October | 2021

WEALTH MANAGEMENT | ARVEST

INVESTMENT MANAGEMENT GROUP | ARVEST

Viewpoint

Executive Summary

- There is always the potential for problems to arise and spook investors in the short run. (Page 2), The two most notable risks at this juncture are 1) the potential for slowing economic growth, and 2) potential earnings margins compression.

-There are not serious risks of recession right now . . . (Page 2), The risk is that rebounding growth rates will be muted relative to expectations.

- Our assessment is that the probabilities of the bear or bull cases . . . are fairly evenly split. (Page 4), As a result, we believe the most prudent course of action is to remain invested as close as possible to the investor's asset allocation targets.

- We are likely past the "peak growth" experienced in the first half of this year, (Page 6), but growth is still solid.

- "While tapering has implications for the bond markets, eventual increases in the Fed Funds Rate is what has the potential to move most asset classes." (Page 6), An earlier conclusion of the bond buying program opens the window for rate increases to occur earlier, which could create some volatility in risk assets.

Tapering is not tightening monetary policy, but it does reduce the magnitude of easing. (Page 9), More importantly, the completion of tapering opens the door to rate hikes.

- It does not appear that the Fed Funds rate will be lifted above the "neutral rate" of 2.50% before the end of 2023. (Page 10), Therefore, monetary policy is unlikely to reach a restrictive level for at least another 27 months.

- We continue to believe that Treasury yields remain below where they should be and that rates will ultimately push higher. (Page 12), We also admit that we wonder if the market is not walking past certain risks . . . and if yield levels may not have pushed too far upward too quickly.

-Recent economic data has shown recovery growth in the US that is well below the pace seen in winter and spring 2021. (Page 15), The market will need help, in the form of a much better-than-expected earnings season, to carry its momentum convincingly into year-end, especially since valuations are already very high.

Asset Class Outlook

Equity	Current	Previous
U.S. Equity	Slightly Unfavorable	Slightly Unfavorable
Int'l Equity	Neutral	Neutral
Emer. Mkts	Neutral	Neutral

Real Assets	Current	Previous
Real Estate	Slightly Unfavorable	Slightly Unfavorable
Infrastructure	Neutral	Neutral
Commodities	Neutral	Neutral

Fixed Income	Current	Previous
Invest. Grade Credit	Slightly Unfavorable	Slightly Unfavorable
Treasury/Agency	Unfavorable	Unfavorable
Mortgage Backed	Slightly Unfavorable	Slightly Unfavorable
Commercial MBS	Slightly Favorable	Slightly Favorable
High Yield	Unfavorable	Unfavorable
Emer. Mkts Debt	Neutral	Neutral
Taxable Muni	Slightly Favorable	Slightly Favorable
Tax-Exempt	Unfavorable	Unfavorable
TIPS	Neutral	Neutral

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A Case for the Bears, A Case for the Bulls, And A Case of Political Shenanigans

When determining portfolio strategy, it is often helpful to think through both sides of the issues objectively, with no preconceived notions. Weighing the potential impact and probability of two separate, often opposed outcomes, giving each full credence, and then determining the best path forward. In that vein, we summarize a case for a negative outlook on markets, along with a positive summary, and then provide our recommendation for investors' portfolio allocation.

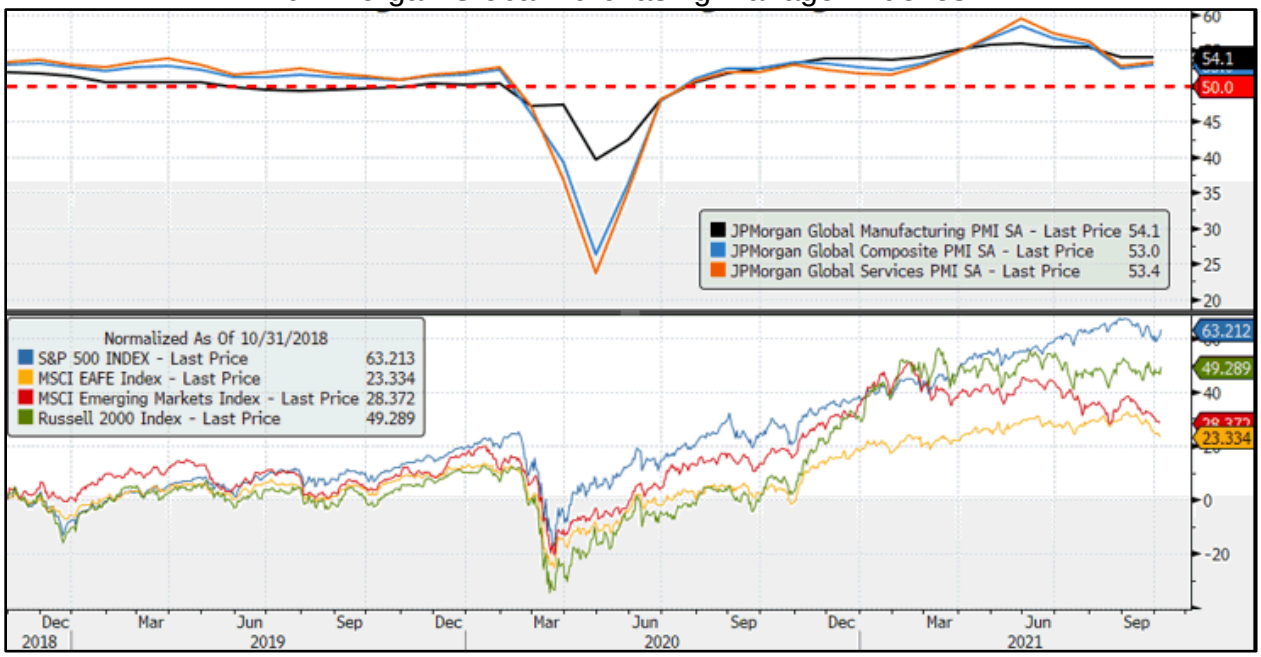
The Bear Case

There is always the potential for problems to arise and spook investors in the short run. Lasting impact for investable companies, whether intermediate or longer term, is almost always related to corporate earnings/cash flows and the potential future growth rate of these cash flows. The two most notable risks to markets at this juncture are 1) the potential for slowing economic growth, and 2) potential earnings margins compression.

Recessions are always market killers. Risk asset prices can decline precipitously just before and during economic contractions. That said, there are not serious risks of recession right now, as economies continue to recover and advance post-pandemic. Instead, the risk is that rebounding growth rates will be muted relative to expectations.

We've already witnessed economic forecasters reducing their estimated growth rates for the second half of this year. This coincides with leading economic indicators like the global purchasing managers indexes (see chart) having rolled over since May. (Note: the PMI readings are still in positive territory, signaling further expansion, but the PMIs are less positive than before.) Often this signals a stall or drop in global equity indexes, especially those that are highly economically sensitive, such as small companies and emerging market stocks.

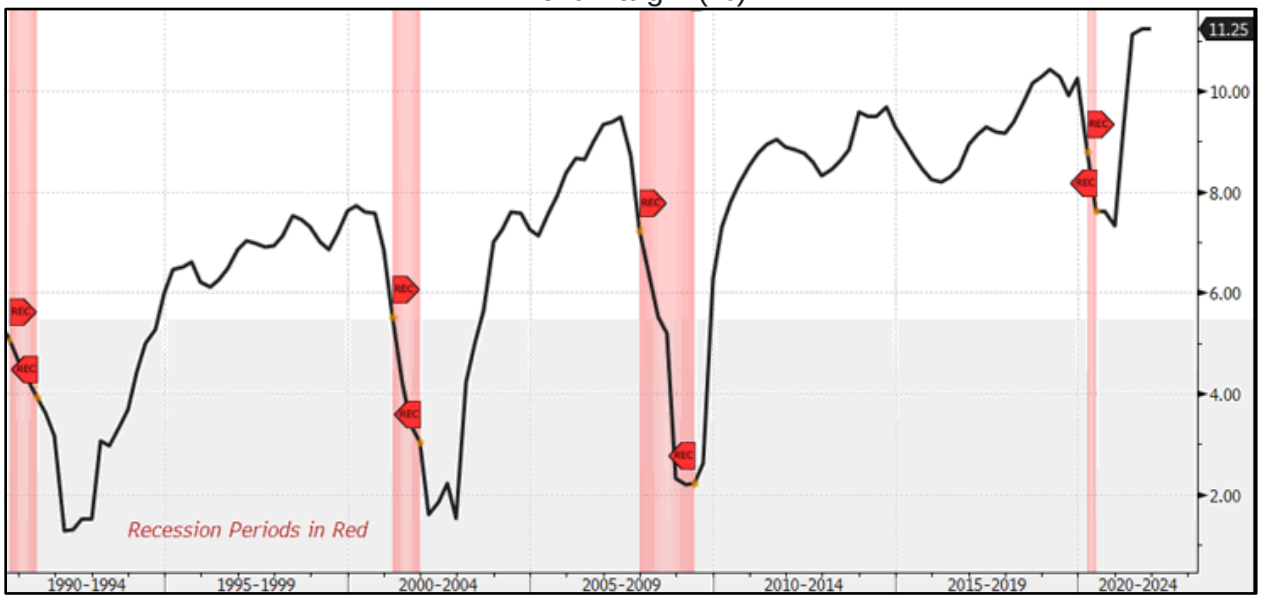
JP Morgan Global Purchasing Manager Indexes



Source: JP Morgan, Bloomberg; Copyright 2021 Bloomberg Finance L.P.

Earnings margins are at all-time highs. While they are expected to remain positive, margins are at risk of falling from 1) increased labor compensation as workers demand higher wages to return to work, and stay, 2) inflation pressures increasing input costs for companies, and 3) a move to deglobalization driving up costs for labor due to reduced comparative advantage realization, and supply chain redundancy being built out and increasing capital investment costs.

Profit Margin (%)



Source: Bloomberg; Copyright 2021 Bloomberg Finance L.P.

Without a rapidly growing economy, it becomes more difficult for companies to generate top-line revenue growth. With margin compression it becomes more difficult to generate the bottom-line net earnings—more than anything, stock market returns are corelated with earnings per share over time. If the consensus forecasts are for a favorable environment and historically high earnings per share, and then these begin to disappoint investors' lofty expectations, markets are at risk of a notable sell-off and/or stalling—trading within a range but not really advancing higher.

The Bull Case

Looking past the 2H2020 economic growth rates, a number of economists anticipate a synchronized global growth story as Europe, Asia, and emerging market economies awake from pandemic related shutdowns/slowdowns along with emergence from Delta variant concerns in the US. When global economies experience a growth acceleration concurrently, it is an extremely positive environment for risk asset performance.

Additionally, nominal GDP growth is anticipated to remain robust by some forecasters' assessment. Normally, GDP growth rates are quoted in *real* terms—economists take total economic growth and subtract out inflation. However, corporate revenue growth includes price inflation—it is quoted in nominal terms. And revenue growth tends to track nominal GDP. Even if real (inflation adjusted) GDP moderates, if inflation remains at elevated levels compared to the last decade, it provides a footing for solid revenue growth for firms.

Perhaps the most potentially impactful case market bulls make, and the one that is most difficult to predict accurately, is the case for a productivity boom. The rationale is that the technological advancements and their adoption during the pandemic—remote work, new tools for anywhere-anytime collaboration, and artificial intelligence and robotics—will increase productive capacity and output. In such an environment both companies/shareholders and workers fare well. The analog for the productivity boom is the late 1990s. Elevated profit margins and valuations remained high and even advanced, risk asset prices continued to climb, and even workers' compensation grew nicely. Should a similar pattern take shape, the secular bull market would remain firmly intact and could continue for years to come.

Bull, Bear, or Boar?

Investors can make their own assessments on whether the bull or bear case has more merit and adjust portfolio risk accordingly. Our assessment is that the probabilities of the bear or bull cases outlined above are fairly evenly split. As a result, boring as it may seem, we believe the most prudent course of action is to remain invested as close as possible to the investor's asset allocation targets. This should provide exposure to risk asset advances without encountering outsized risks that overweighting such risk assets might entail.

There is an old stock market axiom, "bulls make money; bears make money; pigs get slaughtered." The idea being that getting greedy gets you in trouble. Among the Wall Street animals there are also ostriches, whales, sharks, turtles, weasels, chickens, and foxes. And there are boars. Different than pigs, wild boars are adept at surviving in a variety of environments since they are smart and will eat about anything. (anyone who has ever tried to eradicate a herd of feral hogs can attest to their resilience).

Right now, we believe the boar would avoid making allocation bets with major asset classes—stocks vs. bond—and instead should look to root out incremental returns within asset classes by employing style and factor tilts—small company vs. large, cyclical over defensive, value orientation vs. growth, and non-US in addition to US only. They would also have an allocation to real assets such as energy infrastructure and real estate. Within fixed income, a shorter duration stance with some inflation protection also appears prudent. All while avoiding becoming piggishly greedy in an environment where valuations are historically high, and risks are growing.

The Debt Ceiling Debacle

There has been a lot of attention paid to the debt ceiling debate in Washington D.C. For now, it appears that the issue will be kicked down the road via a two-month suspension deal reached in the last two days (as of this writing, a vote has not yet been taken). But there is a chance that the debt ceiling brinkmanship might return prior to the holiday recess in December.

Why do we have a debt ceiling? Many developed economies don't. The US is slightly unique. Prior to 1917, any issuance of debt by the federal government had to be approved by the U.S. Congress. The needs for more responsive fund-raising during World War I led Congress to instead institute a debt ceiling for fiscal discipline and allow the Treasury to issue debt up to that limit at its discretion. And that system worked pretty well for 90+ years until politicians decided they could curry favor with their ideological base by making the debt ceiling another political football.

Market Insights & Asset Allocation

Clay Nickel, CPM®

Why do market participants and large institutions care? It is possible that if the debt ceiling is not raised, and the U.S. Treasury cannot issue new debt to cover previously appropriated expenditures, the Treasury runs out of available funds to pay entitlements (social security and Medicare are the most notable), government and military personnel, contractors, and interest or principle of T-bills, Treasury notes, and government bonds. In other words, the U.S. Government would be in default. Certainly, investors in Treasury securities are directly affected, but the ripple effects are potentially problematic for all investors, as much of the innerworkings of the US and global financial systems rely in some capacity on Treasury security pricing and counterparty arrangements. And 2008 showed an extreme case, albeit from a different cause, of how all asset prices are affected when the financial system seizes up. But exactly what would happen in the event of a U.S. default is hard to predict, and we are loath to stipulate worst-case outcomes.

We've been here before, but it's still new territory. Except for a technical issue in 1979 (when payments were still processed by hand and a glitch delayed interest payments to some Treasury debt holders), the U.S. has never defaulted on its debt. And never defaulted from what amounts to a refusal, not an inability, to pay. So, it's hard to say for sure how the markets might react. During the first round of debt ceiling brinkmanship in 2011, Treasuries and the bond market hedged default risk (yields rose), and the stock market declined. In 2013, the broad markets yawned as only short-term Treasury yields seemed to price the potential risk of default. Similar non-reaction occurred in 2014, 2015, 2017, and 2019 as market participants correctly assumed that the political kabuki theater and sound bite generation would give way at the last moment to politicians doing the right and sensible thing.

What are investors to do? There is little that can be done unless a drastic action, like converting to gold bullion, is taken. In many cases, such remedies are worse than the disease, especially since a market riot would likely spark congressional action to resolve the issue quickly. Again, the US has the ability to meet its obligations with a debt ceiling raise. The best plan again comes back to a well allocated portfolio and managing emotional reaction.

The federal government does not have much impact on day-to-day commerce and earnings for private sector employees, so much of life for private industry and workers would go on as normal if the US had a temporary default. However, retirees might consider having a few months' worth of spending on deposit in sound banks, or even cash—not in money markets backed by Treasury bills or commercial paper that could come under stress until the political impasse is resolved. In the meantime, we suppose it is possible to call your state's senators and congressmen and tell them to quit playing political shenanigans with something as important as the full faith and credit of the United States?

Current Economic Snapshot

Quarterly & Fiscal Year GDP Growth (Average Annual)

Source	1Q21 (Actual)	2Q21 (Actual)	3Q21 (Forecast)	4Q21 (Forecast)	FY21 (Forecast)
Bloomberg	**6.3%**	**6.7%**	**5.0%**	**5.1%**	**5.9%**
AWM/IMG	**6.3%**	**6.7%**	**4.5%**	**5.5%**	**5.9%**

Sources: Bloomberg, Bureau of Economic Analysis; Methodology: Average Annual Return

Investment Management Group's Recession Indicators

Indicator*	Current	Previous	Short Term Trend	Long Term Trend
CB Leading Econ. Indicators	+10.0%	+10.6%	Neutral	Positive
3–Mon./10–YR. Yield Curve Spread	+1.26%	+1.19%	Positive	Positive
New Orders–to–Inventories	+11.1	+16.0	Neutral	Positive
Cap. Goods New Orders	+16.0	+14.7	Positive	Positive
Initial Jobless Claims	362k	353k	Neutral	Positive
New Building Permits	1,728k	1,635k	Positive	Positive

Sources: Bloomberg
**See the Appendix for description of each indicator*

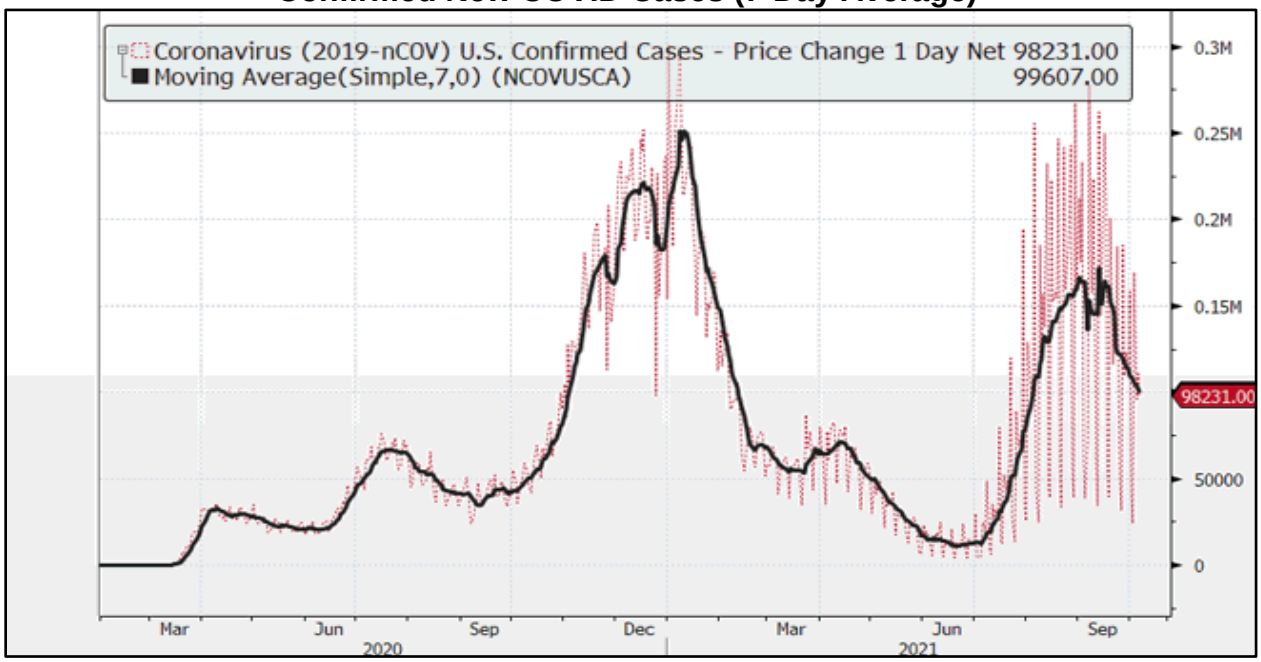
GDP Revisions; Delta Wanes; Jobs on tap

Consistent with the street, we have reduced our forecasts for Q3 to 4.5% growth (from 6.0%) and our Q4 estimate to 5.5% (also 6.0% previously). This also lowers our full year 2021 forecast to 5.9% from 6.1% previously. This is consistent with our observation in last month's Viewpoint that concerns over coronavirus Delta variant would likely slow the still robust growth rate for the third and fourth quarter. So, we are likely past the "peak growth" experienced in the first half of this year, but growth is still solid. And Bloomberg consensus estimates for 2022 are currently at 4.1% for real GDP, which is about double the average over the decade preceding the coronavirus pandemic.

Speaking of Delta, it would appear that contagion rates are on a downhill trajectory, so the worst may be over, at least temporarily—we await to see if cooler fall weather will begin to drive folks indoors, and within close proximity. It is possible that a fall wave of Delta contagion, which has largely been a problem for southern states, takes hold in the northeast and northern plains states. Given the higher vaccination rates in heavily populated northeastern states, and wide-spread school mask mandates, we think this is unlikely, but it is important enough to keep an eye on.

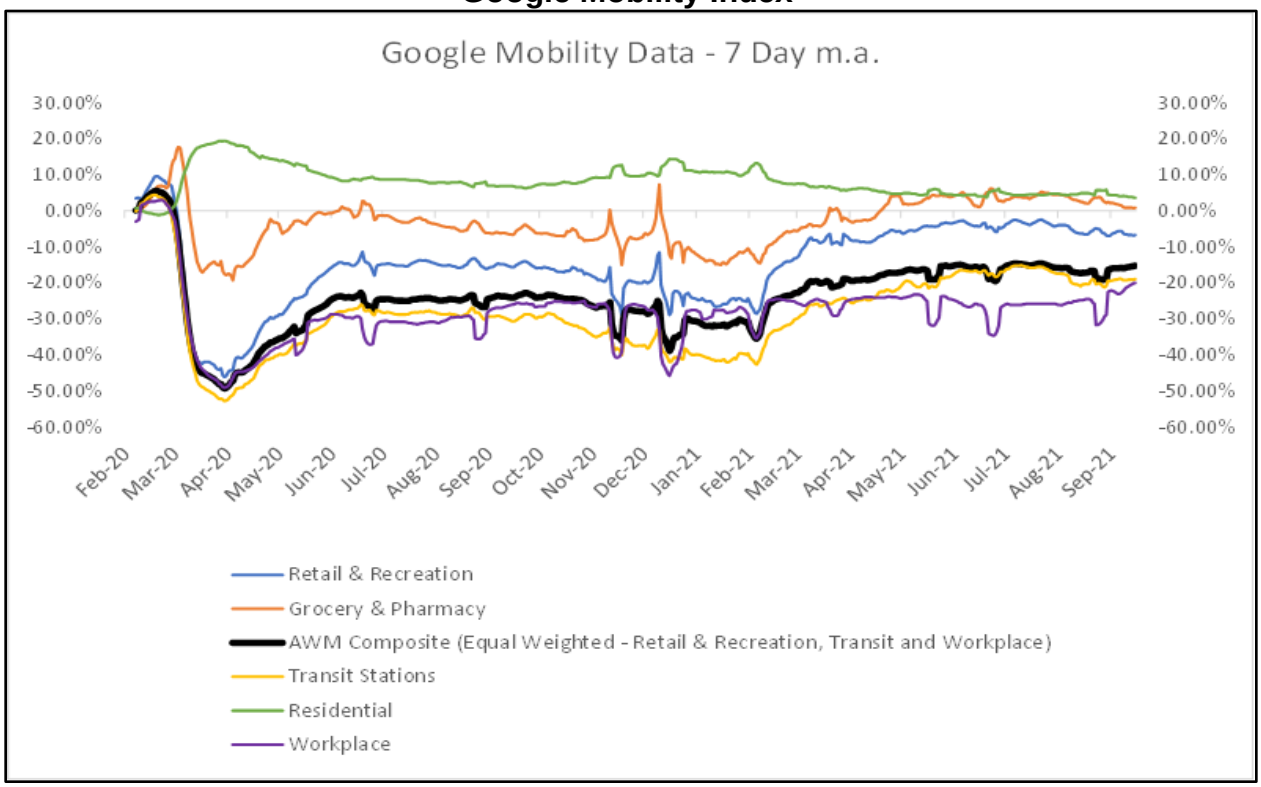
At the time of this writing, September non-farm payrolls are yet to be released. After a below-expectations August report of 235k new jobs, consensus expectations for September are 500k net new jobs. (Economist estimates are again showing wider than normal dispersion.) The jobs number will be watched closely by market participants for implications on the Federal Reserve's plans for tapering. A strong report (500k or more) is anticipated to put the FOMC on a path to begin tapering in November, reduce bond purchases by a larger amount, and conclude by next summer. Another punkish jobs report could imply a later start, slower reductions, and a later end date. While tapering has implications for the bond markets, eventual increases in the Fed Funds Rate is what has the potential to move most asset classes. We still anticipate that the FOMC will maintain an accommodative rate policy, provided inflation does not become unmoored, but an earlier conclusion of the bond buying program opens the window for rate increases to occur earlier, which could create some volatility in risk assets.

Confirmed New COVID Cases (7-Day Average)



Source: Bloomberg; Copyright 2021 Bloomberg Finance L.P.

Google Mobility Index



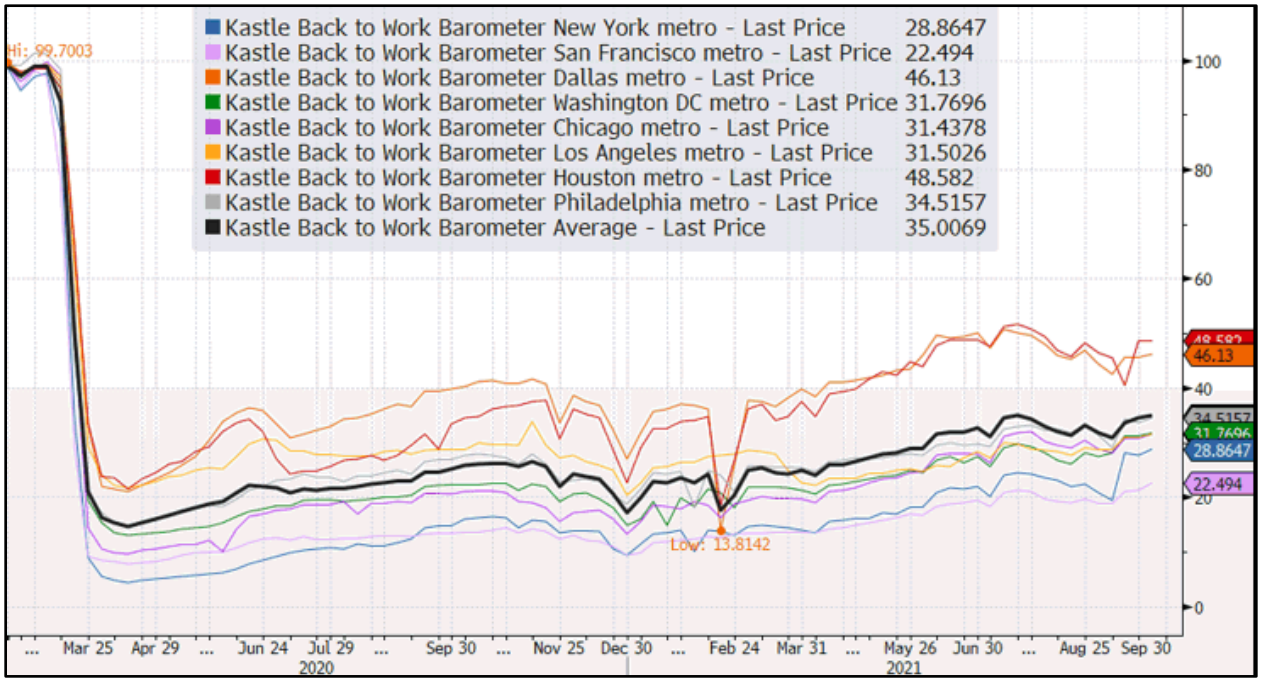
Source: Google; Arvest Wealth Management

Economic Indicators

Clay Nickel, CPM®

Consistent with the decline in confirmed new coronavirus cases, and the reopening of schools nation-wide, we've seen a slight pick-up in our composite of Google mobility data (chart above) and the Kastle Back-to-Work indexes. This bodes well for fourth quarter economic growth meeting or exceeding expectations.

Back-to-Work Barometer



Source: Kastle Systems; Bloomberg; Copyright 2021 Bloomberg Finance L.P.

One potential risk on the horizon is the increasing possibility that China's economic growth could be slower than expected, possibly even flat. Given China's role as a major global growth engine, it could have implications for emerging market and European investments which rely heavily on China's growth.

Clay Nickel

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Clay is responsible for the strategic investment direction of the investment models and portfolios managed by the Investment Management Group and Arvest Bank Trust. He oversees the development of capital market assumptions, the development and management of asset allocations, research on mutual funds, ETFs and outside managers, and communication of investment strategy to Arvest Wealth Management associates and clients. A graduate of Wichita State University, Clay has completed Columbia University's Academy of Certified Portfolio Management and is a member of the Chartered Financial Analyst Institute and Kansas City Society of Chartered Financial Analysts.

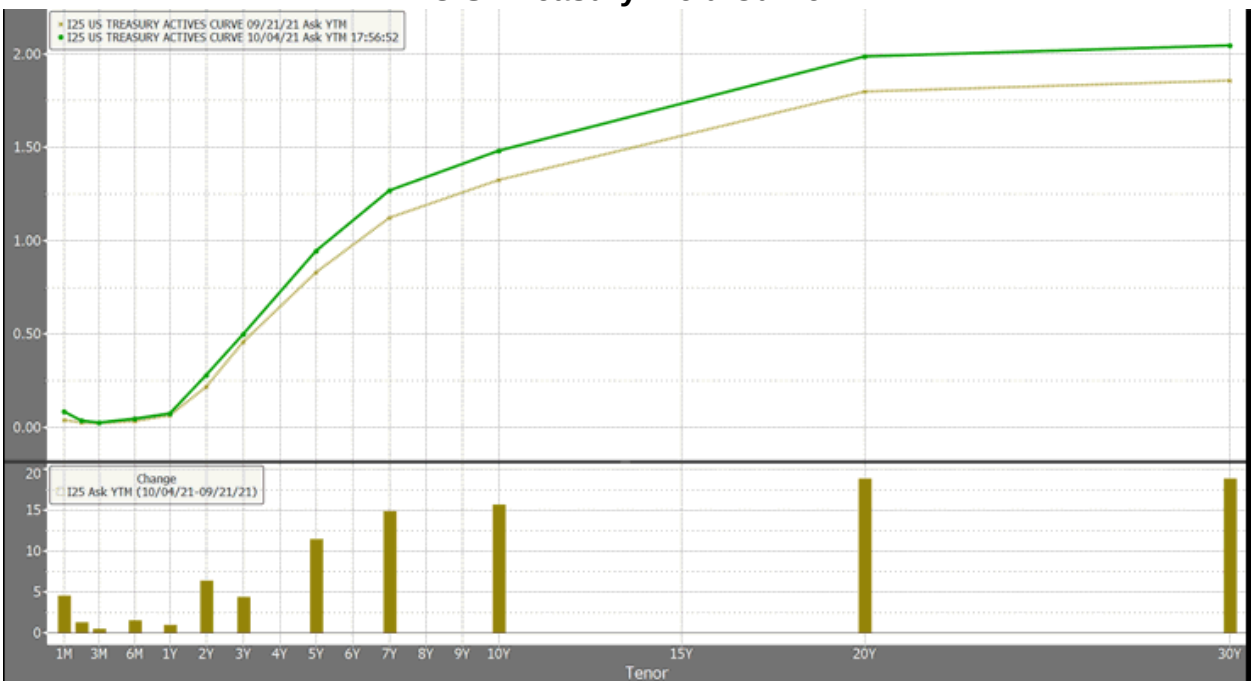
Federal Reserve Watch: The End (of QE) is Near(er)

Fed Chairman Jay Powell jolted financial markets during the Q&A portion of the post-meeting press conference following the September 22 Federal Open Market Committee meeting (FOMC). First, he indicated that the criteria for starting the process of tapering bond purchases was "all but met", opening the door for a November 3 start date for the taper. Secondly, he indicated that he expected the Fed to complete the taper "around [the] middle of 2022." Markets seem to have been planning on a slightly later date for both.

Tapering is *not* tightening monetary policy, but it does reduce the magnitude of easing. More importantly, the completion of tapering opens the door to rate hikes. While a mid-year completion of tapering by no means indicates that rate hikes will begin in July 2022, it does make that a *possibility* (it makes no sense for the Fed to simultaneously buy bonds and hike interest rates, as the two monetary policy tools would be at cross purposes).

The Treasury market has reacted by pushing up yields – by about 11 bp on the 5-year Treasury note, 16 bp on the 10-year Treasury Note, and 19 bp on the 30-year Treasury bond. The yield curve steepened, as the front end of the curve remains anchored by Fed policy.

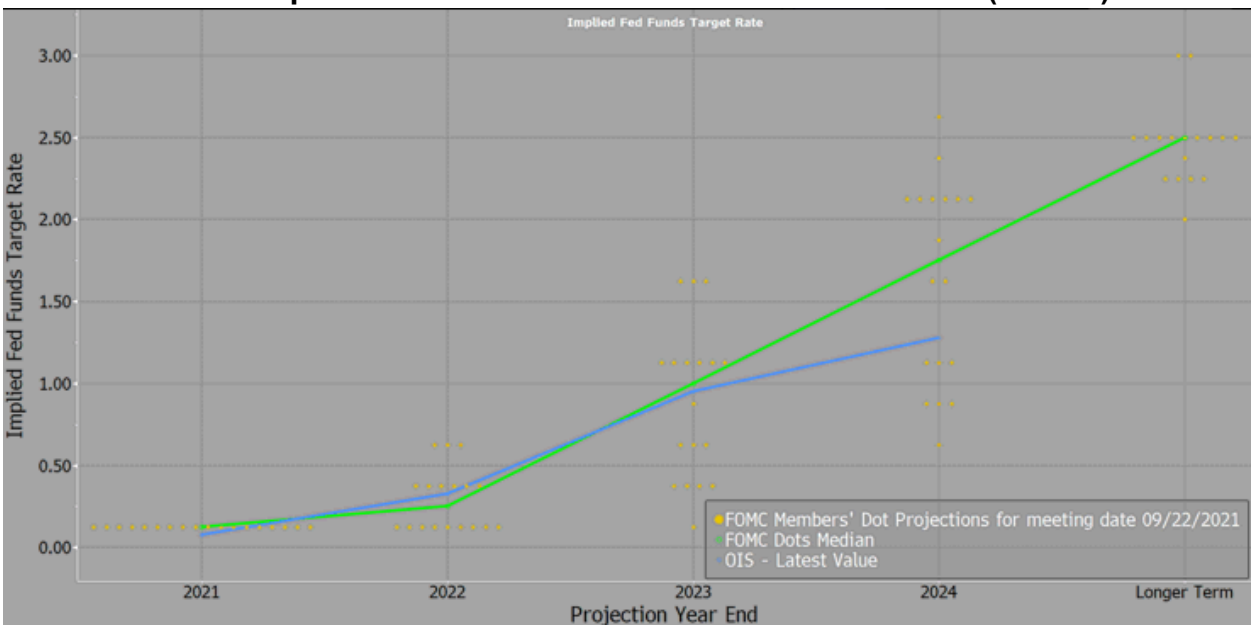
U.S. Treasury Yield Curve



Source: Bloomberg; Copyright 2021 Bloomberg Finance L.P.

Additionally, the FOMC released a new "Dot Plot" (FOMC members' own rate forecasts). The median dot for the first rate hike now lands in 2022 (presumably late 2022) compared to a 2023 projected lift-off according to the previous forecast. The FOMC now forecasts four rate hikes by the end of 2023 and seven hikes by the end of 2024 (1.75% Fed Funds rate). On the other hand, markets are more sanguine. While Overnight Indexed Swaps (OIS) forward rates agree that the first rate hike will occur in the fourth quarter of next year, and that we will witness four rate hikes in 2023, markets only forecast one additional rate hike in 2024 (to 1.25%).

Federal Open Market Committee Interest Rate Forecast ("Dots")



Source: Bloomberg; Copyright 2021 Bloomberg Finance L.P.; Federal Reserve

We would remind, however, that it is more typical that the FOMC raises rates at a quicker cadence. For instance, if the FOMC began raising rates in November 2022 and hiked rates by 25 bp at each meeting (ala 2004-2006), the Fed would reach its current Longer Term forecast rate of 2.50% by the end of 2023. If they elected to hike rates quarterly by 25 bp (ala 2017-2018), they would hit 1.25% by the end of 2023 and 2.25% by the end of 2024. With inflation currently running hotter than the Fed originally predicted, either path seems possible. While nothing has been "typical" during this pandemic, it does seem quite plausible that the markets' forecast is too sanguine – indicating that bond yields may continue to experience some upward lift in the coming months as market expectations of monetary policy continue to turn more hawkish.

With regard to risk assets, however, it does not appear that the Fed Funds rate will be lifted above the "neutral rate" of 2.50% (the Fed's own estimate of the Longer Term forecast rate) before the end of 2023 (at the earliest). Therefore, monetary policy is unlikely to reach a restrictive level (i.e., Fed Funds rate above the neutral rate) for at least another twenty-seven months (and probably longer). While rising bond yields and more hawkish expectations for monetary policy may make the waters much more choppy for risk assets in the coming months, they historically don't tend to spell doom – at least until monetary policy actually turns restrictive.

Federal Reserve Watch

Scott Phillips, CFA

Scott Phillips, CFA

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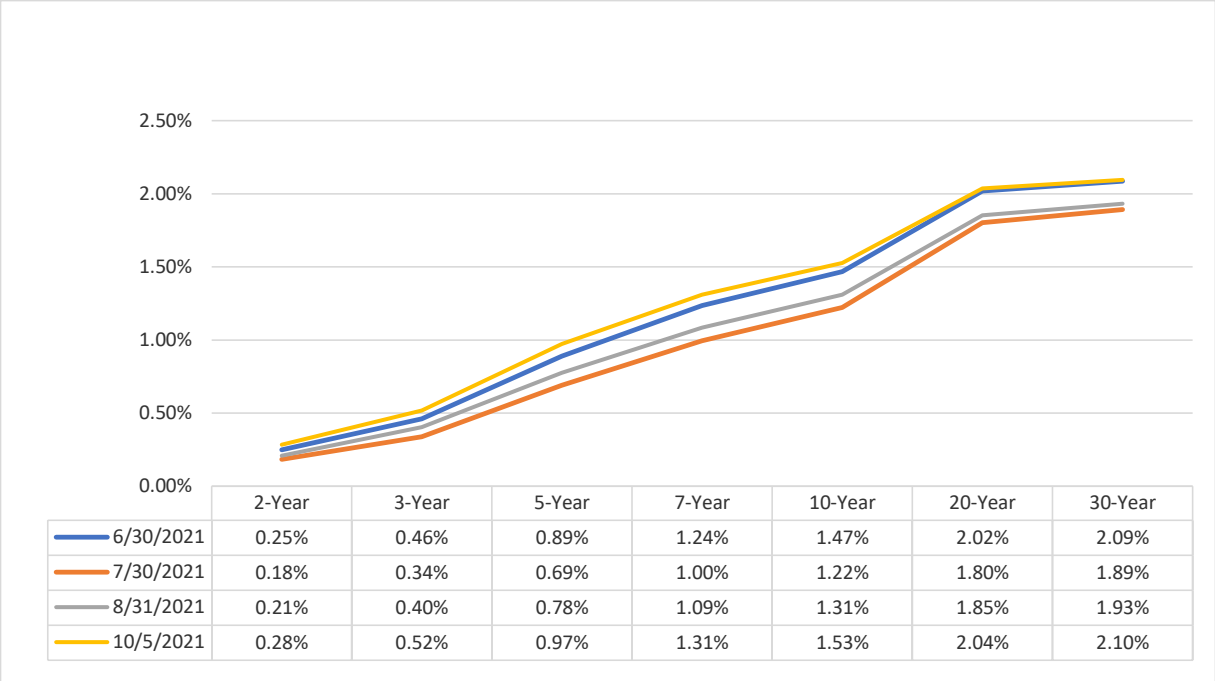
Scott manages Arvest Bank's investment portfolio and is primarily responsible for the bank's liquidity and funding, interest rate risk management and hedging, and loan and deposit pricing. He is a member of the Bank's Asset-Liability Committee. He serves as a co-manager of the ABG Bond Fund, ABG Employee Benefit Bond Fund and ABG Government Bond fund. Scott manages a few separately managed fixed income portfolios for Arvest Bank's Trust Division. He received a bachelor's degree in economics & finance from Missouri Southern State University and a Master of Arts in economics from the University of Arkansas. Scott achieved the designation of Chartered Financial Analyst in 1990 and is a member of the CFA Society of Arkansas. He has been managing portfolios for Arvest since 1988.

Taxable Bond Market

Dennis Whittaker, CFA

Treasury yield levels have experienced an upward push since the end of August as market expectations for the timing of a rate hike by the Federal Reserve have pushed forward (i.e., the implied yield on the December 2022 contract has gone from pricing in 0.722 rate hikes on August 31, 2021 to 1.055 rate hikes on October 5, 2021), inflation worries persist and the trend in COVID cases appears to have eased from its most recent peak. As can be evidenced from the graph below, the yield for the 10-year Treasury benchmark rose by approximately 22 basis points between August 31, 2021 and October 5, 2021, and has pushed back to its highest level since late June 2021. More critically, the yield on the 5-year Treasury even managed to eclipse 1% in late September 2021 for the first time since late February 2020.

Treasury Yields Have Risen in Recent Weeks, but Has It Been too Fast, too Soon?



	2-Year	3-Year	5-Year	7-Year	10-Year	20-Year	30-Year
6/30/2021	0.25%	0.46%	0.89%	1.24%	1.47%	2.02%	2.09%
7/30/2021	0.18%	0.34%	0.69%	1.00%	1.22%	1.80%	1.89%
8/31/2021	0.21%	0.40%	0.78%	1.09%	1.31%	1.85%	1.93%
10/5/2021	0.28%	0.52%	0.97%	1.31%	1.53%	2.04%	2.10%

Source: Bloomberg

As we indicated in last month's comments, our belief was that Treasury yield levels were too low for current economic conditions. Indeed, we continue to believe that Treasury yields remain below where they should be and that rates will ultimately push higher. Nevertheless, we also admit that we wonder if the market is not walking past certain risks (i.e. Evergrande; domestic fiscal policy uncertainty) and if yield levels may not have pushed too far upward too quickly. As such, while we are retaining our current duration policy band (82.5% to 92.5% of the passive benchmark for accounts managed versus the Bloomberg Aggregate Bond Index), we would likely look at reducing the size of our duration underweight in the event the 10-year Treasury made a sustained movement up toward the 1.70%-area.

Meanwhile, our sector strategy remains unchanged. Unfortunately, spreads for the residential mortgage-backed securities sector (RMBS) have tightened to a level below 30, which acts to frustrate our plans to potentially lower our allocations to the investment grade corporate bond sector. Still, the option-adjusted spread (OAS) level for the dollar denominated emerging market index has pushed to +300 basis points as of the close on Monday, October 5. If this spread level is sustained over the next several days, we do plan on exploring a potential allocation into the sector for our managed accounts at our next Fixed Income Strategy session later this month.

Taxable Bond Market

Dennis Whittaker, CFA

Bond Market Considerations Table and Sector Considerations

	10/5/2021	8/31/2021	Change
2-Year Tsy	0.28%	0.21%	0.08%
3-Year Tsy	0.52%	0.40%	0.11%
5-Year Tsy	0.97%	0.78%	0.20%
7-Year Tsy	1.31%	1.09%	0.22%
10-Year Tsy	1.53%	1.31%	0.22%
30-Year Tsy	2.10%	1.93%	0.16%
3MO-10YR	148.52	126.31	22.21
2YR-10YR	123.82	109.75	14.07
10YR-30YR	56.61	62.03	-5.42
5YR BE	263.09	250.07	13.02
10YR BE	245.95	233.83	12.12
30 Year BE	234.30	223.45	10.85
IG OAS	84.00	87.00	-3.00
HY OAS	293.00	288.00	5.00
MBS OAS	26.00	33.00	-7.00
MOVE	62.83	59.54	3.29
ABS OAS	27.00	27.00	0.00
CMBS OAS	59.00	61.00	-2.00
Agcy	30.00	34.00	-4.00
Taxable Muni OAS	86.00	89.00	-3.00
EM USD OAS	300.00	281.00	19.00

Source: Bloomberg

Bond Market Considerations Table and Sector Considerations

	10/5/2021	10/1/2021	9/17/2021	9/14/2021	9/8/2021	8/31/2021
2-Year Tsy	0.28%	0.26%	0.22%	0.21%	0.22%	0.21%
3-Year Tsy	0.52%	0.49%	0.47%	0.43%	0.44%	0.40%
5-Year Tsy	0.97%	0.93%	0.86%	0.79%	0.81%	0.78%
7-Year Tsy	1.31%	1.25%	1.16%	1.07%	1.11%	1.09%
10-Year Tsy	1.53%	1.46%	1.36%	1.28%	1.34%	1.31%
30-Year Tsy	2.10%	2.03%	1.90%	1.86%	1.96%	1.93%
3MO-10YR	148.52	142.10	131.86	123.80	128.94	126.31
2YR-10YR	123.82	119.58	113.59	107.47	110.27	109.75
10YR-30YR	56.61	56.36	53.22	57.15	61.47	62.03
5YR BE	263.09	253.76	254.24	252.25	257.07	250.07
10YR BE	245.95	237.92	234.75	233.50	238.03	233.83
30 Year BE	234.30	228.36	223.25	222.73	226.00	223.45
IG OAS	84.00	84.00	85.00	86.00	88.00	87.00
HY OAS	293.00	293.00	274.00	279.00	282.00	288.00
MBS OAS	26.00	26.00	32.00	33.00	32.00	33.00
MOVE	62.83	57.38	56.06	51.73	57.02	59.54
ABS OAS	27.00	30.00	30.00	28.00	27.00	27.00
CMBS OAS	59.00	61.00	63.00	62.00	61.00	61.00
Agcy	30.00	33.00	36.00	36.00	34.00	34.00

Taxable Bond Market

Dennis Whittaker, CFA

Taxable Muni OAS	86.00	88.00	89.00	89.00	89.00	89.00
EM USD OAS	300.00	298.00	287.00	286.00	281.00	281.00

Source: Bloomberg

Dennis Whittaker

Senior Portfolio Manager-Fixed Income | dwhittaker@arvest.com

Dennis is responsible for the construction and management of several fixed income portfolios. Prior to rejoining Arvest Wealth Management in 2006, he managed a tax-exempt mutual fund for an investment advisory firm and prepared all their fixed income research. Dennis has a BSBA in economics and holds the Chartered Financial Analyst designation. He is a member of the Fixed Income Analysts Society and the Board of Directors for the Southern Municipal Finance Society, previously serving as chair, and a former member of the Board of Governors of the National Federation of Municipal Analysts.

U.S. Equity Market

Christopher Magee, Ryan Ritchie, and Bret O'Meara

After 7 consecutive positive months, the S&P 500 finally posted a negative one in September. The index dropped in price by 4.8%, but is still up by 14.7% YTD and has provided a total return of 15.9%.

After months of complacently pushing stocks higher, investors have lost their confidence amid a familiar set of concerns, leavened with some new issues. The Delta variant gave new life to COVID-19. The absolute number of cases in the US finally appears to be heading down. Yet people are gradually moving indoors for the colder months – and that has proven to be the most dangerous time.

Another by-now familiar concern, the semiconductor shortage and the general scarcity of materials, is weighing on key consumer-sensitive industries such as automotive and housing, while also threatening earnings momentum, particularly in the Technology sector. Parts scarcity and rising wages are pushing up prices, and the market seems less ready to accept the Fed's blithe reassurance that inflation is transitory.

The nation may be as politically divided as ever, but many investors on both sides of the aisle would like to see some progress on an infrastructure bill. A break in the Washington stalemate, rather than the content of any individual bill, would likely send a positive message to the market.

The oldest concern remains valuation, particularly if inflation and goods shortages sap earnings momentum. Investors are accustomed to worrying about valuation because it was a familiar trope during the nearly 12-year bull market from March 2009 to March 2020. After the blink-and-its-gone bear market in late winter 2020, stocks raced to new highs ahead of the expected recovery in earnings. For a few quarters now, earnings have exceeded high expectations; but it is fair to wonder if this momentum is sustainable.

The third-quarter earnings season is looming. It carries the weight of high expectations, which increases the risk of a market-jolting disappointment. 3Q21 earnings for S&P 500 companies are expected to rise in the mid-20% range from 3Q20. The market rallied in April and July because 1Q and 2Q earnings, respectively, were much better than initially anticipated. Merely hitting high expectations this time around, rather than exceeding them, might be perceived as a shortfall.

Key sectors expected to drive EPS growth include Energy, Materials, and Industrial, all projected to post earnings growth above the market average. Yet those three sectors account for only about 15% of total market capitalization. The big-three sectors of Technology, Healthcare, and Financial Services will need to deliver, joined by Communication Services and Consumer Discretionary.

Recent economic data has shown recovery growth in the US that is well below the pace seen in winter and spring 2021. The S&P 500's forward P/E is still above 20, and the price-to book of the index is at 4.5. These are near record levels and the last time these were reach before 2020 was 20 years prior in the year 2000. The market will need help, in the form of a much better-than-expected earnings season, to carry its momentum convincingly into year-end, especially since valuations are already very high.

U.S. Equity Market

Christopher Magee, Ryan Ritchie, and Bret O'Meara

Bret O'Meara

Advisory Solutions Support Specialist | bomeara@arvest.com

Bret assists and support the management of investment portfolios through research, analysis, and trading of equity securities. He joined Arvest Wealth Management in 2010 as a member of the Retirement Plan Services Group before transitioning to the Investment Management Group. Bret has a BSBA in economics and finance and MBA, and taught courses in accounting and economics at Northwest Arkansas Community College for six years.

Christopher Magee

Senior Equity Portfolio Manager | cmagee@arvest.com

Christopher is the lead manager of the Arvest Bank Group Equity Fund and the Investment Management Group DIG Equity Portfolio and is responsible for construction of equity portfolios for institutional and retail clients, including equity research, security selection, sector weightings and trading. Prior to joining Arvest Wealth Management in 1992, he served as a trust investment officer at a national bank in Shreveport, Louisiana and a bank in Amarillo, Texas. He has a BSBA in finance, with an emphasis in investments, and is a graduate of Cannon Financial Institute's Advanced Trust Investments School.

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Ryan is co-manager of the Arvest Bank Group Equity Fund and co-lead manager of the Investment Management Group's strategic portfolios and is responsible for the construction of equity portfolios for institutional and retail clients, including equity research, sector weightings, and trading. Additionally, he is responsible for directing the implementation of Arvest Wealth Management's equity strategy throughout trust and brokerage relationships. Ryan has a BSBA in finance with an emphasis in financial management. Ryan has been managing portfolios since 2002.

Appendix

Investment Management Group Team Members

Clay Nickel, Chief Investment Officer & Strategist

Christopher Magee, Sr Equity Portfolio Manager

Ryan Ritchie, Portfolio Manager

Dennis Whittaker, Sr Portfolio Manager

Alex Jantsch, Portfolio Analyst

Josh Warner, Portfolio Analyst

Abbey Vibhakar, Fixed Income Analyst

Jake Baker, Fixed Income Analyst

Curtis Jones, Fixed Income Analyst

Bret O' Meara, Advisory Solutions Support Specialist

Jennifer Tichenor-Turner, Adv Solutions Support Specialist

Colton Nix, Advisory Solutions Support Specialist

Charles Kurtz, Executive Assistant

Description of IMG Recession Indicators

- Conference Board Leading Economic Indicators (LEI) - The indicator tracks the Year-over-Year percentage change in the Conference Board Leading Economic Indicators Index. The index is an American economic leading indicator intended to forecast future economic activity. It is calculated by The Conference Board, a non-governmental organization, which determines the value of the index from the values of ten key variables.

- U.S. Treasury Yield Curve (3-month to 10-year Spread) – This indicator measures the spread between the fixed income yields of the 3-month Treasury Bill and the 10-Year Treasury Bond. The lower this number, the flatter the yield curve is. The flatter the yield curve is, the less longer term investors are getting compensated over shorter term investors for the inherent interest rate risk. If the spread goes below zero, this means that the yield curve has inverted.

- ISM New Orders-to-Inventories Spread – This indicator looks at the spread of reported new order levels versus reported current inventories levels. The Institute for Supply Management (ISM) surveys 300 manufacturing firms on numerous manufacturing data points to get data points for both new orders and inventories.

- Core Capital Goods (New Orders) – This indicator tracks the Year-over-Year percentage change in the value of new orders received during the reference period. Orders are typically based on a legal agreement between two parties in which the producer will deliver goods or services to the purchaser at a future date.

- Initial Jobless Claims – This indicator tracks the number of initial unemployment claims of people who have filed jobless claims for the first time during the specified period with the appropriate government labor office. This number represents an inflow of people receiving unemployment benefits.

- New Building Permits – This indicator tracks the number of construction permits that have been issued and approved for new construction, additions to pre-existing structures, or major renovations.

DISCLAIMER: These are not the only indicators that the IMG team looks at, and no decision should (or will) be made on any single indicator. These are simply what the IMG team utilizes to *help* forecast potential for a recessionary environment.

Disclosures

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The Investment Management Group (IMG) is comprised of Arvest Wealth Management registered investment adviser representatives who provide portfolio management services with respect to certain of Arvest Wealth Management's investment advisory wrap fee programs (the "IMG managed programs").

Arvest Wealth Management does not provide tax or legal advice. Be sure to consult your own tax and legal advisors before taking any action that would have tax consequences.

Consider your investment objectives, and the risks, charge and expenses of any investment product carefully before investing. Obtain a prospectus or other product information from your Client Advisor and read it thoroughly before investing.

Investments and Insurance Products: Not a Deposit	Not Guaranteed by the Bank or its Affiliates
Not FDIC Insured | Not Insured by Any Federal Government Agency	May Go Down in Value