

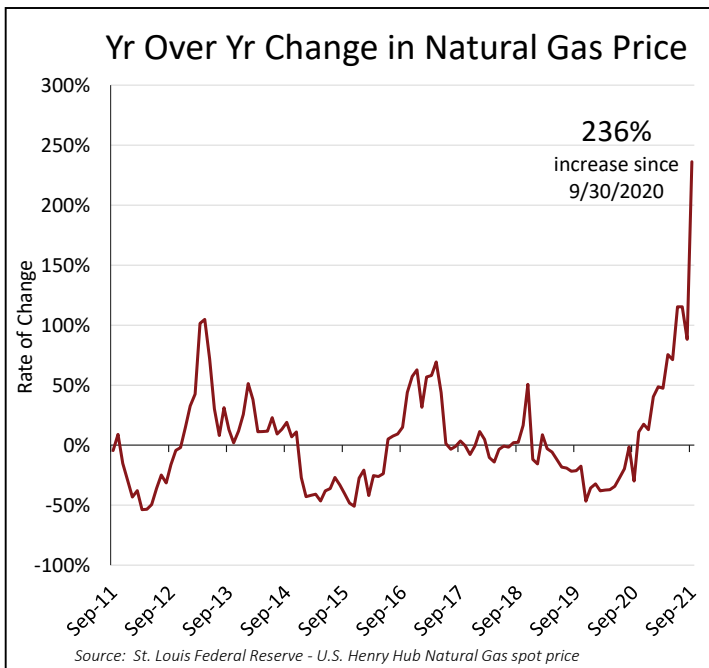
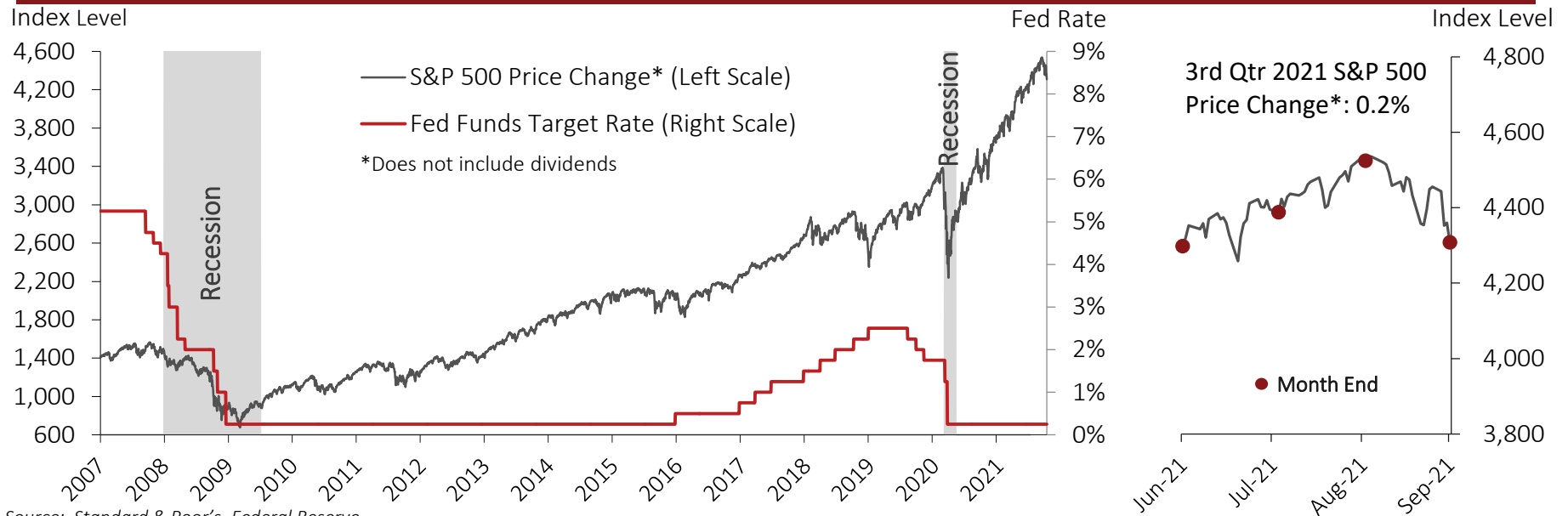
# Capital Market Review

September 30, 2021

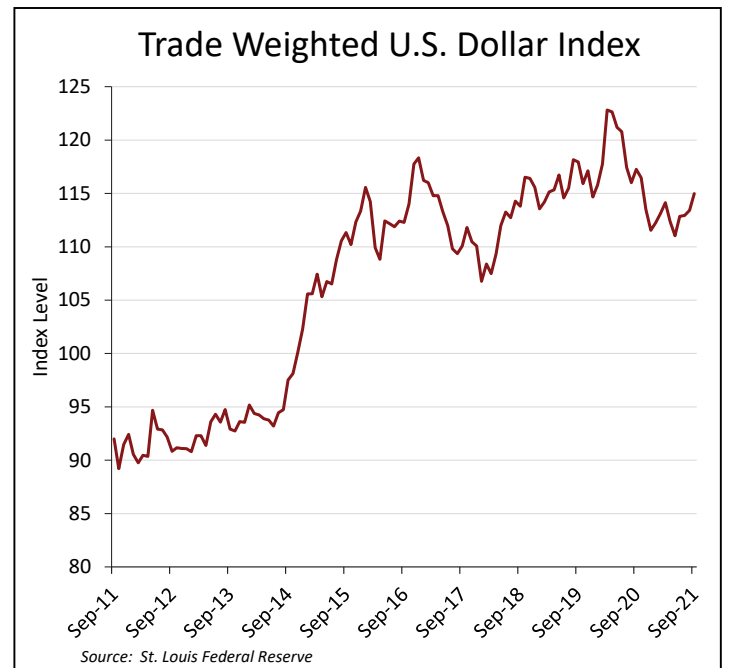


De**M**arche

# Sixth Straight Qtr Rise Despite Sept Slump



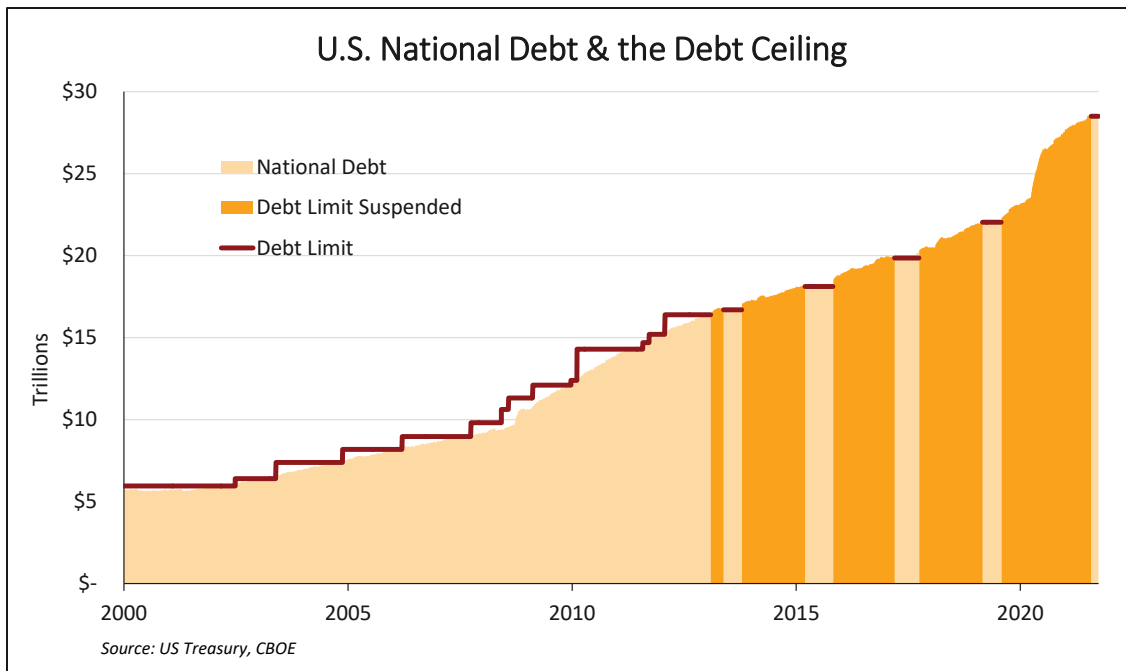
The S&P 500 continued its march forward, despite a September slump that took away about 4% of return. The dollar strengthened in the quarter and interest rates slightly increased. The dollar move was due to a shift in expectations that the Fed will act earlier and more aggressively to reduce stimulus and curb inflation. A strengthening Dollar not only provides a headwind to international equity returns, but also global bond returns. Inflation is being impacted by energy prices, specifically natural gas. The price of natural gas has increased rapidly to its highest level in a decade after reaching its lowest point over the last 10 years in early 2020.



INDEX	3 <sup>rd</sup> Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
MSCI World	0.0	13.0	28.8	13.1	13.7	12.7
DeMarche 3000	-0.8	13.9	30.4	13.7	14.6	13.9
Russell 3000	-0.1	15.0	31.9	16.0	16.9	16.6
S&P 500	0.6	15.9	30.0	16.0	16.9	16.6
MSCI EAFE USD	-0.4	8.3	25.7	7.6	8.8	8.1
Bloomberg Aggregate	0.1	-1.6	-0.9	5.4	2.9	3.0
FTSE Non-US Gov't Bond	-2.0	-7.9	-3.4	2.9	0.8	0.5
Bloomberg Global Aggregate	-0.9	-4.1	-0.9	4.2	2.0	1.9
NCREIF (Private RE)	5.2	10.9	12.2	6.7	6.8	9.0
Bloomberg Commodity	6.6	29.1	42.3	6.9	4.5	-2.7

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized. \*Does not include Canada or Brazil.

Indicator Year Ending 9/30	2021	2020	2019	2018	50-YEAR Average
GDP Annual Growth Rate	4.9	-2.9	2.3	3.1	2.7
Unemployment	4.8	7.8	3.5	3.7	6.3
Inflation (CPI)	5.4	1.4	1.7	2.3	3.9
10-Year Interest Rates	1.5	0.7	1.7	3.1	6.1



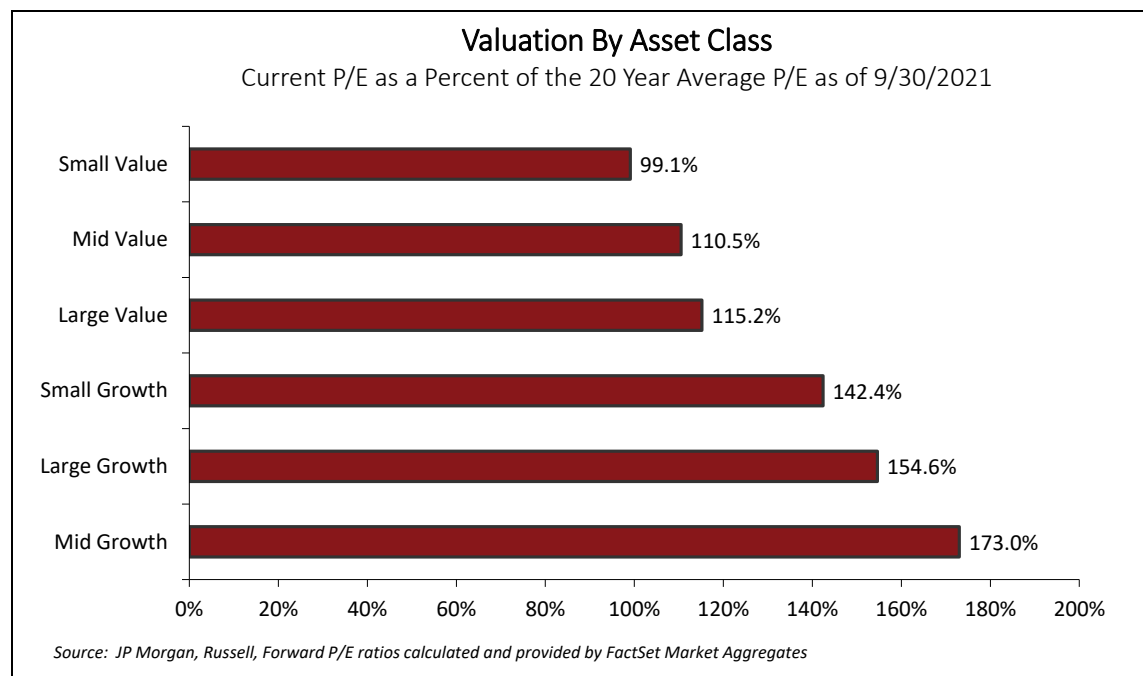
- Global stock markets took a breather this quarter from the rebound that started last spring. Markets started the quarter strong, with the S&P 500 reaching all time highs in early September, but pulled back during the latter half of the month in response to slowing economic data, such as job creation and inflation.
- Bonds posted de minimis gains in the quarter and longer term returns reflect low interest rates. The Bloomberg Aggregate does show a 3-year return of over 5 percentage points, primarily due to the decline in interest rates that took place in early 2020 in the wake of the pandemic.
- The uptick in inflation was led by energy prices, specifically natural gas, which was reflected in commodity prices during the quarter. Oil prices actually fell in the first half of the quarter before rebounding strongly in September. Other commodity sectors - agricultural goods, livestock, industrial metals – slowed price increases in the quarter but still reflect strong price increases year to date.
- We hear a lot of commentary about the debt ceiling in the press. The chart at the left shows the history of the debt ceiling over the last 20 years. Since 2000, Congress has increased or suspended the debt ceiling 14 times to make sure the U.S. could continue paying its obligations. As September ended, Congress was unable to reach an agreement regarding raising the debt ceiling.

### DeFact

The Federal Reserve began talking about “tapering” asset purchases this quarter and to start the process in the fourth quarter. The Fed has been buying Treasuries and Agency mortgages to the tune of \$120 billion a month. The Fed’s balance sheet has grown from \$4 trillion to \$8.5 trillion during the pandemic. The tapering of asset purchases means that the Fed will buy less each month; now estimated at \$15 billion less each month. This action could cause longer term interest rates to rise thereby increasing borrowing costs for businesses and individuals alike. ~CNBC

INDEX	3 <sup>rd</sup> Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
DeMarche Growth	-0.5	12.5	27.0	17.7	18.7	16.5
DeMarche Value	-1.5	16.8	39.1	6.2	7.8	9.8
DeMarche Aggressive	-5.7	9.0	48.9	19.3	17.2	15.3
DeMarche Defensive	-0.3	14.4	29.0	13.4	14.4	13.7
S&P 500	0.6	15.9	30.0	16.0	16.9	16.6
S&P Mid-Cap 400	-1.8	15.5	43.7	11.1	13.0	14.7
S&P Small-Cap 600	-2.8	20.1	57.6	9.4	13.6	15.7
Russell 1000	0.2	15.2	31.0	16.4	17.1	16.8
Russell 1000 Growth	1.2	14.3	27.3	22.0	22.8	19.7
Russell 1000 Value	-0.8	16.1	35.0	10.1	10.9	13.5
Russell 2000	-4.4	12.4	47.7	10.5	13.5	14.6
Russell 2000 Growth	-5.7	2.8	33.3	11.7	15.3	15.7
Russell 2000 Value	-3.0	22.9	63.9	8.6	11.0	13.2

Notes: Data are presented as percent returns. All 3-, 5- and 10-year returns are annualized.



- Large cap stocks performed better than small cap stocks in the quarter, most likely due to investor risk aversion in the quarter. Earnings have been strong this year and small caps have responded in the first half of the year, and outperformed large cap. However, this quarter small cap fell behind when markets consolidated gains as investors assessed forward earnings expectations.
- Large cap growth was the only U.S. equity style to post positive returns in the quarter. Information Tech – the largest sector – gained 1.8% in the quarter. Apple and Microsoft contributed 76 basis points of that performance. Conversely, small growth stocks declined the most in the quarter as small cap health care – its largest sector – fell over 11%.
- Large cap and small cap financials are the largest weights in their respective value indexes and were the primary positive contributor to performance. Higher interest rates tend to help out financial stocks. Small cap value health care (like small growth) was punished in the quarter and were the primary driver of negative performance.
- The chart to the left shows current P/E ratios compared to the 20-year average P/E ratio for large, mid and small growth and value. Small cap value is relatively inexpensive compared to other equity styles and to its history. Growth stocks seem to be expensive. These data remind us that rebalancing and being diversified can improve return metrics as small value has been the best performer over the past 12 months.

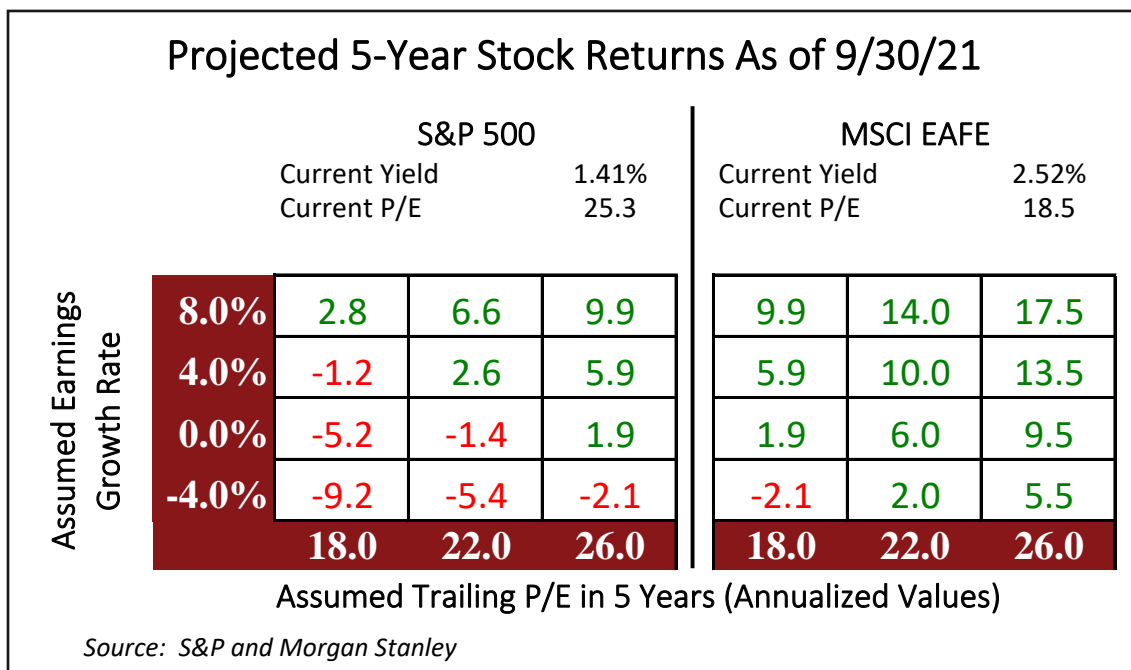
### DeFact

The Russell 1000 Growth index is dominated by very large market cap stocks – Apple, Microsoft, Amazon, Facebook and Alphabet. These five companies make up about 38% of the market cap of the S&P 500, which is comprised of 500 companies. In September the index fell 5.6 percentage points with the top 5 contributing about 48% of that decline. In other words, 38% percent of the market cap of the index was the cause of almost half of the decline in the index. ~DeMarche.

INDEX	3 <sup>rd</sup> Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
MSCI EAFE Local	1.3	14.2	27.2	7.2	9.0	10.1
MSCI EAFE USD	-0.4	8.3	25.7	7.6	8.8	8.1
Growth	0.1	6.9	20.9	11.9	11.4	10.1
Value	-1.0	9.6	30.7	3.0	6.0	6.0
MSCI Japan	4.6	5.9	22.1	7.5	9.4	8.4
MSCI AC Asia-ex Japan	-9.3	-3.5	14.4	9.2	10.1	8.5
MSCI China	-18.2	-16.7	-7.3	5.9	9.1	8.7
MSCI Germany	-4.3	4.5	16.5	6.0	7.3	8.5
MSCI France	-2.0	11.6	34.3	7.4	11.0	9.3
MSCI UK	-0.3	12.2	31.2	2.4	4.8	5.4
MSCI EAFE Small Cap	0.9	10.0	29.0	9.0	10.4	10.7
MSCI EM	-8.1	-1.2	18.2	8.6	9.2	6.1
MSCI All Country-ex US	-3.0	5.9	23.9	8.0	8.9	7.5

Notes: Data are presented as percent returns. All 3-, 5- and 10-year returns are annualized.

- International stock returns regressed slightly in the quarter. The MSCI EAFE reflected in dollar terms was negative but in local terms it was positive. The local return was higher than the S&P 500 but when it translates back into dollars, it became negative. The dollar slightly strengthened in the quarter providing a headwind to returns.
- Emerging markets suffered the most in the quarter and was pulled down by the Chinese stock market. The Chinese Communist Party (CCP) had a regulatory crackdown on technology and digital companies, then came the Evergrande real estate debt debacle. Chinese stocks fell 18.2% in the quarter. Year-to-date, Tencent and Alibaba are down over 17% and 36%, respectively.
- International small cap stocks performed well in the quarter and in the one year, outperforming its large cap developed international cousins in all time periods. Since 1<sup>st</sup> quarter 2020, small caps have strung together outperformance for five of the last six quarters.
- To the left is a chart we have used in the past – the Bogle chart. The chart projects a return per a given earnings growth rate and P/E ratio. The MSCI EAFE index looks inexpensive compared to S&P 500. The domestic market has been performing well and now looks fully valued. Allocations to international could provide diversification and the opportunity of outperformance over the next five years.



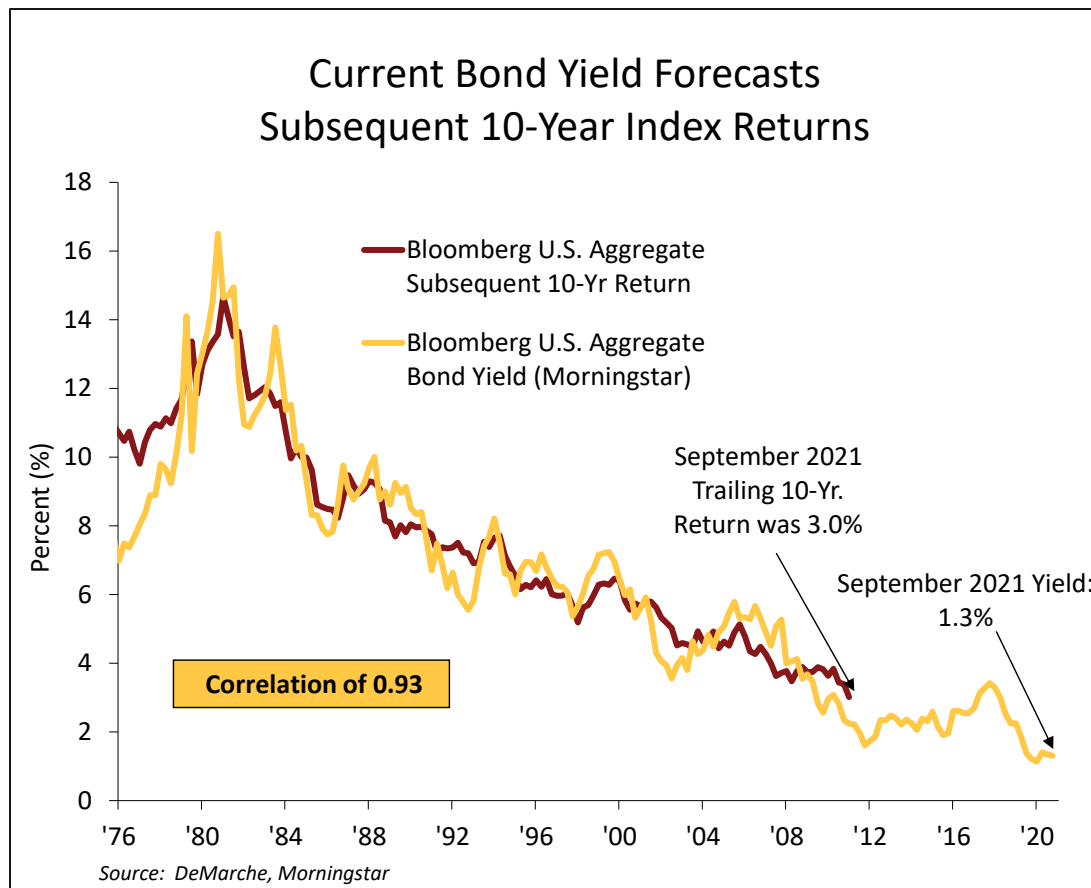
## DeFact

The Tokyo stock market (Nikkei) set a new high on September 14<sup>th</sup>, at 30,670.10, its highest close since August 1, 1990. It proceeded to fall back and not regain a new high for the rest of the month. It closed September at 29,452.66. The Tokyo market got a boost when the Japanese government said that more than half of the country's population has been fully vaccinated. ~Kyodo News

INDEX	3 <sup>rd</sup> Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
Bloomberg 1-3 Gov Credit	0.1	0.1	0.3	2.9	1.9	1.5
Bloomberg Aggregate	0.1	-1.6	-0.9	5.4	2.9	3.0
Bloomberg Gov Credit Long	0.1	-4.6	-3.0	10.1	5.2	5.8
Bloomberg US TIPS	1.8	3.5	5.2	7.4	4.3	3.1
ICE BofA Merrill Lynch High Yield	0.9	4.6	11.3	6.6	6.3	7.3
CSFB Leveraged Loan (bank loans)	1.1	4.7	8.5	4.1	4.6	5.0
Bloomberg Global Aggregate	-0.9	-4.1	-0.9	4.2	2.0	1.9
JPM EmgMkt Bd Gbl Dvrsfd (hard)	-0.7	-1.4	4.4	5.7	3.9	5.8

Notes: Data are presented as percent returns. All 3-, 5- and 10-year returns are annualized.

- Interest rates, as measured by the 10-year Treasury, increased slightly in the quarter. An increase in interest rates has a negative impact to the total return of bonds. Investment grade bonds, as measured by the Bloomberg Aggregate eked out a small gain for the quarter of 5 basis points. You can see that coupon return just barely offset the negative price return.
- High yield bonds posted a 93 basis point gain in the quarter. While equities struggled in September, high yield bonds spreads to Treasuries remained narrow. Usually, when equities decline, high yield also declines as credit spreads are highly correlated to equities. Since spreads did not widen, it suggests that corporate balance sheets and their future ability to service debt remains stable.
- Treasury Inflation-Protected Securities (TIPS) have performed well, posting a return of 1.8% for the quarter and 5.2% for the year. TIPS adjust their principal twice a year to take into account changes in inflation, so while the yield may be negative, the price gain more than offsets it. For example, 5-year TIPS currently have a negative 1.70% yield, but with the CPI over 5%, the result is a positive return.
- The era of low bond returns looks poised to continue for some time. To the left, we see that the current coupon on bonds is a strong predictor of subsequent 10 year returns. This suggests that the next 10-year return on investment grade bonds is likely to be around 1.4%.



## DeFact

Forty years ago, on September 30, 1981, the bond market peaked; ushering in a multi-decade bull market in bonds. Mortgage-backed bonds with 20-year maturities were trading at 18.75%. Alaska Housing Finance, the issuer, struggled to sell the full allotment of bonds. In fact, only half the issue sold. Another example, on September 20, 1981, the U.S. Treasury issued 20 year bonds at a peak rate of 15.8%, a full 2 percentage points higher than a similar issue traded at auction two months earlier. ~WSJ

INDEX	3 <sup>rd</sup> Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
NCREIF Property (Private RE)	5.2	10.9	12.2	6.7	6.8	9.0
Apartment	6.5	12.3	13.4	6.9	6.7	8.6
Industrial	10.9	26.5	32.4	18.3	16.4	14.5
Office	1.9	4.4	4.9	4.7	5.3	7.7
Retail	1.6	2.0	0.7	-1.4	1.1	6.8
NCREIF Timberland	1.9	4.4	5.0	2.4	2.9	4.9
NCREIF Farmland	1.5	3.9	5.5	4.9	5.5	10.2
NAREIT (Public RE)*	0.2	21.4	32.5	11.2	8.3	11.9
Bloomberg Commodity	6.6	29.1	42.3	6.9	4.5	-2.7
HFR FOF Composite	0.8	5.8	14.4	6.5	5.8	4.5
Conservative	1.2	7.1	13.3	5.5	4.9	4.0
Diversified	0.9	5.5	13.4	6.4	5.7	4.4
Strategic	0.5	6.1	17.5	7.9	6.9	5.2

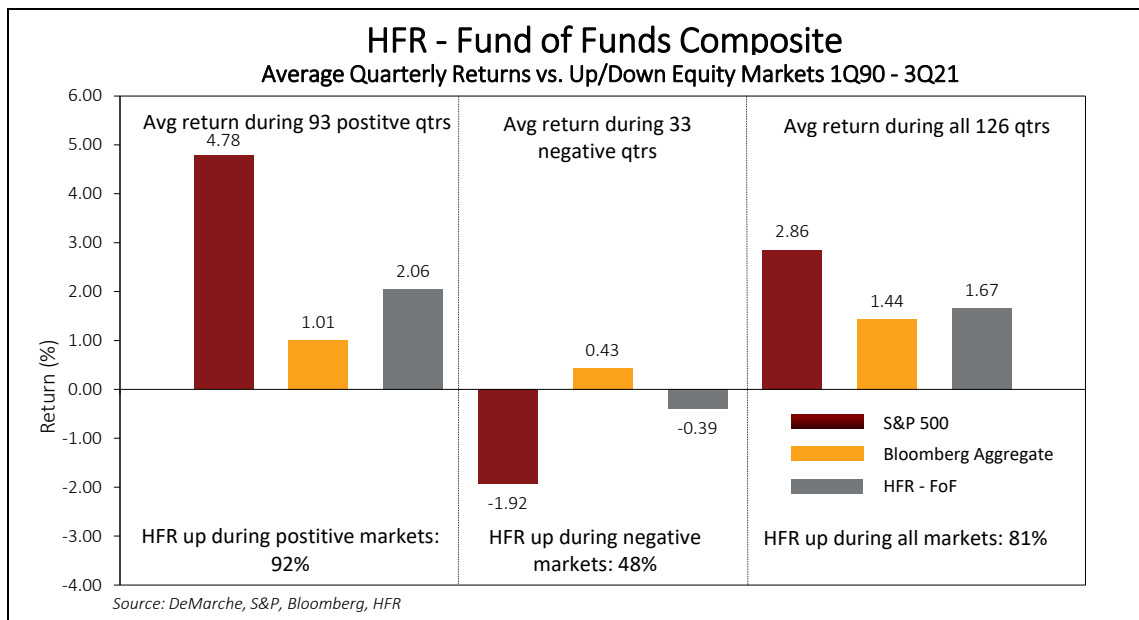
### Private Market Indexes

as of 3/31/2021	1 <sup>st</sup> Qtr	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR
Preqin Private Equity	11.7	11.7	51.1	20.2	18.5	15.0
Preqin Private Debt	4.4	4.4	20.0	6.9	7.8	8.1
Preqin Infrastructure	1.5	1.5	9.9	8.5	8.9	9.6

Notes: Data are presented as percent returns. All 3-, 5- and 10-year returns are annualized.

\*Public RE is not a less liquid strategy. It is listed for comparative purposes.

- REITs generated a modest return for the quarter, just like all other equity sectors. REITs pay out a large majority of their income as dividends to investors. Large dividend payers are usually negatively impacted if rates increase due to the bond like nature of the dividend stream.
- Real estate returns were positive for the quarter, reflecting the rebound from the pandemic. However, we are seeing a bifurcation between winners and losers by sector. Industrial continues its torrid pace and now the apartment sector is posting strong returns compared to office and retail.
- The chart to the left shows the diversifying power of hedge funds to equities. Since 1990, there have been 93 positive equity market quarters and in those quarters, hedge fund returns did lag equities as you would expect. However in 33 quarters of down equity markets, hedge funds have outperformed equity markets and provide diversification. In up markets, hedge funds have outperformed bonds, providing diversification to the classic stock/bond mix.



### DeFact

The Case-Shiller Index, which measures average home prices in major metropolitan areas, rose 18.6 percent in June from a year earlier, compared to a 16.8 percent annual increase in May. It was the highest annual rate of price growth since the index began in 1987. ~WSJ

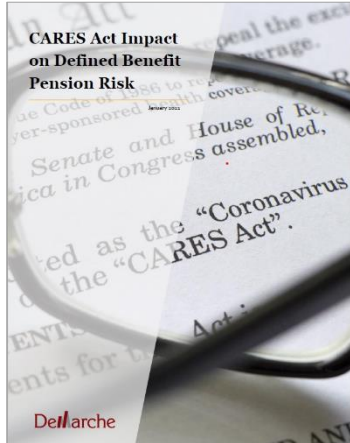


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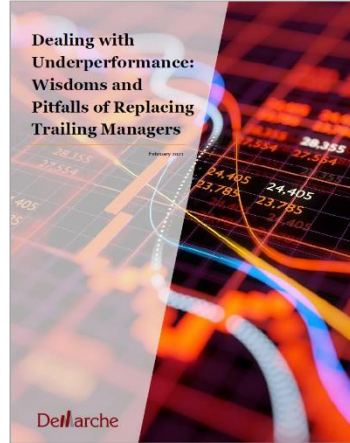
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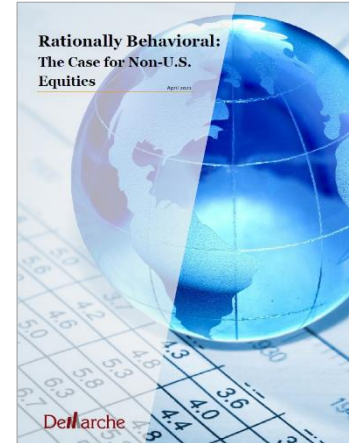
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## March



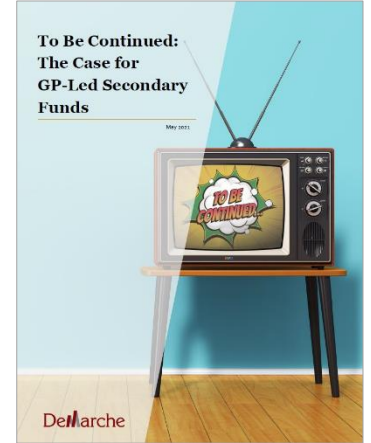
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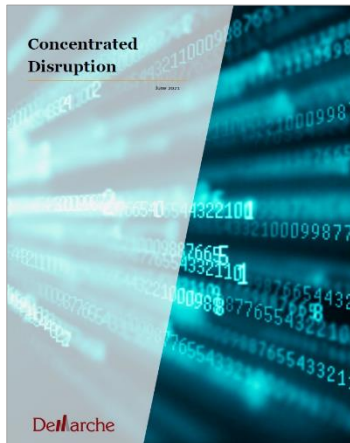
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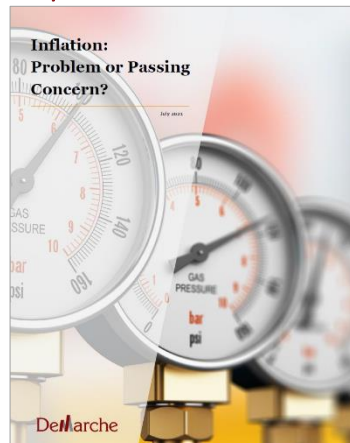
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Don Lennard  
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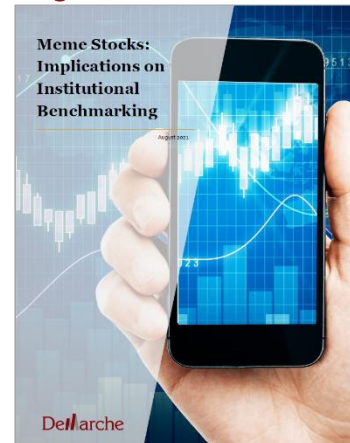
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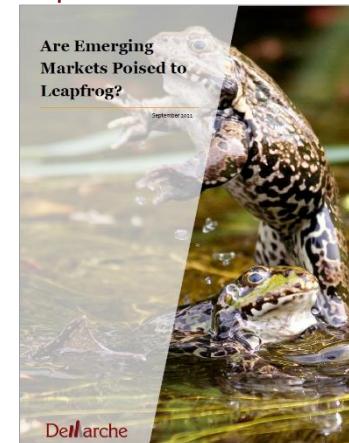
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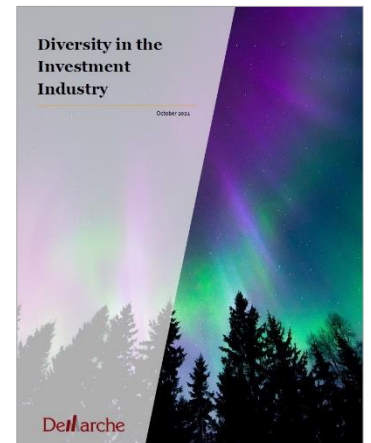
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