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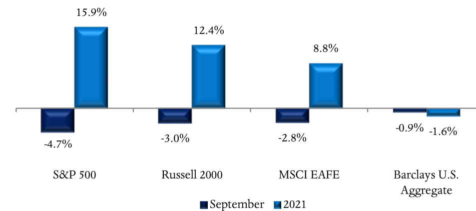
Markets

Global equities were broadly flat over the quarter, after a moderate decline in September erased the period's earlier gains, and remain solidly positive thus far in 2021. Budding investor concerns include slowing economic growth, ongoing supply-chain disruptions, as well as rising inflation and higher interest rates. The S&P 500 benchmark declined -4.7% in September (+0.6% in Q3; +15.9% ytd) in what turned out the be the most challenging month since March of last year. The smaller capitalization Russell 2000 index dropped -3.0% (-4.4% in Q3; +12.4% ytd). The MSCI EAFE, which contains a broad array of overseas stocks, fell -2.8% in September (-0.3% in Q3; +8.9% ytd). In Asia, Chinese equities trail their global counterparts thus far in 2021 (+4.9% ytd) but managed to rise +0.8% in September and +0.4% in Q3. Japanese equities rallied strongly last month (+5.5%) on the back of political change (+3.0% in Q3; +8.9% ytd).

Fixed income markets managed through some risk-off growth fears, inflation worries, oil price increases, fiscal policy dilemmas, and the Federal Reserve (Fed) finally turning a bit hawkish. This led to a sharp 18 bps increase in 10-year Treasury yields last month (from +1.31% to +1.49%) following their decline to 1.20% earlier in the quarter. This led the Barclays US Aggregate index lower by -0.9% (+0.05% in Q2; -1.6% ytd). Meanwhile, higher yielding corporate bonds fared better, with the index rising by 3bps last month (+0.9% in Q2; +4.7% ytd).

Energy commodity prices have been firm and rising both in the US and Europe. Crude oil advanced to a three year high (+56% ytd) with the US WTI benchmark ending September above $75/barrel. Similarly, domestic gasoline prices have leaped +60%, and natural gas has soared 121% (to a seven year high), thus far in



2021. In Europe, natural gas prices also jumped in September; the commodity has risen a shocking five-fold over the past two quarters. Curtailed supply (drilling permits on US federal lands have plummeted by 75%) appears linked to the transition to renewable fuels.

Geopolitics

Germans went to the polls in late September, this time without Chancellor Angela Merkel, signaling an end to 16 years in power. Her absence deeply hurt the Christian Democratic Union party and led its center-left rival, the Social Democratic Party (SDU), to (a minority) victory for the first time in more than a decade and a half. Olaf Scholz indicated that the SDU's win gives him a mandate to try and form a government, but his conservative rival for the chancellor job, Armin Laschet, has still signaled he will try and form one too (despite leading his party to its lowest share of the result since its founding after World War II). Since neither leading party has anywhere near the power to govern alone, they are both courting the support of The Greens and Free Democratic Party, to form a coalition. The outcome means that it could take some time for a government to be formed and a replacement Chancellor to be named.

In Japan, prime minister Yoshihide Suga, whose popularity had declined, announced he would no longer lead the Liberal Democratic Party (LDP). In month-end elections Fumio Kishida, a former foreign minister, defeated, popular favorite, Taro Kono, leading the LDP to victory. Although likely to pursue similar economic policies to his predecessors, Kishida is thought to be

more moderate than some in his party when it comes to foreign policy, namely with regard to China.

United States

As the US economy continues to rebound amid shortages of labor, and bottlenecks along the supply chain, prices are rising. Last month, the CPI rose for the fifteenth consecutive period, up 5.3% year-over-year (an understated figure that includes a lowly 2.6% increase in shelter, its largest component). In reality, the mean average of listed rents increased 11.5% in August, according to Zillow. The latest PPI soared 8.3%, while finished goods increased by a record 10.6% over the same period last year. Aside from higher energy and raw materials prices, looking at the year ahead, food prices are expected to rise at a 7.9% pace medical care at 9.7% and rents by 10.0%.

Meanwhile, Congress continues to debate the size and details of a proposed $1 trillion infrastructure bill, as well as a $3.5 trillion package of social spending and entitlement programs. While we fully expect the ultimate amount of new fiscal spending to be lower, the end result is a likely continuation of the $3 trillion annual deficits seen over the past two years. Government spending has led to a $28.8 trillion National Debt and hitting of the "debt ceiling."

The Federal Reserve announced that it will soon (probably in November) begin to slow the pace of its monetary asset purchases, a process that may conclude in the middle of next year. This timeline implies a steep drawdown of $15 billion per month, reversing a trend where the Fed has been the largest purchaser of Treasury bonds in each of the past several years. The central bank also released its projections for interest rates, with the median expectation now indicating an increase to 1.75% by the end of 2024, a faster pace than the market had been pricing in. The tone of various Federal Reserve members also turned more hawkish due to inflationary trends. Chairman Powell characterized the situation as "getting a little bit worse" and "continuing into next year probably."

September 2021 Economic Statistics

	Sep-21	Dec-20	Dec-19
Federal Funds Target Rate	***0 - 0.25%***	0 - 0.25%	1.50-1.75%
Consumer Confidence Index	***109.3***	88.6	126.5
Manufacturing PMI Index	***61.1%***	60.7%	*47.2%*
Unemployment Rate	***4.8%***	6.7%	*3.5%*
JPY / USD	***111.27***	103.24	*108.61*
USD / EUR	***1.1581***	1.2213	*1.1210*
Gold / oz.	***$1,756.66***	$1,896.49	*$1,517.01*
Oil (WTI) / bbl	***$75.03***	$48.52	*$61.06*

Europe

European manufacturing and services gauges of economic activity slowed sharply in September. Concerns over gas shortages during the upcoming winter period have surfaced. The German federal statistics office reported that local inflation reached 4.1% (a 29-year high) last month, led by a 14% spike in energy costs and a 5% increase in food prices. In the UK, there have been recent gasoline shortages, leading to long lines for supplies and a reduction in economic activity. The UK's latest CPI reading showed a 3.2% increase in prices, month-to-month, the largest on record (since 1997).

The European Central Bank (ECB) announced a reduction in the pace of its asset purchases, but in contrast to the Fed, was keen to stress that this was not the beginning of a process of tapering purchases down to zero. The Bank of England (BoE) delivered a similarly hawkish shift, suggesting that it could raise interest rates before the end of the year, possibly coinciding with a wind-up of their quantitative easing program.

Asia

The negative news from China seemed relentless in the third quarter. First, a move to turn private tutoring companies into non-profit organizations worried some investors, who started to question whether similar actions could be applied to other sectors. Then, more regulations on the technology sector were announced, including a ban on children playing computer games for more than three hours per week. Compounding the regulation-related issues, there have been widespread

power outages, driven by coal and natural gas shortages as well as a drought-driven reduction in hydropower. Port shutdowns, scarcity of labor, and regional supply chain interruptions have further added to economic concerns. Most recently, the debt-laden real estate sector entered into a down-turn, led by Evergrande which is on the brink of defaulting on its $300 billion of outstanding debt. In a tell-tale sign, the country's manufacturing PMI index contracted for the first time since the March of 2020 Covid shutdown period, in addition, sub-indexes measuring production, hiring, as well as total new (and export) orders all fell below the expansionary 50 level.

Outlook

The coming period is likely to feature a slowing global economy, rising inflation and ongoing supply shortages. Even if demand tapers, labor and manufacturing constraints, as well as transportation bottlenecks, are likely to continue for many months. In the US, there is a labor market mismatch, which has varied causes. Specifically, there are a record 11.0 million job openings, yet only about 8.5 million people looking for work. As such, corporations are having to find innovative ways to attract and retain workers. For example, the nation's largest employers (Walmart, Amazon, and Target) have all recently announced free college tuition programs. The aforementioned imbalances have now replaced Covid-19 as the main concern with regard to the economy. As for the ongoing pandemic, our base case scenario is that new daily cases will continue to trend downwards as global vaccination rates increase. Elevated savings, along with solid wage growth, should help most consumers to weather the inflationary period.

The environment remains positive for equities, which has led to a robust advance so far this year. Looking ahead, we would argue that a correction from record highs would be a healthy development, serving to clear away any speculative excesses. The main risks for financial markets are rising interest rates and the pending curtailment of liquidity from the Federal Reserve and other central banks. While the Fed will certainly try to taper its loose monetary policy, currently $120 billion per month, their conviction remains to be seen, especially if markets oppose, and the economy softens. Recall, the Fed has embarked on numerous "Quantitative Easing" programs since late-2008 and their balance sheet has grown to $8.4 trillion, seemingly in one direction. While higher short-term interest rates appear to be a long way off, fiscal deficit spending is expected to remain high. Government spending is much more powerful than central bank monetary stimulus, which bodes well for the economy, consumers and corporate profits.

Fixed income investors face a great dilemma, faced with earning negative real rates of return (losing purchasing power after inflation) but with relative safety of principal, or migrating to riskier parts of the capital structure with commensurately greater portfolio volatility. For conservative investors we continue to recommend short term credit, to be reinvested more attractively, if and when interest rates rise. Floating rate securities should also fare well in a rising rate environment.

Economies are approaching their high water mark, recovering smoothly from the pandemic-driven recession. Equity investors have cheered the tremendous monetary and fiscal stimulus that have been deployed to combat the downturn, which 'saved the day' leading to increasing confidence amid growing corporate profits. Looking ahead, we expect to see plateauing growth amid lingering inflation. In such an environment, we believe that actively managed strategies should be able to exploit the coming economic transition, adding significant value by identifying and investing in the winners and losers.

Interest rates are beginning to rise on the back of persistent inflation, an inhospitable environment for bondholders, but conducive to several of our select alternative strategies. We retain a positive view of hedged credit, as well as inflation protected investments such as real estate, energy exploration, and water infrastructure. Further, as long-term investors with the belief that innovation is still in its infancy, we continue to favor select venture investments as well as our proprietary Nordic Technology and Innovation Fund.

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Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.