Schroeder | Capital Management, LLC
Global Investment

Investment Review and Outlook – Fall 2021

The U.S. Economy – The Current Picture is Mixed:

The economic recovery remains mixed, with recent reports on manufacturing activity, services and consumer spending showing pockets of strength and resilience. However, the advances are being held back by shortages of industrial materials, important components needed for manufacturing and consumer products. In addition, significant dislocation of transportation services and logistics are a major problem for the economy and are worsening and causing inflation concerns, due to supply chain distribution bottlenecks.

Supply chain shortages are widespread and have accelerated in recent weeks, as container ships remain idle at our major freight terminals, struggling with an inadequate number of workers to unload containers to position domestic carriers for imported product distribution across the U.S. It is reported that there is a shortage of 80,000 truck drivers contributing to the problem. This is also a symptom of Covid-related disruptions in the labor force that was recently underscored in the weak job growth numbers in September, missing estimates by a wide margin. At the same time, companies have needed to increase wages to attract workers, creating wage inflation.

Accessing adequate energy supplies is a problem. A global supply-demand imbalance in economically-sensitive oil and natural gas has resulted in dramatic price increases around the world for both industrial and consumer markets as we approach the high-seasonal winter demand. Residential demand for heating oil and natural gas are expected to be significantly impacted. Higher pricing for industrial America is also being passed on to consumers; that is inflationary.

On the positive side, it needs to be emphasized that many companies have already reported their third quarter earnings results and the overall profit view is very good with the majority meeting or exceeding forecasts as they continue to compare favorably with last year's devastating Covid-related economic setback. In a sense, earnings reports are riding to the rescue of Wall Street.

The Federal Reserve – Investor Expectations:

The Federal Reserve is nearing an inflection point, in which it will begin paring back the pace of monetary stimulus, following one of the most accommodative periods in history. The consensus among economists is that the Fed is likely to gingerly step on the monetary brake, so as not to prematurely impact the business recovery, given the paltry increase in jobs last month among other reports that were below expectations.

Moderately stronger economic growth and the current higher inflation trend has influenced the Fed to moderate their aggressive stimulus policy, along with the solid first half of 2021 GDP of more than 6%. Unsettling increases in producer and consumer prices along with supply chain shortages are also contributing to this change in attitude.

Federal Reserve Chair Jerome Powell has also acknowledged that while recent pricing strains within the overall economy may last somewhat longer than he had envisioned earlier, historically low interest rates may not rise before mid-to-late 2022.

Washington D.C.

Events in Washington clearly are having an effect on financial markets in the form of increased volatility in equity prices and interest rates. In recent weeks we have seen partisan wrangling, both between and within the major parties, over efforts to extend the nation's debt limit and stave off the financial consequences of a possible government default. While the probability of this occurring was extremely low, the bickering among members of Congress was unsettling and was not lost on the securities markets and the general public. Eventually, members of both parties agreed to a temporary debt ceiling extension. As a result, markets drew some comfort from the deal. However, the extension was only a short-term fix with the deadline for a long-term deal pushed out to early December.

In the weeks to come, we are likely to see a rerun of dissension among politicians. Also complicating matters is an effort by the majority party to include other expensive measures in a more permanent debt extension agreement, including a version of the long-awaited infrastructure proposal. Coupling other spending measures could add trillions of dollars to our federal deficit. Also expected is proposed legislation to increase income taxes for both business and individuals.

Some kind of a deal may be forthcoming relatively soon. However, volatility in our securities markets should continue to be expected with alternating gains and losses, as sentiment goes back and forth during congressional negotiations on several fronts. Politicians are very sensitive at this time, as the 2022 mid-term congressional elections are only twelve months away.

Securities Markets and Investment Strategy:

On balance we are optimistic about the market's outlook in the coming months but also mindful of potential fiscal or monetary missteps along the way. Investors will assess the lingering effect of Covid on the economic recovery and the impact it has on the U.S. workforce along with the disruption of manufacturing and distribution of goods. A close eye is also poised on inflation within the overall economy, fueled in part by a surge in oil prices and supply chain bottlenecks.

The continuing economic recovery from the depths of early to mid-2021, with attendant advances in revenue and profit expansion for the bulk of corporate America, underscores our sense of optimism. At the same time, consolidation of the current stock market advance in October should be expected, especially if future estimated growth is disappointing and if controlling the troublesome inflationary trend becomes more elusive. As investors balance the positives and negatives within the economic landscape, a partial resolution of some of the issues discussed above seems likely to keep the overall economy on track during the balance of 2021 and into 2022.

Portfolio strategy in the months ahead continues to focus on securities that we have been favoring: beneficiaries of industrial expansion, especially as we anticipate new infrastructure legislation, financials, and selected areas in the consumer arena that is two-thirds of the overall economy.

We are very disciplined when assessing capital risk vs. reward opportunities and apply historic valuations when making security selections. This approach has been successful over the years.

G. Frederick Schroeder, CFA
President and Chief Investment Officer

October 26, 2021