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Market Commentary

Wildermuth WEALTH

Market Roars Back Despite Increasing Inflation

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After a rough September which saw the S&P 500 decline more than 5%, essentially all equity markets roared back in October. The S&P 500 climbed over 6% during the month, and all major indices reached new highs, delivering their strongest gains since last November.

The market strength drove valuations back up as well after tumbling in September. While valuations remain a little below levels reached earlier in the year and during the craze of 1999, current PE ratios are over a full standard deviation above the norm, trading at a 27% premium to average share price over the past 25 years.

rather than those only affected by the pandemic, leading even Chairman Powell to express doubts about the Fed's original thoughts.

Industry chiefs around the world have clearly stated that prices are only going higher. Shortages of workers, trucks, cargo ships, fuel, semiconductors, metals, building materials, and much more have companies from your local restaurant to car manufactures scrambling to find supplies which are usually at much higher prices. Nestlé, Danone, and Procter & Gamble all reported in October that consumers should expect to pay more at the grocery store.

As a general rule-of-thumb, price increases above 5% are harder to implement without changing buying patterns, according to supermarket and consumer goods executives. There are certainly caveats, particularly among more premium brands

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Still, the market may remain at these levels for the foreseeable future given strong earnings and a good job market. Jobless claims remain near pandemic lows while earnings have come in strong. Government spending is also pushing demand for seemingly everything and adding to valuation pressure.

The Federal Reserve has hinted at taking away the punch bowl, but for now they continue to feed the party. Fed officials have announced that they will begin winding down their $120 billion-a-month bond-purchase program in November. This is a potential start, but the bigger issue is how soon inflationary pressures will fade. This uncertainty is creating much uneasiness inside and outside the central bank.

Fed Chairman Jerome Powell and senior officials have repeatedly denied concerns this year that a surge in prices during the uneven pandemic recovery would lead to permanently higher inflation. Yet, there are signs that inflation is coming from a broadening set of products and services

and, globally, different countries have different trigger points, but expect the next several months to deliver unwelcome surprises to consumers. Inflation has moved beyond the grocery store. Oil and gas are going up, partly due to policy choices, which impacts residential electric power and chemicals.

In an attempt to alleviate some of the shortages, the Port of Los Angeles, one of the country's busiest ports, will begin operating around the clock. By going to 24/7, the port joins the neighboring Port of Long Beach, which went to 24/7 operations in September. Major ports in Asia and Europe have operated around the clock for years. The expanded port operations nearly doubles the hours that cargo can move, according to the White House.

In addition to goods, average hourly earnings for private sector workers rose 4.6% in September, a bit less that the 5.4% inflation rate. Companies are trying to hold on to employees because so few other workers are available. With prices for goods and materials rising, shortages in many key

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areas, and tight labor markets pushing up wages, it appears that inflation will continue much longer than originally estimated by the Fed.

The Fed's Nov. 2-3 policy meeting is focused on starting to reduce, or taper, asset purchases later in the month. Mr. Powell has already secured broad consensus among his cohorts on a plan to phase down their pandemic-era stimulus program by next June. The timing is important because officials want to complete the taper before they raise rates. This is an accelerated timeline as earlier this year, the Fed gave investors the impression that bond purchases would be reduced around January and the process would take a year to complete.

While the U.S. has been struggling with various shortages and higher costs, the eurozone economy grew briskly this summer, outpacing the larger U.S. and Chinese economies. The loosening social restrictions and diminishing COVID threat allowed the region to reopen more fully resulting in an annualized growth rate of 9.1% for the quarter. This is roughly the same as the previous quarter and significantly faster than the U.S.'s 2% annual growth rate and China's 1% rate logged over the same time period.

Yet, while Europe's growth looks great, they are digging out of a deeper hole than the U.S. and have yet to reach their pre-COVID output levels unlike both the U.S. and China. In addition, it appears increasingly likely that the supply chain shortages impacting U.S. growth will hold back their future growth as well.

China's growth rate came in low for some of the same reasons as the U.S., notably shortage of materials and goods. However, their situation is a bit different. In addition to differences in dealing with the delta variant, they have been reeling from Xi Jinping's attempts to reinstall much of socialism across their society. The Chinese president has taken strong actions nearly decapitating the private tutoring industry overnight and crippling a strong critic of his, Jack Ma, the president of the Ant Group. Mr. Jinping's unpredictable impact on various other companies, including much of the technology sector, has caused investor heartburn. Minimally, China's future is much less certain than it was a few short months ago, which doesn't bode well for much of the world working in or with Chinese companies.

Looking forward, the recent recovery in stock prices was nice for investors, but after a fabulous 2021 in which the S&P 500 is up over 20%, the future appears a bit less rosy. With the Fed planning on cutting stimulus and the very strange policy choices coming out of Washington, the tailwinds that we have enjoyed for the past decade, and particularly the last five years, seem in danger of shifting. When the Fed starts really making changes, we anticipate that the markets will become more volatile possibly ending the long party. While this projection could easily be wrong, minimally, at today's valuations, the market has simply less room to run than a few short years ago. The market also offers investors more risk today given the general dearth of alternatives.

S&P 500 is a market capitalization weighted index of the 500 largest publicly-traded companies in the U.S. **Shiller's CAPE P/E Ratio** is based on average inflation-adjusted earnings from the previous 10 years. The ratio is used to gauge whether a stock is undervalued or overvalued by comparing its current market price to its inflation-adjusted historical earnings record.

As of 9/30/2021 Nestle, Danone, & Procter Gamble each represented 0.00% of the Fund's portfolio respectively.