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Congress Wealth Management

Quarterly Market Update / Q3 2021

VISION
WEALTH PLANNING, LLC

We at Congress Wealth believe markets and asset prices are driven and ultimately determined by economic cycles. As a team, we spend a lot of time thinking, analyzing, and communicating our thoughts on where we believe we are in the economic cycle. In our minds, it's what matters the most.

Credit conditions – the cost and availability of credit – is THE key driver of any economic cycle. When favorable credit conditions exist, investment can be made in labor and materials and technology to produce the goods and services we all consume. That economic activity translates into corporate earnings and corporate earnings ultimately drive the direction of the stock market, not every day but over time. Economic cycles begin with the adoption of very accommodative monetary policies and end when those policies are reversed. To put it in current context, the current economic cycle began in the spring of 2020 when the Fed flooded the financial system with low interest rates and record amounts of liquidity to respond to the global pandemic. The current cycle will end when the Fed substantially raises short interest rates, inverts the yield curve and credit conditions evaporate. We believe that happening is likely years away. Credit is the fuel that drives economic cycles - always has been and always will be. The current economic cycle will be no different.

Over the past five years, our firm has written often, preached loudly, and practiced daily the principles of cycle investing. Risk assets have done well over that period because corporate earnings grew, market multiples expanded and credit conditions were very, very accommodative. In the five-year period ended September 30, 2021, the cumulative total return of the S&P500 is approximately +118%. Over the similar period, the technology-heavy Nasdaq index achieved a +186% cumulative total return. The popular FAANG stocks have most certainly had their moment in the sun. Over this timeframe, international markets (both developed and emerging markets) achieved a cumulative total return of approximately +57%. Fixed income markets substantially lagged. Bond defaults were virtually non-existent during this period, but very low yields made it very hard for major fixed income markets to do well. In the five-year period ended

September 30, 2021, the oft-quoted Barclays Aggregate Bond Index had a cumulative total return of just +16%. The challenge for fixed income markets remains the same today. Low bond yields mean high bond prices, and the price you pay for an asset very often determines its likelihood of success with regards to total return. Broadly speaking, most fixed income markets remain "price challenged."

While most equity markets have done very well since the spring of 2020, we forget that over the course of the past five years markets have also had plenty of drama and several meaningful drawdowns. Brexit, surprise presidential election results, governmental shutdowns, monetary policy blunders and a once-in-a-century global pandemic are occurred during this great period for risk assets, and all provided momentary periods of above-average volatility. During the past five-years, the equity markets have had nine drawdowns of at least -7% and two much deeper drawdowns of more than -20%. However, sell-offs have been short in duration because corporate earnings grew and liquidity conditions remain buoyant. Very favorable credit conditions may not have had a big impact on fixed income returns, but they most certainly have aided returns in risk asset classes like the stock market, private equity and venture capital, and housing.

We believe the biggest challenge for the next leg of the economic cycle resides in the Fed's management of additional economic growth versus managing growing inflationary pressures. Despite nearly 7 million people in the U.S. still either unemployed or underemployed, job openings currently stand at nearly 10 million. The quicker that mismatch between that data is resolved, the quicker supply chain bottlenecks will be eased and prices of goods will moderate. While the timing of such is unknown, what is known is that the Fed will taper their monthly bond purchases starting later this fall. Fed interest rates hikes appear to be a way off, but the pure act of tapering likely signals the end of the beginning of the current economic cycle. Not the end of the cycle, but the end of the beginning. With nearly 5 trillion more in incremental money supply in the financial system today when compared to 20 months ago, the economic cycle appears ready to march onward.

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