MORSE ASSET MANAGEMENT, INC.
23 Old Kings Highway South, Suite 200, Darien, CT 06820

October 21, 2021

2021 Q3 Investment Commentary

The third quarter of 2021 was choppy with the US markets pushing to all-time highs and then retreating to end the period flat. Continued uncertainty around supply chains, inflation and potential policy responses dominated the headlines, causing investors to step back and re-evaluate, tempering exuberance. Quarterly corporate earnings announcements, which began last week, have already lifted markets back to highs. This positive catalyst should refocus investors back to the powerful economic recovery and strong fundamentals that will propel markets through year end.

Interest rates continued to be volatile with the 10-year Treasury swinging almost 20% lower during the quarter and then back again, ending almost flat. The movement was less vicious than the prior two quarters but as before, impacted equites as investors re-evaluated valuations. The main driver of volatility continues to be investor uncertainty around the Federal Reserve, and timing of potential quantitative tightening, exacerbated by inflation worries. We continue to view inflation as a short-term supply and demand imbalance rather than a monetary phenomenon. Monetary conditions remain accommodative and liquidity abundant.

In September, the Consumer Price Index measured inflation increasing +5.4% year-over-year. While the headline number is unsettling, the actual spread above the Federal Reserve's target of 2% can be accounted for with only three categories: gasoline, autos, and shelter. Thus, inflation is not a widespread monetary phenomenon, on which the Fed should act, but a supply and demand imbalance. As external forces are removed and time passes, supply and demand will self-correct and bring inflation back to trend. This continues to be confirmed by bond market expectations, with the 5-year TIPS inflation adjusted breakeven remaining closer to 2% and the yield curve flattening. The structural forces keeping inflation in check before COVID-19 are still present. Thus, we continue to agree with the Fed that the inflation we are seeing is transient and does not require intervention.

The unemployment rate has and should continue to fall as workers are enticed back into the labor market. The rate of COVID-19 infections is declining, jobs are plentiful, and wages are rising. Recent data indicates there are more than 1 million more job openings than unemployed.

By the end of the second quarter of 2021, US GDP had already recovered and exceeded pre-COVID levels. This is despite there being 6.7 million fewer jobs, roughly the total number of jobs lost in the Great Financial Crisis. As of June 30th, Real GDP in the US is up 12.2% year-over-year (Chart 1), a pace of economic recovery not seen in over 70 years, even with supply chain issues, inflation, and the Delta variant spike in COVID-19 cases. The momentum of this strong economic growth will continue forward into next year.

According to Factset's *Earnings Insight* on October 15, the year-over-year earnings growth rate for the S&P 500 is expected to be 30.0%, which is well above the 5-year average of 11.8% and will mark the third highest rate since 2010. For the full 2021 calendar year, analysts are projecting earnings growth of 43.2%. Growth will continue into 2022, albeit at a slower pace of 9.5% (Chart 2). There is a growing concern with forward estimates potentially overshooting. Earnings may be softer for sectors and companies most impacted by supply chain issues and cost inputs, but we believe there is room for upside surprises by our portfolio companies.

Our playbook continues to focus on significant secular trends, durable and high-quality businesses, and above-average growth potential. We are disciplined, focused on the facts, fundamentals, and long-term trends most relevant to your investments.

Liquidity is ample. The economic outlook strong. Investor sentiment is not euphoric. The weight of the evidence is positive.

Investment opportunities are abundant, and we are cautious but firmly bullish.

Morse Asset Management Investment Team

Robert B. Morse, Jian Wang, James Cushing

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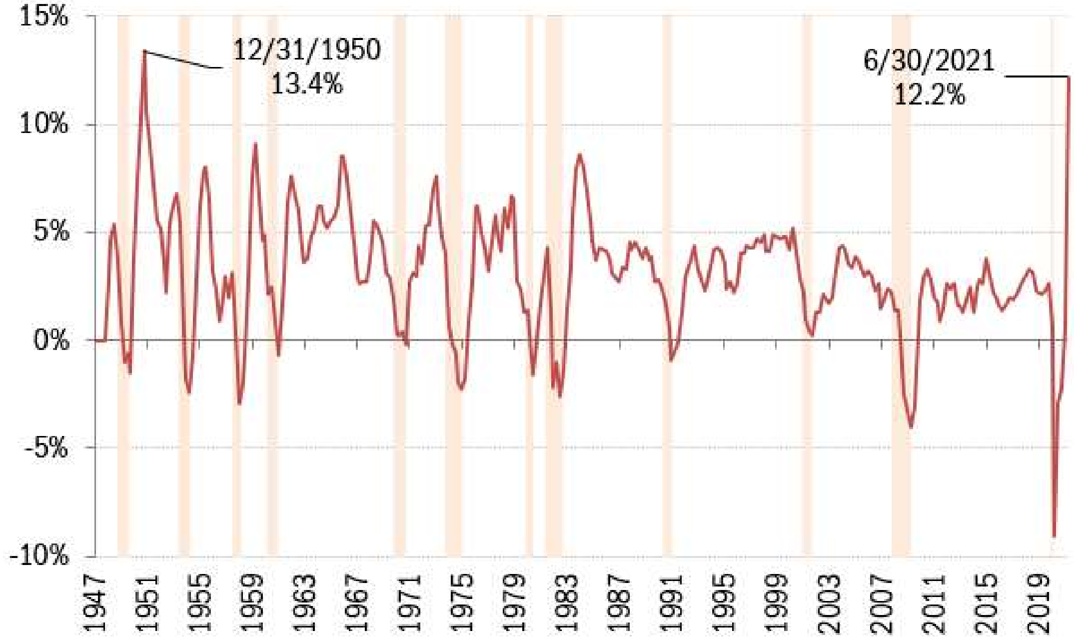
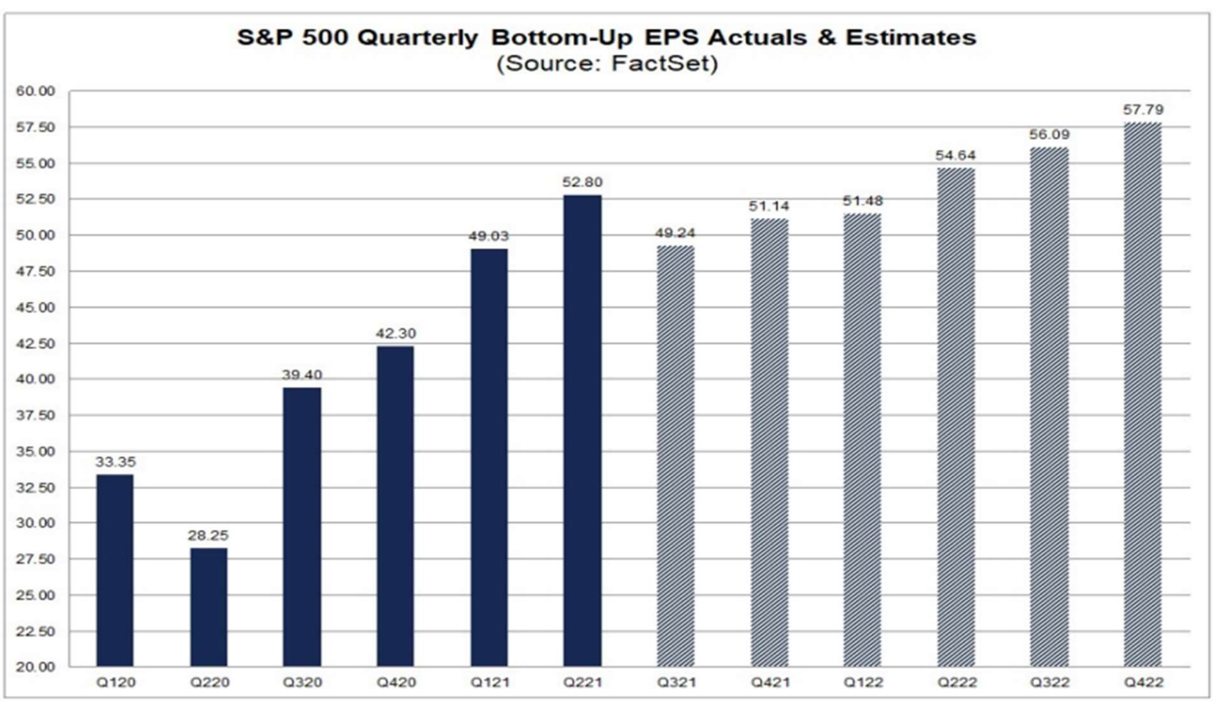
1. US Real GDP – Year-over-year growth rate



Source: TrendMacro

2. S&P 500 Earnings



Source: Factset