AUGUSTINE
ASSET MANAGEMENT

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MARKET SUMMARY

Equities

MSCI AC World	709.5
Price / Earnings	18.4x
Dividend Yield	2.0%
S&P 500	4,308
Price / Earnings	21.3x
Dividend Yield	1.4%

US Interest Rates

2 Year Treasury	0.3%
10 Year Treasury	1.5%
30 Year Treasury	2.1%
Bloomberg US Agg.	1.6%

US Corporate Spreads

Investment Grade	0.9%
High Yield	3.9%

Equity Volatility

CBOE SPX Volatility	23.1

US Economic Figures

GDP Growth 2Q21	6.7%
Unemployment	4.8%
Inflation (core)	4.0%
Fed Funds Rate (mid)	0.1%
3 Month LIBOR	0.1%

Commodities

Oil (Brent)	$78.52
Natural Gas	$5.87
Copper ($/lb.)	$4.09
Gold ($/oz.)	$1,757

Foreign Exchange

Euro	$/€	1.16
Japanese Yen	¥/$	111
Chinese Yuan	元/$	6.45

Market summary data as of:
September 30, 2021

Transitory

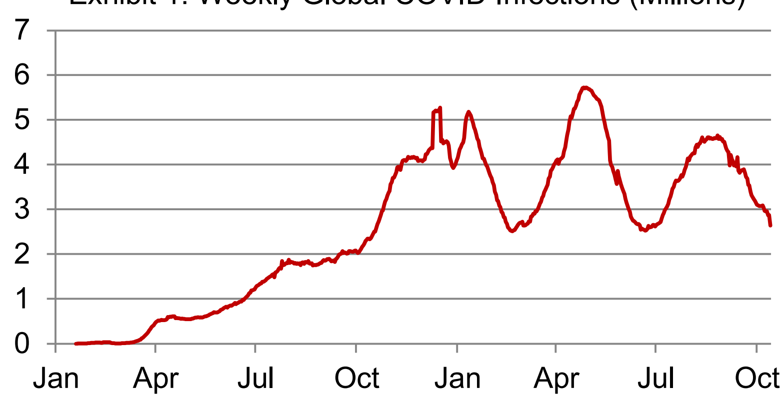
Language, like anything based on social consensus, has a way of changing over time. Meanings and sounds of words can drift through what linguists call semantic shift. Luckily, dictionaries tell us what words mean and sound like by today's consensus, subject of course to additions, subtractions, and modifications.

Take, for example, "transitory" which according Merriam-Webster is:

> **transitory** adjective
> tran·si·to·ry | \ ˈtran(t)-sə-ˌtȯr-ē , ˈtran-zə- \
> 1: of brief duration : temporary
> 2: tending to pass away : not persistent

The word aptly describes the effect of the COVID delta variant on the recovery in economic activity and corporate profits this year. Case counts and hospitalizations rose dramatically in the third quarter. Some areas reinstated strict lock-down measures, and consumers stepped back from a broad range of travel, leisure, and entertainment activities, creating a soft patch in economic activity.

Exhibit 1: Weekly Global COVID Infections (Millions)



By the end of the quarter, the wave of infections was quickly receding and with it the headwind to further recovery. While potential remains for new variants to emerge, the transitory effect of delta is waning and yielding to the continued release of pent up demand evident earlier in the year.

The third-quarter speed bump notwithstanding, the outlook for the economy and corporate profits is strong. Business activity should benefit from deferred capital spending and replenishment of inventories. Consumer spending, which is already higher than pre-pandemic levels, appears well supported by a combination of plentiful jobs, accelerating wage growth, and higher (government enhanced) savings.

Exhibit 2: US Job Openings Rate %

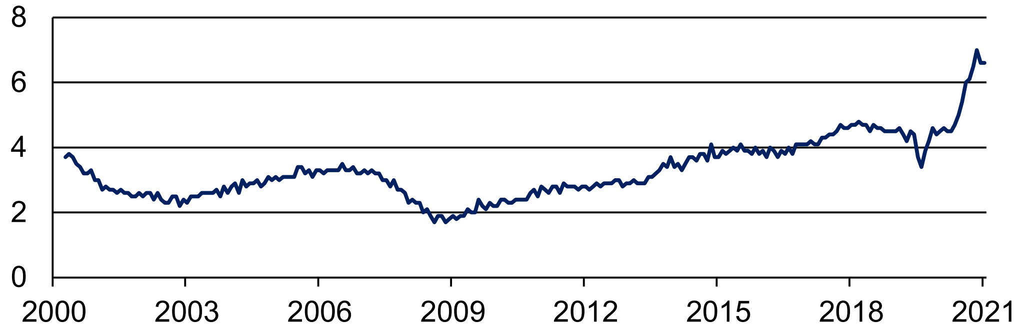
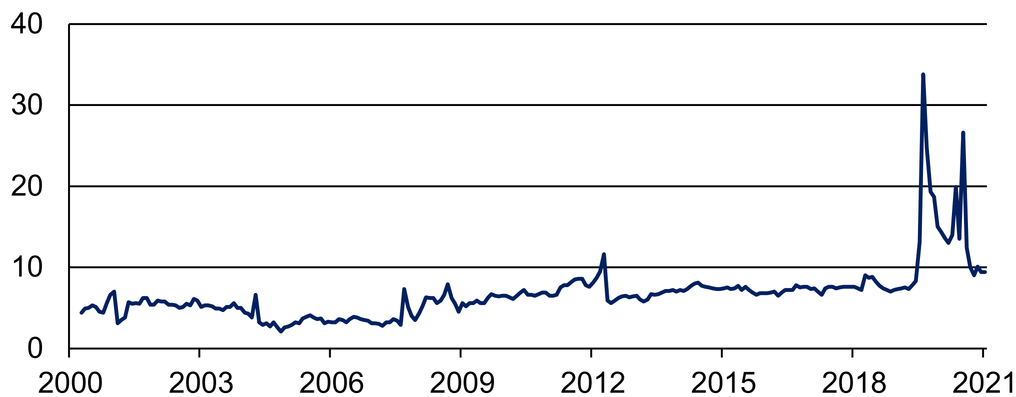


Exhibit 3: US Private Hourly Wage Annual Growth Rate %

Exhibit 4: US Household Savings Rate % of Disposable Income



In our last quarterly letter, we highlighted the effect of strong economic conditions, tight labor markets, and supply chain challenges on the prices of goods and services. Inflation, having been near the Fed's long-term target of 2% for many years, had risen substantially. Despite Fed communiqués describing higher inflation as transitory, it has persisted, with headline consumer price inflation staying above 5% for five consecutive months. Fed officials continue to refer to inflation as a transitory issue, in line with the Keynesian consensus that its driving force – excess demand – will quickly subside.

Yet, the credibility of that position is looking stretched. Nascent signs of a more structural lift can be seen in rising inflation expectations among consumers, more forceful demands from organized labor for higher wages, and on/near-shoring of supply chains in favor of more reliable but higher cost production locations. And perhaps the sheer quantity of money from the world's major central banks, that increased their balance sheets by over $9.7 trillion over the last 18 months, has contributed to rising prices?

Exhibit 5: Inflation %…Higher for Longer?

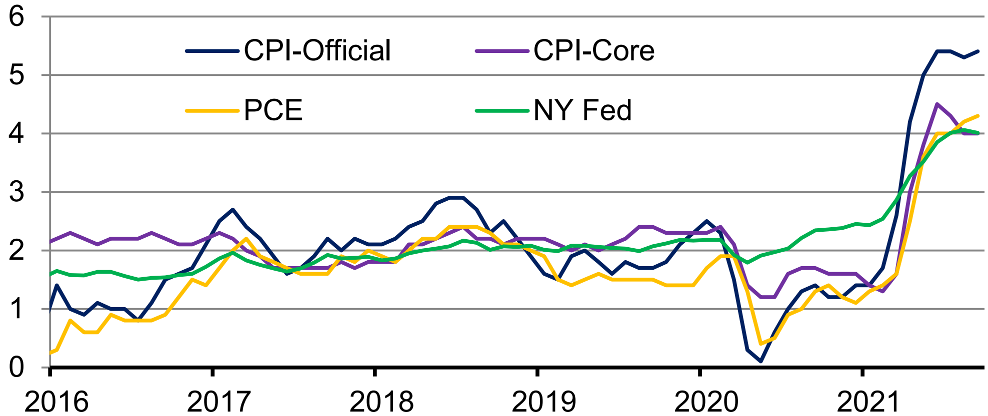
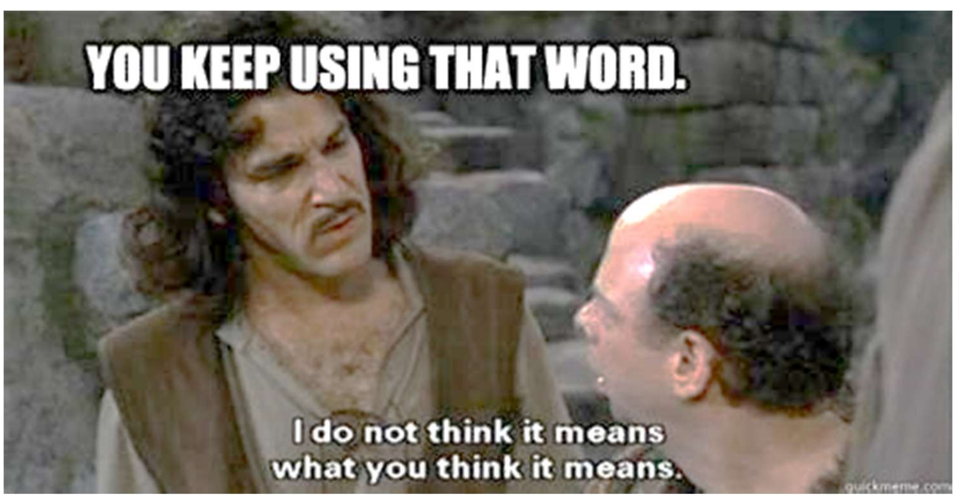
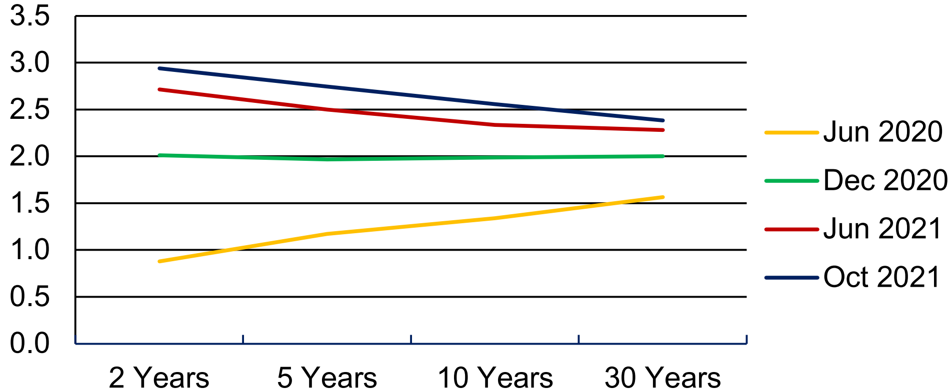


Exhibit 6: It's a Long Way to Transitory



While the headline inflation rate can, as we expect, moderate from its current 5.4% as supply and logistics problems are worked through in coming months, it's quite possible that it will settle in an area that is higher than the Fed's long-term target of 2%. Market expectations are suggesting that outcome, as seen in the market for inflation-protected US treasury bonds, known as TIPs. The implied "breakeven", or future inflation rate that makes the price of such bonds worth their protection, has risen substantially over the last few quarters, suggesting that inflation will moderate from today's level but will not return to the modest average rate seen over the past many years.

Exhibit 7: Market-Based Average Inflation % Expectations by Time Horizon



Whether hedging their position on inflation or simply acknowledging that the mandate for full employment (witness the unprecedented amount of unfilled jobs and private wage inflation above 5%) has been largely met, the Federal Reserve appears poised to do less easing, with a gradual reduction of their bond purchase program likely to begin before the end of the year and conclude by the middle of next year. While tapered purchases are still easing, just less of it, the winding down of new purchases brings closer the date when tightening will begin.

Financial markets, of course, tend to reflect an expected future ahead of time. Expectations for the first increase of the short-term interest rate has moved forward into late 2022, and long-term interest rates have risen in recent months to reflect the shift in the long-term inflation outlook. Yet, the current 1.5% yield for the 10 year treasury may still be too low compared with expected inflation above 2.5% and less central bank intervention.

Further increases in long-term rates can affect financial markets, particularly in the segments that are highly valued and especially if rates rise quickly. Sensitivity of the inverse relationship of financial asset prices to changes in interest rates is known as duration. It's a well understood and mathematical dynamic in fixed income markets and a less buttoned-down, but still relevant, concept in equity markets.

With the yield of the US bond market (Bloomberg US Aggregate) historically low, its duration is at a record high and presents more downside risk to bond prices in the face of rising yields. Taking the inverse of the global stock market's (MSCI All Country World) dividend yield as an approximate measure of "equity duration", we come to a similar conclusion. Historically high valuations, rationalized by a recent history of very low interest rates, have made financial markets more vulnerable to rising rates.

Exhibit 8: Bloomberg US Aggregate Duration

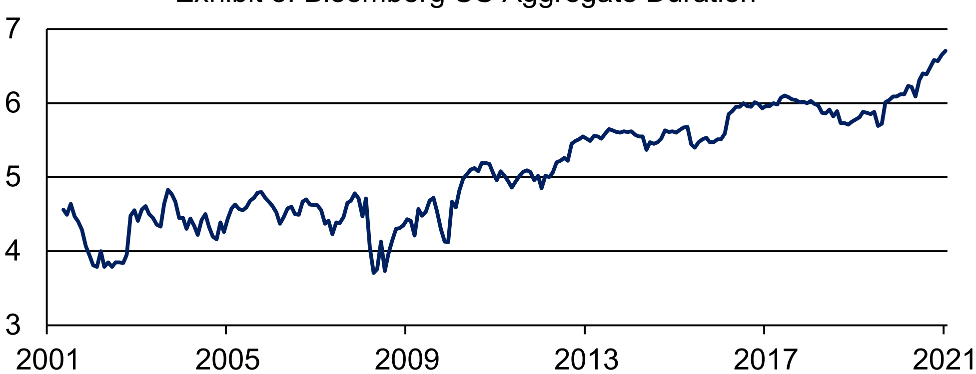
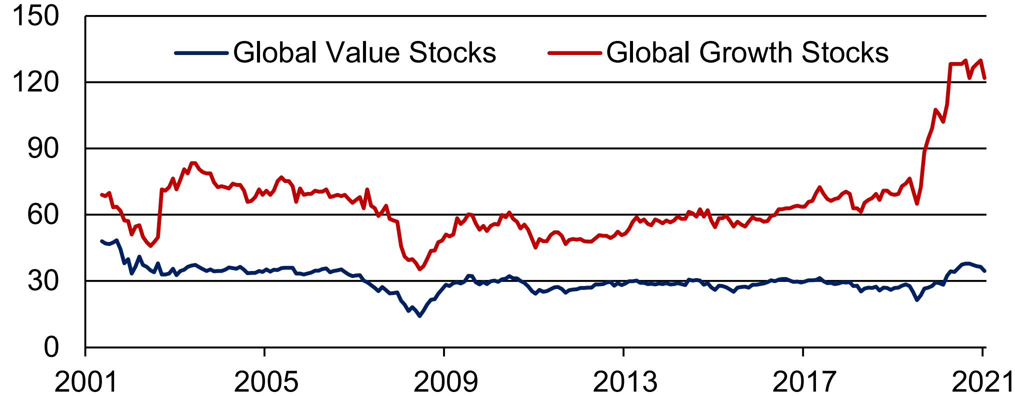


Exhibit 9: MSCI All Country World Growth & Value Indices “Duration”



With the global economy emerging from last quarter’s COVID delta wave, the outlook for further recovery and for corporate profits is strong. Strong enough that historically low interest rates may continue to rise. As such, we are mindful that the most highly-valued parts of the market – stocks that trade at high multiples versus earnings and cash flow and bonds with long maturities – present risks in an otherwise favorable investment environment. We are managing the strategies in client portfolios accordingly, applying valuation and quality criteria in stock selection, and limiting bond holdings to short and medium term maturities.

We hope this review of the economy and markets helps inform you of our outlook and how we are managing the capital you have entrusted to us. We would be pleased to answer any questions you have and are grateful for the opportunity to work with you.

With best regards and wishes for your health and safety,

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