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Quarterly Economic Review

October 2021

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Economic Review

A September slump put a pause on the global equity bull market. The S&P 500 Index dropped 4.7% for the month, developed international equities (MSCI EAFE Index) fell 2.9%, and emerging-market (EM) stocks (MSCI EM Index) dropped 4.0%. For the third quarter, the S&P 500 was up just 0.6%, MSCI EAFE was down 0.4%, and EM stocks declined 8.1%. For the year to date, the S&P 500 is up an impressive 15.9%, MSCI EAFE is up 8.3%, and the MSCI EM Index is down 1.2%.

The culprit behind emerging-market stocks' poor recent showing is China. The MSCI China Index was by far the worst-performing stock market in the third quarter, down 18.2%. For the year to date it is down 16.7%. Chinese stocks comprise roughly 35% of the EM equity index.

Meanwhile, within the broad U.S. market, smaller-company stocks and growth stocks beat value stocks for the second straight quarter, with sector performances reflecting a somewhat more risk-averse investor mindset, consistent with the COVID-19-related economic growth slowdown during the quarter.

In the bond markets, core bond returns were essentially flat and yields were little changed for the quarter. But it was a roller-coaster ride, with the 10-year Treasury yield plunging below 1.2% in early August, and then shooting back up in the last two weeks of September. Credit-sensitive bond segments outperformed core bonds, and for the year to date, core bonds are now down 1.6%, while high-yield bonds and floating-rate loans are up 4.6% and 4.4%, respectively.

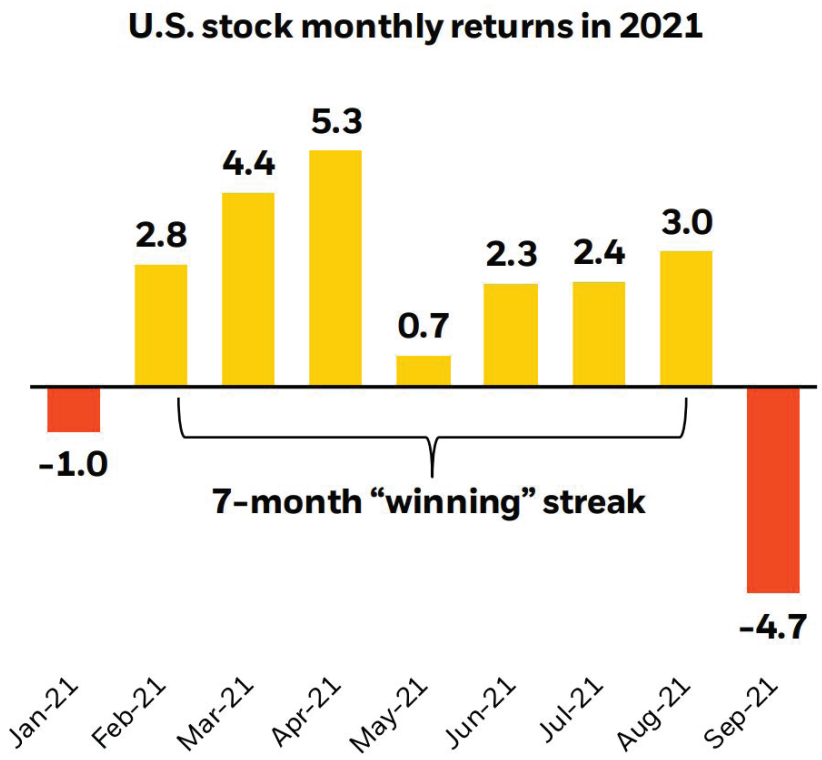
Flattish returns for many assets during range bound 3rd quarter

Prices for most asset categories finished largely unchanged from where they started the quarter. Commodities posted strong gains, ranking as the top-performing category year to date, supported by solid industrial demand and restrained production. Emerging-market equities declined on concerns around China's regulatory tightening and slowing growth. Year to date, U.S. stock performance remained strong, while bond returns were lackluster.

	Q3 2021 (%)	YTD (%)		Q3 2021 (%)	YTD (%)
Commodities	6.6	29.1	U.S. Corporate Bonds	0.0	-1.3
Real Estate Stocks	1.0	23.1	Non-U.S. Developed-Country Stocks	-0.4	8.3
High Yield Bonds	0.9	4.7	Emerging-Market Bonds	-0.5	-1.5
Non-U.S. Small Cap Stocks	0.9	10.0	Gold	-0.7	-7.4
U.S. Large Cap Stocks	0.6	15.9	U.S. Mid Cap Stocks	-0.9	15.2
Long Government & Credit Bonds	0.1	-4.6	U.S. Small Cap Stocks	-4.4	12.4
Investment-Grade Bonds	0.1	-1.6	Emerging-Market Stocks	-8.1	-1.2

Past performance is no guarantee of future results. It is not possible to invest directly in an index. All indexes are unmanaged. See Appendix for important index information. IG: Investment grade. Assets represented by: Commodities—Bloomberg Commodity Index; Emerging-Market Bonds—JP Morgan EMBI Global Index; Emerging-Market Stocks—MSCI EM Index; Gold—Gold Bullion, LBMA PM Fix; High-Yield Bonds—ICE BofA High Yield Bond Index; Investment-Grade Bonds—Bloomberg U.S. Aggregate Bond Index; Non-U.S. Developed-Country Stocks—MSCI EAFE Index; Non-U.S. Small Cap Stocks—MSCI EAFE Small Cap Index; Real Estate Stocks—FTSE NAREIT Equity Index; U.S. Corporate Bonds—Bloomberg U.S. Credit Index; U.S. Large Cap Stocks—S&P 500®; U.S. Mid Cap Stocks—Russell Midcap® Index; U.S. Small Cap Stocks—Russell 2000® Index; Long Government & Credit Bonds—Bloomberg Long Government & Credit Index.
Source: Bloomberg Finance L.P., Haver Analytics, Fidelity Investments Asset Allocation Research Team (AART), as of 9/30/21.

September snaps 7 month "winning streak" for stocks



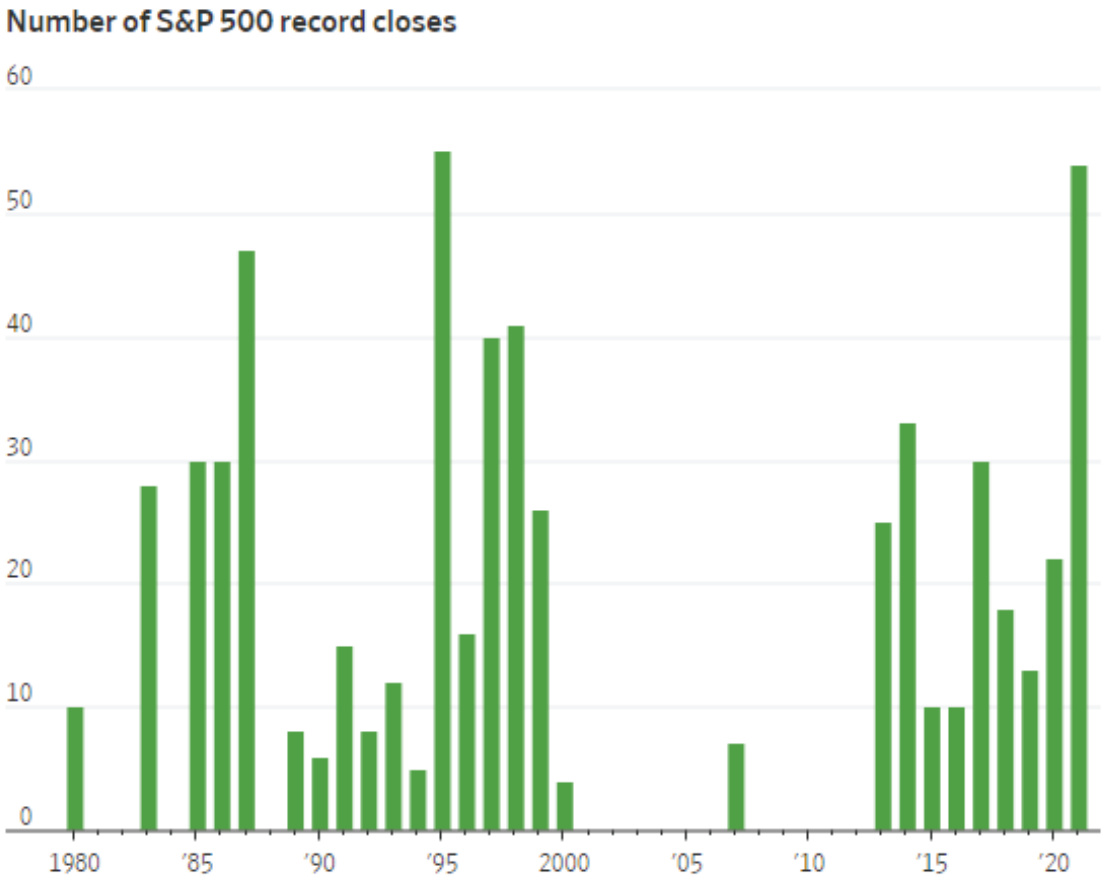
Other recent winning streaks for stocks

Since 1990

Ending Month	Length of streak (months)	1 year later
Jan-18	15	-2.3%
Sep-95	10	20.3%
Jun-96	8	34.7%
Jan-07	8	-2.3%
Apr-11	8	4.8%
May-91	7	9.9%
Mar-93	7	1.5%
Sep-09	7	10.2%
May-13	7	20.5%
Sep-16	7	18.6%
Aug-21	7	?
Apr-98	6	21.8%
Aug-03	6	11.5%
Apr-06	6	15.2%
Sep-18	6	4.3%
Jan-99	5	10.4%
Feb-04	5	7.0%
Dec-04	5	4.9%
Jun-14	5	7.4%
Aug-20	5	31.2%
Average	7	*12.1%*

Source: Morningstar as of 9/30/21. U.S. stocks are represented by the S&P 500 TR Index from 3/4/57 to 9/30/21 and the IASBBIU.S. Lrg Stock TR USD Index from 1/1/50 to 3/4/57, unmanaged indexes that are generally considered representative of the U.S. stock market during each given time period. **Past performance does not guarantee or indicate future results.** Index performance is for illustrative purposes only. You cannot invest directly in the index.

Although 2021 has had plenty of record high closes to date.

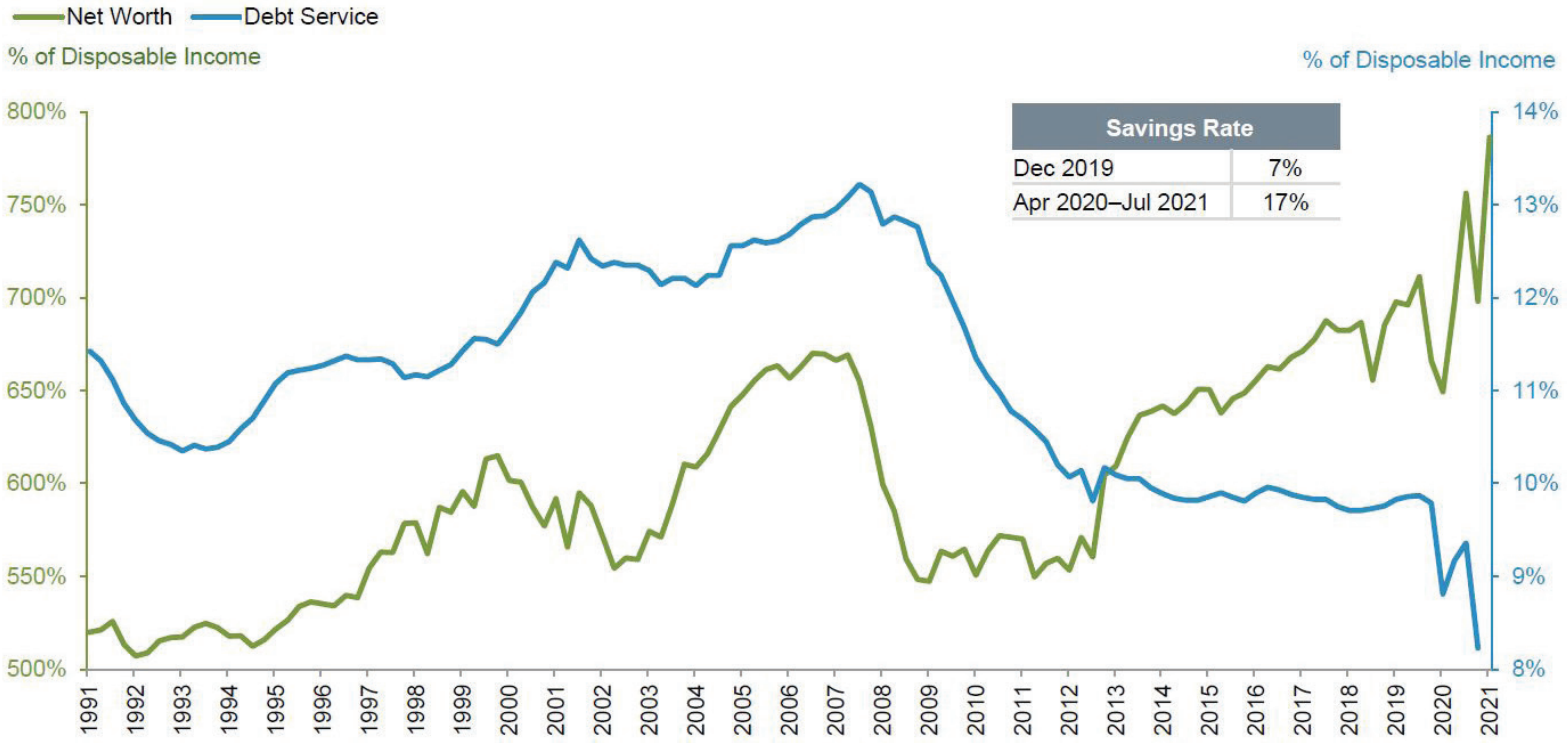


Note: Represents year-to-date periods ended Sept. 9. Blank entries for some years indicate no records were hit.
Source: Dow Jones Market Data

Asset rally and savings gains bolster US consumers.

U.S. consumers enjoyed the highest net worth and lowest debt-service obligation on record. Historic monetary and fiscal stimulus boosted housing and financial asset prices, drove interest rates down, and delivered direct fiscal transfers that helped generate record savings gains. Higher inflation and inequality are challenges, but consumers broadly are in solid shape, and pent-up demand may offer a steadying mid-cycle influence.

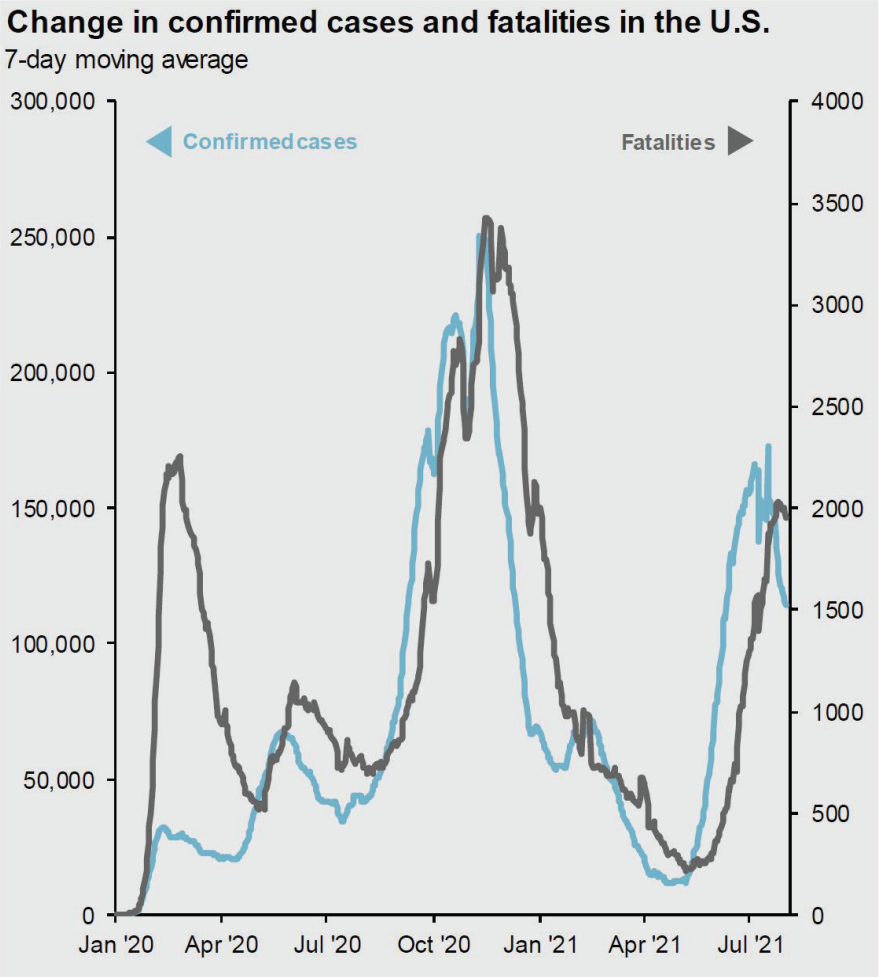
U.S. Household Wealth and Debt Payments

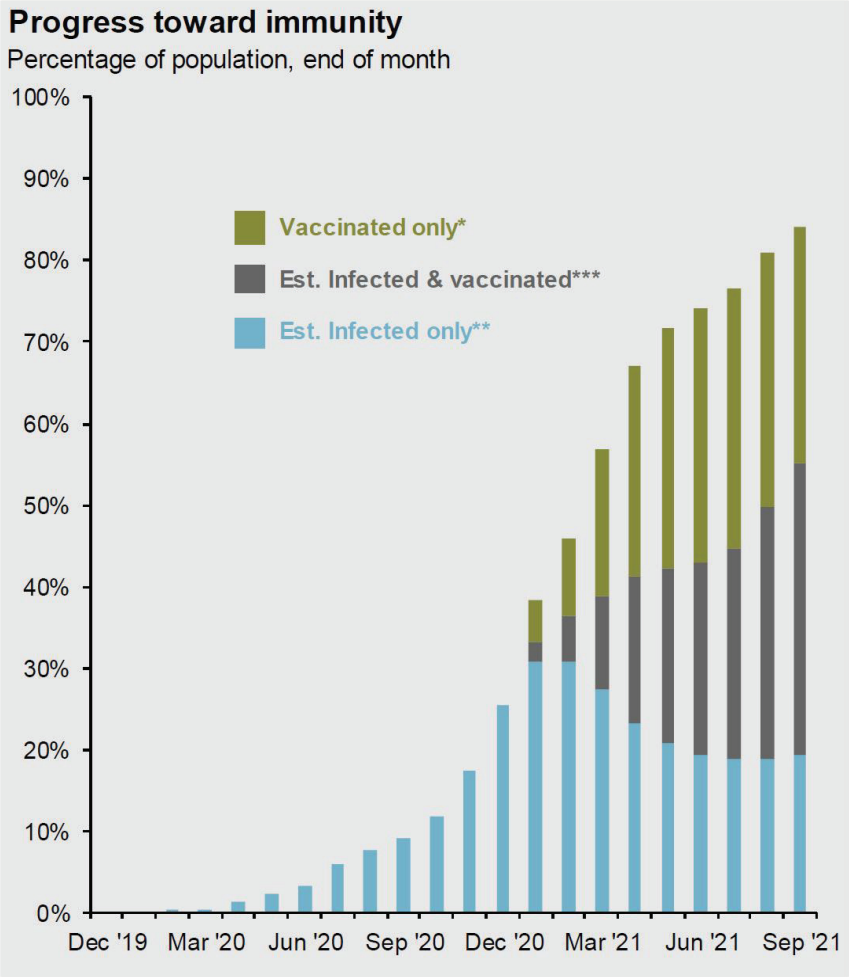


Savings Rate	
Dec 2019	7%
Apr 2020–Jul 2021	17%

Source: Fidelity Investments.

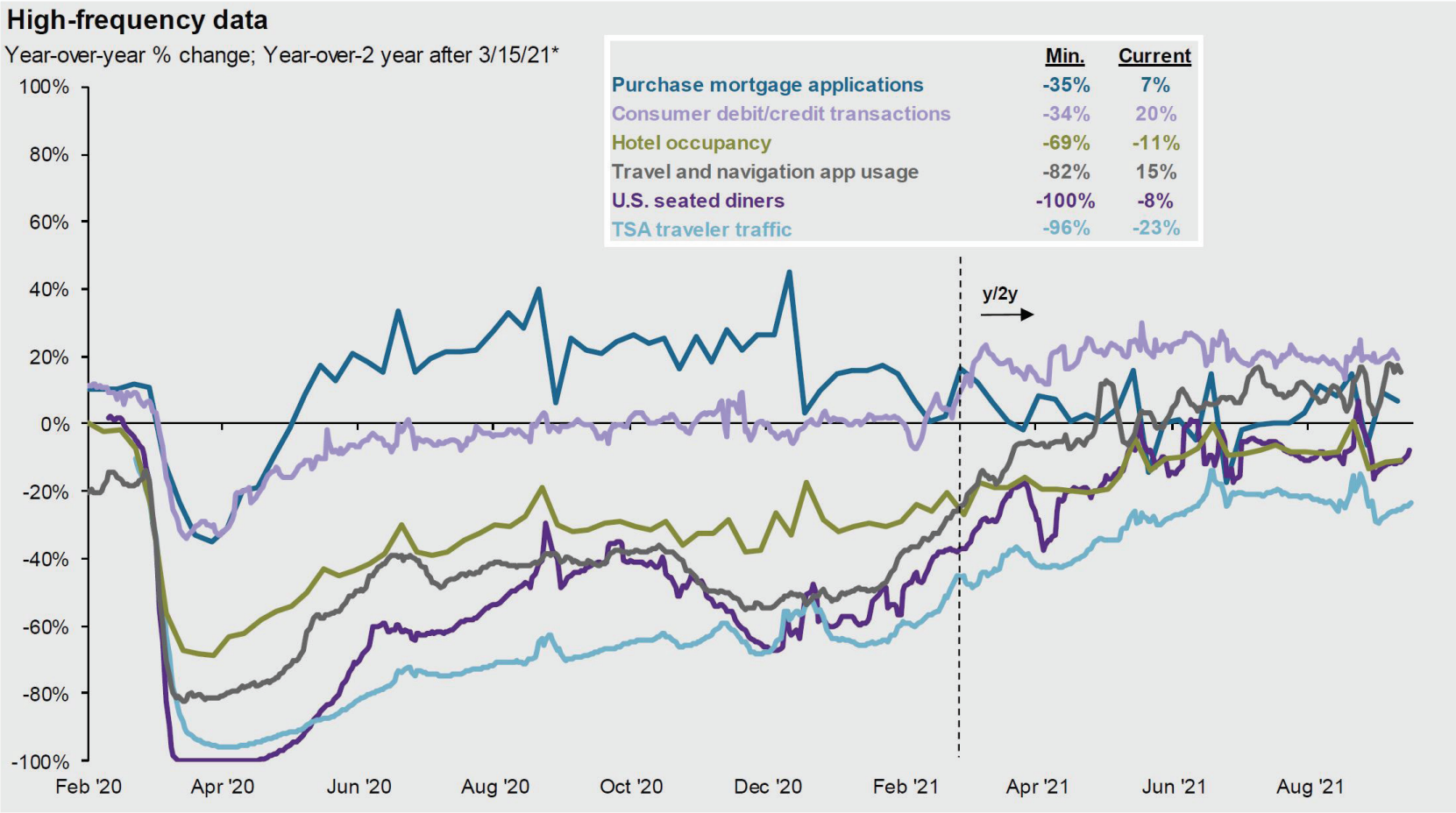
The 4th COVID wave seems to be in retreat as the US makes progress towards herd immunity.





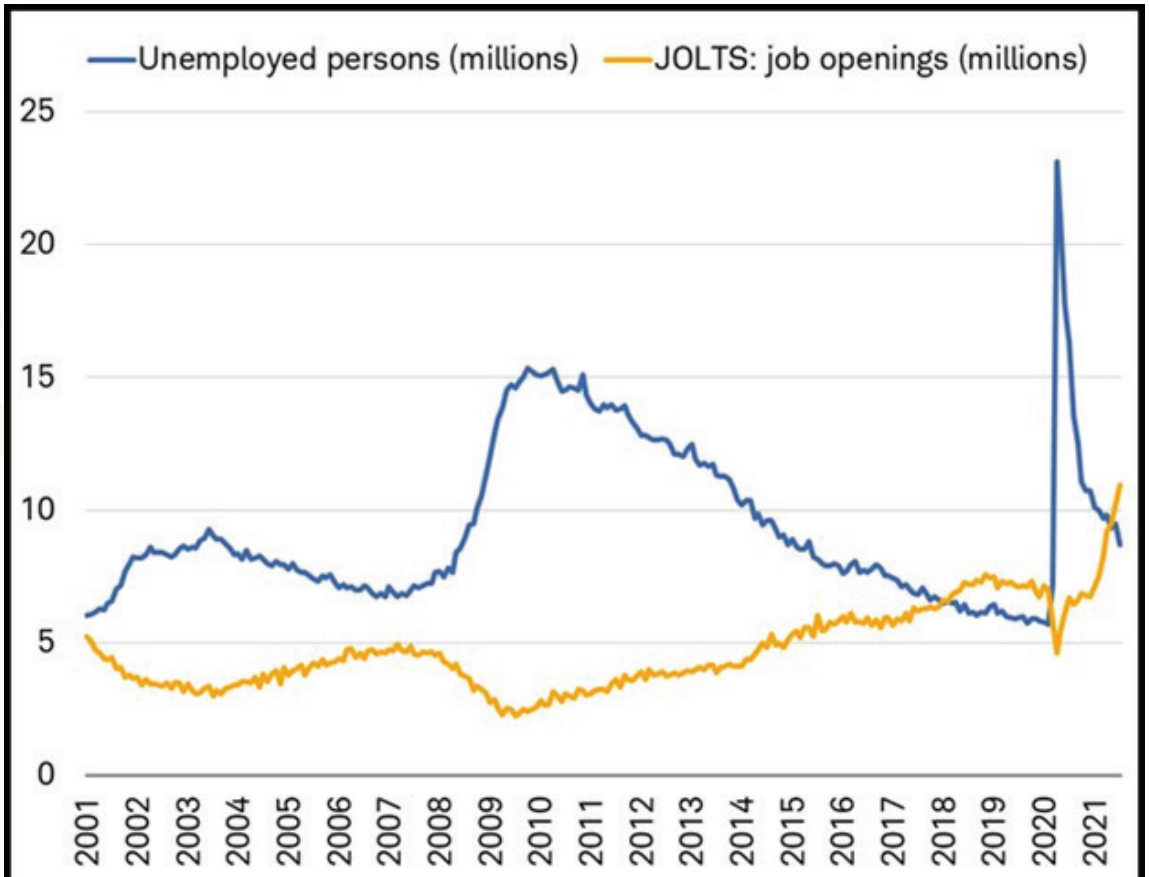
Source: J.P. Morgan Asset Management

And, Americans are resuming "normal" activity.



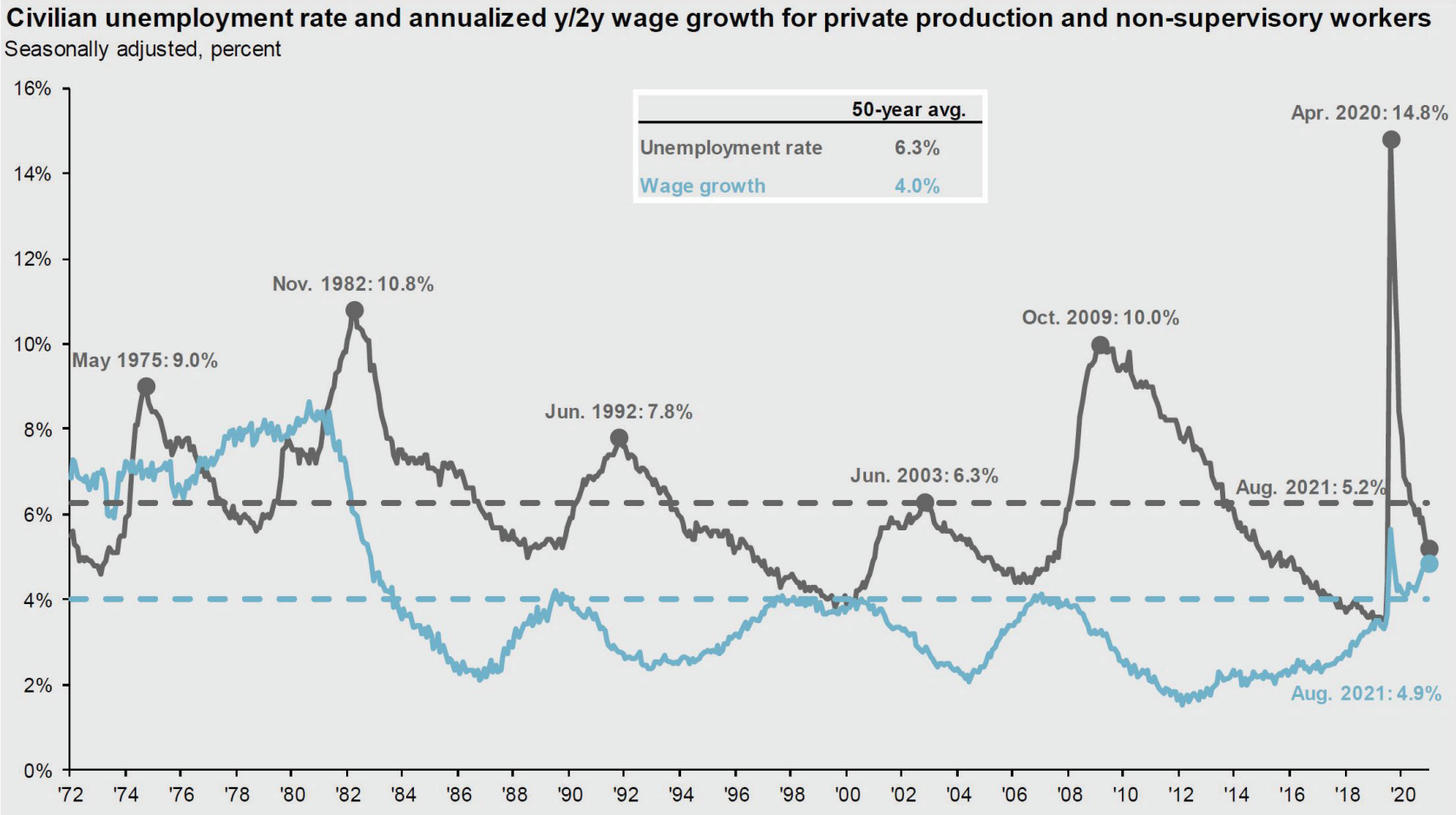
Source: J.P. Morgan Asset Management

As the economy continues to improve, there are currently more job openings in the US than unemployed persons...



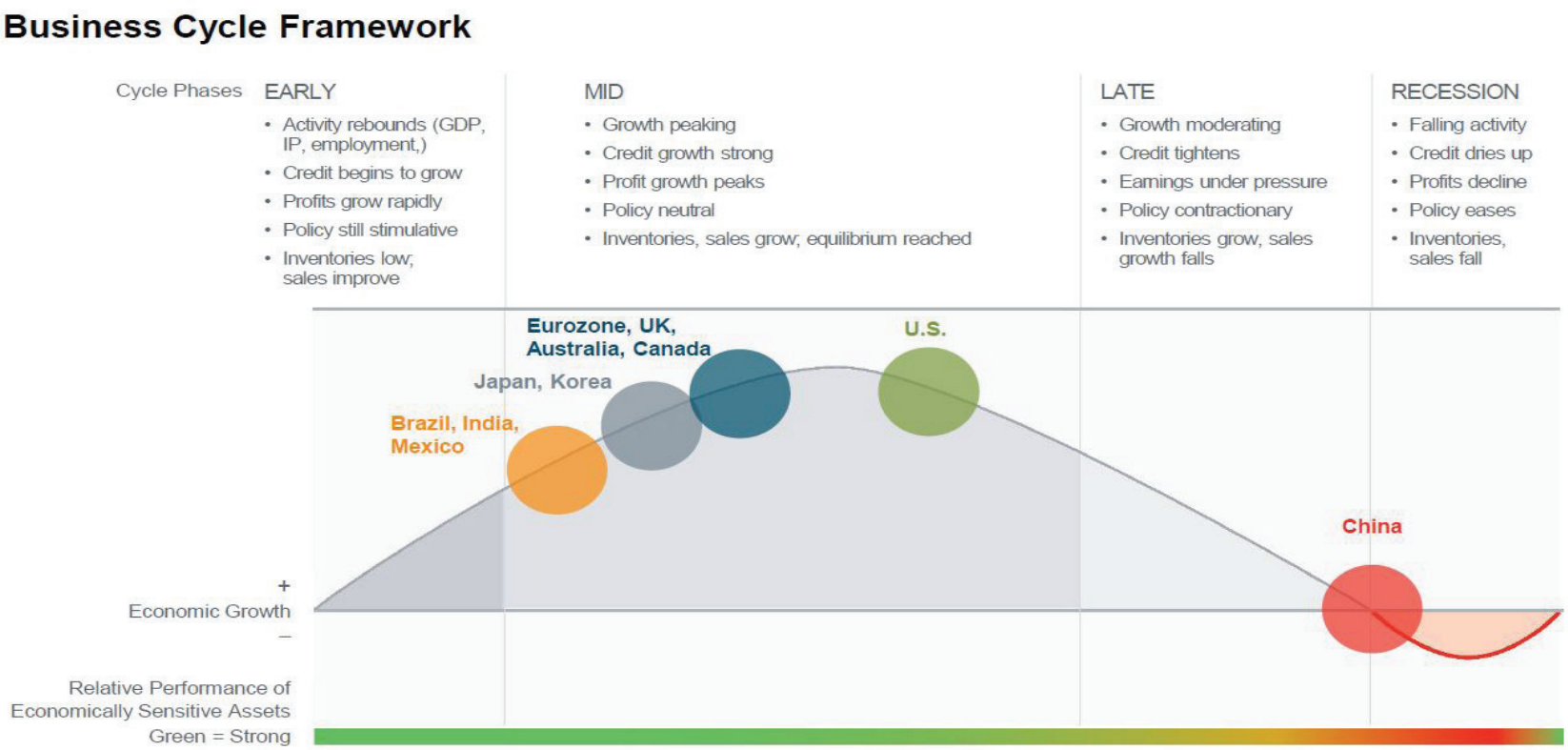
Source: Charles Schwab, Bloomberg, Bureau of Labor Statistics, as of 7/31/2021. Job Openings and Labor Turnover Survey (JOLTS) is a monthly survey of private nonfarm establishments and local government entities which provides information on total number of job openings, hires, and separations (voluntary quits and layoffs/discharges).

...putting updward pressure on wages



Source: J.P. Morgan Asset Management

Global expansion still broadens amid growing crosswinds



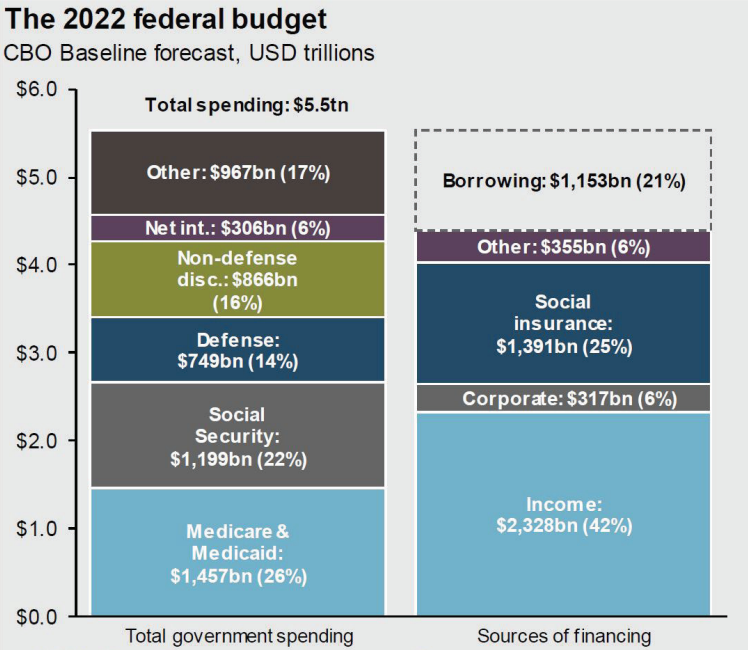
Source: Fidelity Investments.

Speaking of crosswinds...

Tailwinds	Headwinds
Inflation Concerns Absent	**Inflation Concerns Prevalent**
Policymakers Behind Us (Monetary and Fiscal)	**Policymakers Against Us** (Less Accommodative Fed, Higher Taxes andRegulations)
Companies Have the Power = **Profits** Rising	**Workers** Have the Power = **Wages** Rising
US Dollar Up	**US Dollar Down**
Demographics Favorable: Boomers Investing, Millennials Day-Trading	**Demographics Challenging:** Boomers Devesting, Millennials Consuming (Homes, Family, etc.)
Wall Street Wins	**Main Street Wins**

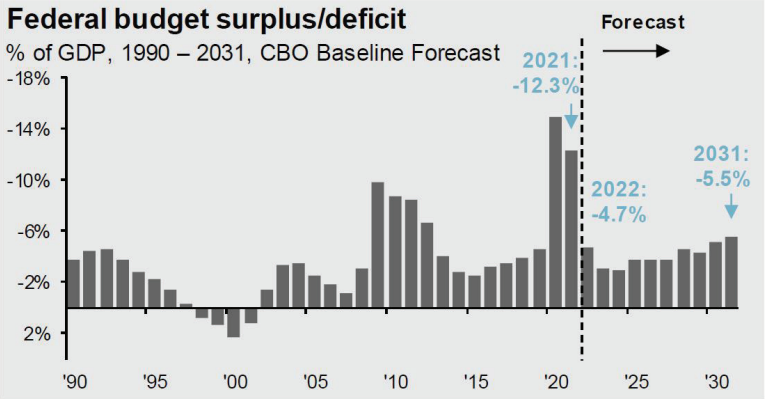
The comments above refer generally to financial markets and not RiverFront portfolios or any related performance. Opinions expressed are current as of the date shown and are subject to change. Past performance is not indicative of future results and diversification does not ensure a profit or protect against loss. All investments carry some level of risk, including loss of principal. An investment cannot be made directly in an index.

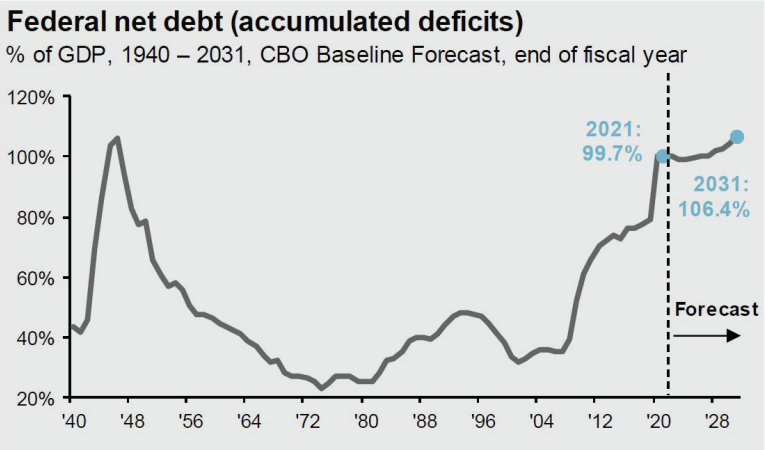
The massive federal stimulus and debt issuance is set to end in 2022.



CBO's Baseline economic assumptions

	2022	'23-'24	'25-'26	'27-'31
Real GDP growth	6.1%	1.6%	1.3%	1.6%
10-year Treasury	1.9%	2.1%	2.6%	3.2%
Headline inflation (CPI)	2.7%	2.3%	2.4%	2.4%
Unemployment	4.1%	3.8%	4.2%	4.4%



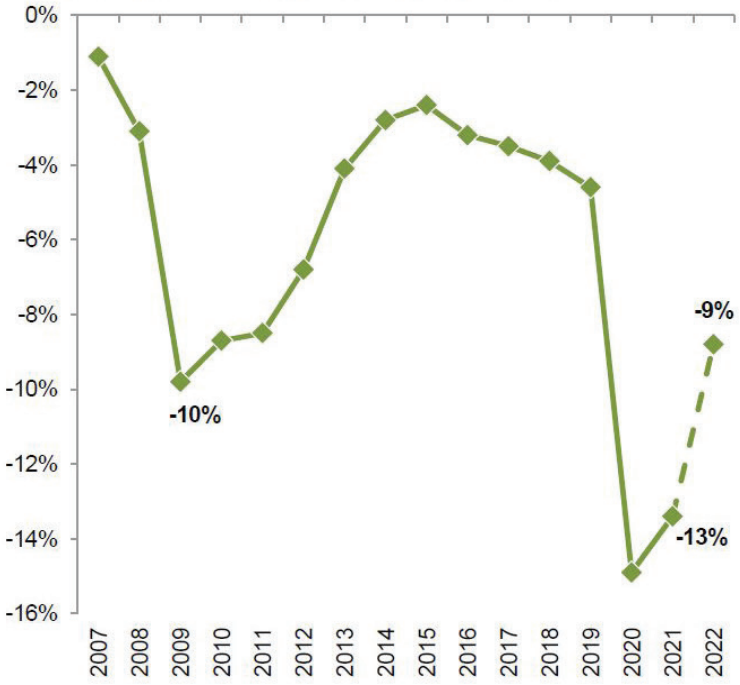


Source: J.P. Morgan Asset Management

While Federal fiscal support is waning, there may be offsets for 2022

After nearly $3 trillion of emergency stimulus in FY 2021, considerably less fiscal support is expected for 2022. The budget deficit is set to shrink significantly next year, but other factors are expected to largely offset any resulting fiscal drag. Strong labor markets should make up for fewer unemployment benefits, and consumers and state governments are in better shape after receiving substantial assistance during the downturn.

Fiscal Deficit as a Percentage of GDP

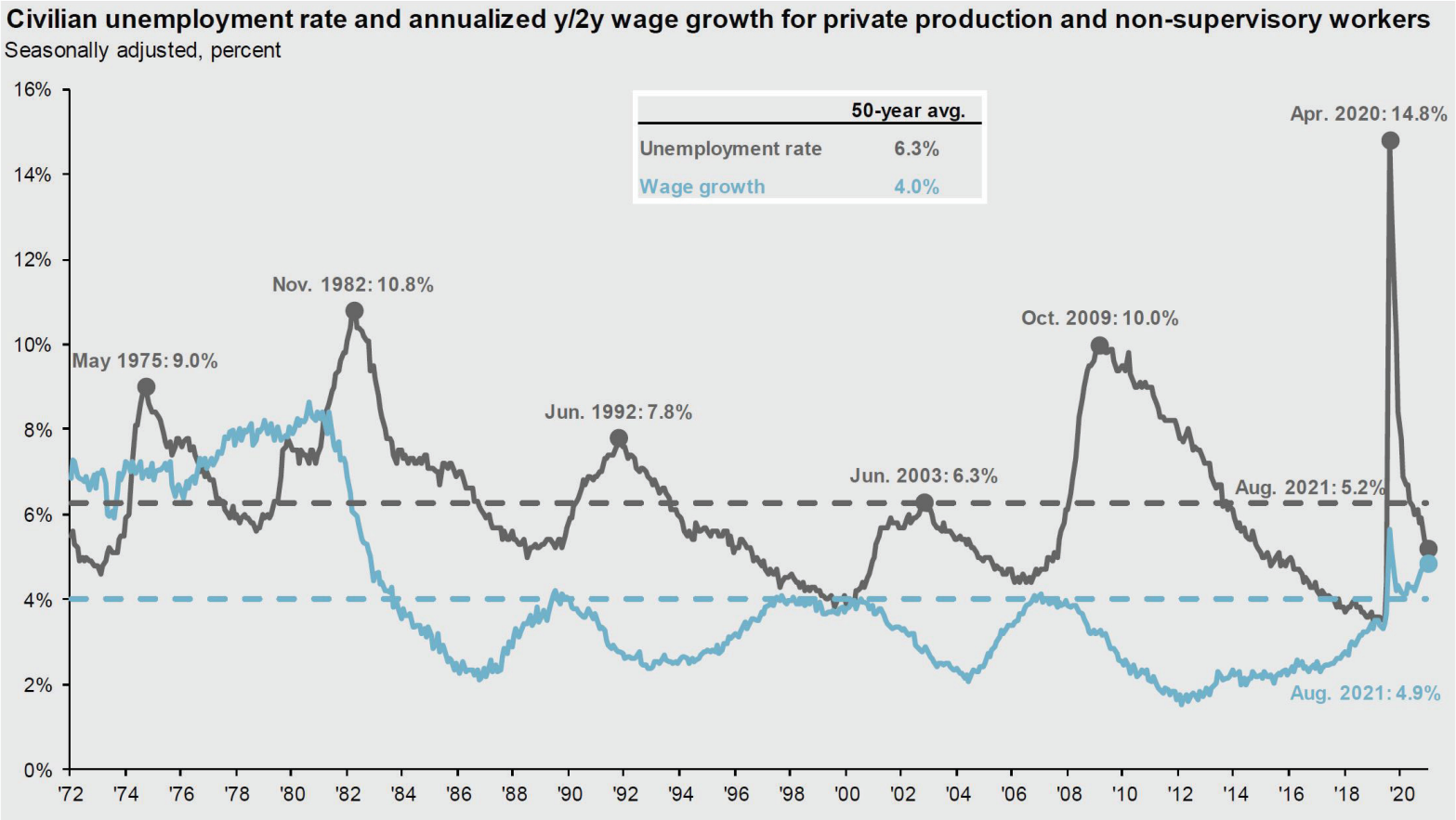


Potential Stimulus Replacements

Major stimulus categories (2021)	Outlook (2022)
Checks for households	Income gains, pent-up savings
Aid to state and local governments	Budget surpluses
Aid to small businesses	More reopening?
Extra unemployment benefits	Employment / wage gains

Source: Fidelity Investments.

Inflation spiked dramatically in 2021...



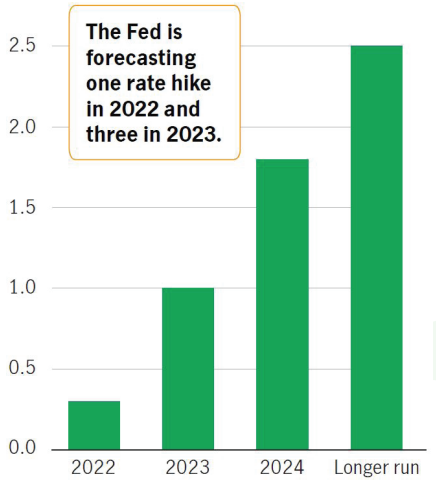
Source: BLS, FactSet, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of September 30, 2021.

Source: J.P. Morgan Asset Management

However, as supply chain disruptions subside, inflation may drift down

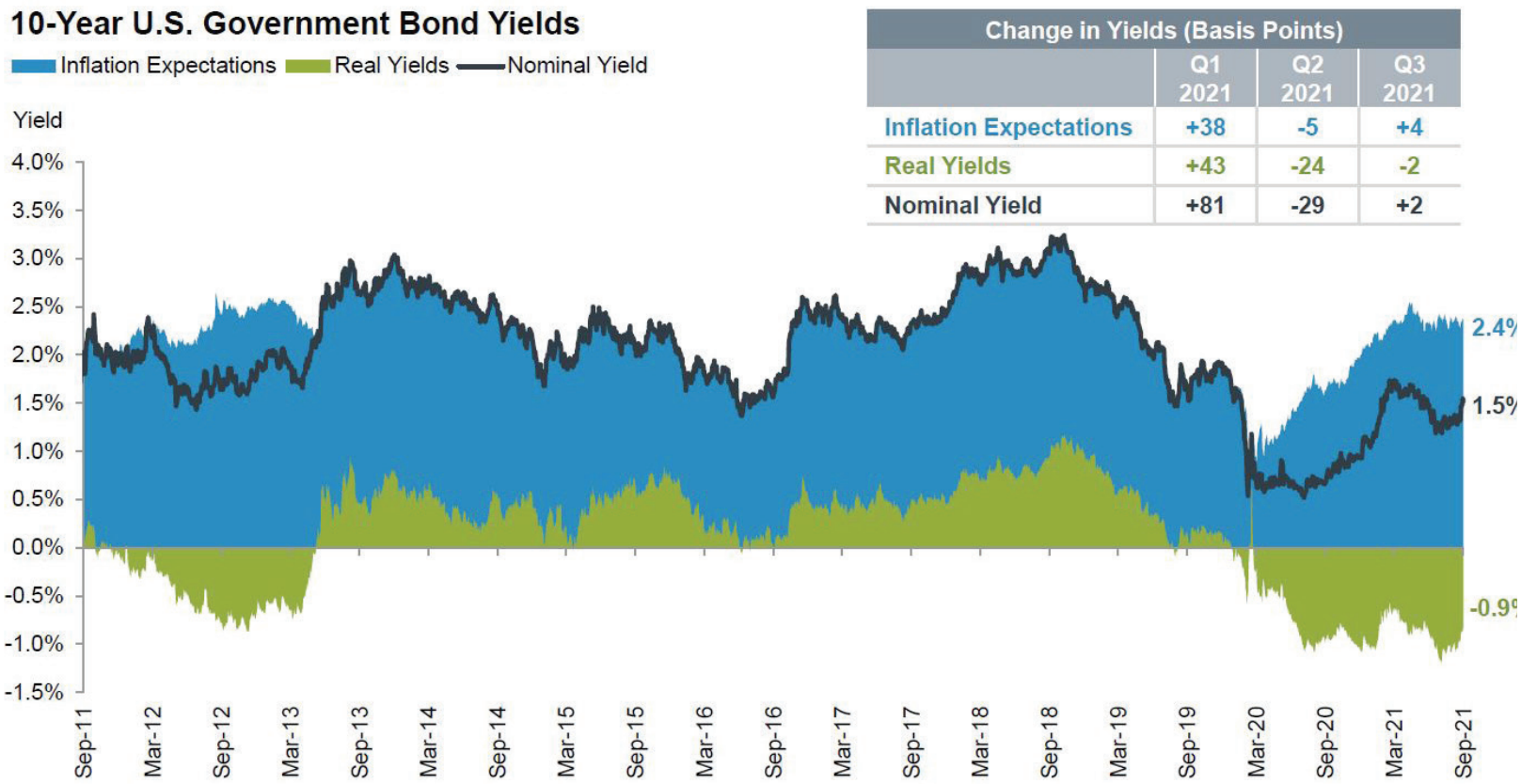
	Potential upside risks may persist in 2021				Potential downside risks may take over in 2022			
	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Core CPI	1.65%	3.70%	4.00%	3.50%	3.00%	2.00%	2.00%	2.00%
		• Positive base effects drive higher readings based on pandemic lock-downs • Supply chain constraints • Pass-through of weaker USD from prior period		• Base effects fade and start to work in opposite direction • Supply chain constraints ease as workers come back		• Productivity drives growth, and inflationary pressures normalize • Potentially higher tax rates decrease fiscal stimulus from 2021		

FOMC rate projections (%)



Source: FactSet, as of 9/30/21. The Federal Open Market Committee (FOMC), which meets eight times a year, is the body responsible for setting the federal funds rate. Fed refers to the U.S. Federal Reserve. The Consumer Price Index (CPI) tracks the average change of prices over time by urban consumers for a market basket of goods and services. It is not possible to invest directly in an index. Past performance does not guarantee future results.

Bond yields have turned negative after inflation



Change in Yields (Basis Points)	Q1 2021	Q2 2021	Q3 2021
Inflation Expectations	+38	-5	+4
Real Yields	+43	-24	-2
Nominal Yield	+81	-29	+2

Source: Bloomberg Finance L.P., Fidelity Investments (AART), as of 9/30/21.

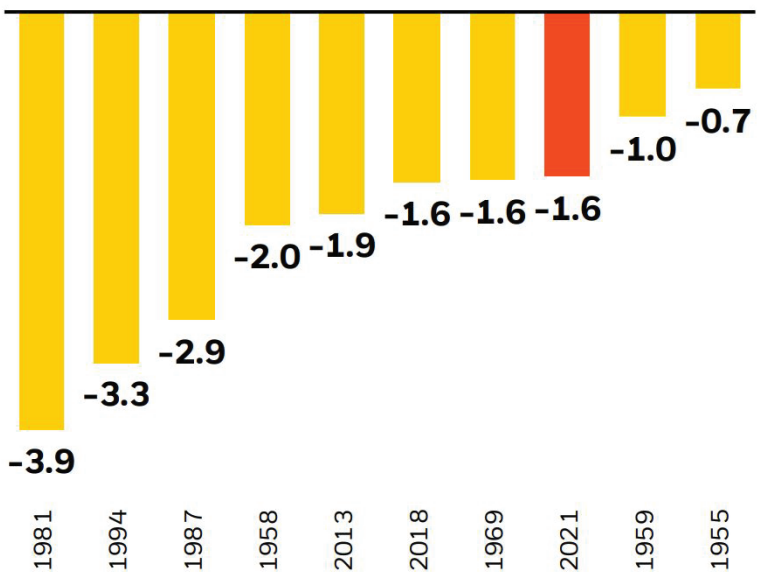
Inflation and interest rate increases caused historically awful bond performance

Taxable fixed income sector returns

2021 was the 8th worst historical start for bonds...

For the worst starts, the next 3 months on average saw bond returns bounce back

Top 10 worst starts of the year for bonds
(Since 1926, total return for first nine months of calendar year)

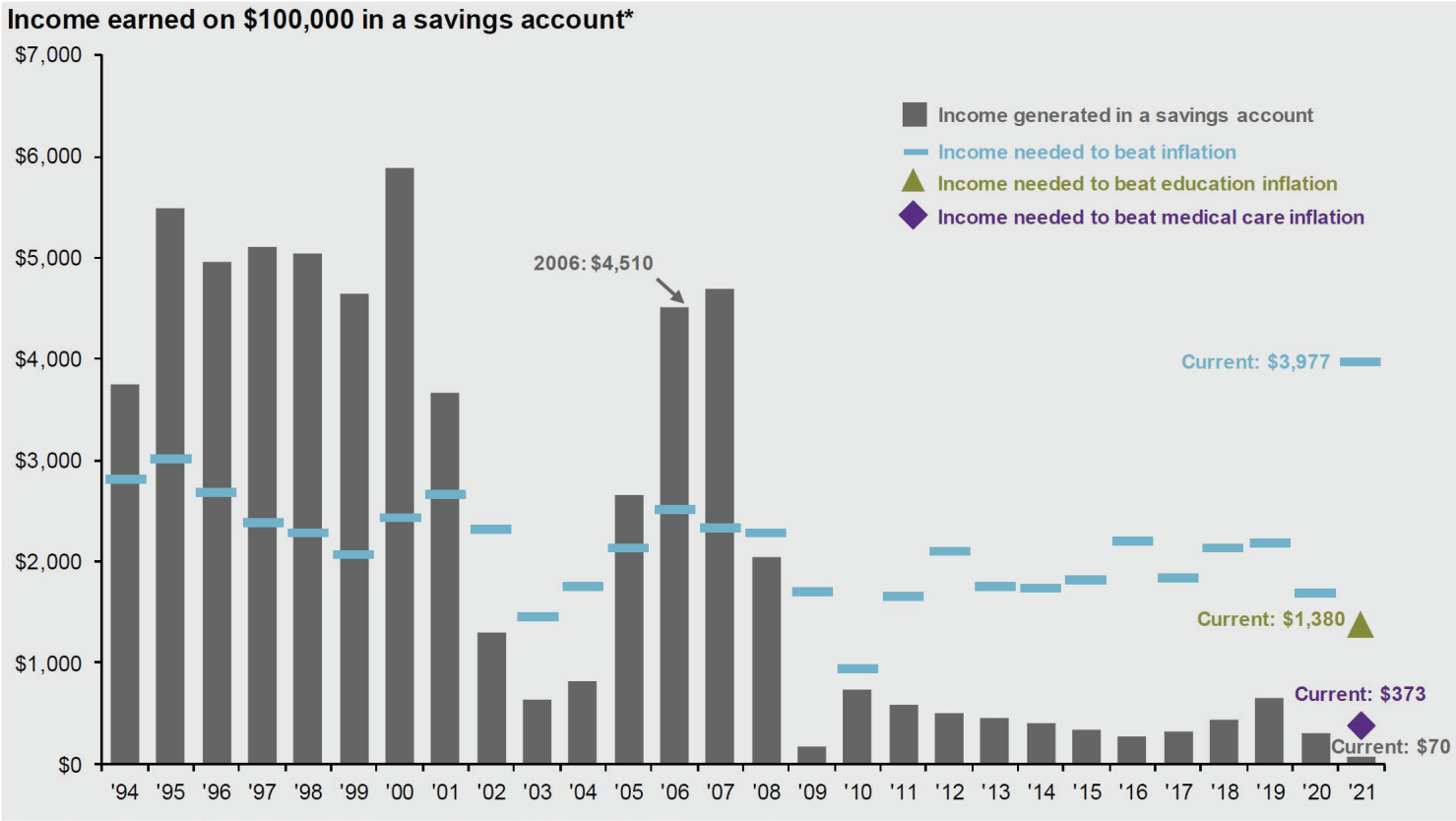


Returns after each "worst start"
(Since 1926, total return for given time periods)

Year	First 9 months	Next 3 months
1981	-3.9	10.6
1994	-3.3	0.4
1987	-2.9	5.8
1958	-2.0	0.7
2013	-1.9	-0.1
2018	-1.6	1.6
1969	-1.6	0.9
2021	-1.6	?
1959	-1.0	0.6
1955	-0.7	0.1
Avg	*-2.1*	*2.3*

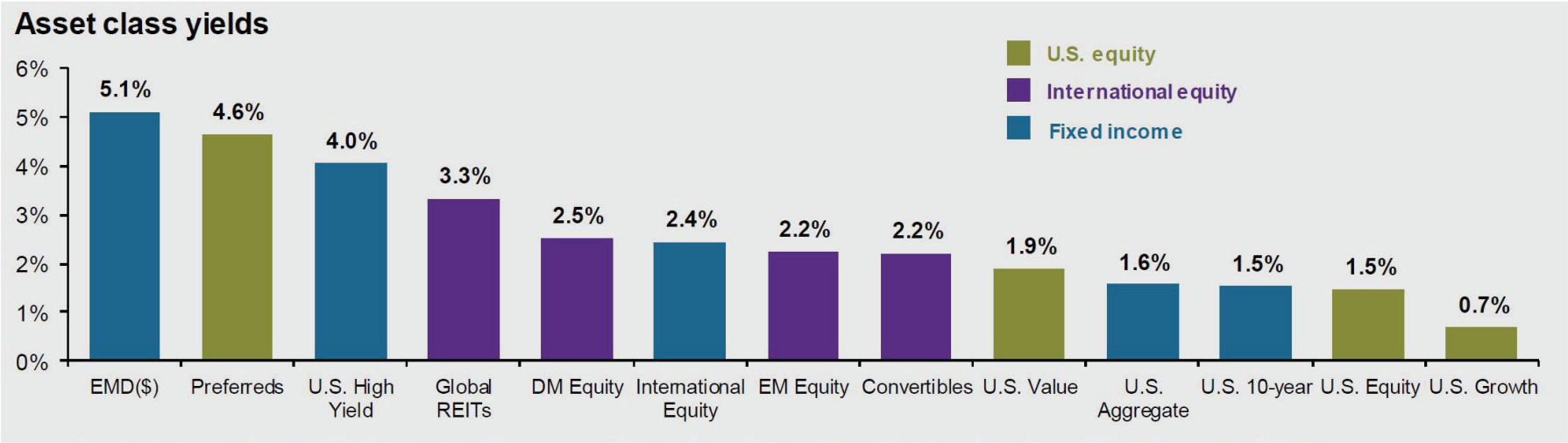
Source: Morningstar as of 9/30/21. U.S. bonds represented by the IA SBBI US Gov IT Index from 1/1/26 to 1/3/89 and the Bbg Barc U.S. Agg Bond TR Index from 1/3/89 to 9/30/21. **Past performance does not guarantee or indicate future results.** Index performance is for illustrative purposes only. You cannot invest directly in the index.

And even a modest improvement in bond returns will not help investors outpace inflation needs...



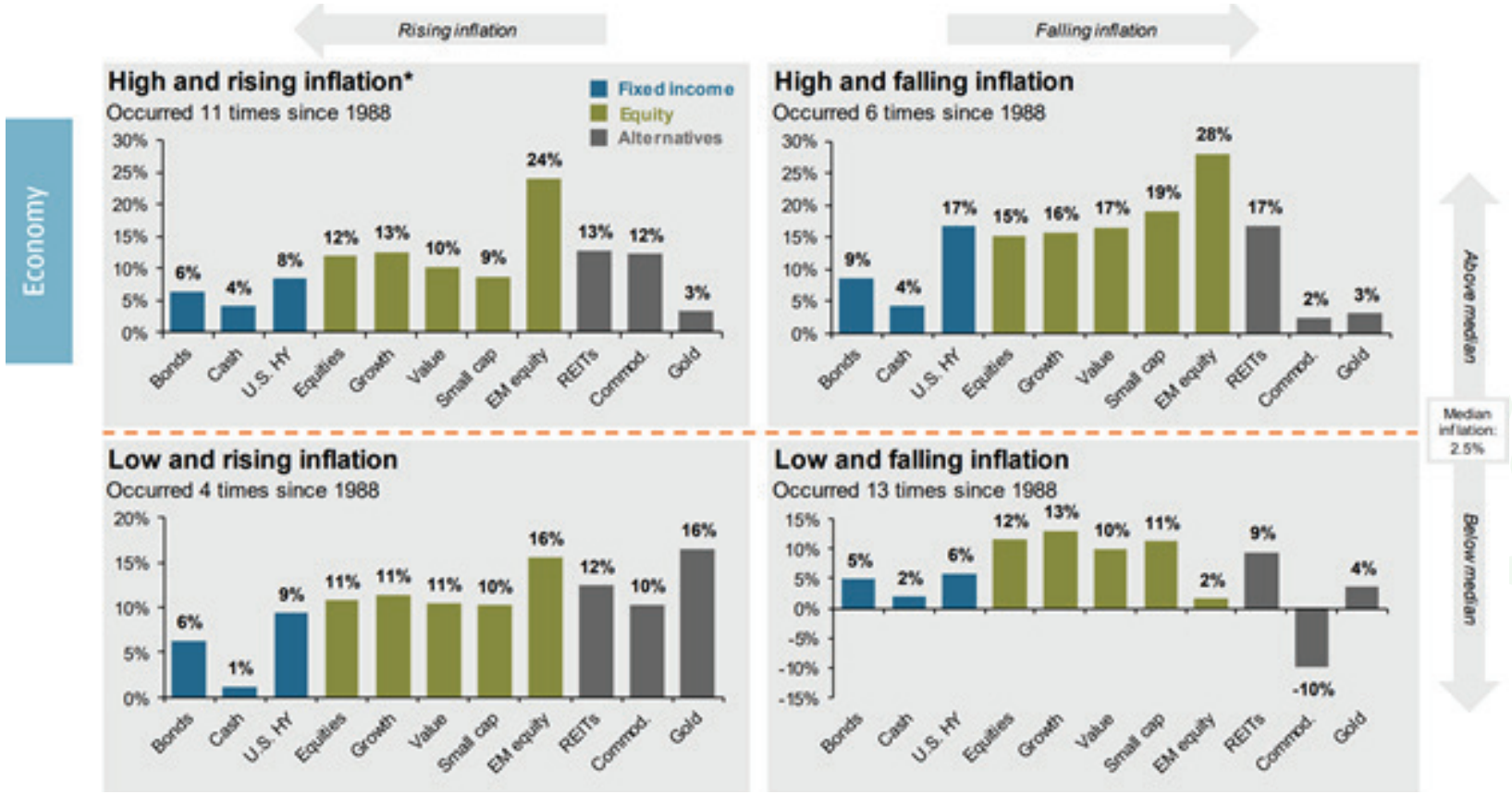
Source: J.P. Morgan Asset Management

...driving many investors to chase yield in other asset classes.



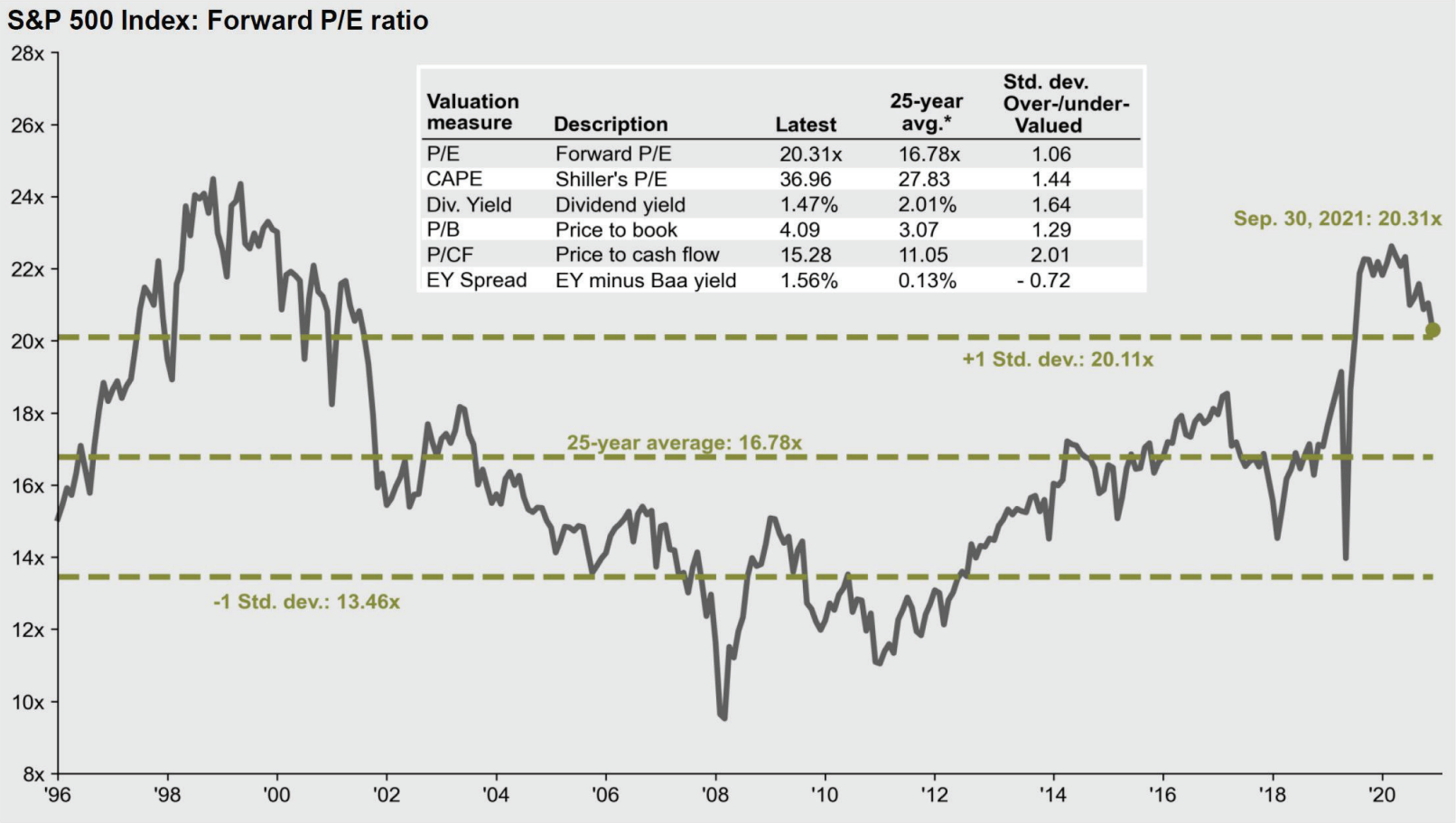
Source: J.P. Morgan Asset Management

Equities can be source of yield as well as inflation hedge



Source: J.P. Morgan Asset Management

And valuations are much more reasonable after the September slump.



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	20.31x	16.78x	1.06
CAPE	Shiller's P/E	36.96	27.83	1.44
Div. Yield	Dividend yield	1.47%	2.01%	1.64
P/B	Price to book	4.09	3.07	1.29
P/CF	Price to cash flow	15.28	11.05	2.01
EY Spread	EY minus Baa yield	1.56%	0.13%	- 0.72

Source: J.P. Morgan Asset Management

And, stock prices have been supported by strong earnings

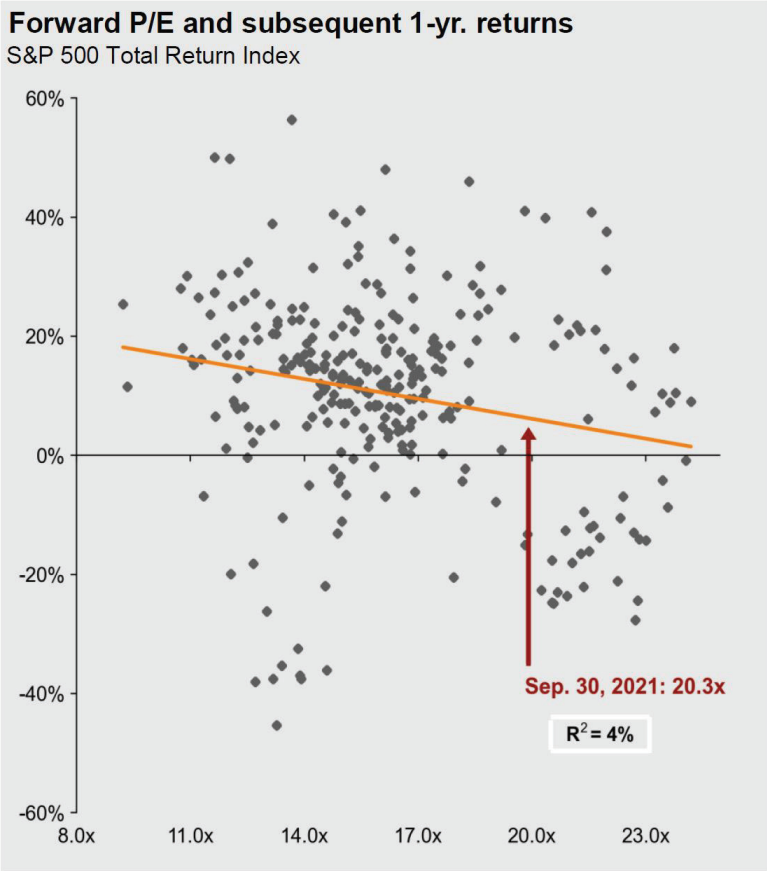
Stock prices and earnings estimates have moved higher nearly in lockstep

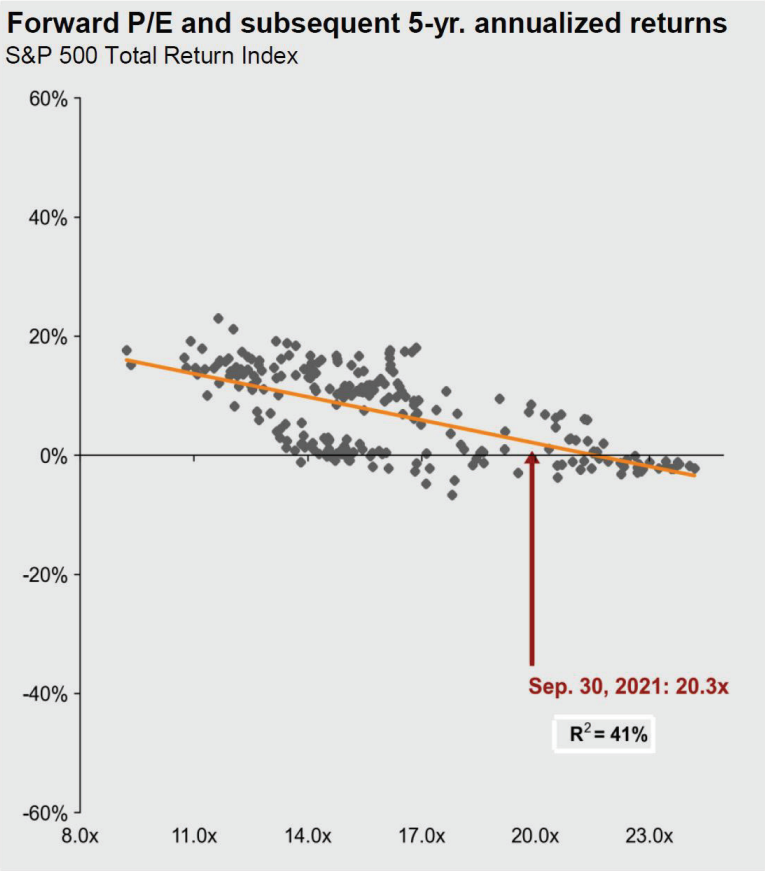
EPS growth estimates YoY (%)

	2021	2022
Energy	—	24.10
Industrials	100.62	36.19
Materials	83.72	-1.54
Consumer discretionary	73.56	33.45
Financials	55.85	-6.50
S&P 500 Index	**42.36**	**9.44**
Communication services	34.19	10.40
Information technology	26.40	10.01
Healthcare	22.47	4.81
Real estate	14.18	5.81
Consumer staples	8.86	6.78
Utilities	2.45	5.50

Source: FactSet, as of 9/30/21. The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States. It is not possible to invest directly in an index. Earnings per share (EPS) is a measure of how much profit a company has generated calculated by dividing the company's net income by its total number of outstanding shares. YoY refers to year over year. Past performance does not guarantee future results.

Although short term forward returns from these valuation levels have historically been modest...





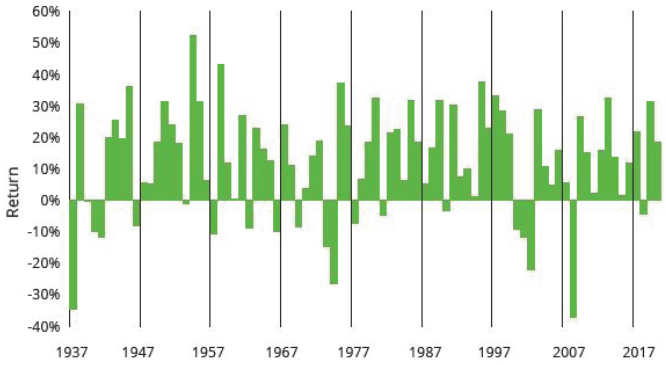
Source: FactSet, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Returns are 12-month and 60-month annualized total returns, measured monthly, beginning 8/31/96. R^2 represents the percent of total variation in total returns that can be explained by forward price-to-earnings ratios. Price-to-earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since July 1996, and J.P. Morgan Asset Management for September 30, 2021.
Guide to the Markets – U.S. Data are as of September 30, 2021.

Source: J.P. Morgan Asset Management

...patience in the market has historically led to decent long term returns.

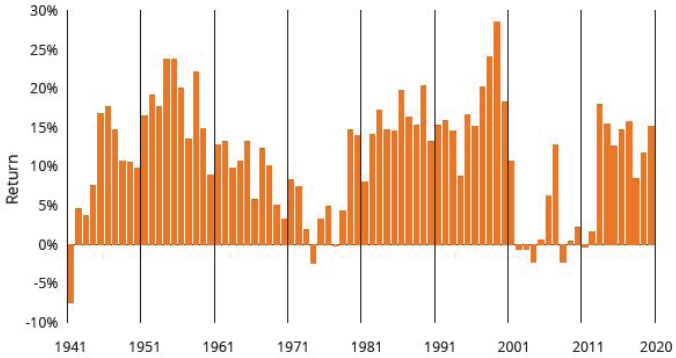
One-year holding periods (Jan. 1, 1937–Dec. 31, 2020)

Stocks were up 76% of the time—64 up periods, 20 down



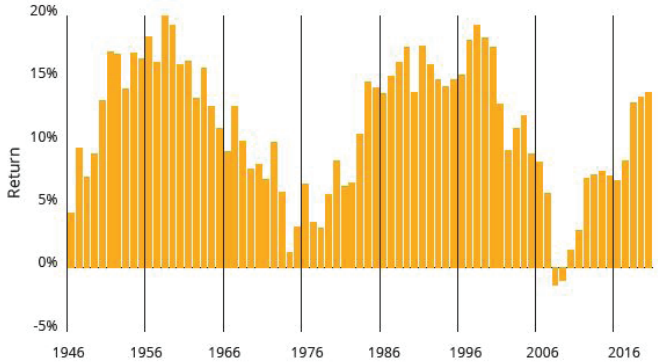
Five-year holding periods (Jan. 1, 1937–Dec. 31, 2020)

Stocks were up 90% of the time—72 up periods, 8 down



Ten-year holding periods (Jan. 1, 1937–Dec. 31, 2020)

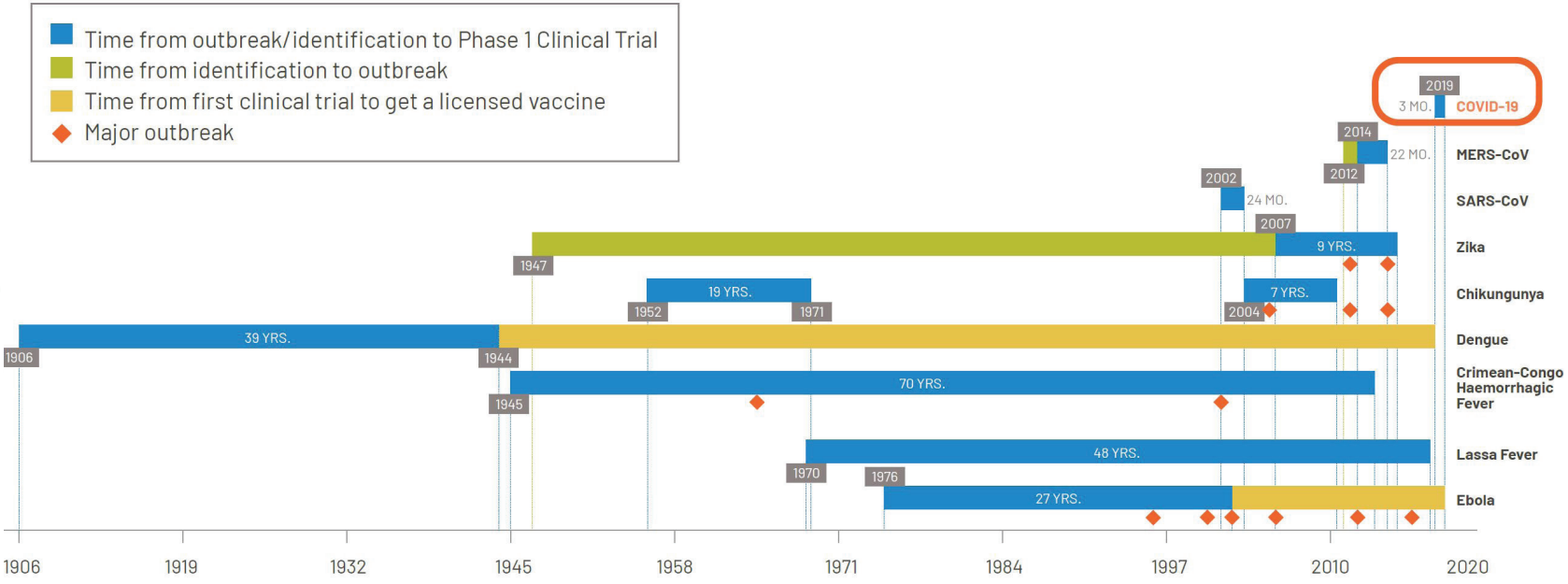
Stocks were up 97% of the time—73 up periods, 2 down



Data Sources: Morningstar and Hartford Funds, 2/21. Equities are represented by the S&P 500 Index. The Index is unmanaged and unavailable for direct investment. For illustrative purposes only. **Past performance does not guarantee future results.**

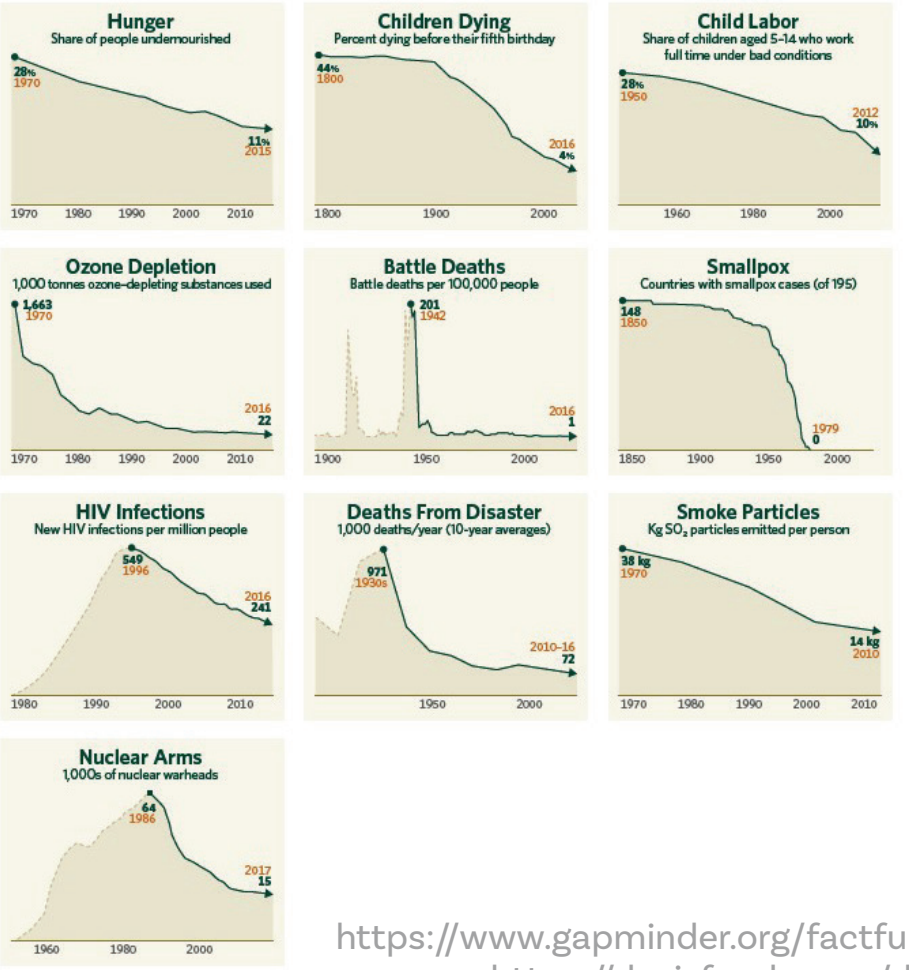
Ending with some good news...

RESEARCHERS DECODED GENETIC MAP AND BEGAN CLINICAL TRIALS OF COVID-19 VACCINE IN A RECORD 69 DAYS



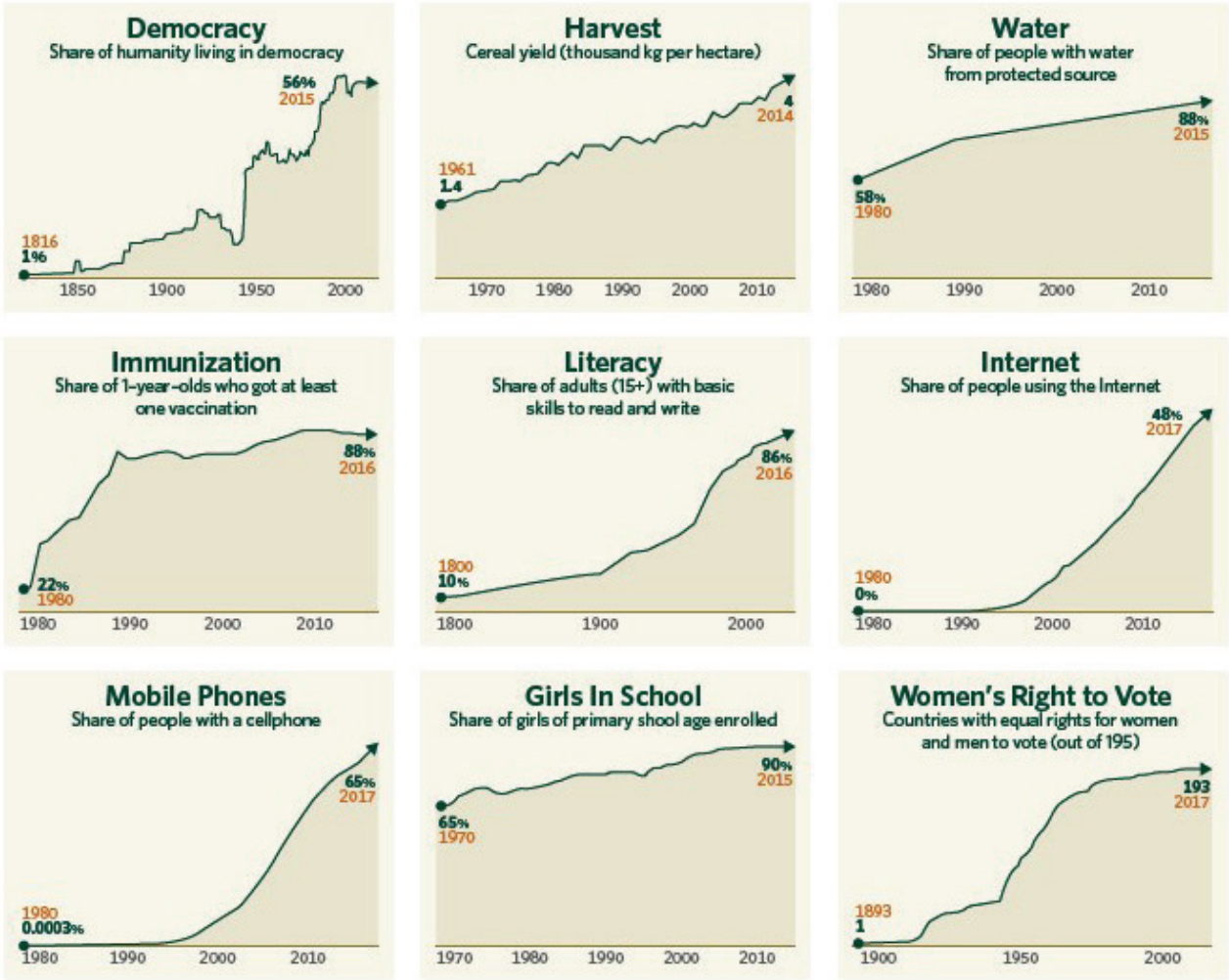
Source: National Research Journal; Kim, Y.C., Dema, B. & Reyes-Sandoval, A. COVID-19 vaccines: breaking record times to first-in-human trials. npj Vaccines 5, 34 (2020). https://doi.org/10.1038/s41541-020-0188-3.

According to gapminder.org, bad things have been in decline...



https://www.gapminder.org/factfulness-book/32-improvements/
https://davisfunds.com/document/read/DNYPMComm/

...and good things are on the rise.



https://www.gapminder.org/factfulness-book/32-improvements/
https://davisfunds.com/document/read/DNYPMComm/

Portfolio Implications

Portfolio allocations remain well-diversified and balanced across a range of global asset classes, risk factor exposures, and investment strategies, each of which has different expected performance depending on the macro and market environment that unfolds.

We believe the portfolio positioning allows for the generation of relatively strong returns in a continued global economic recovery with moderately rising interest rates and inflation and decelerating growth in the United States.

Overall, a large underweight to core bonds in favor of flexible, shorter-duration, credit-oriented bond and positions in lower-risk and diversifying alternative strategies should help to mitigate risks of higher than expected inflation and interest rates.

Within the equity allocation, balanced exposure across the value-growth style spectrum is warranted. There is potential for value and cyclical stocks to strongly rebound (again) as COVID-19 recedes and inflation and interest rates rise. And after an unusually long and severe period of underperformance versus growth stocks, value stocks, in aggregate, look particularly cheap versus growth. But, also maintaining long-term, strategic exposure to high-quality, innovative growth companies with strong competitive advantages--that are selling at reasonable valuations--is important as well.

Disclosures

Please remember that past performance may not be indicative of future results. Therefore, no current or prospective client should assume that the future performance of any specific investment, investment strategy (including the investments and/or investment strategies recommended by the adviser), will be profitable or equal to past performance levels.

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All investment strategies have the potential for profit or loss. Changes in investment strategies, contributions or withdrawals may materially alter the performance and results of your portfolio. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Meridian Financial Partners, Inc. ("Meridian"), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Diversification does not guarantee against market losses, it is a method used to help manage investment risk.

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