MEEDER
INVESTMENT MANAGEMENT

**Q3 2021** CAPITAL MARKETS UPDATE

# President's Perspective

# CAPITAL MARKETS UPDATE AS OF SEPTEMBER 30, 2021

» 3rd Quarter Brings Volatility

» Labor Shortages Weigh on U.S. Economy

» China's Property Market Shakes Emerging Markets

## U.S. EQUITY MARKETS

Gains in the 3rd quarter were a little harder to come by than in previous quarters, with the S&P 400 Mid-Cap Index (MID) and the Russell 2000 Small-Cap Index (RUT) posting losses of -1.8% and -4.4% respectively. The S&P 500 fared slightly better, posting a gain of +0.6% for the quarter. Equity market volatility also picked up toward the end of September, coinciding with a significant jump in the U.S. 10-year Treasury yield.

Despite the discrepancy in returns throughout the U.S. equity market, the long-term trend remains in place for now. Through the end of August, the S&P 500 Index achieved its 6th best start to a calendar year since 1950. In fact, the current bull market is off to its fastest start since World War II, doubling in August in only 354 trading days.

Despite the strong trend, we have observed poor market breadth and below-average volume. As a reminder, market breadth is simply a running tally of how many individual stocks are participating in an uptrend. The percentage of S&P 500 stocks that are above their 200-day moving average stands at less than 60%, indicating there are still many equities not participating in this trend higher.

## U.S. ECONOMY

Consumers are continuing to react to concerns about the rise in COVID-19 cases during the summer months. For example, the University of Michigan Consumer Sentiment survey recently reached 70, its lowest level since 2011. Alternative data is showing the same thing, as the number of restaurant diners, airline travelers, and hotel revenue per room all slowed during the months of August and September.

The U.S. labor market showed signs of slowing in August as well. The U.S. Bureau of Labor Statistics August employment report revealed that the economy added a disappointing 235,000 jobs during the month, falling well short of Bloomberg-surveyed economist's median forecasted gain of 733,000. This comes after a strong July, during which companies added just over 1 million jobs. Labor force participation in August remained elevated at 61.7%. The total nonfarm payroll remains 5.3 million shy of its February 2020 peak.

The ISM U.S. Manufacturing PMI has averaged 59.9 for the past 12 months and the most recent survey for the month of August came in at 59.9. As a reminder, a figure above 50 is a sign of economic expansion. While the economy continues to expand, U.S. manufacturers are struggling to keep products flowing, dealing with a combination of shortages in raw materials and intermediate components together with a lack of labor supply.

## THE FED'S VIEW

Fed Chairman Jerome Powell spoke at the annual Jackson Hole Economic Symposium, and investors largely walked away feeling a little bit less nervous about tapering and rising rates. While Powell remained unclear about just when the 2021 tapering process would begin, he did send a message of caution around less-than-stellar employment levels and stuck to the central bank's message that the current bout of inflation is due in part to supply-chain disruptions and will likely be transitory.

At the Fed's September meeting, he sounded a bit more hawkish than he did in previous meetings, clarifying that the employment picture is improving. The Fed is currently purchasing $120 billion a month of Treasury and Agency mortgage-backed securities (MBS). Since early 2020, these purchases have grown the balance sheet by more than 80%. The Fed is likely to start to taper its bond purchases either in late 2021 or early 2022 with most expecting rate hikes to be delayed until 2023. It is important to note that at the Fed's September meeting, the Fed Dot Plot now indicates that 50% of members anticipate a rate hike as early as 2022.

## CHINA'S PROPERTY MARKET SHAKES EMERGING MARKETS

While Developed International equities, as represented by the MSCI EAFE Index, lost -0.34% during the 3rd quarter, it was especially tough for investors in Emerging Markets equities, as the MSCI Emerging Markets Index posted losses of more than -8%. Concerns over a possible default by property developer China Evergrande sent emerging markets bonds and stocks lower during the quarter.

China Evergrande Group, one of the largest real estate developers in the country, missed paying its full bond interest in September, its second unpaid offshore debt obligation in a week. The company is under a debt pile of $305 billion and its liabilities account for 2% of China's GDP. Although there have been fears of a contagion effect, the Chinese central bank eased some worries after vowing to protect homebuyers' interests. It is also important to note that Evergrande's bonds are not as widely held as many of the large U.S. bank securities that sparked a financial contagion during the Great Financial Crisis.

## HOW IS THIS IMPACTING PORTFOLIOS?

At Meeder, we manage investment solutions across different risk profiles and time horizons. Meeder manages these strategies using a systematic approach that guides us in the allocation of our portfolios. Many of these solutions employ one or more of our core investment strategies: Growth, Defensive Equity and Fixed Income.

### GROWTH

Investment portfolios comprised of the Growth Strategy maintain a more aggressive objective and typically remain invested in the stock market. In the third quarter, gains were a little more difficult to come by than in previous quarters. While the S&P 500 was slightly positive for the quarter, U.S. Mid-Cap and U.S. Small-cap Equities, together with both Developed International and Emerging Markets equities, all generated negative returns.

While inflation remained well above its long-term average, the August report for Consumer Price Index (CPI) did come in slightly below the previous month, something we haven't seen since inflation really ramped up in November 2020. Fed Chairman Powell remained in the spotlight, as he seeks reappointment early next year by President Biden, and all eyes remain on both the pace of Fed purchases and interest rates. Most expect tapering to begin later this year and the next rate hike to occur in late 2022 or 2023.

### DEFENSIVE EQUITY

Portfolios that utilize the Defensive Equity Strategy follow a rules-based and data-driven approach using the Meeder Investment Positioning System (IPS) model. This model is used to determine the risk relative to reward in the marketplace and identifies when we should be increasing or decreasing the portfolio's target equity exposure.

Our Defensive Equity strategy began the third quarter with a 100% equity allocation and 0% cash and primarily decreased equity exposure throughout the quarter. By the end of August, the equity allocation stood at 85%, and reached a 75% equity allocation at the quarter end.

We utilize a quantitative model that compares the REWARD to the RISK of the stock market to determine our equity allocation. Our RISK measure started the quarter below its long-term average but increased in September to a figure just above its long-term average. September also marked the first 5% drawdown in 2021, something that usually occurs multiple times per year historically. In addition to above-average RISK, the REWARD of our model displayed several areas of concern. While the REWARD component demonstrated that trends and momentum remain largely positive, market breadth continued to weaken through much of the third quarter. This was a worrisome trend that started in June and has persisted during multiple months. In addition to this short-term concern, areas of our model that continue to remain cautious include above-average valuations and inflation, slowing economic data, and increased expectations of higher interest rates. Overall, investor sentiment remains mixed, with most newsletters displaying relatively high pessimism, while option activity remains relatively optimistic.

### FIXED INCOME

The Meeder Fixed Income Strategy tactically shifts portfolio exposure utilizing our proprietary investment models. These models are designed to actively monitor factors to guide us in determining the credit quality, emerging market debt exposure, and the portfolio's U.S. Treasury duration.

Quantitative fixed income models that guide our tactical portfolio decisions led us to reduce credit and duration risk in Meeder Fixed Income portfolios during the third quarter. Momentum and volatility factors in our Credit Quality model weakened in mid-July, leading us to decrease high-yield positions in our portfolios. Additional weakness in the momentum factors in late-September, guided us to further reduce our portfolios' exposure to high-yield bonds. Momentum, volatility, and macroeconomic factors in our Emerging Market model also indicated weakness in late September, leading us to exit all emerging market bond positions in our fixed income portfolios. High-yield corporate bonds and investment-grade bonds were positive contributors to performance in our fixed income portfolios during the quarter, while emerging market bonds and U.S. Treasury positions detracted from overall performance. Meeder Fixed Income portfolios' duration was reduced during the third quarter, remaining well below the broad bond market benchmark, the Bloomberg U.S. Aggregate Bond Index.

## GUIDING PRINCIPLES

Throughout the years, we have sought to improve our investment strategies, evolve our offerings, and always maintain a focus on serving both advisors and clients. I'd like to discuss some of the guiding principles that have allowed us to successfully navigate through both bull and bear markets for more than three decades.

We believe our longevity is sustained due to our guiding principles. From the very beginning, the purpose of our Defensive Equity strategy was to provide downside protection using a holistic approach that includes a combination of investment disciplines. Throughout the years, we maintained a systematic focus on reducing volatility while providing growth, which we believe helps investors stay committed to their long-term objectives. We also apply this systematic approach to managing our Growth and Fixed Income portfolios. We believe this focus allows us to capitalize on the highest probability outcomes, rather than getting caught up in the cycle of infinite possibilities.

These principles are more important than ever. While we are proud of our accomplishments in the past, we remain focused on providing even better outcomes for investors in the future. We are honored to have the opportunity to assist our clients in achieving their goals and look forward to working alongside our clients each and every day. Please contact one of our Investment Professionals at Meeder to further discuss how we can assist you in achieving your investment objectives.

Sincerely,

**ROBERT S. MEEDER**
PRESIDENT AND CEO

MEEDER INVESTMENT MANAGEMENT

6125 Memorial Drive, Dublin, OH 43017 | 1.866.633.3371 | meederinvestment.com



0107-MIM-WM-10/13/2021-13988