



Canandaigua
National
Trust Company

QUARTERLY
PERSPECTIVE
FALL 2021

Economic Recovery, Inflation, and The Fed

After a strong start to 2021, the third quarter was a volatile one for global markets, as the Dow, the Russell 2000 Nasdaq and ACWI (All Country World Index) declined, while the S&P 500 was able to eke out a quarterly gain. As uncertainty regarding the recovery emerged, treasury prices, the dollar, and crude oil prices increased, while gold prices dipped lower. Despite the difficult quarter, the benchmark indices remain well ahead of their 2020 closing values, led by the S&P 500, which ended the quarter up nearly 15.0% year-to-date.

Market Returns	3 rd Quarter 2021	Year to Date
S&P 500 Index	0.58%	15.92%
DJ Industrial Average	-1.46%	12.12%
Russell 1000 Value Index	-0.78%	16.14%
Russell 1000 Growth Index	1.16%	14.30%
Russell 2000 Value Index	-2.98%	22.92%
Russell 2000 Growth Index	-5.65%	2.82%
MSCI EAFE (Net) Index	-0.45%	8.35%
MSCI EMERGING MARKETS (Net) Index	-8.09%	-1.25%
DJ U.S. Select Real Estate Securities Index	1.25%	24.48%
Bloomberg U.S. Aggregate Bond Index	0.05%	-1.55%
Bloomberg Municipal Bond Index	-0.27%	0.79%
Bloomberg U.S. Corporate High Yield Index	0.89%	4.53%

Source: Zephyr/Informa Investment Solutions

July kicked off the third quarter with large caps reclaiming their lead over small caps, as the S&P 500, the Dow, and the Nasdaq advanced, while small caps as defined by the Russell 2000 fell over 3.5%. Despite a surge in COVID cases spurred by the Delta Variant, 80% of S&P 500 companies reported earnings that exceeded expectations and stocks continued to rise early in the quarter, only to be taken lower in September as concerns on inflation, the debt ceiling, and unwinding stimulus by the Fed built a wall of worry for investors.

Globally, emerging markets fell 7.3%, bogged down by China's regulatory crackdown across several industries as well as real estate developer Evergrande's financial distress becoming a daily news item. The path forward remains unclear, with a bull case indicating a halt to regulatory crackdowns and a bear case where China does even more to prevent excesses.

Inflation continued to be a main concern, as dysfunctional supply chains coupled with strong consumer demand pushed Consumer Price Index readings up over 5% year-over-year. Adding to concerns, many businesses have been unable to fill job openings, leaving them short-staffed and struggling to meet demand. This in turn has led to strong wage gains as employers seek to retain current workers. While the Fed continues to maintain its thesis that these issues are temporary, and inflation will eventually dissipate, inflation readings continue to be strong, including in areas like rent, health care, insurance, and wages. These tend to be stickier areas where price gains are less likely to fade.

(continued on page 2)



LAURIE HAELEN, AIF®

Senior Vice President,
Manager of Investment and
Financial Planning Solutions

Leveraging over 25 years
of experience in the Wealth
Management industry, Laurie
oversees the Wealth Solutions
team, which includes Trust,
Investment Management and
Financial Planning. She is
responsible for the creation and
implementation of the solutions
within the team and ensuring
the delivery of the highest
quality of service for our clients.

She may be reached at
(941) 366-7222, ext. 41970 or
LHaelen@CNBank.com.

Productivity gains have offset some of these pressures, and U.S. economic output (GDP) recently surpassed its pre-pandemic levels despite having roughly 4 million fewer workers in the job force. But the question of whether this inflation spike is transitory remains and will factor significantly into how the Fed approaches interest rates going into 2022.

Meanwhile, The Federal Reserve noted that the economic recovery remained on track. Second-quarter gross domestic product advanced at an annualized rate of 6.5%, according to the initial estimate from the Bureau of Economic Analysis. Employment continued to improve during the quarter and Fed chair Jeremy Powell clearly signaled that this strong performance made taper time more imminent.

The Federal Open Market Committee met in September. While noting that the economy has continued to recover, the ongoing spread of the Coronavirus, particularly the Delta Variant, may be slowing the pace of recovery. With the goals of maximum employment and inflation running at 2.0%, the Committee decided to maintain the current target range for the federal funds rate at 0.00%-0.25%. However, the FOMC indicated that it may begin scaling back its purchases of securities as early as this November.

Despite the lackluster quarter for most equities, the bull market run of the past several years—particularly for U.S. stocks—has left investors wondering if equities have become overvalued. In fact, valuations (based on price-to-forward earnings) have actually fallen because earnings revisions have moved higher at a faster pace than prices. This is true in most major markets globally and may help equities continue their upward march at least in the short-term.

On the other side, fixed income is likely to face a difficult road over the next year. The Fed has signaled its intent to begin tapering its bond purchases starting in November, and rates have already begun drifting higher in anticipation. While an actual rate increase from the Fed is unlikely prior to late 2022 or early 2023, bonds prices will continue to face significant headwinds as rates begin to normalize.

Heading into the fourth quarter of 2021, several economic indicators have improved, while a few have waned. While earnings continue to be strong, supply chain issues going into the holiday season remain top of mind. And of course, while latest COVID numbers look promising, there is always the risk of another variant slowing the recovery down again.

However, the consumer is well positioned with strong income growth and historically high savings rates along with relatively low debt service payments, leading to continued strong demand. This should bolster corporate earnings going forward, and while rates may begin to move higher, they will likely remain low by historical standards for an extended period.

As always, we encourage our clients to talk to their advisor if they have any concerns about the current market impeding their ability to meet their goals. Despite the daily noise, a long-term approach to investing continues to be optimal for taking advantage of the opportunities presented by the global markets.



Our professionals are featured on radio talk show, "Ask the Experts", to discuss a variety of financial topics. The show is broadcast on WHAM 1180 in the Western NY region, Saturdays at 8:00 pm. Those who reside outside of the region can listen online at wham1180.com.

Final 2021 Show

November 27

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