotten serious liftoff. There are many ways to play these sustainable investment themes.



We continue to invest in Energy. It requires a portfolio of solutions to run the world. Growth is to be had in Traditional as well as Renewable. It's still very early days for renewables. Commodities do very well in an expansionary economy. Demand for stuff, particularly infrastructure, is on the rise. It's a global theme. It's very investable.

Rising rates can take a toll on stocks. It's even worse for Bonds. The 40-Year Bond Bull might have finally run its course. We continue to navigate the choppy environment seeking investment opportunities in this new paradigm. Dividend stocks are always a favorite of ours. We like companies that not only pay a dividend every year, but have the track record of increasing it too. We call them Boring Blue Chips, though there's nothing boring about a predictable income stream.

SEPTEMBER SELLING SEASON

September is notorious for Market sell-offs. It is seasonally the worst month for stocks on the calendar. September 2020 was a rough patch for this Bull. September 2021 proved so too. October historically has been the most common month for Market bottoms, leading to a year-end rally. The set-up this time is definitely there.



After such a strong start to the year for stocks, a correction was overdue. Investor sentiment got pretty frothy in the Spring. The Stock Market got very crowded while stocks kept getting more and more expensive. It's basically gone sideways since Summer started. A 5% sell-off had been absent. It finally happened in September. That's normal. That's healthy. Corrections do just that; Correct the excesses. Corrections also spook investors. That's where opportunities come.



Sentiment went from Bullish to Bearish, in short order. That's traditionally a contrarian sign that a bottom is close. With just 46% Bulls, as measured by Investors Intelligence, this is the lowest sentiment reading since it washed out in the 30% range during the March 2020 crash. That's when investors were most Bearish, at the bottom. That was 18 months ago.

YEAR-END FINISH

We believe there is still more to go in this Bull cycle. August and September brought a healthy re-set. Throughout this recovery rally, investors crowded into Tech. Everyone owns Tech. It's the fastest grower. It's where innovation lives. It got very expensive. Banks and Energy are not crowded, far from it. They're not expensive either. We see more opportunity there for year-end.

There's basically been a rolling correction from sector to sector beneath the surface. It's occurred throughout 2021. It's not over yet. We believe weakness is buyable. There has been significant improvement in the Economy and in Corporate America. That's what the Market cares most about. Wall Street is the only Market that panics buyers when things go on sale. Escalator up, elevator down; That's the Market way. We cannot lose sight of where we came from. Life is all about challenges. That's where opportunity lives. The response is what determines success and failure. What an eventful 18 months it's been.



The background of the page features a light blue graphic of a line and bar chart. The line chart has several data points connected by thin lines, and the bar chart consists of vertical bars of varying heights. The overall aesthetic is clean and professional, with a focus on data visualization.

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