ICR® 3rd Quarter Newsletter – October 2021

After continuing to grind higher in July and August, the U.S. stock market gave back those gains in September to finish mostly flat for the quarter, as measured by the S&P 500. The various sectors showed little dispersion between the best-performing (financials) returning 2.7% and the worst-performing (industrials) losing 4.2%. After getting off to a hot start this year, small cap growth stocks pulled back 5.7% in the third quarter and are now barely positive for the year.

Foreign stocks didn't fare any better, with the MSCI EAFE foreign developed markets index down about 1% and the emerging markets index down almost 9%, led by a sharp downturn in China which makes up about 34% of the index. The weakness in Chinese markets was due to slowing growth figures along with increased regulatory actions aimed at technology and private education companies.

Bond yields were a wild ride in the third quarter. The ten-year U.S. treasury started at 1.47% but dropped to a low of 1.15% in early August as fears persisted of slowing economic growth and spreading COVID variants. However, yields reversed course over the final eight weeks of the quarter ending almost exactly where they started. This seemed to be mostly due to more hawkish language from the Federal Reserve (i.e. reducing bond buying and raising interest rates sooner than markets had expected).

One area of strong growth in the third quarter was in the commodities space. The Bloomberg commodity index gained 6.6%, bringing its year-to-date return to 34.2%. Of course, this isn't necessarily good news for the typical consumer, who has seen retail gas prices rise over 40% this year alone. Increased industrial demand combined with supply chain bottlenecks have been the driving forces behind this sharp increase in the cost of filling up your gas tank.

September marked the first negative month for the S&P 500 since January and its worst month since March of last year. This uptick in volatility coincided with the Fed's updated forecasts for interest rates along with concerns surrounding the so-called "debt ceiling." But what is the debt ceiling and why is it causing anxiety in markets?

For a long time, Congress approved each individual issuance of debt, even setting the interest rate and maturity. As the country – and its debt issuance – grew, the approvals became gradually more general, until 1939 when they decided to just approve an aggregate limit ($45 billion at that time). Since then, Congress has had to adjust that limit 99 times, mostly upward, but down a few times in the 1940s and 1950s.

At the time of this writing, the debt ceiling has been raised temporarily until December 3rd, by which time another increase will be necessary for the U.S. Treasury to continue normal operations. A true default in the traditional sense has never happened and is still unlikely. In 1979, during another contentious debt ceiling debate, the Treasury had to delay payments on certain issuances, but the payments were eventually made. This is known as a "technical default," since the Treasury did not live up to its contractual obligations, but eventually made its creditors whole.

While it's likely that an agreement will eventually be reached, the consequences of delaying that agreement could be dire. Imagine a scenario where social security payments are delayed, affecting people's ability to pay their rent. Or the Treasury may suspend payments to state and local agencies causing their operations to grind to a halt. And, of course, not making timely payments on Treasury bonds would undermine the future credibility of our government. The immediate economic disruption could be massive and the erosion of confidence in the U.S. government as a borrower could have lasting

impacts, likely making future debt issuance more expensive and potentially calling into question the U.S. dollar as the world's reserve currency. In this worst-case scenario, it's hard to imagine the markets reacting positively.

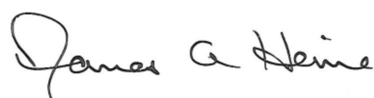
Practically speaking, though, there is no reason for a country that issues debt in its own currency to ever default. It doesn't have to find the money somewhere – it can just print it. (This has its own issues, of course, like the potential for inflation.) For the U.S. government to default, it would have to actively choose not to pay bills that it is fully capable of paying. It would be like if you got your credit card bill, had plenty of money in the bank to pay it, but instead said, "No, I think I'd rather be sent to collections." The right time to decide on debt is when you spent the money – not when the bill comes due. And the same is true for Congress, though they don't seem to understand that.

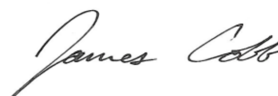
The debt ceiling is an antiquated notion with no real purpose other than political grandstanding. This is not a statement specifically about either political party. Lawmakers as a whole need to compromise on how much is spent in the first place. Whether that spending gets paid for shouldn't even be a question in a country that prints its own fiat currency. The potential harm caused by the recurring debt ceiling debate is completely avoidable. If Congress can agree on anything, here's hoping they can reach a bipartisan agreement to abolish the debt ceiling rules and recognize that spending and paying the bills are one and the same.

The debt ceiling is just one of many risks in the markets these days, though there are still reasons for relative optimism including positive corporate earnings and increased vaccination rates around the world. As always, it is a challenging investment environment, but one with plenty of opportunities for the patient investor.

We truly enjoy working for – and with – our clients. Please reach out to us with any questions or if we can help you in any other aspects of your financial life. We can't make the market go up, but we believe we can provide you with the tools, advice, and planning to help you meet your goals.

Sincerely,





James A. Heine

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Market Report (as of 9/30/21)

Index	2021 YTD (%)	3-Year Annualized (%)	5-Year Annualized (%)
S&P 500	14.7	14.0	14.7
Dow Jones Industrial Average	10.6	8.6	13.1
U.S. Aggregate Bond Index	-1.6	5.4	2.9
MSCI EAFE (Foreign Index)	6.2	5.0	6.0

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