DT INVESTMENT PARTNERS, LLC

Q3 2021
FINANCIAL MARKETS COMMENTARY

The Fed Puts Financial Markets on Notice

DT INVESTMENT PARTNERS

RISK-BASED ASSETS PERFORMANCE SUMMARY

- With the exception of U.S. Large Cap stocks and Commodities (Oil & Industrial Metals), returns for risk-based assets finished lower for the volatile third quarter. A rise in the Delta variant, a gradual weakening in economic data, a significant increase in Chinese Government regulation of certain publicly traded companies, stubbornly high short term inflation, the potential for higher corporate and capital gains taxes, political drama over the debt ceiling, and the Fed indicating that tapering of bond purchases may soon begin all negatively contributed to growth-oriented asset prices.

- Although incoming economic data has been weakening since early August and the timing and ultimate size of a $1 trillion infrastructure spending deal and President Biden's $3.5 trillion social spending and climate package is highly uncertain, investors continued to buy U.S. Large Cap stocks at record high prices. The S&P 500 Index has reached 54 record highs year-to-date. Earnings yields on stocks still offer better relative value than bond yields. With the exception of China, risk markets across the globe have been and continue to be buoyed by extreme levels of monetary policy accommodation. There is a belief among investors and traders alike that global monetary authorities, particularly the U.S. Federal Reserve (Fed), will maintain a safety net under risk-taking for the foreseeable future.

- Investors sold Emerging Market stocks as China's economic growth fell below its pre-COVID 19 growth trend due to premature monetary and fiscal policy tightening and newly enacted virus-related lockdowns. In addition, the Chinese government cracked down on educational and technology companies, imposing significant regulations on highly-profitable companies. Near quarter-end, China's heavily indebted real estate sector came under the spotlight as investors speculated on whether or not the government would allow the most indebted real estate company in the world to fail.

- U.S. Large Cap sector performance was mixed during the quarter with Financials, Utilities and Communication Services leading the way higher, while Industrials, Materials, and Energy fell (See Page 5).

BOND PERFORMANCE SUMMARY

- Bond yields remained tame for much of the third quarter. However, following the Fed's 9/22 Federal Open Market Committee meeting, yields rose/prices fell across 2-10 year maturities, as the Fed signaled that it could begin to reduce its monthly bond purchases as soon as its November 3rd meeting and raise interest rates as early as mid-late next year.

- Despite a sharp rise in bond yields during the last week of the quarter, most U.S. fixed income sectors were still able to generate positive returns led by U.S. Inflation-Protected securities (TIPs) (See Page 5). Municipal bonds started the quarter strong, but then weakened with the rise in U.S. Treasury bond yields/price declines.

- Investment Grade Corporate bonds, Government Agency bonds, and Mortgage-Backed Securities (MBS) generated flat to marginally positive returns. Concerns over slowing economic data and the continued lack of stability in the interest rate markets pressured prices in these spread sectors.. Early in the quarter, MBS prepayment speeds slowed as homeowner refinancing's declined. Following the Fed's September meeting, investors anticipated further slowing in MBS prepayment speeds in anticipation of the Fed raising rates sooner than many expected. As a result, the average life of MBS securities extended, locking owners of these bonds into lower yields for longer.

CONTRIBUTORS & DETRACTORS TO PERFORMANCE

- Performance contributors for the third quarter versus the Global Stock/Intermediate Bond blended benchmark index included our overweight allocation to U.S. Large Cap stocks and our outside-of-benchmark allocation to High Yield bonds. In addition, our underweight to Emerging Market and International Developed Market stocks and our shorter bond duration than the benchmark contributed to performance.

- Detractors to performance included our overweight to risk-based assets, our country-specific allocation to Australian stocks, and our outside-of-benchmark allocation to Gold.

- ***Chairman Powell has repeatedly said the Fed would give markets plenty of advance notice before it begins withdrawing the easy-money policies. Well, it appears that notice has been given!*** In the statement released following its two day meeting on September 22nd, the Fed announced that a reduction in its monthly bond purchases ($80 billion in U.S. Treasuries and $40 billion in MBS) "may soon be warranted." This makes the next Fed meeting in November the likely starting point for tapering of monthly bond purchases. The Fed's monthly bond purchases would potentially end by the middle of next year. The Fed believes completing the tapering process is a precondition to raising rates.

- ***Following the meeting, Chairman Powell again emphasized that the decision to wind down asset purchases and the decision to raise interest rates are separate.*** The decision to raise interest rates will ultimately depend on how much progress the job market has made towards reaching full employment, and how persistent the recent bout of inflation ends up being. The realization that the short-term inflation created by global supply bottlenecks could last a little longer seems to have convinced the Fed that it will soon be time to reduce their monthly bond purchases. New FOMC member projections released showed half of the 18 Fed officials expect to raise interest rates by the end of next year, up from 7 officials back in June.

- Financial markets responded with stocks rallying on the belief that the bar to raise interest rates is much higher than for tapering bond purchases. Stock investors are thinking that interest rate increases will not begin until late next year or in early 2023. In addition, recent history (2013-2014 taper tantrum) suggests that whenever bond yields go high enough to negatively impact the stock market, the Fed backs off tightening monetary policy.

- Bond investors may have different thoughts regarding the timing of interest rate increases as bond yields rose/prices fell, following the Fed announcement. Bond yields have continued climbing since the meeting, recently hitting a 3 month high. However, inflation breakeven rates remain well within tight ranges (2.40% - 2.60% for 5 years). The recent spike in bond yields may indicate that investors are revising higher their future expected path for interest rates following the hawkish Fed meeting, rather than pricing in an inflation scare.

- The Delta variant appears to have weakened consumer spending and economic growth this summer. Worker shortages and supply limitations have been more severe than many economists had forecast. However, these manufacturing and distribution disruptions should eventually ease as Covid-19 cases decline. Many economists have recently begun to raise their growth forecasts for next year. The Fed raised its 2022 growth forecast to 3.8% in its September projections released during its September 22nd meeting, from 3.3% in June. They also noted that the surge in inflation because of supply-chain bottlenecks and other challenges related to the reopening of the economy has been larger and longer-lasting than they anticipated.

- Although the Core Personal Consumption Expenditures Index (Fed's preferred measure) at 3.6% for the 12 months ended in August 2021 was well above the central bank's 2% target, many Fed officials stated that they expect it to return to around 2% after temporary supply-chain disruptions end. There was a burst of inflation this past Spring that will result in higher year-over-year reported inflation. However, nothing so far has refuted the view that rising prices are anything more than the result of temporary global business shutdowns from the initial COVID-19 virus in the Spring of 2020 and the re-emergence of the Delta variant this year. ***The Delta variant has only extended the length of the "transitory period."***

- At a moderated discussion hosted by the European Central Bank on September 29th, Fed Chairman Powell said ***"The current inflation spike is really a consequence of supply constraints meeting very strong demand. And that is all associated with the reopening of the economy, which is a process that will have a beginning, middle and an end."***

- ***We still believe the uptick in inflation is transitory in nature.*** Historically, supply-side disruptions that lead to price spikes tend to dissipate as the economy recovers. After a short-term, temporary rise in inflation while the economy recovers from the exogenous shock of the global pandemic, widespread vaccinations and learning to live with the virus will allow producers to return to full capacity, diminishing price increases over time.

- ***We believe the macro headwinds against a sustained rise in inflation are still too great. Aging demographics, declining fertility rates, shrinking labor force participation rates, massive global debt levels, rapid technological innovation, and a global savings glut make periods of deflation, rather than inflation, more likely.***

- Although growth has been slowing and economic data surprises relative to market expectations have been declining, the economic backdrop is still supportive for risk assets in the developed world. Financial conditions remain accommodative. Fiscal and monetary policy should remain easy as the virus remains front and center, reducing the likelihood of a policy mistake that disrupts the recovery. ***Ultimately, a return to low economic growth, low inflation, and low interest rates awaits us following a recovery.***

- In the meantime, volatility will likely remain elevated as the recovery expands and price shocks continue until the supply-side catches up to demand. The future course of the virus, the debt ceiling debate in Washington, the ultimate size and scope of future fiscal stimulus programs and potential tax increases to help pay for them, rising natural gas prices, Chinese property market stress, and the future onset of Fed tapering will keep investors on their toes as we enter the fourth quarter. We continue to expect higher returns from stocks than bonds. Monetary and fiscal policy are easy and $4.5 trillion in cash is sitting in money market funds earning almost zero return.

- We continue to favor a slight overweight to risk-based assets, while remaining underweight bonds. In particular, we are overweight U.S. Large Cap stocks. Despite the Delta variant and slowing economy, earnings yields of Large Cap stocks still look attractive relative to bonds. The stability and higher quality of U.S. Large Cap stocks should benefit from institutional investors sitting on large cash balances and the potential for government infrastructure spending.

- We are also overweight International Developed Market stocks, Gold, and Government bonds, equal-weight U.S. Small Cap stocks and underweight U.S. Mid Cap and Emerging Markets stocks, High Yield bonds, IG Corporate bonds, and MBS.

- International Developed Market stocks currently offer better relative value than U.S. stocks. Gold should continue to provide a portfolio hedge due to high anxiety over the global economy, the spread of the Delta variant, rising geopolitical risks, inflation fears, easy global monetary policy, and low bond market yields.

- Strong demand for Municipal bonds should continue to outpace supply in the near term, regardless of any infrastructure bill passage. Credit selection remains paramount. Credit spreads have tightened significantly as investors ignore quality in their search for yield. We continue to focus on credit and preservation of capital first and foremost.

Andrew Zimmerman, Chief Investment Strategist

ASSET CLASS TOTAL RATE OF RETURN PERFORMANCE SUMMARY AS OF 9/30/2021

Stock Indices	Asset Class	QTD Return	YTD Return	1 Year Return
MSCI AC World Daily TR N	Global Equities	-1.05%	11.12%	27.44%
S&P 500 INDEX	U.S. Large Cap Equities	0.58%	15.91%	29.98%
S&P 400 MIDCAP INDEX	U.S. Mid Cap Equities	-1.76%	15.52%	43.67%
RUSSELL 2000 INDEX	U.S. Small Cap Equities	-4.36%	12.40%	47.65%
MSCI EAFE	International Developed Market Equities	-0.33%	8.84%	26.36%
MSCI EM	Emerging Market Equities	-8.03%	-1.16%	18.52%
U.S. Large Cap Sector Stock Indices				
S&P 500 ENERGY INDEX	U.S. Large Cap Equities - Energy Sector	-1.72%	43.10%	82.83%
S&P 500 HEALTH CARE IDX	U.S. Large Cap Equities - Health Care Sector	1.43%	13.45%	22.56%
S&P 500 CONS DISCRET IDX	U.S. Large Cap Equities - Consumer Discretionary Sector	0.01%	10.28%	19.15%
S&P 500 CONS STAPLES IDX	U.S. Large Cap Equities - Consumer Staples Sector	-0.31%	4.69%	11.34%
S&P 500 INFO TECH INDEX	U.S. Large Cap Equities - Information Technology Sector	1.34%	15.28%	28.90%
S&P 500 UTILITIES INDEX	U.S. Large Cap Equities - Utilities Sector	1.78%	4.20%	11.06%
S&P 500 INDUSTRIALS IDX	U.S. Large Cap Equities - Industrials Sector	-4.22%	11.48%	28.95%
S&P 500 COMM SVC	U.S. Large Cap Equities - Communication Services	1.60%	21.59%	38.39%
S&P 500 MATERIALS INDEX	U.S. Large Cap Equities - Materials Sector	-3.51%	10.49%	26.48%
S&P 500 FINANCIALS INDEX	U.S. Large Cap Equities - Financials Sector	2.74%	29.04%	58.97%
S&P 500 REAL ESTATE IDX	U.S. Large Cap Equities - Real Estate Sector	0.88%	24.38%	30.52%
Commodities Indices		**QTD Return**	**YTD Return**	**1 Year Return**
ISHARES GOLD TRUST	Gold	-0.89%	-7.86%	-7.14%
S&P GSCI Tot Return Indx	Broad Commodities	5.22%	38.27%	58.30%
Bond Indices				
U.S. Aggregate	Core Bonds	0.05%	-1.55%	-0.90%
Intermediate	Intermediate Government & Corporate Bonds	0.02%	-0.87%	-0.40%
U.S. Corporate High Yield	High Yield Debt	0.89%	4.53%	11.28%
U.S. Treasury	U.S. Treasuries	0.09%	-2.50%	-3.30%
U.S. TIPS	U.S. TIPs	1.75%	3.51%	5.19%
U.S. Agency	U.S. Government Agencies	0.06%	-0.74%	-0.70%
U.S. MBS	Mortgage-Backed Securities	0.10%	-0.67%	-0.43%
Corporate	Corporate Debt	0.00%	-1.27%	1.74%
Municipal Bond Index	Municipal Debt	-0.27%	0.79%	2.63%
S&P PREFER STOCK IX CME	Preferred Stock	-1.29%	1.17%	6.63%

Sources: Bloomberg and DT Investment Partners. Investors cannot invest in a market index directly, the performance of an index does not represent any actual transactions and its performance does not reflect the deduction of any fees or expenses associated with actual investing. Market performance information is included on this slide solely to demonstrate the potential benefits historically associated with long-term investing in a portfolio of well-diversified asset classes and does not represent or suggest results DT Investment Partners would or may have achieved when managing client portfolios

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Notes

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