Disruptors of Growth … Or Distractions?

Actionable Ideas Webinar Series

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Whittier Trust

Chief Investment Officer

Tuesday, October 5, 2021

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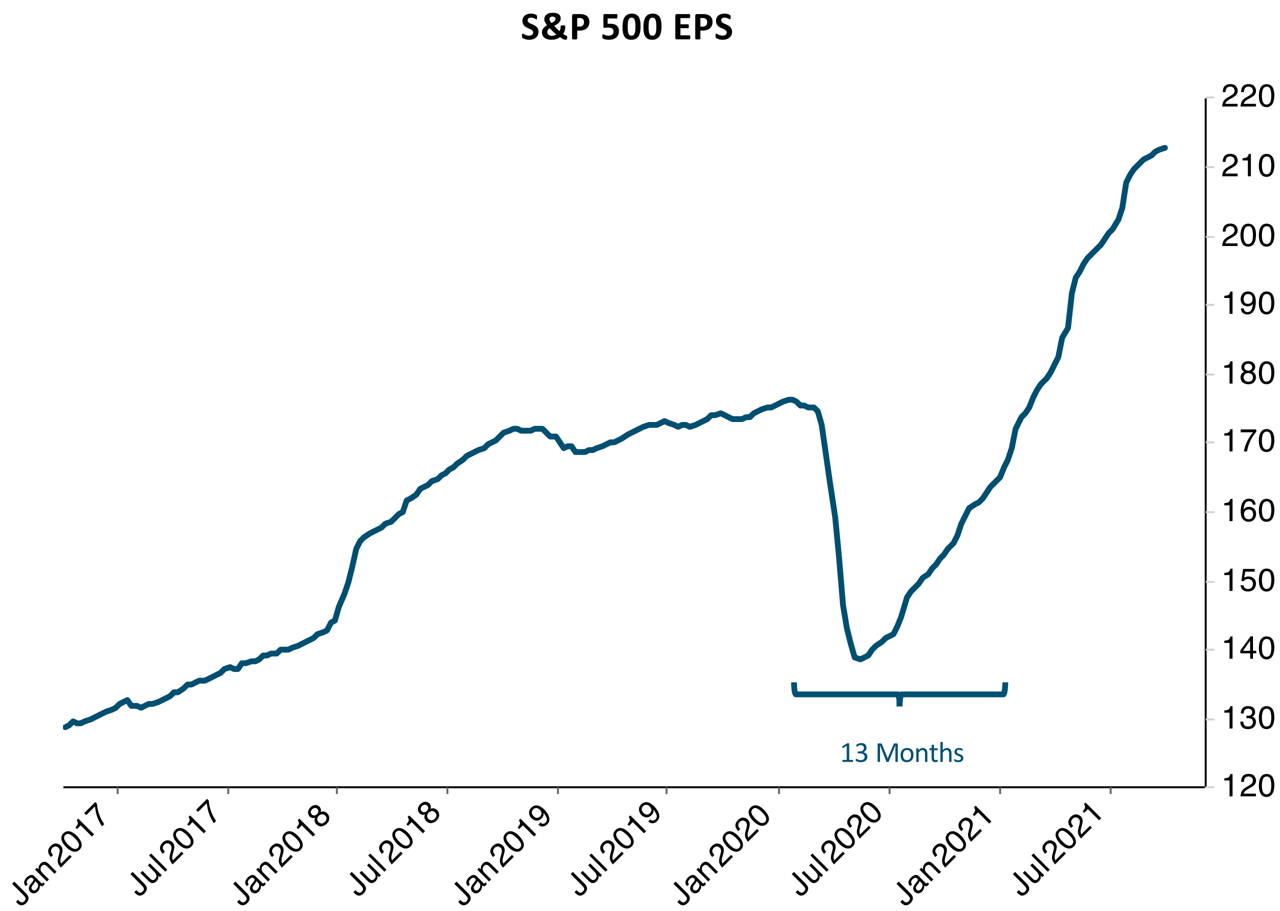
Rapid Recovery

Source: OECD Interim Economic Outlook Forecasts 2021.

Rapid Recovery



Source: FactSet.

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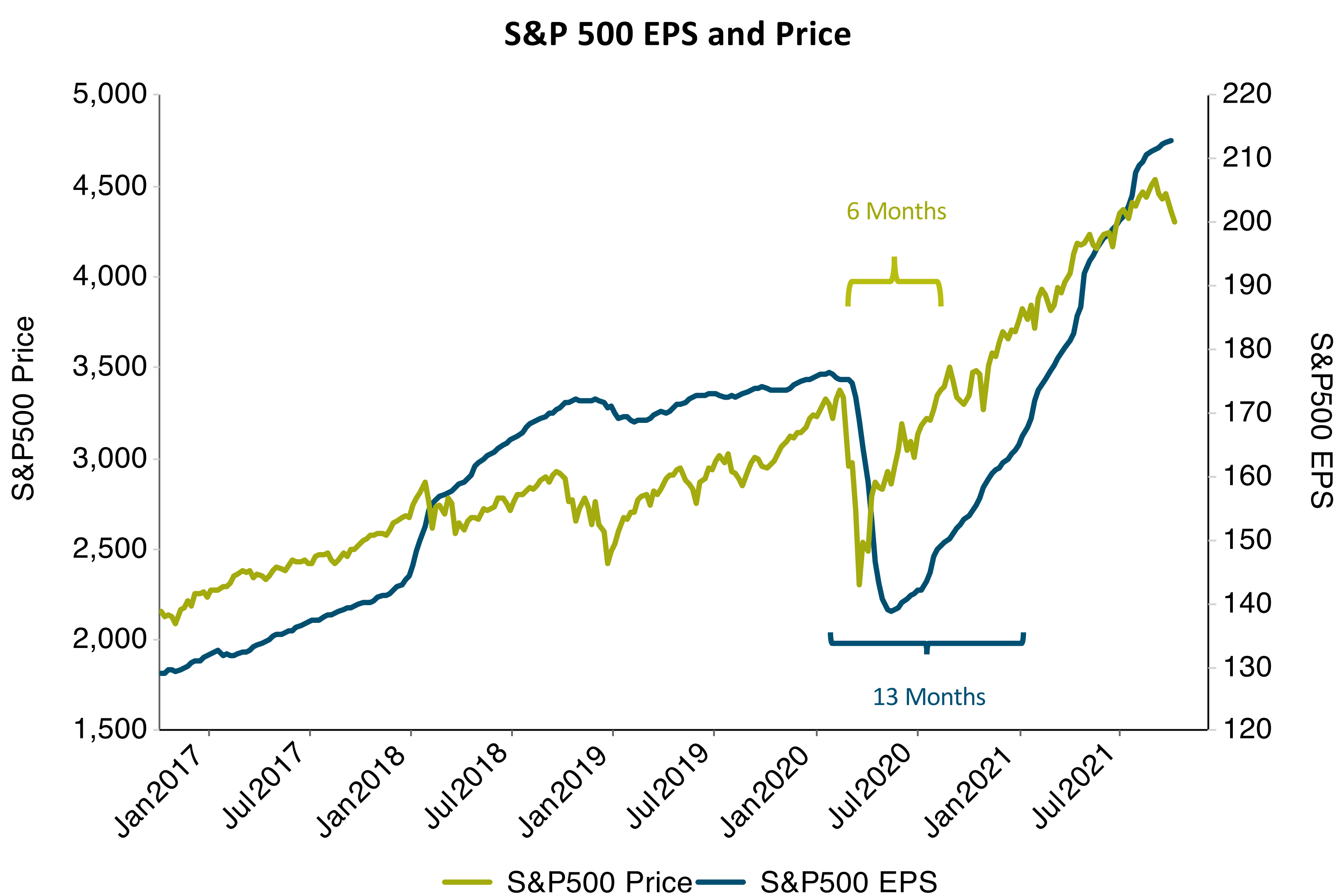

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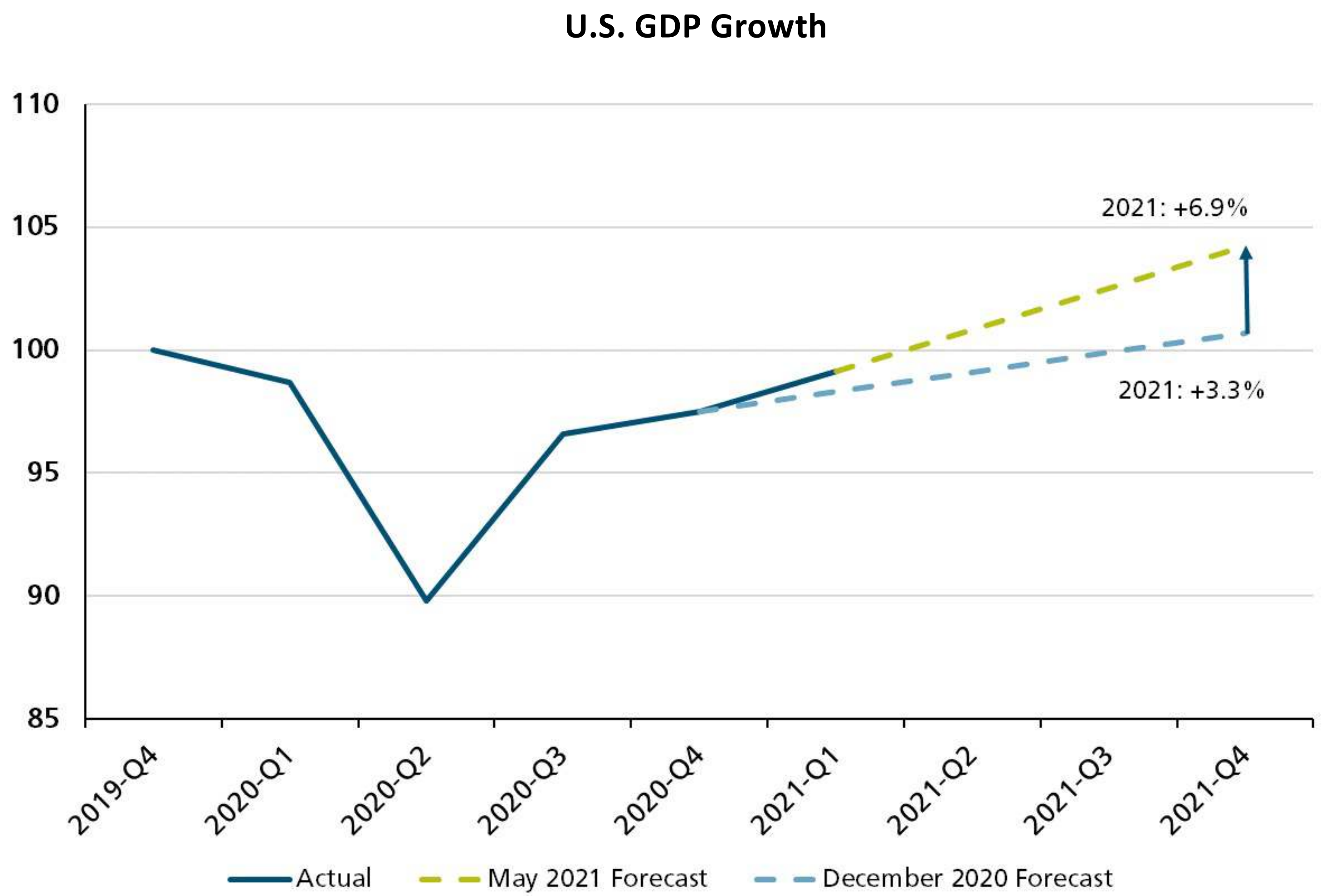
Source: FactSet.

Rapid Recovery with Upside Surprises



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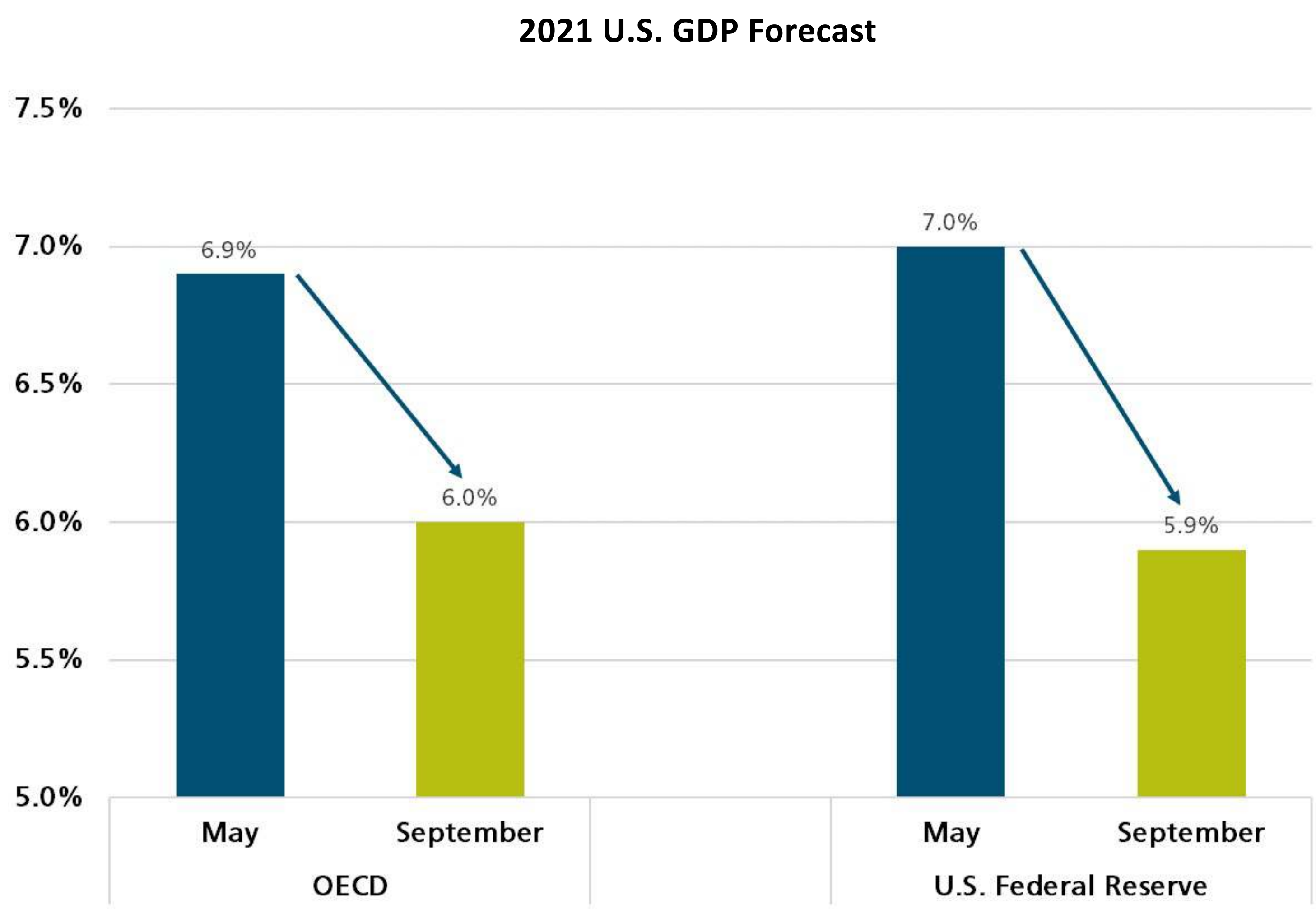
Source: OECD Interim Economic Outlook Forecasts 2021.

Continued Expansion or Contraction?



Source: OECD and U.S. Federal Reserve.

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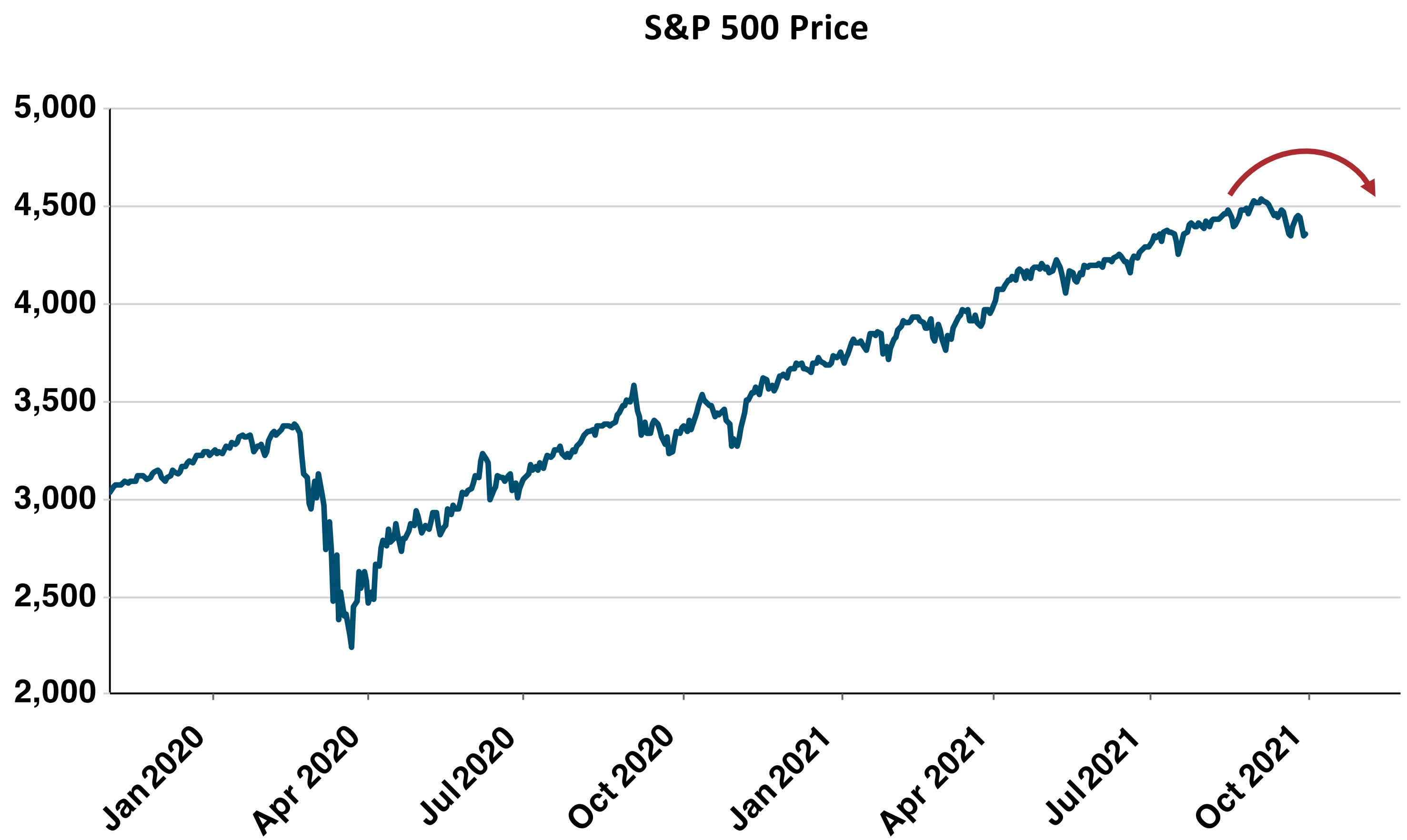

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Source: FactSet.

Discussion Points

- Delta Variant
- Inflation Spike
    - Supply chain disruptions or demand shocks
    - Transient, stubborn or secular
- Higher Taxes

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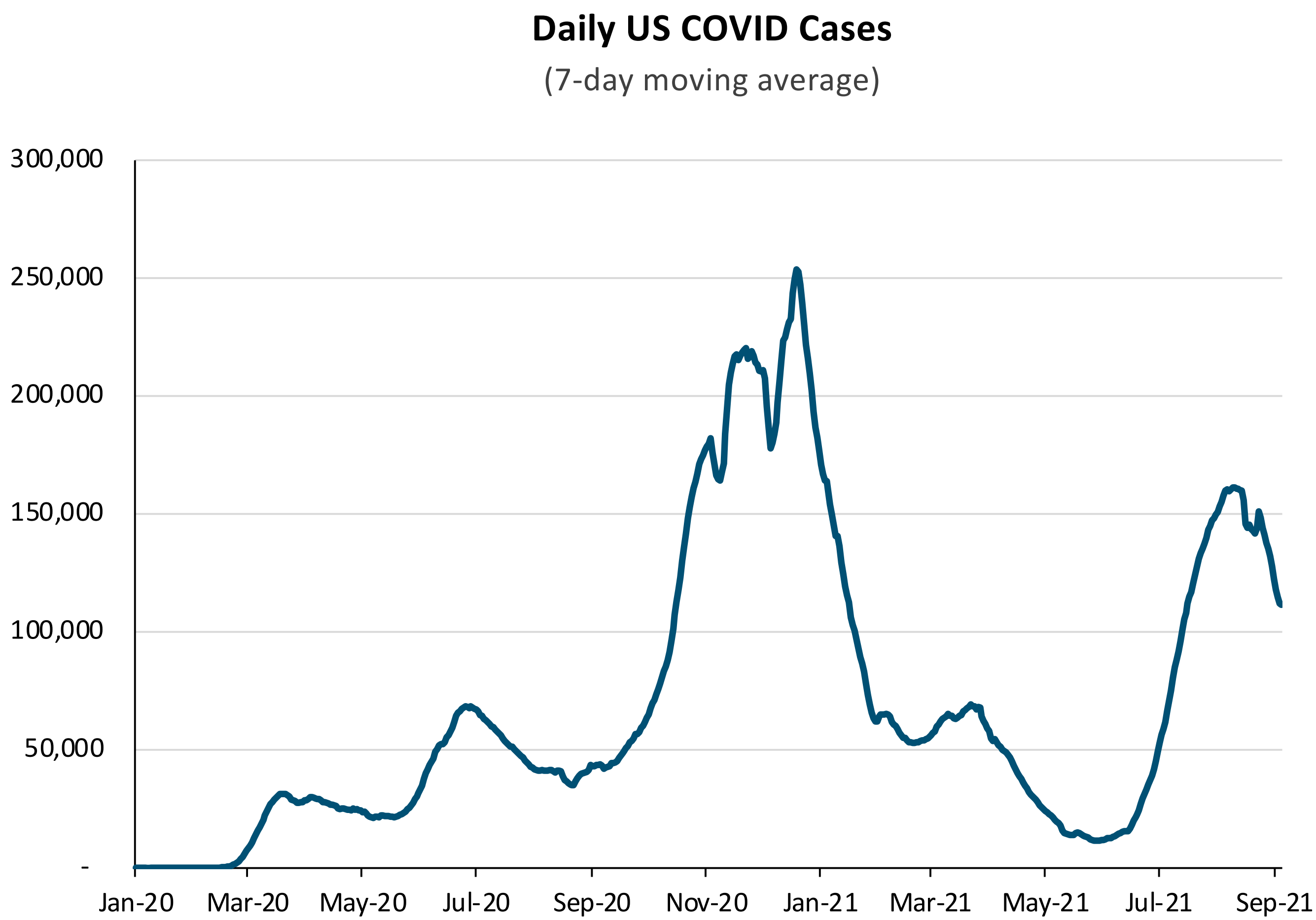
- Inflection in Stimulus
    - Monetary tapering and tightening
    - Fiscal cliff
- Impact of Deceleration on Valuation

The Delta Wave



- Daily Covid Cases are now falling …

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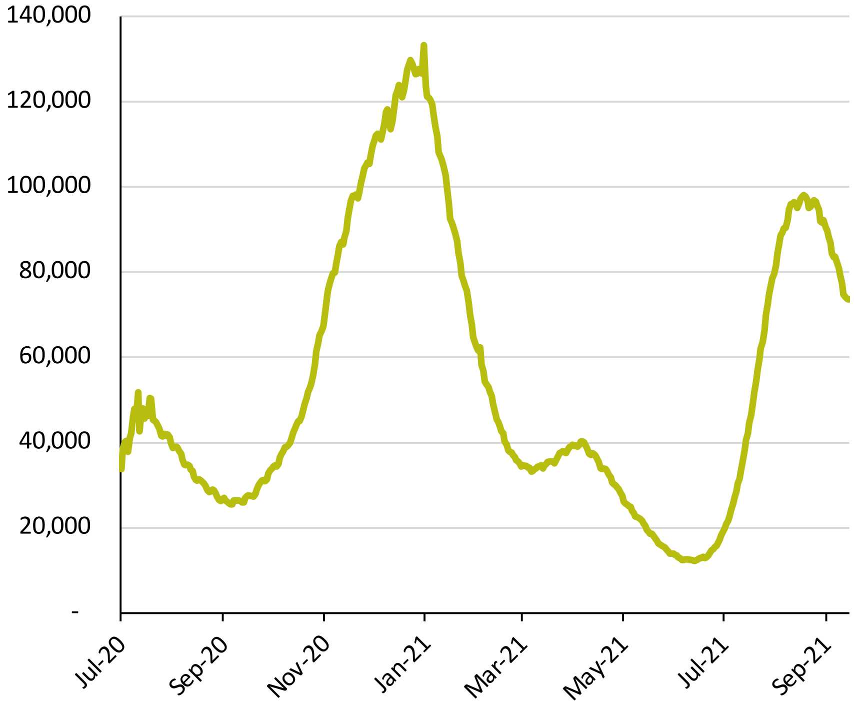
Source: CDC.

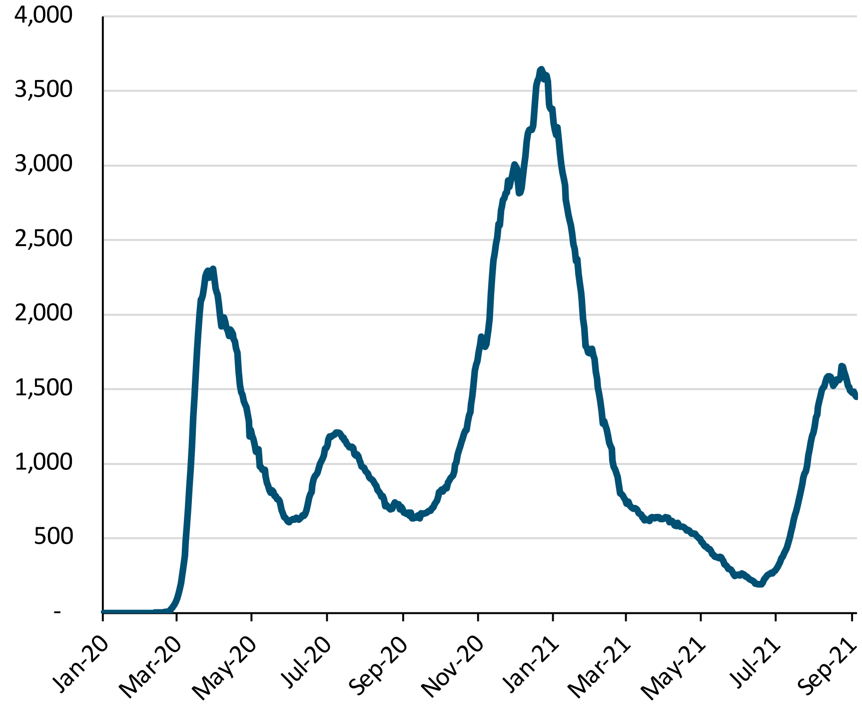
The Delta Wave

US COVID Hospitalizations



Daily US COVID Deaths

(7-day moving average)



- … as are hospitalizations and deaths

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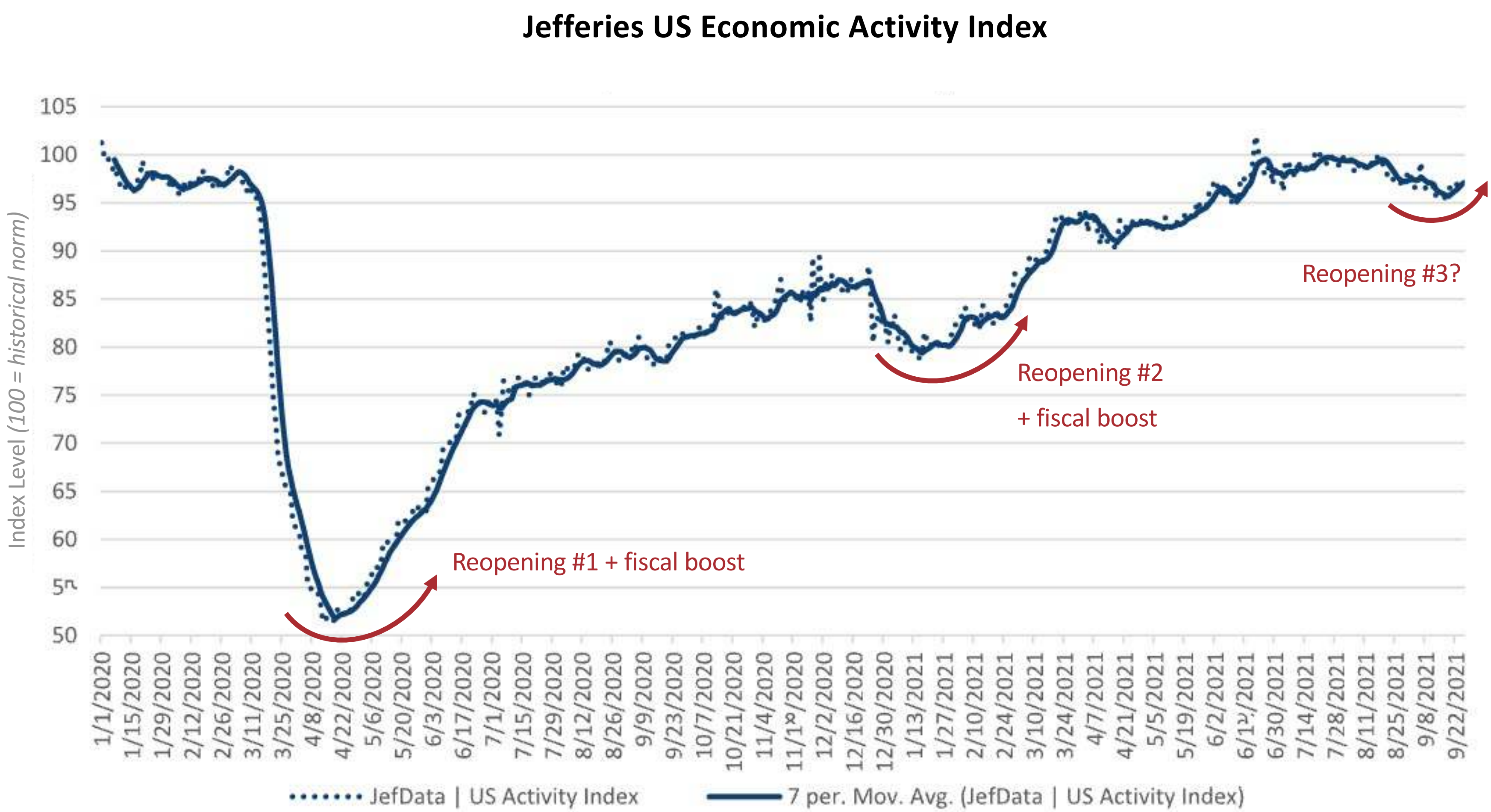
Source: CDC, Our World in Data.

Delta Waves and Economic Activity



- Decline in Delta cases may well spark a resurgence in economic activity

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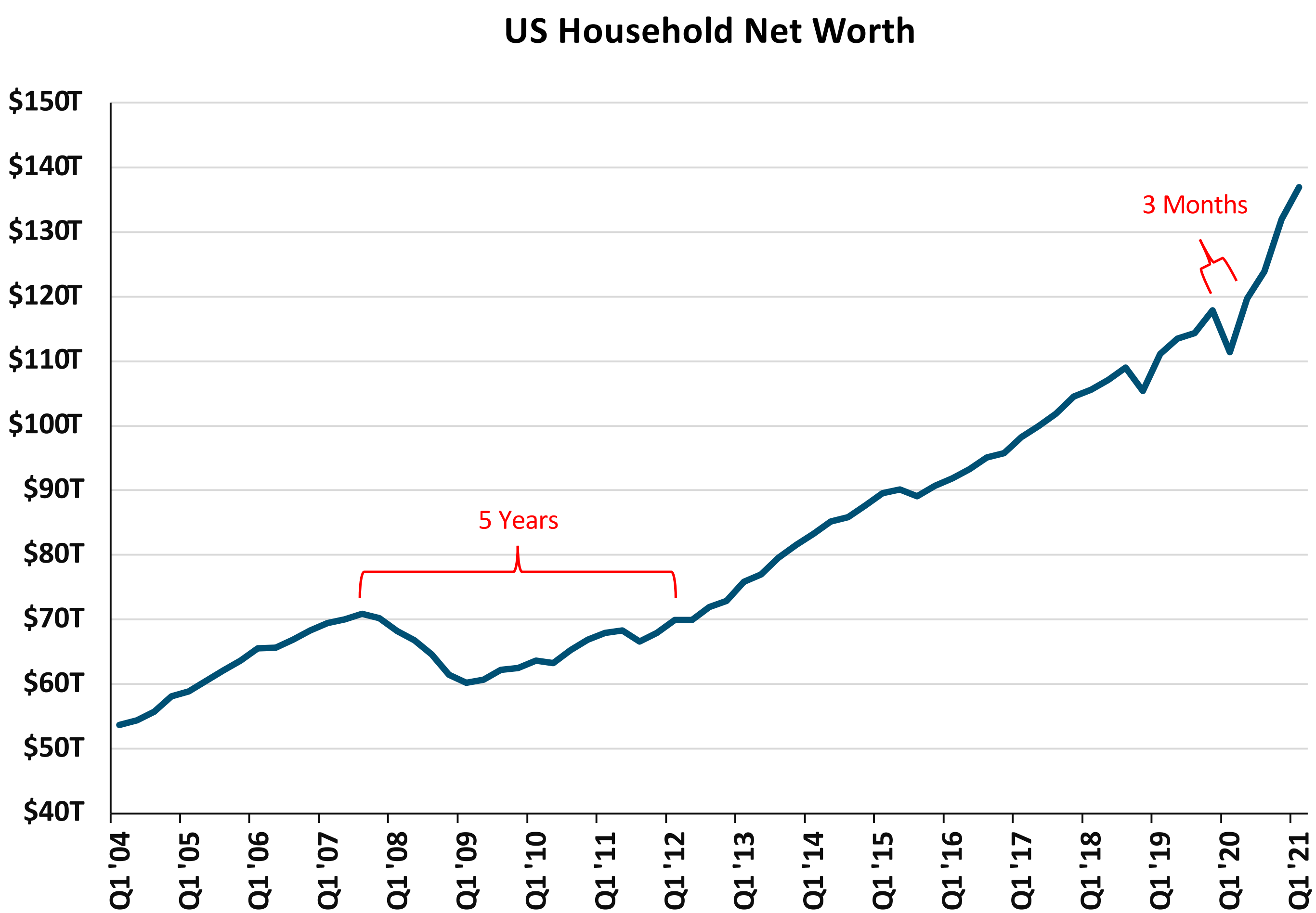
Source: Jefferies. As of September 26, 2021.

U.S. Consumer Still Strong

- Higher disposable incomes
- Stronger balance sheets
    - Resilient stock market
    - Strong housing market
    - Low interest rates
- Higher savings rates
- Declining jobless claims and unemployment rate
- Higher consumer confidence

Rapid Recovery in Consumer Net Worth



Source: Federal Reserve.

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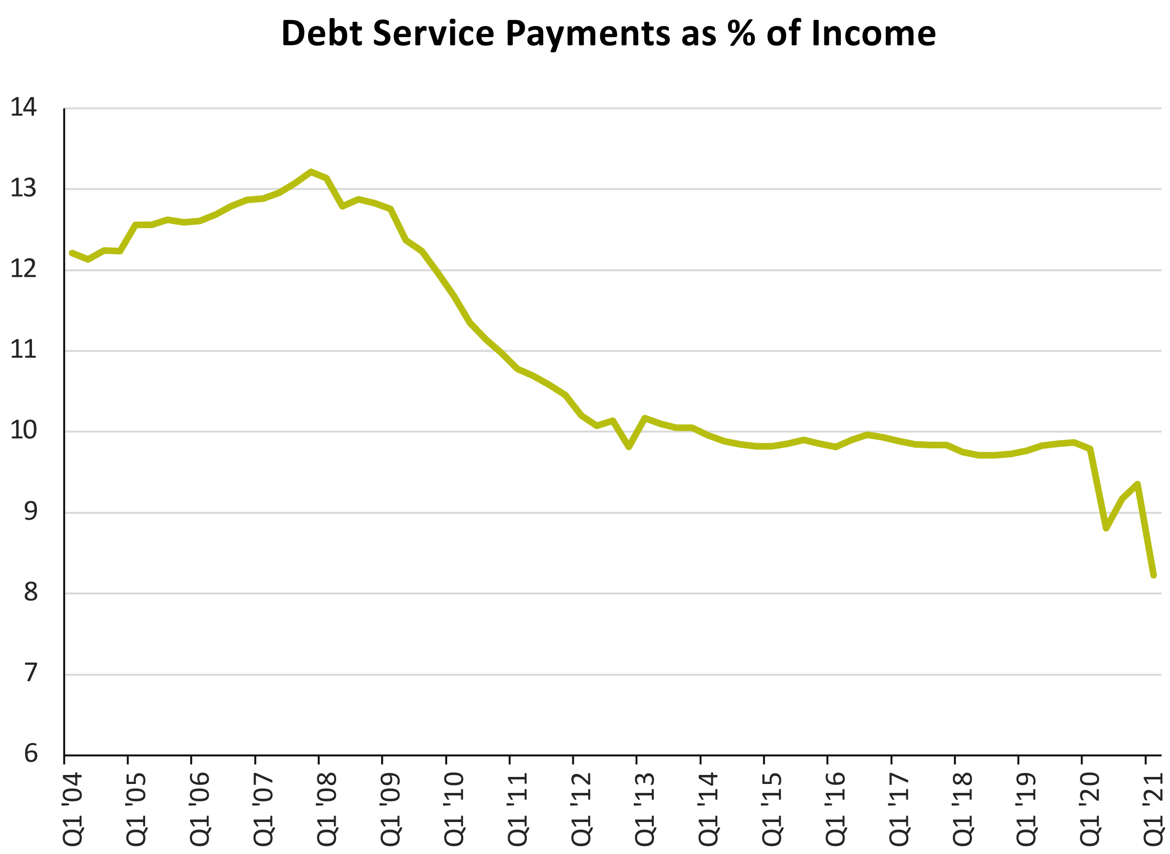
U.S. Consumer Debt Burden is Lower

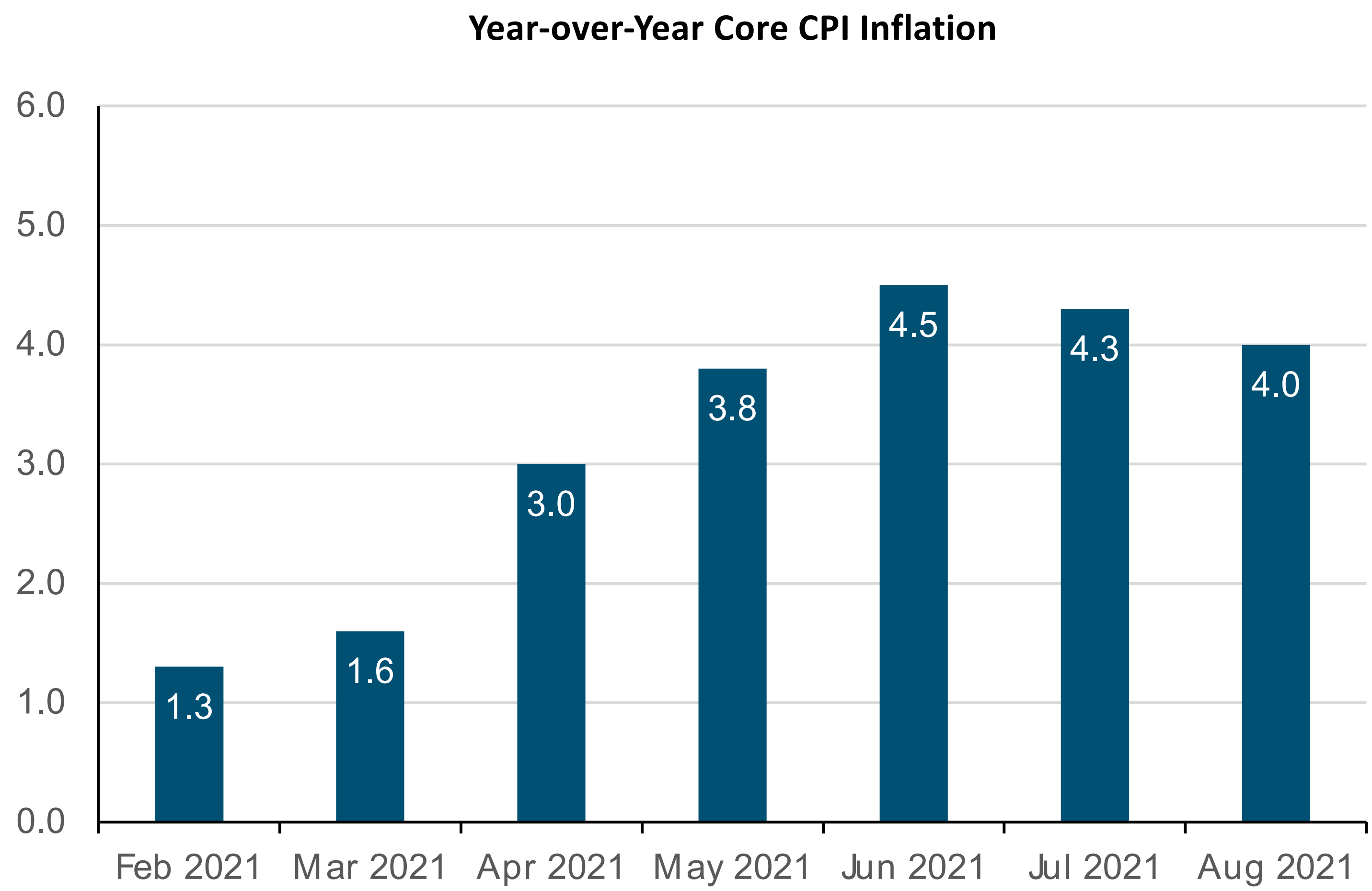


- Low interest rates have reduced consumer debt burdens

Inflation Concerns

- Supply chain disruptions and pent-up demand
- Brent oil above $80 … and gas above $5?
- Wage inflation from shortage of labor
- Inflation expectations in the long run?

Inflation Pressures Abating



- Inflation is gradually receding, but at a slower pace than which it spiked

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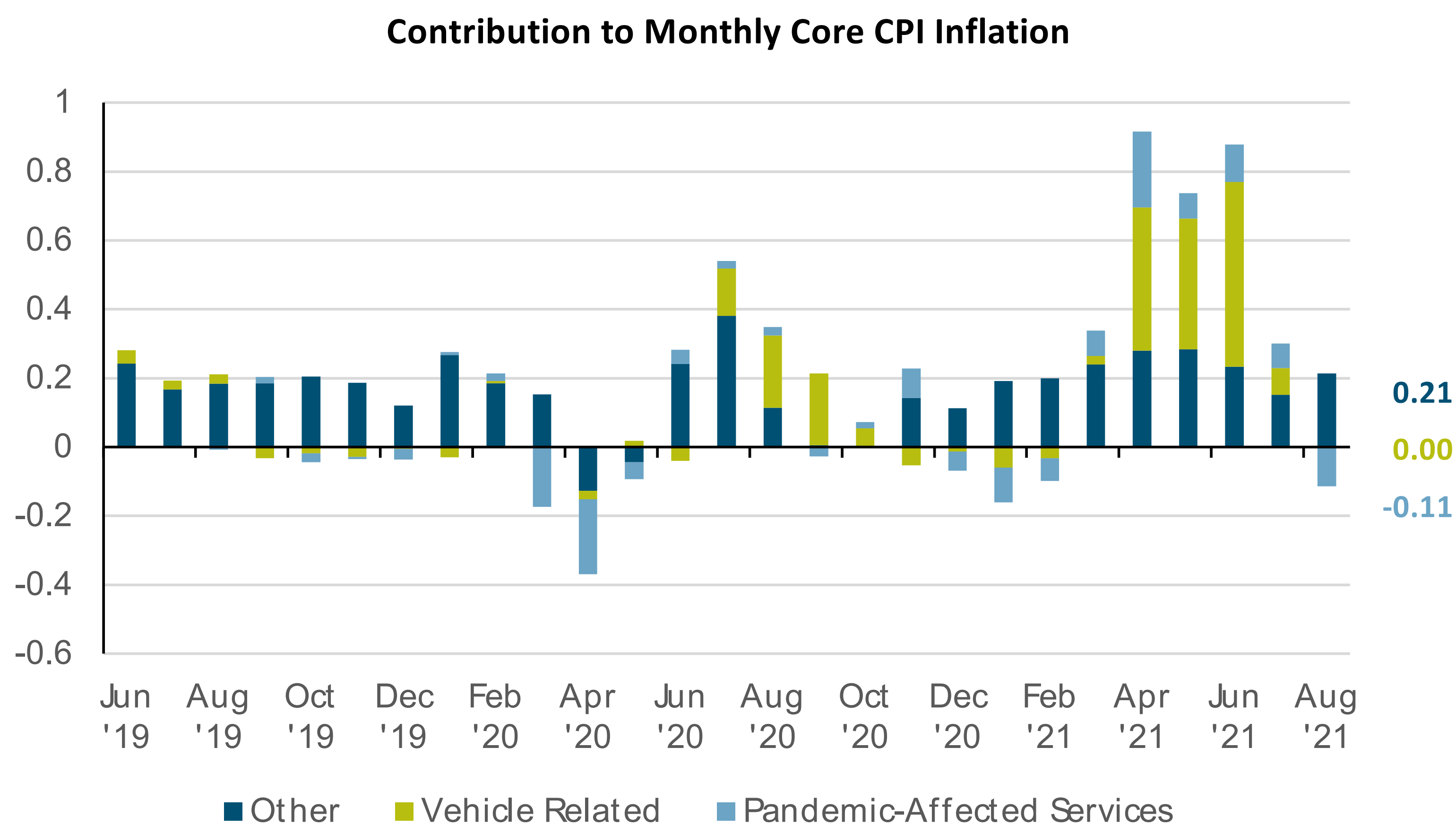
Source: BLS, CEA as of 8/31/2021

Mix Effects Dissipating



- Pandemic effects of supply chain disruptions and excess pent-up demand are diminishing

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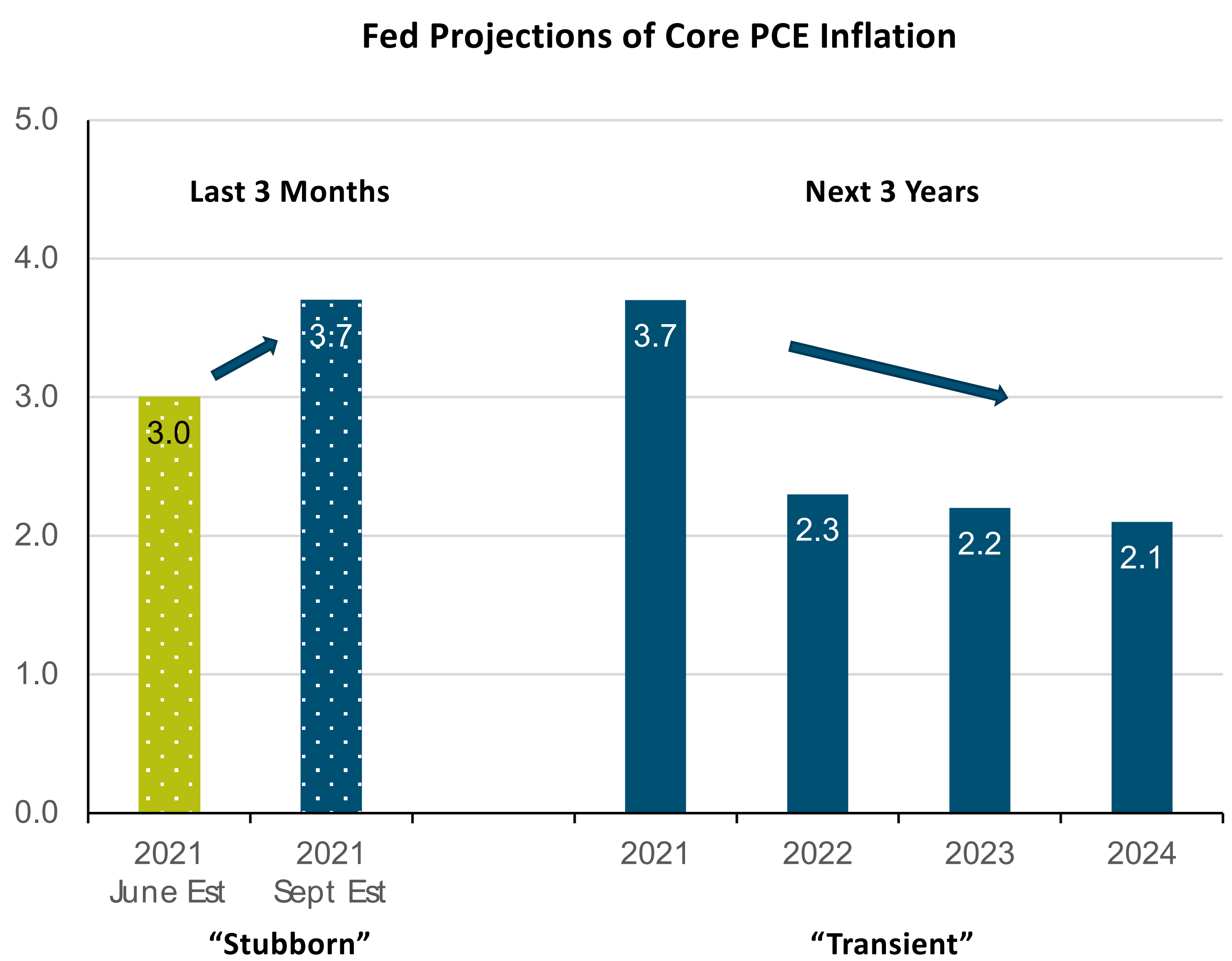
Source: BLS, CEA as of 8/31/2021
Contribution to Monthly Core CPI Inflation calculated using May 2021 relative importance.
Pandemic-Affected Services includes categories such as airfare, hotels, live events.

Stubborn … but Still Transient in the Long Run



- Inflation estimates for 2021 have risen in the last 3 months, but are lower in 2022, 2023 and 2024

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Source: September FOMC Minutes

Stubborn … but Still Transient in the Long Run

Future Inflation Expectations

- 5-year, 5-year forward inflation expectations have inched lower in recent weeks

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Source: FRED as of 9/24/2021

Higher Taxes …

Select Tax Provisions from the House Ways and Means Committee Proposal

Category	Provisions
Individual and Investment Income Taxes	• Top individual rate to 39.6% • Top capital gains rate to 25% • High income surtax of 3% • Expand applicability of 3.8% NIIT • Carried interest changes • Tax on cigarettes and nicotine
Corporate Taxes	• Top rate of 26.5% • Cap the QBI deduction for pass-through entities • GILTI rate to 16.6% • Corporate base-broadening
Estate Taxes	• Early expiration of lifetime gift tax exemption

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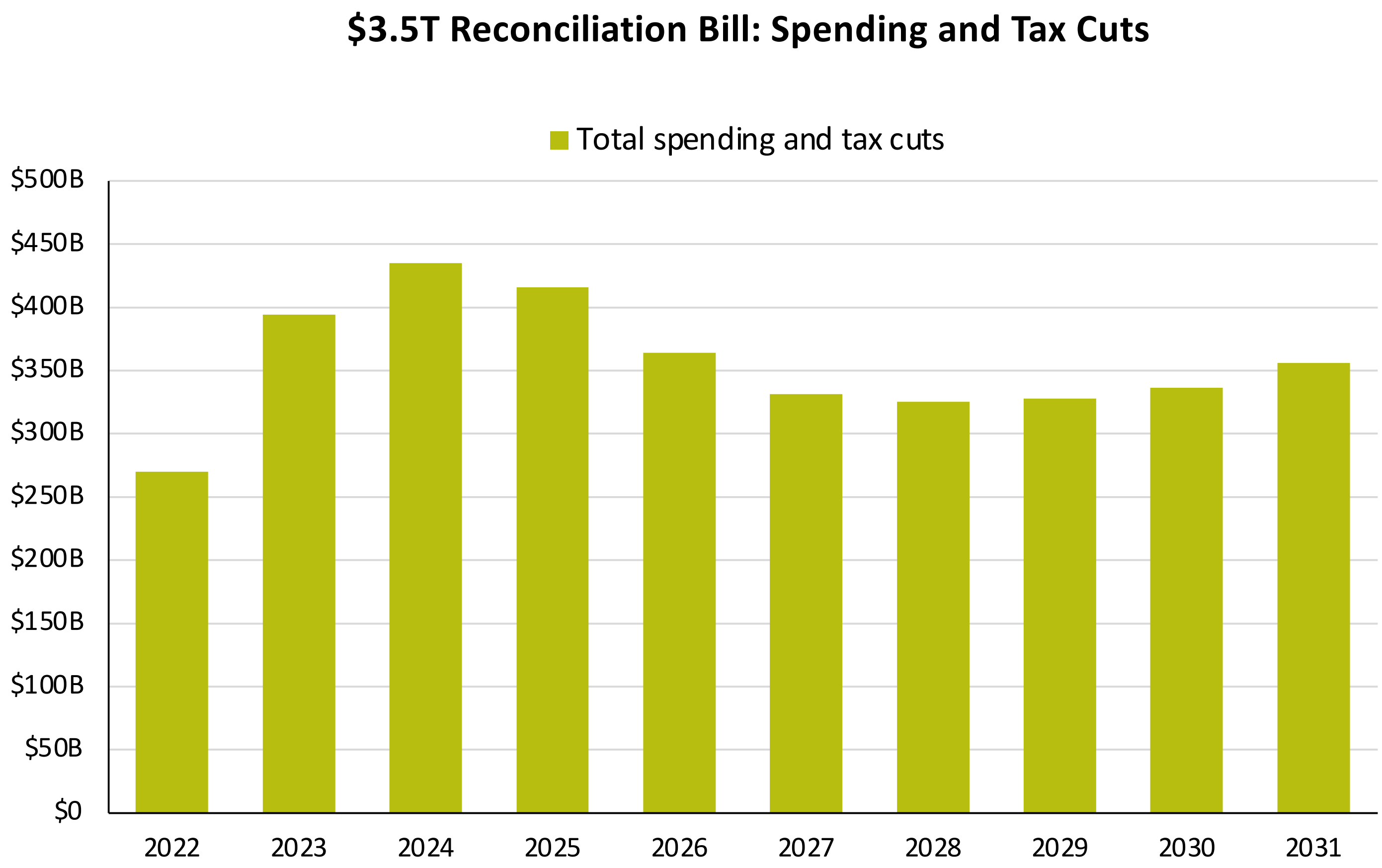
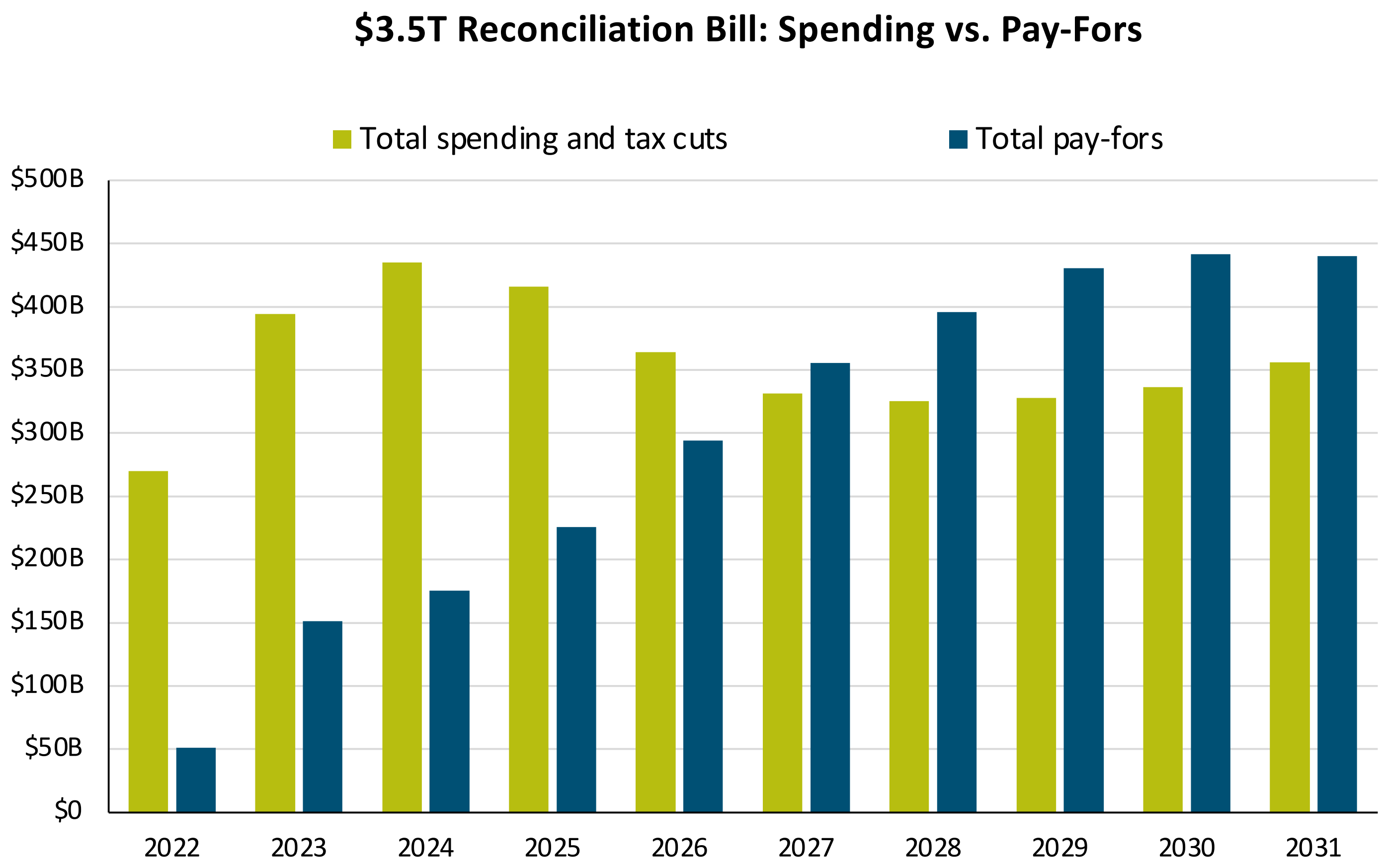
Source: Evercore ISI, waysandmeans.house.gov.

… and More Spending



Moody's Analytics. Budget cost estimates do not include any dynamic benefits.

Federal Spending Offset by Higher Taxes



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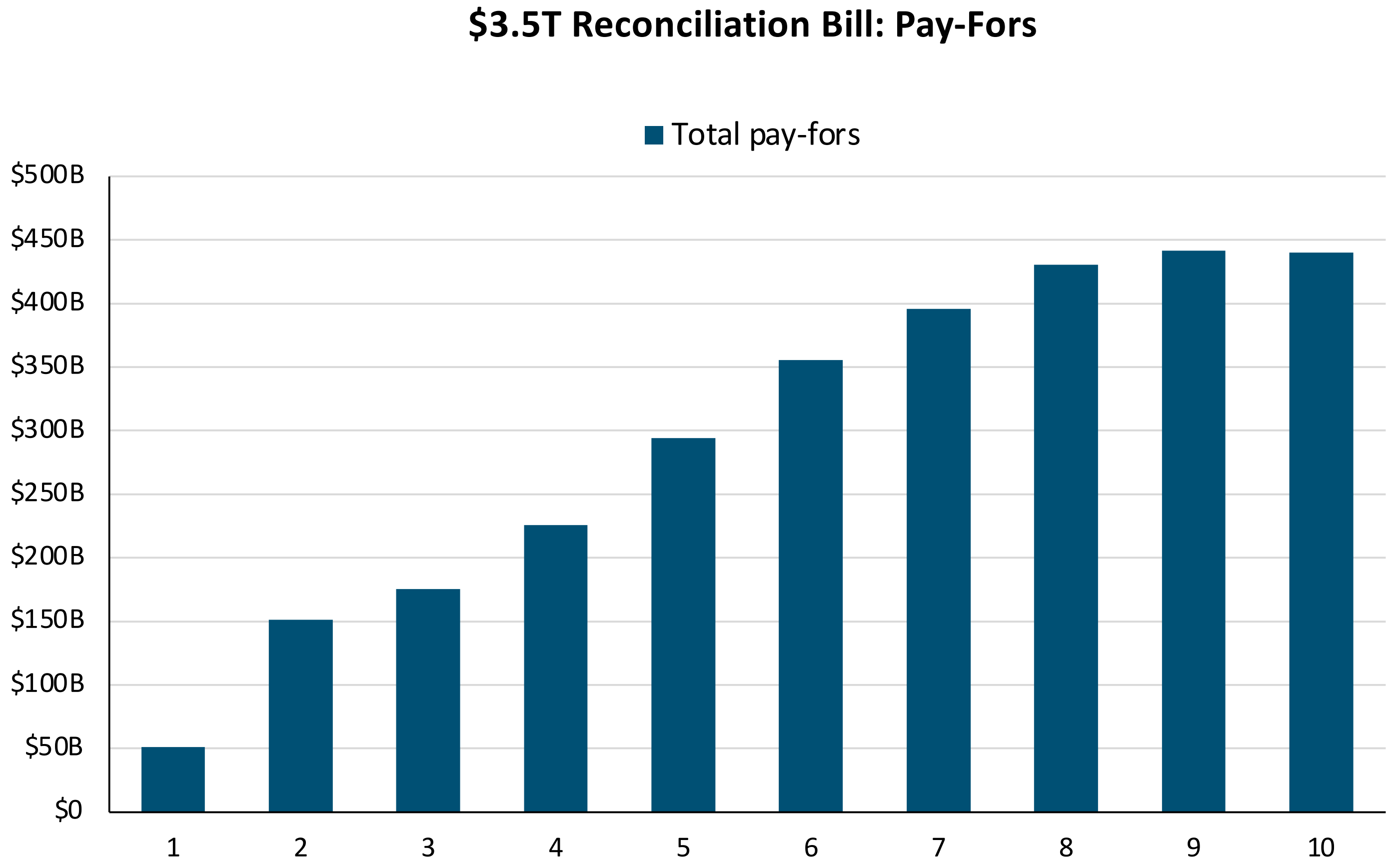
Higher Taxes



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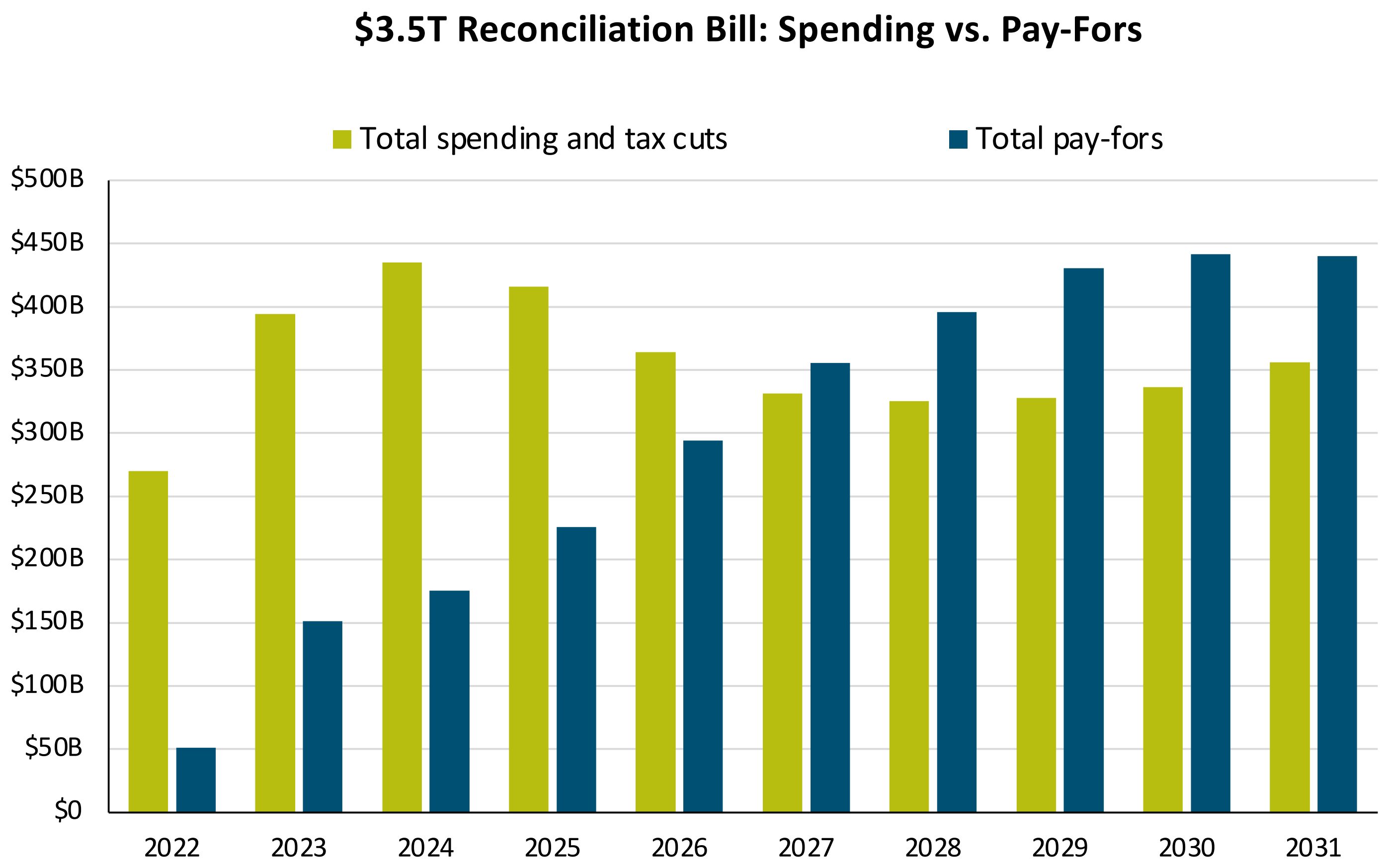
Higher Taxes Offset by Fiscal Stimulus



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Inflection Points in Stimulus

- **Monetary**

- Tailwind**:** Fed balance sheet from $4t to well above $8t

- Headwind: Fed focus now on tapering and tightening

- **Fiscal**

- Tailwind: Fiscal stimulus already at $5.8t … plus another $4.7t

- Headwind: Prospects of an imminent fiscal cliff

Fed Tapering

- September FOMC Statement

  "If progress continues broadly as expected, the Committee judges that a moderation in the pace of asset purchases may soon be warranted"

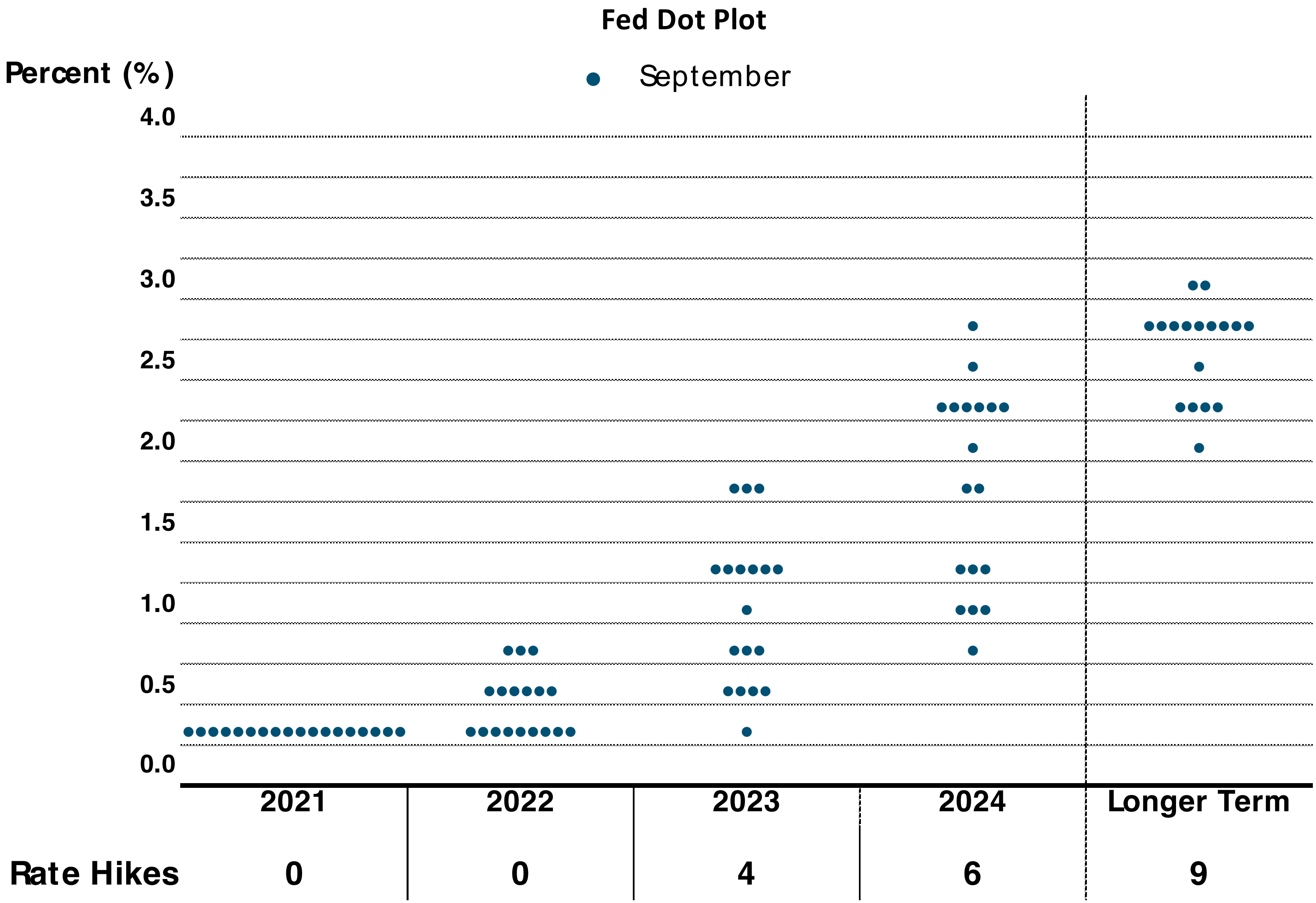
- A nod towards normalizing monetary policy in the near term …

  … without actually committing to a start date ☺

- First rate hike after the end of bond purchases

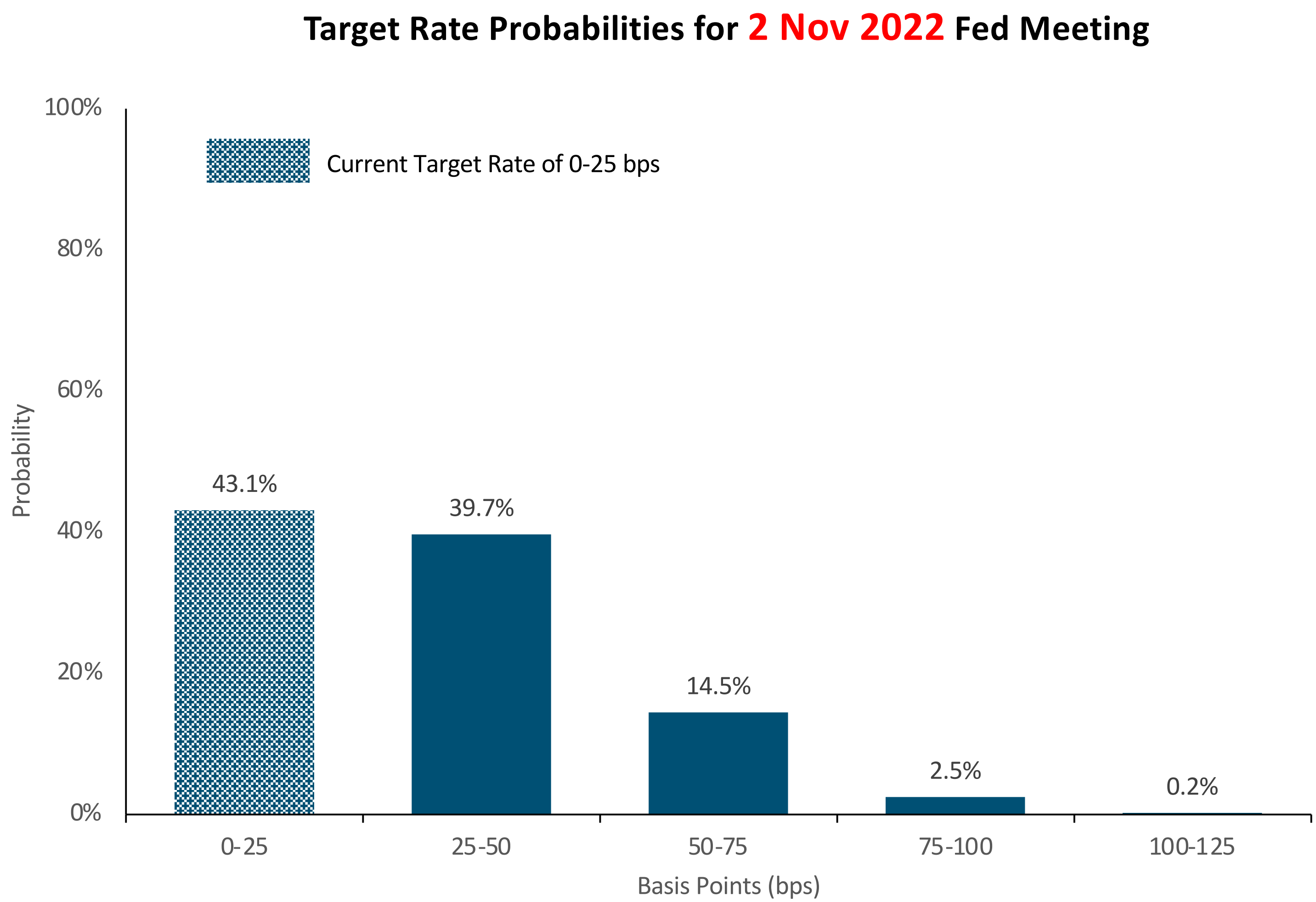
- **We expect that tapering will begin before year-end and last 6-9 months**

Fed Tightening



Source: FOMC Summary of Economic Projections as of 9/22/2021
UR = Forecasted Unemployment Rate
FOMC participants'' assessments of appropriate monetary policy Midpoint of target range or target level for the federal funds rate

Market Expectations of Tightening



Source: CME Group as of 9/29/2021

Impact of Fiscal Stimulus

- Financial Impact Measure (FIM)

  - More comprehensive than just federal deficits
  - Combines impact of local, state and federal fiscal policy

- Interpreting FIM

  - FIM = 0: Neutral — Spending and taxes rise in line with potential GDP
  - FIM > 0: Expansionary — Spending and taxes rise more than potential GDP
  - FIM < 0: Contractionary — Spending and taxes rise less than potential GDP

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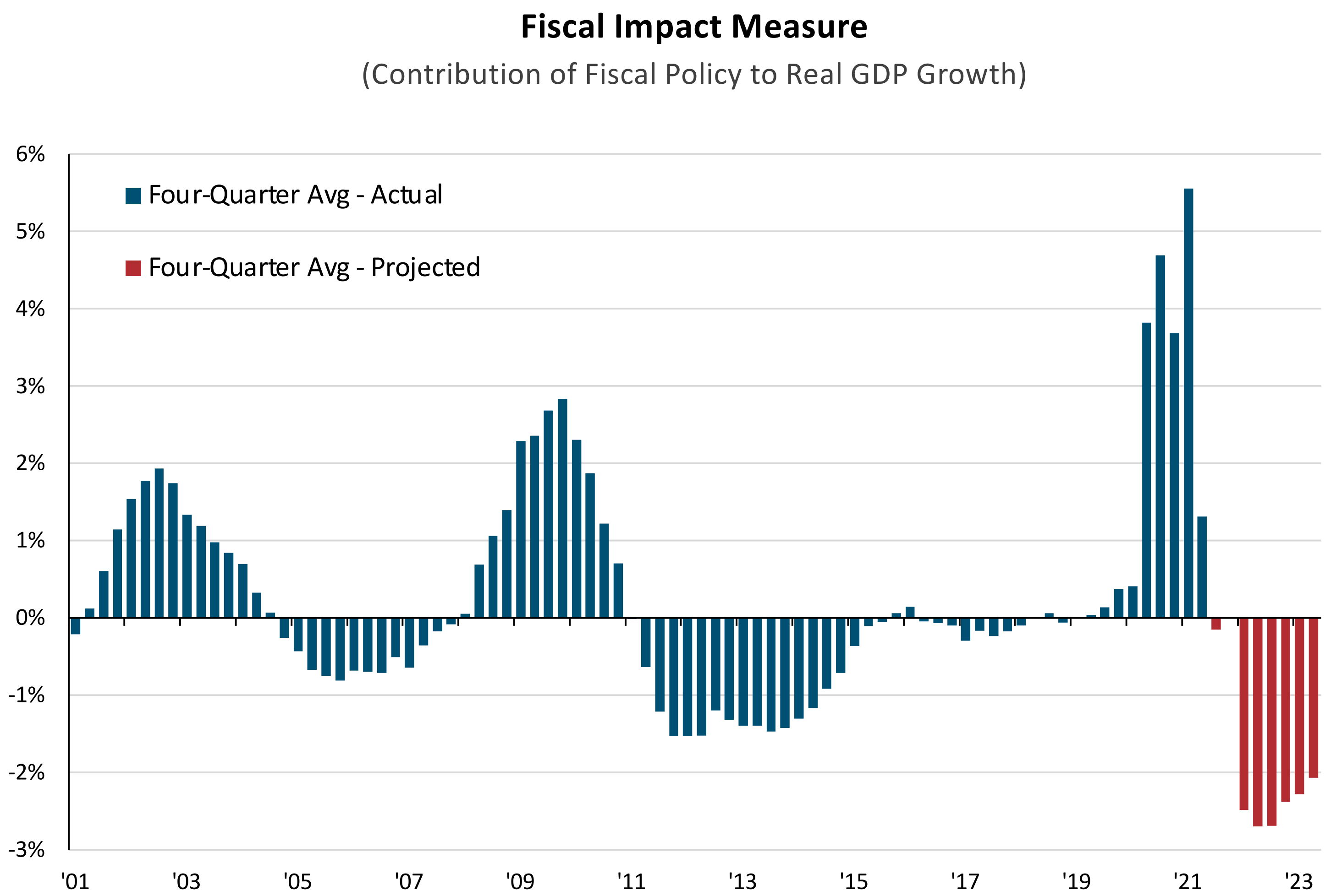
Source: Hutchins Center

Imminent Fiscal Cliff



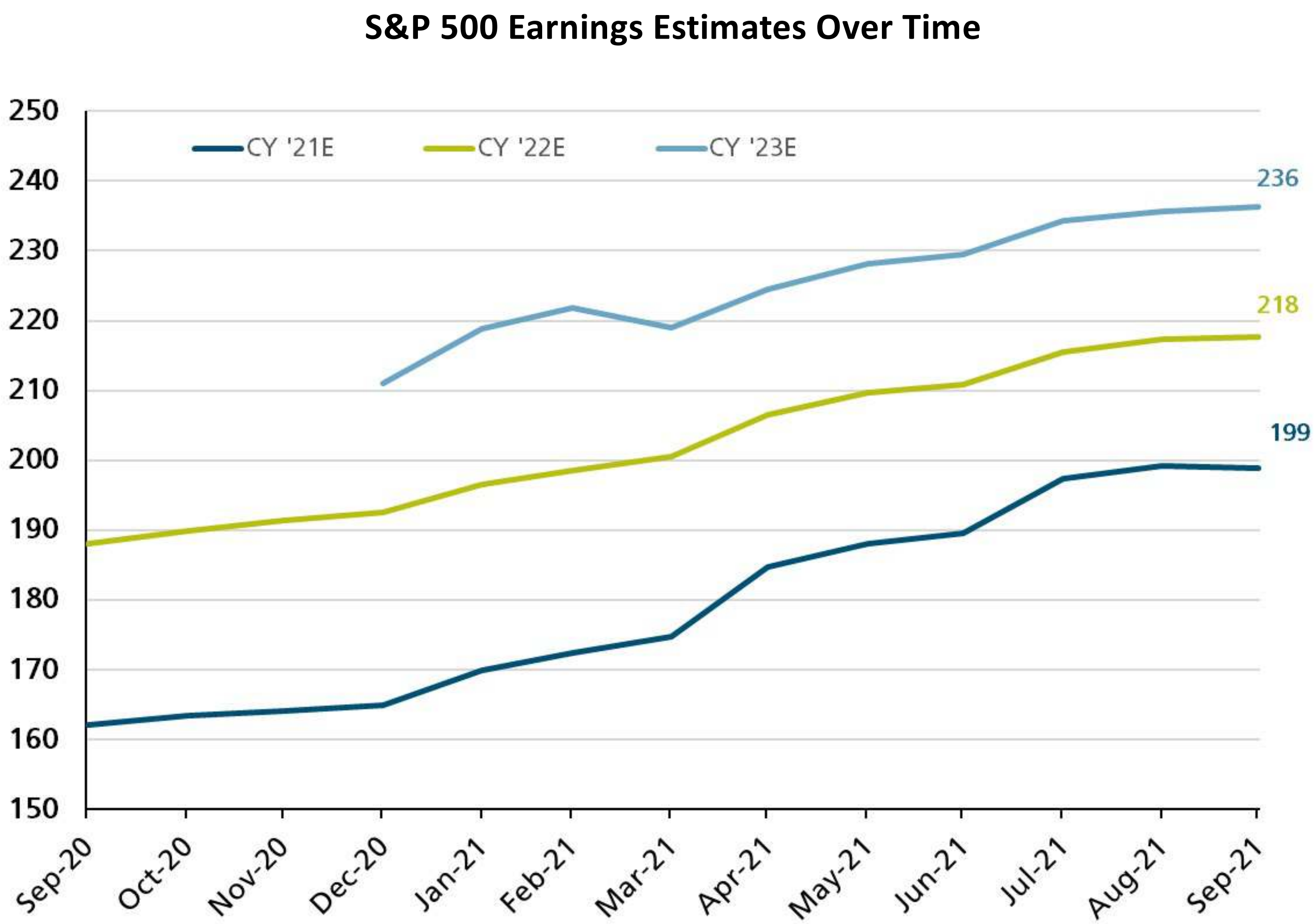
- Withdrawal of fiscal stimulus will decelerate growth by 2 to 3%

Source: Hutchins Center on Fiscal & Monetary Policy, Brookings Institution, BEA.

Stimulus Inflection … Expected and Priced In

- 2020 Policy Measures:
  - Emergency tools for use in the throes of a pandemic
- 2021 Policy Responses:
  - Normalization for an economy recovering to a new and higher equilibrium
- Upcoming policy inflection has been known from Day One of the crisis
- Stock and bond markets have already priced this inflection in

Earnings Continue to Grow



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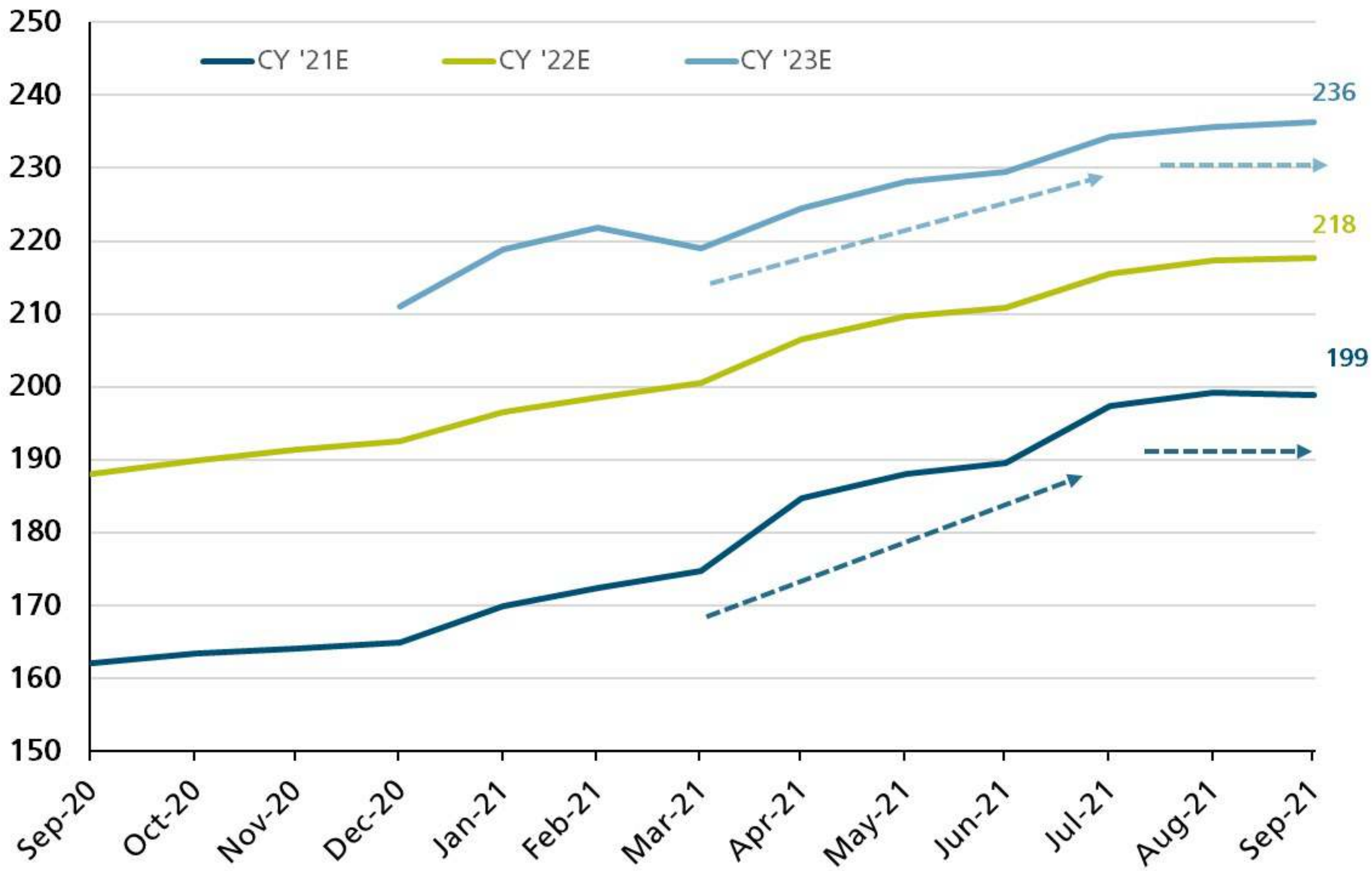
Source: FactSet.

As Earnings Growth Decelerates …

S&P 500 Earnings Estimates Over Time



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Source: FactSet.

… P/E Ratios are Compressing As Well

S&P 500 Price to Earnings Ratio

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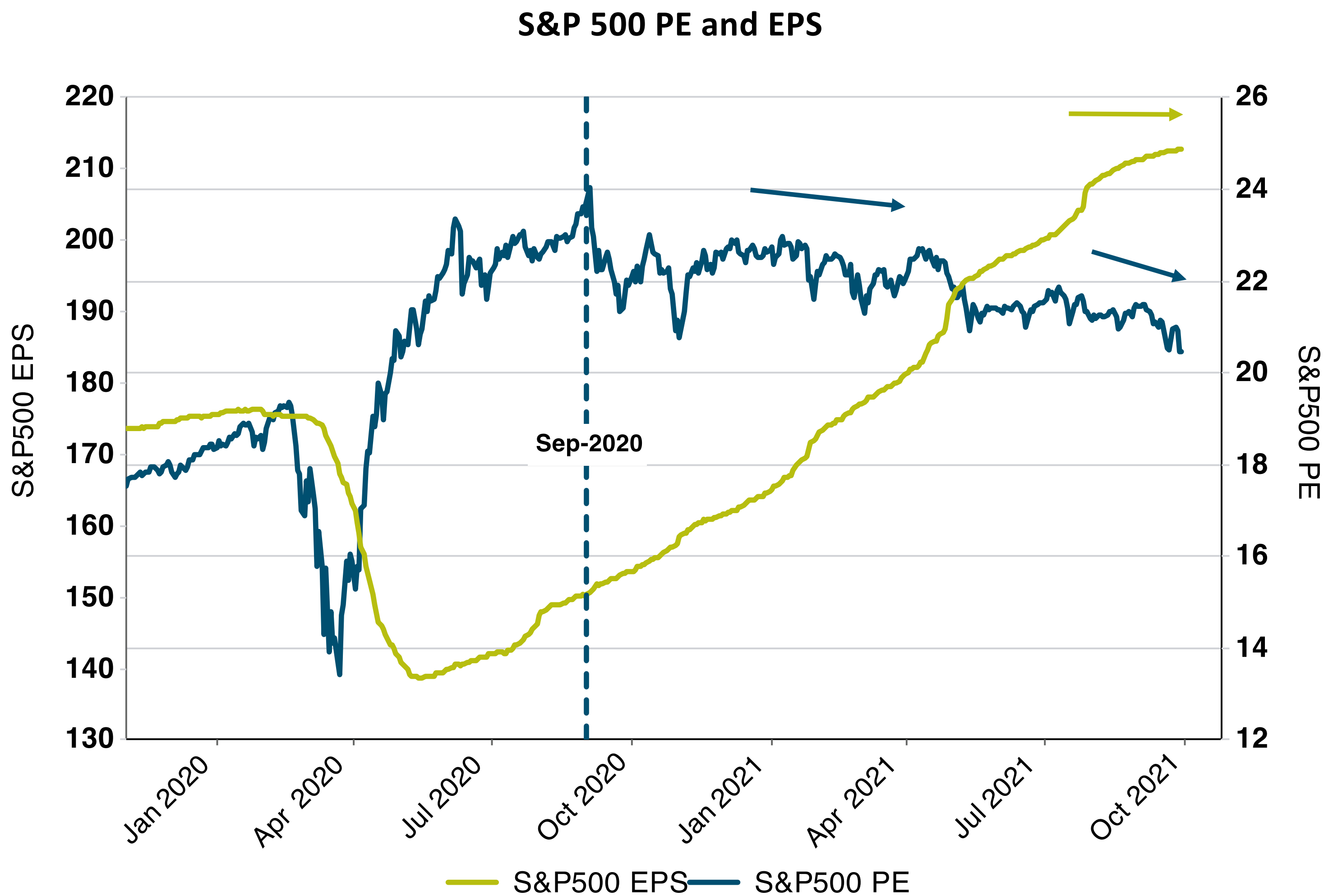
Source: FactSet.

P/E Ratios Peaked Before Earnings Decelerated



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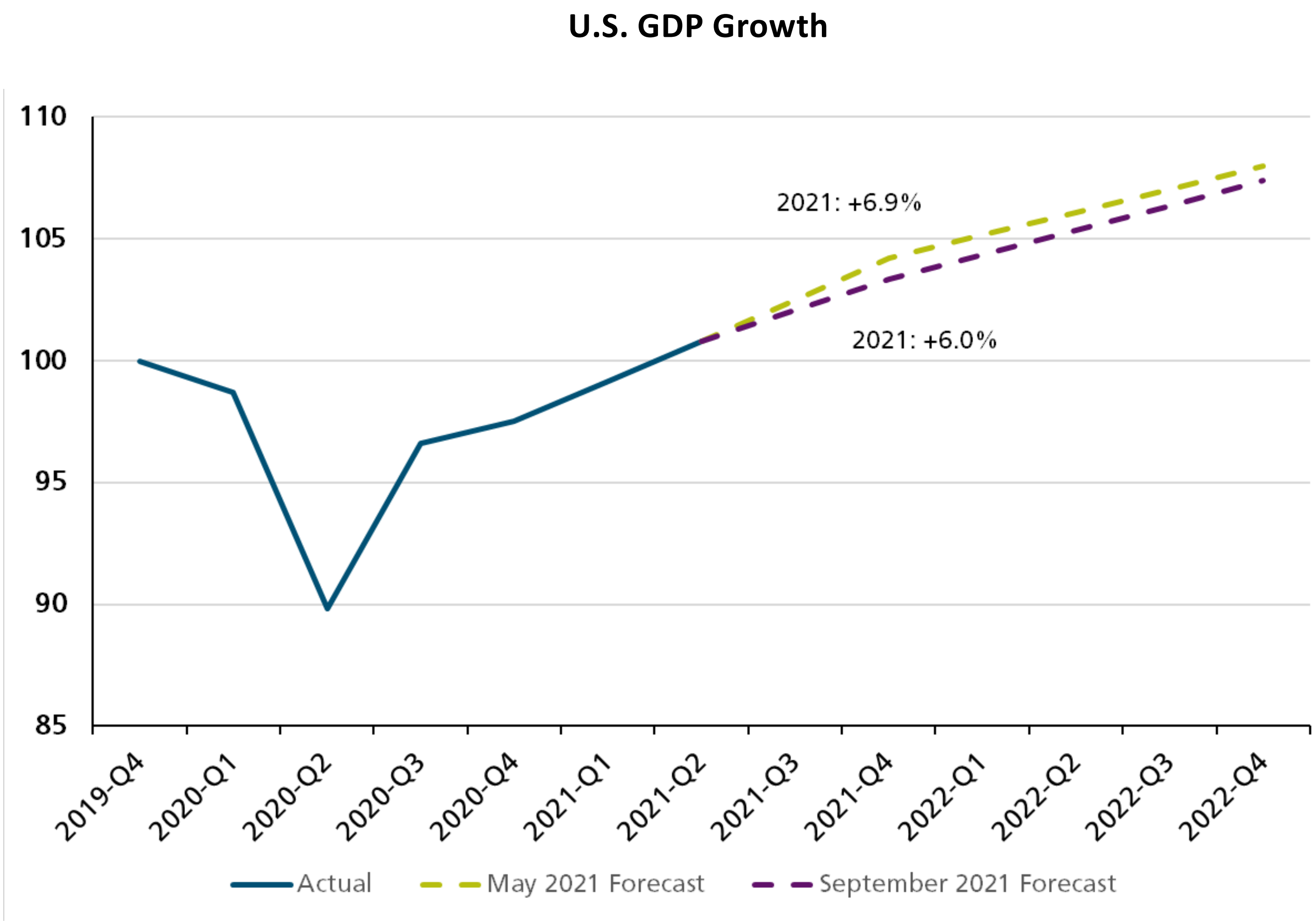
Source: FactSet.

An Optimistic Look at Growth



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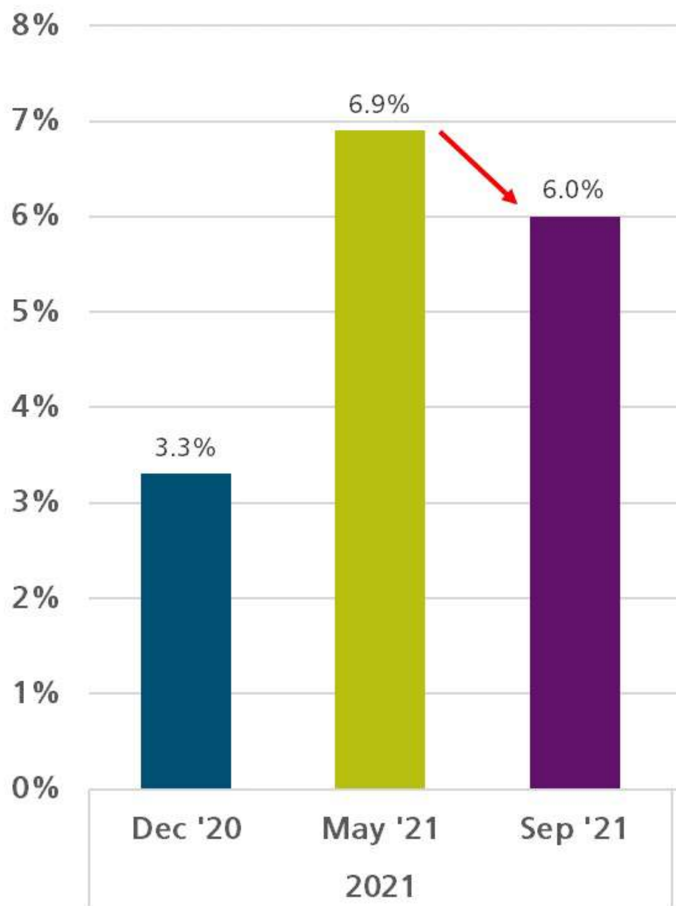
Source: OECD Interim Economic Outlook Forecasts 2021.

Growth in 2021 So Far

U.S. GDP Forecasts



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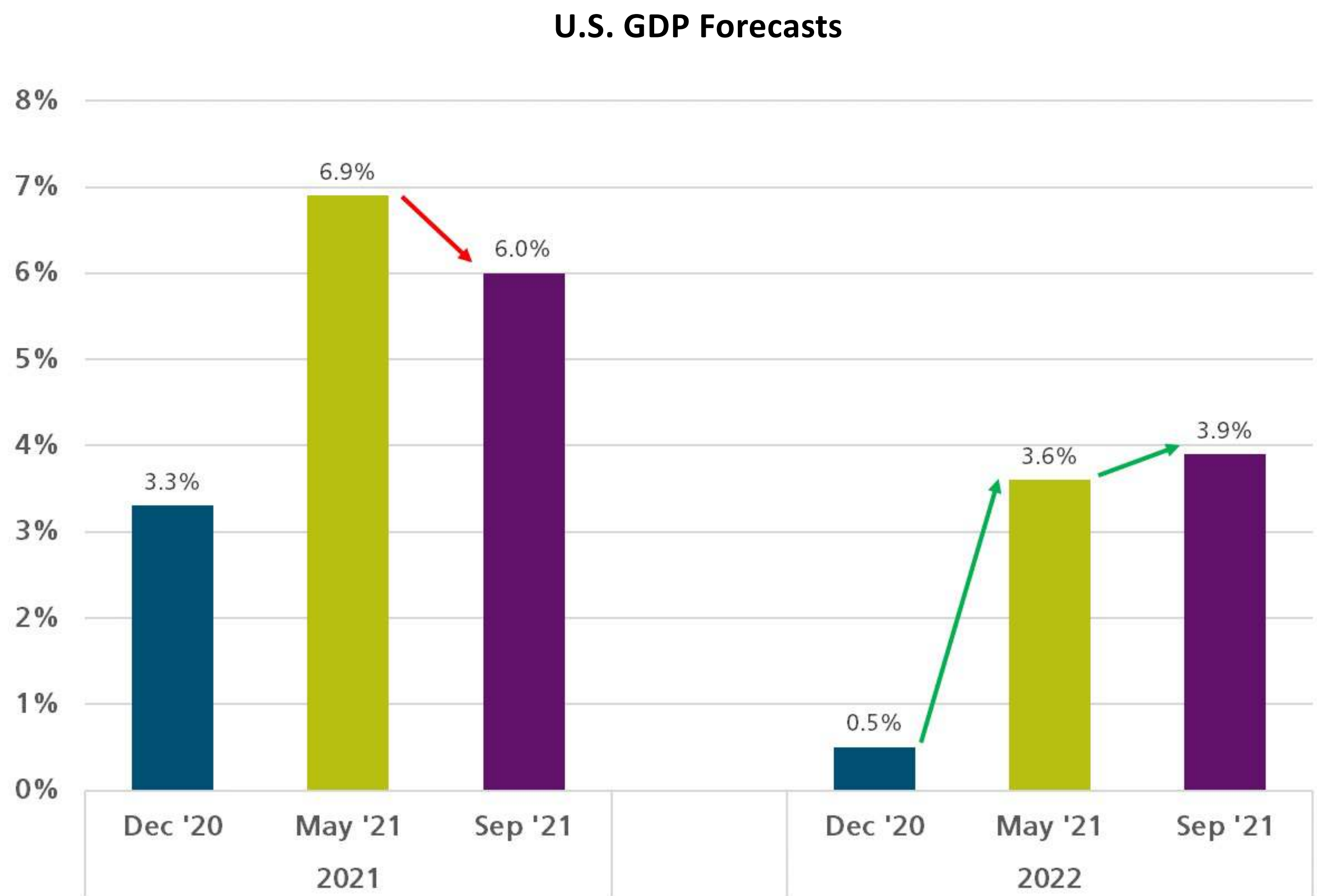
An Optimistic Look at Future Growth



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Source: OECD Interim Economic Outlook Forecasts 2021.

Growth Decelerating at a Slower Pace

U.S. GDP Forecasts, %

Forecast Time	2021	2022	Difference
Dec 2020	3.3	0.5	-2.8
Sep 2021	6.0	3.9	-2.1
Difference	+ 2.7	+ 3.4	

Improving

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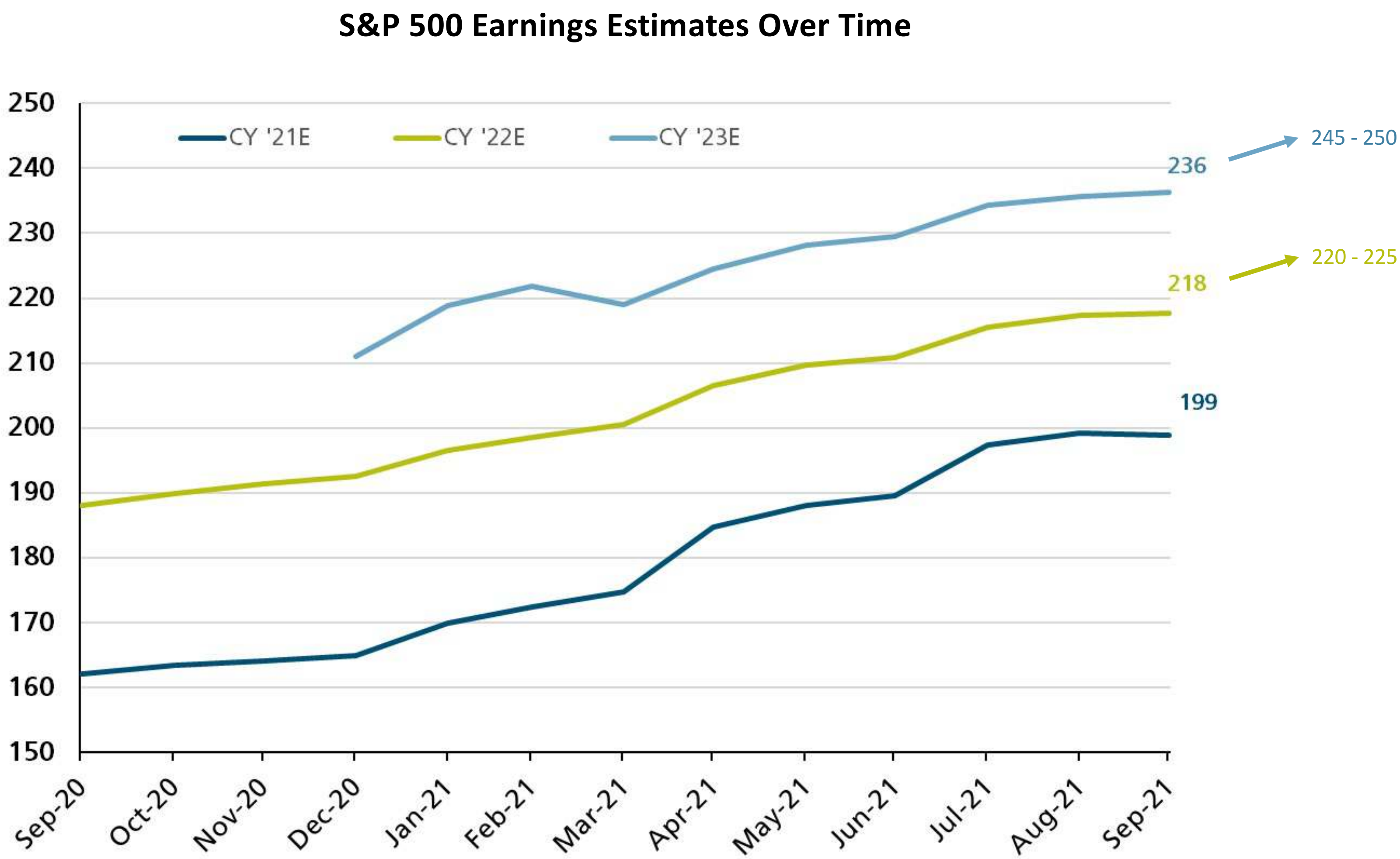
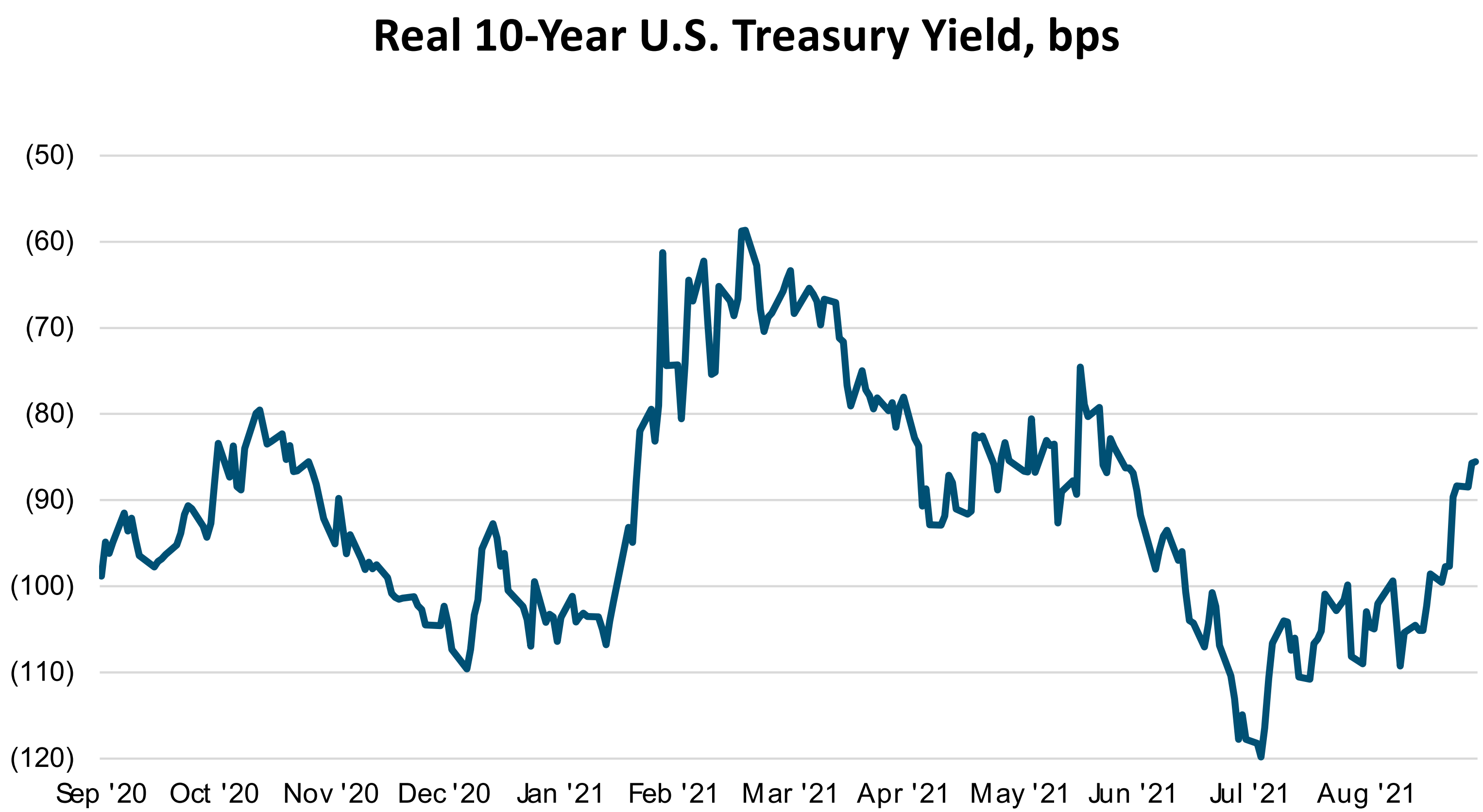
Source: OECD Interim Economic Outlook Forecasts 2021.

Earnings Continue to Grow



Source: FactSet.

Rising Real Rates Bode Well for Growth



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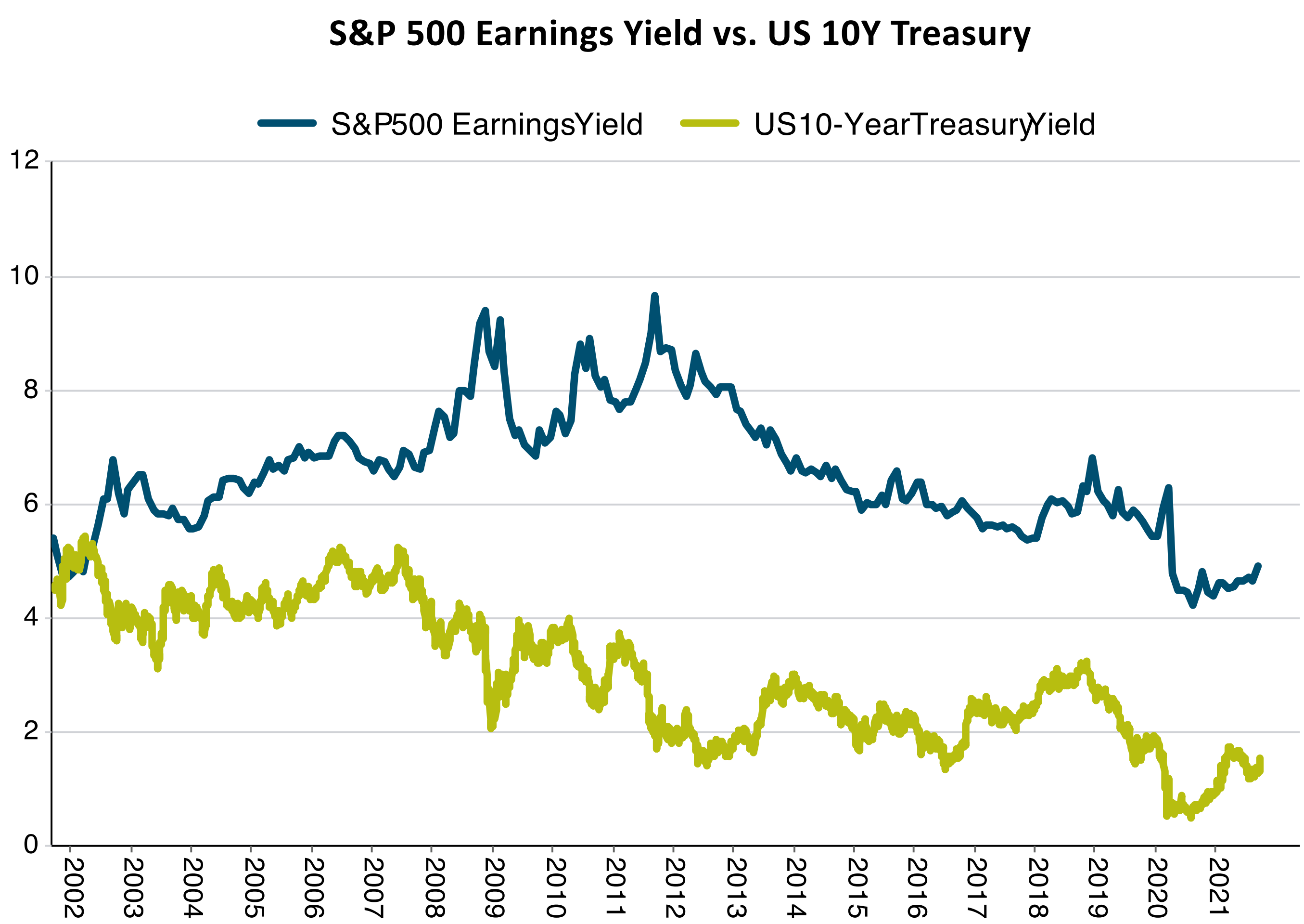
Source: Bloomberg

Stock Valuations are Still Reasonable



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Summary and Key Takeaways I

We believe:

- Delta variant will have a limited economic impact … as will future strains

- Covid virus will soon become endemic … from a pandemic

- Inflation may remain stubbornly persistent over the next 6-12 months

    - It will eventually become transient as it drops below 3% by 2023

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Summary and Key Takeaways II

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- Fed will begin tapering before year-end … and end it after 6 to 9 months

- Fed and markets project the first rate hike in Q4 22 – Q1 23
    - it may well happen in Q3 22

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    - Growth will still be robust in 2022 and 2023

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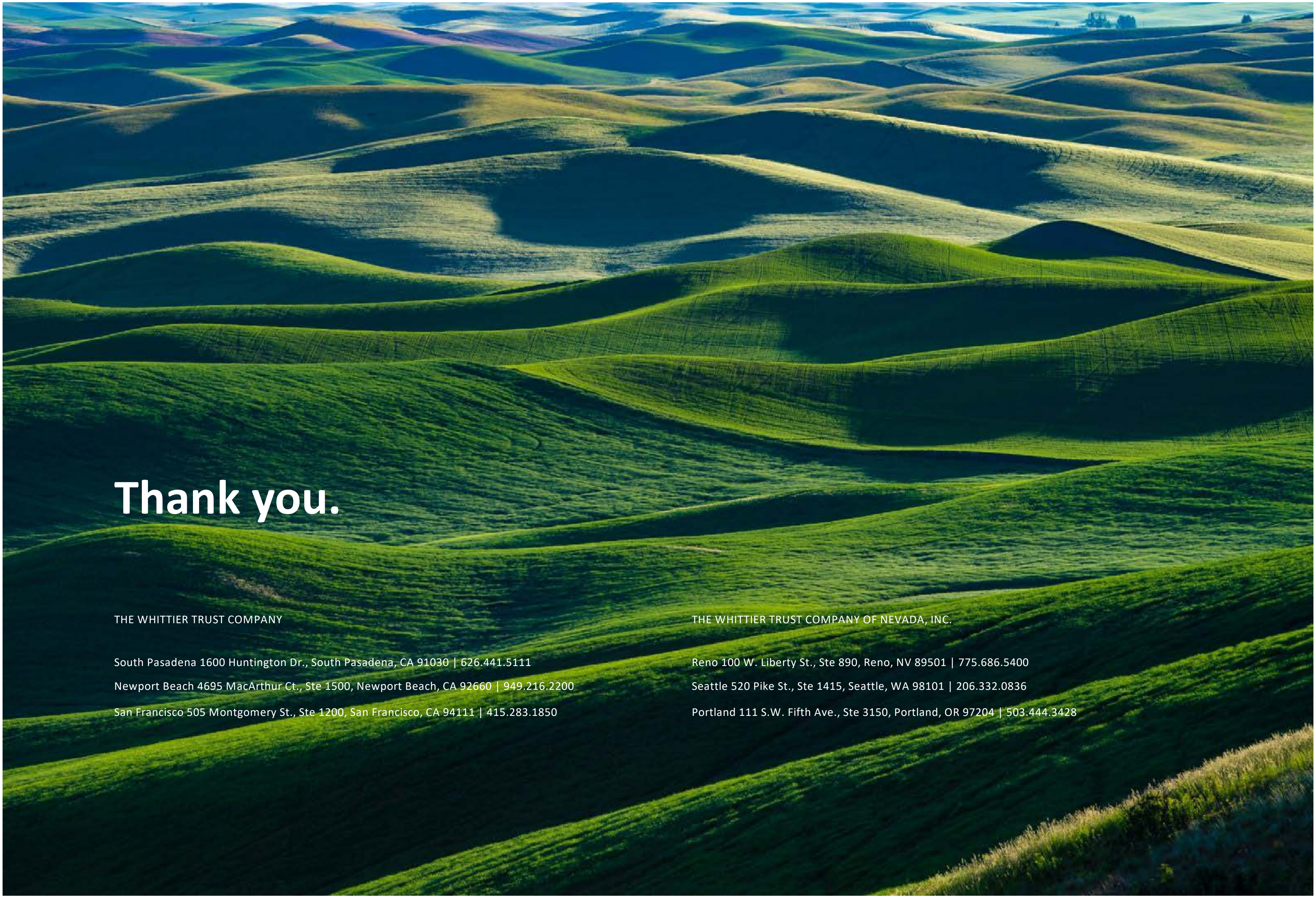

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