Birch Hill
INVESTMENT ADVISORS

Market View

October 2021

FINANCIAL MARKETS

Stock prices continued moving steadily up in July and August before faltering in September amid growing predictions of a correction. During 2021's first nine months, the Standard & Poor's 500 Index continued leading other indexes with a return of 15.9%. The higher-quality Dow Jones Industrials Index returned 12.1%. In general, riskier, "higher beta" stocks performed best. With the notable exception of Chinese stocks, most other non-US equity indexes also produced attractive returns. Chinese stocks suffered as new central government regulations limited some business activities and highly leveraged Evergrande, China's second-largest real estate developer, teetered on the brink of financial collapse.

Interest rates were essentially unchanged during the quarter. Before year-end, the Federal Reserve will likely begin reducing their bond purchases, thus slowly decreasing one kind of economic support. This change could nudge longer-term interest rates higher over the next several years.

Market Indicators		9/30/2021
TOTAL RETURN		
US Stock Markets	12 Mos	Year-to-date
S&P 500 Index	30.0%	15.9%
S&P 400 Mid Cap	43.7%	15.5%
Russell 2000 Small Cap	47.7%	12.4%
Int'l Stock Markets		
ETF Returns in US$		
EAFE Index (Europe, Australia, Asia, Far East)	25.4%	8.4%
Japan (MSCI Index)	20.3%	4.7%
China (FTSE 50)	-5.6%	-15.9%
Emerging Mkts Index	16.0%	-2.1%
US Fixed Income Yields	12/31/2020	9/30/2021
6 Mo US T-Bill	0.09%	0.05%
2 Yr US T-Note	0.13%	0.28%
10 Yr US T-Note	0.93%	1.52%

PENDING TAX LAW CHANGES

While not a certainty, tax law changes that will affect high-income and wealthy individuals have a greater-than-average likelihood of enactment this year. Possible changes include an increase in the top marginal tax rate on ordinary income, an increase in capital gains tax rates for high-income earners, a decrease in lifetime exemptions for estate and gift tax purposes, and a decrease in the annual gift tax exclusion. Other changes could greatly affect the use of certain trusts for estate tax planning purposes. To discuss how these developments may affect your tax planning, please contact your Birch Hill advisor.

SLOWING ECONOMIC GROWTH

The third-quarter US economic growth rate appears to have exceeded 6%, a strong showing but somewhat slower than the second quarter. Some economists have reduced economic growth expectations for the rest of 2021, due to the surge in the COVID-19 Delta variant. Supply disruptions and shipping bottlenecks have also restrained growth, particularly for autos and imports. Meanwhile, consumers have not yet spent all of their excess savings accumulated during the pandemic, and employers in many industries are finding it difficult to fill open jobs. This environment could extend inflationary pressures.

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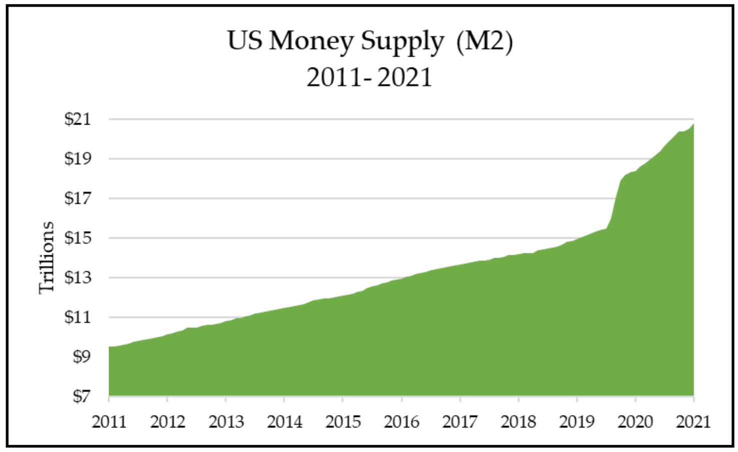
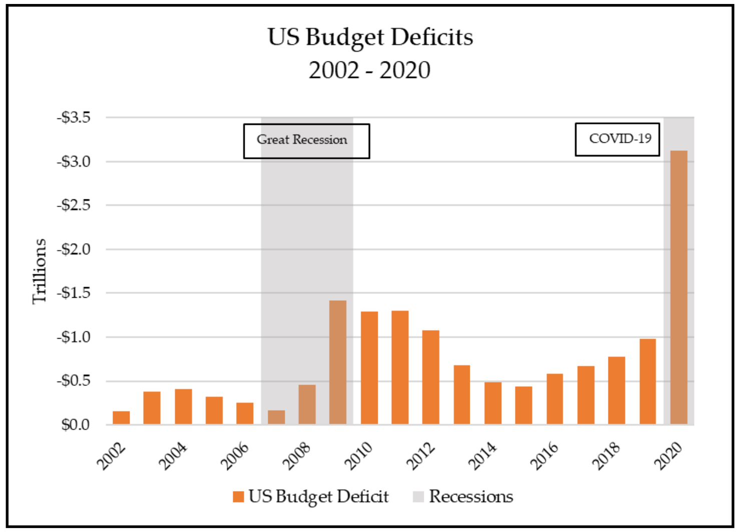
A SEA OF LIQUIDITY

Flooding the economy with money was the US government's economic response to the pandemic. The deluge came in two main forms: stimulus payments and bond purchases. Stimulus payments included supplemental unemployment benefits and stimulus checks, which helped to balloon the federal deficit. The Fed's bond purchases resulted in a surge of rapid growth in the money supply. As shown in the nearby charts of M2 money supply growth and the federal budget deficit, the scale of the stimulus was jaw-dropping.



The rapid, two-pronged stimulus effort effectively supported the economy during a very stressful time. Many small businesses, local governments, and charitable organizations survived the pandemic-induced closure of the economy thanks to support from the CARES Act. The CARES Act also provided supplemental payments to unemployed workers.



Historically, excess money supply growth or central bank stimulus has driven price inflation. This inflation in the prices of goods and services may last longer than currently predicted. Thus far, inflation has primarily appeared in higher home values and higher prices for many financial assets (stocks and bonds).

Stock price inflation has been widespread but uneven. As frequently happens during periods of stock market enthusiasm, the stocks of sound, resilient companies have risen, but the real action is further out the risk curve. As stock prices have continued rising, investors have become increasingly willing to buy riskier and speculative financial assets. The flood of pandemic stimulus cash may allow this liquidity-supported phenomenon to continue for some time. Efforts by the Federal Reserve or Congress to rein in liquidity could have a chilling effect on markets, particularly on the current high fliers.

CONCLUSION: US ECONOMY HAS REBOUNDED, BUT RISKS EXIST

A flood of economic stimulus spared much of the US economy during the pandemic. An economic rebound has been swift, although accompanied by supply disruptions and percolating inflation. Excess liquidity has boosted home prices and financial markets. The stocks of sound companies have done well, while riskier financial assets have soared. Long-term investors should continue to hold diversified portfolios of higher-quality equities and short- to medium-term quality bonds.

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