NEW REPUBLIC PARTNERS

# MARKET COMMENTARY

3Q 2021

NEW REPUBLIC PARTNERS

# Market Commentary

| Market Monitor 2021 | Q3% | YTD% |
|---|---|---|
| MSCI ACWI Index | -1.2% | 11.5% |
| S&P 500 Total Return Index | 0.1% | 15.9% |
| Bloomberg Barclays Agg. Bond Index | 0.10% | -1.6% |

Performance is not correlated to portfolio holding period.

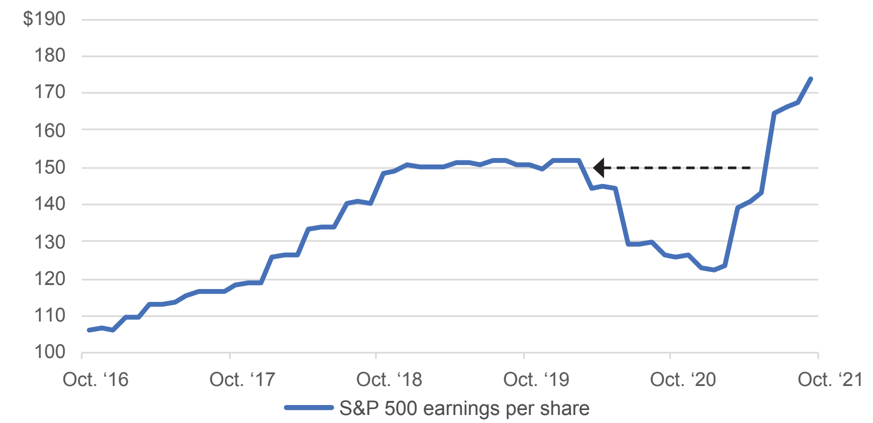
## A Recovery Interrupted in Q3

Global equity markets treaded water over the third quarter, rising in July and August, only to give it all back—and more—in September

- Markets continued to wrestle with inflation fears combined with new worries around growth, as another wave of Covid cases, led by the Delta variant, dented recovery expectations.
- At the same time, corporate earnings and consumer savings in the U.S. remained at historic levels, both positive factors for the markets.
- While U.S. equity markets were little changed for the quarter, the biggest hiccup to the re-opening/recovery story occurred in Emerging Markets as the EM index fell 8%, led by China.

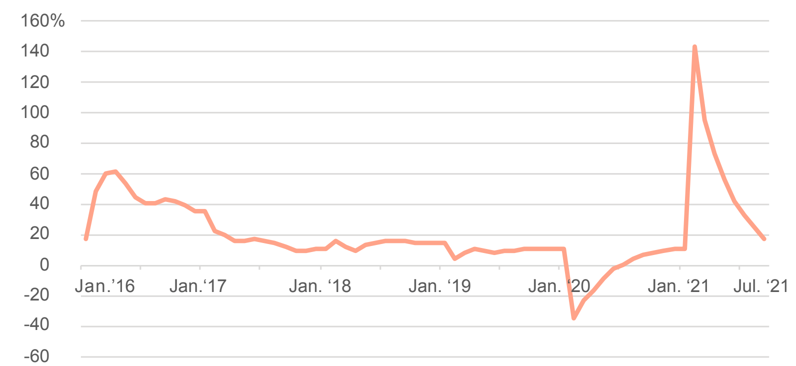
With its strong government hand, China reminded investors of the policy-driven market it has always been. In a short timeframe, the government clamped down on its home-grown technology companies, gutted the for-profit education sector, and reigned in property companies. Without a doubt, the depth and breadth of the government's targeting are greater than in years past.

CORPORATE EARNINGS ABOVE PRE-COVID LEVELS




Data Source: Bloomberg. All data as of 9/30/2021.

CHINA RESIDENTIAL PROPERTY SALES (SQ. M YOY%)




Data Source: Bloomberg.

# Market Commentary

## China's "Common Prosperity"

China's self-inflicted pain is meant to support the government's "Common Prosperity" campaign geared towards addressing inequalities in the economy while raising the popularity of the current government leadership. The timing is notable as China's President Xi Jinping is making a bid for a 3rd term in October 2022. There appears to be a limit on how much pain is palatable though, as tightening the screws, particularly on property development, can inhibit growth and run contrary to the "Common Prosperity" campaign.

We would not go as far as some investors have to call China "un-investable" based on the swift changes that have occurred. As the 2nd largest economy and driver of nearly 1/3 of global economic growth, avoiding China would be a mistake of omission. However, these events do underscore the need for experience and the ability to partner with the best active managers when investing in China.

Some smart investors are leaning into the sell-off in Chinese equities as China's policy-driven nature is not new to them. They observe opportunities in sectors that are aligned with China's aspirational middle class and in companies that stand to benefit from the recovery trade as fiscal and monetary relief pours in next year. As China's own Vice Premier Liu He pointed out recently, the importance of the private sector to China cannot be overstated as it comprises 50% of tax revenues, 60% of GDP, 70% of innovation, 80% of employment, and 90% of all registered companies for the country. For the near term, we are approaching China with caution; however, our long-term outlook for China remains intact, as we continue to allocate capital to managers who have demonstrated the ability to generate returns in different Chinese political and regulatory environments.

## U.S. GDP, Capital Markets and Peak Worries

As the U.S. economy transitions from "peak" to mid-cycle, worries around "peak" abound, whether related to GDP growth, earnings growth, or fiscal and/or monetary stimulus. While earnings and GDP growth have decelerated, both are still elevated relative to history. GDP growth is set to slow from 6% in 2021 for the U.S. to 3-4% in 2022 by some estimates, which is still robust and favorable to equities, as the S&P has rallied 12% on average when GDP is between 2-4%. At the same time, fiscal and monetary policies remain supportive of capital markets in our view, as the rate-hike cycle has been pushed out to sometime in 2022.

*"While earnings and GDP growth have decelerated, ... [they are] still robust and favorable to equities ..."*

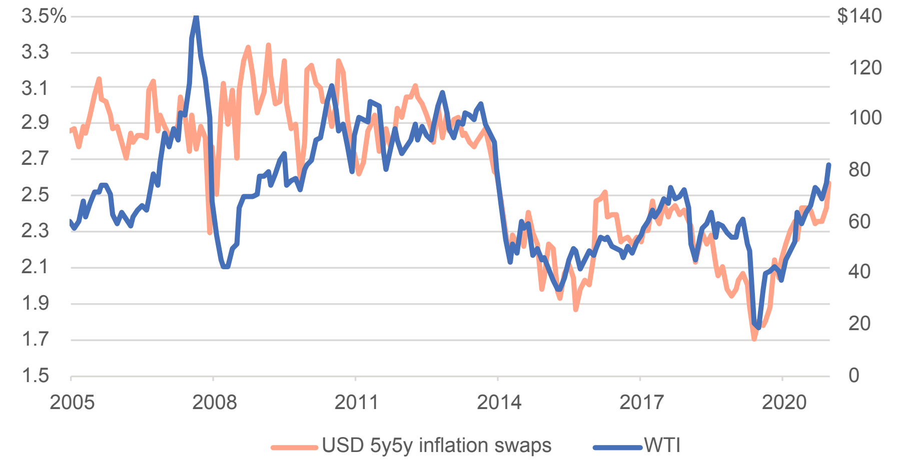
NEW REPUBLIC PARTNERS

# Market Commentary

## Inflation Expections on the Rise

Despite this sanguine market view, there are still risks that warrant mitigation through a diversified investment portfolio. The supply chain issues that we noted in 2Q persisted through the 3rd quarter as tension between strong demand and challenged supply chains led to rising prices. U.S. ports stand as a prime example of this tension, with operating capacity at 60% due to labor shortages and shipping costs up threefold vs. 2019 levels. Commodity prices have followed suit with Brent crude and natural gas trading at 7-year highs. Higher levels of inflation are not to be dismissed, but the key ingredient for inflation is wage growth, which has not yet risen to levels required for sustained inflation. It is on the rise though and justifies close monitoring.

OIL PRICES DRIVING INFLATION EXPECTATIONS UPWARD

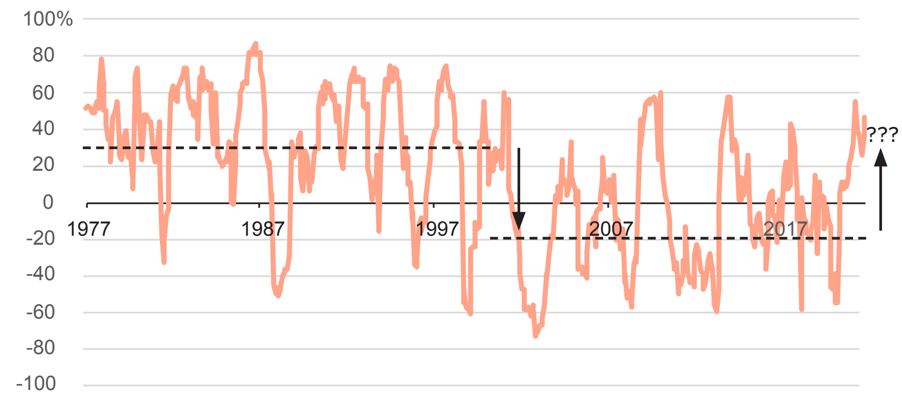



Data Source: Bloomberg.

## Risk Management Through Asset Class Diversification

It is incumbent upon asset allocators to find sources of portfolio risk mitigation that protect against or benefit from scenarios of a spike in interest rates, stagflation (i.e. high inflation and low growth), and/or raised inflation expectations. Such a portfolio will not hit on every cylinder in a given quarter or given year, but that is by design, driving strong risk-adjusted returns over time. Equities and fixed income are bound to correlate in environments like this, and investors need alternatives to a traditional 60/40 portfolio to succeed.

EQUITY-BOND CORRELATION (ROLLING 1-YR RETURNS)




Data Source: Bloomberg.

NEW REPUBLIC PARTNERS

# Market Commentary

## Risk Management Through Asset Class Diversification continued

An allocation to real assets provides such an alternative for portfolios in this type of market. With listed REITs, MLPs, and commodities up 22%, 39%, and 38% respectively, real asset portfolios are having a banner year alongside ramping inflation worries. Over the past five years, however, those same real assets were relative laggards, having returned an annualized 8%, -2%, and 9% respectively, while global equities returned 14% per annum. Simply put, it takes fortitude to hold a balanced portfolio in the face of runaway equity markets. In addition, an allocation to absolute return strategies can serve as a ballast for portfolios and help replace what is now overpriced, core fixed income.

Absolute return strategies focus on distinct opportunities across equity- and non-equity-based asset classes. Collectively, they have low correlation to traditional markets and play an important stabilizing role in client portfolios over time.

In the end, asset class diversification insulates a portfolio from severe outcomes. A diversified investor will not look like a hero in a given year, but over the long run, consistent compounding of capital adds up.

## Disclosure



Investment Committee

**Thomas K. Hoops, CFA** **Samuel B. Bowles** **Michael P. Phipps, CAIA** **J. Keith Benedict**

NEW REPUBLIC PARTNERS

704.626.1526

NEWREPUBLICPARTNERS.COM