WEEKLY MARKET INSIGHTS

October 18, 2021

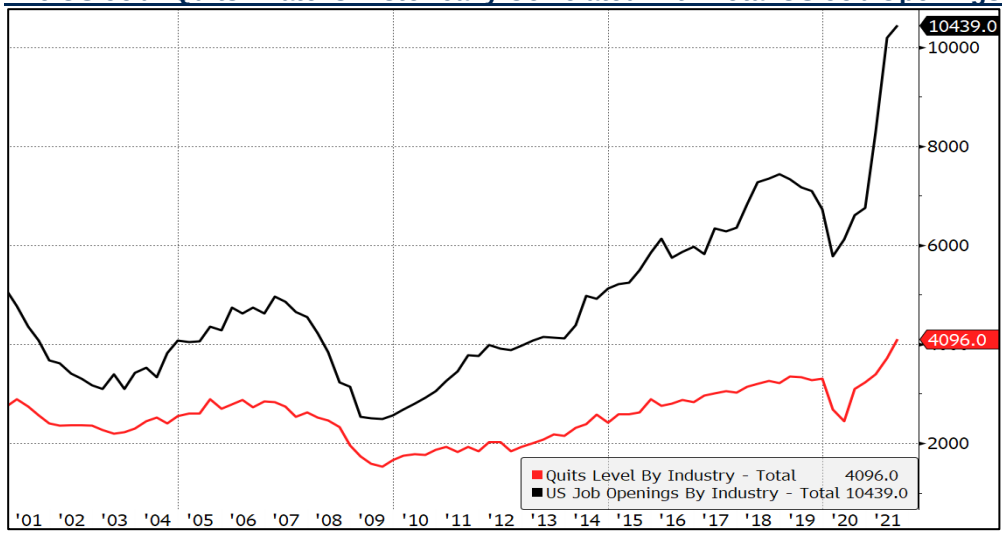
INVESTMENT MANAGEMENT GROUP | ARVEST

"We can evade reality, but we cannot evade the consequences of evading reality" – Ayn Rand

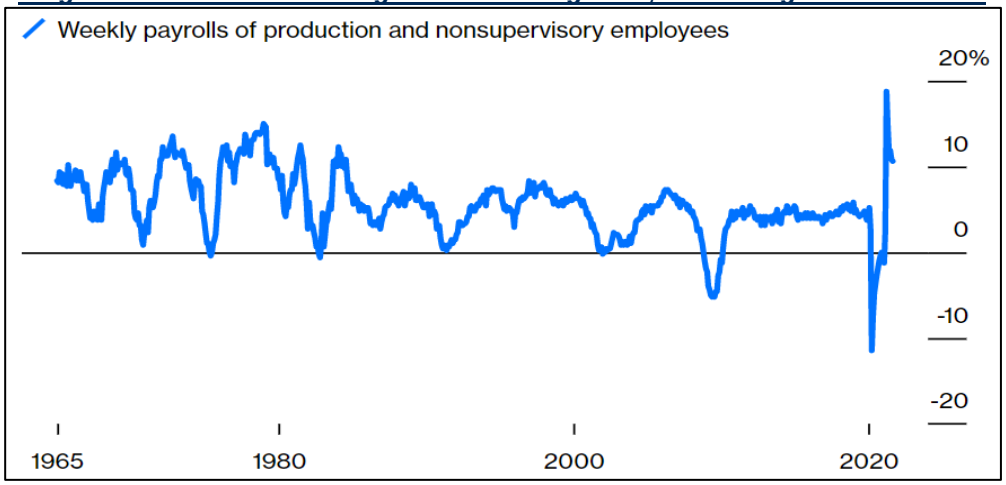
As we begin the 4th Quarter of 2021, it's worth discussing the reality of the broader economic sentiment. The global economy is recovering relatively well given the situation, but such a massive disruption was never going to be a smooth ride to get out of. We can debate the specifics of where we think interest rates, unemployment, and inflation will be in the future, but we all need a dose of humility in evaluating this economic environment. While expectations are always needed in any market environment, specific forecasts are not. Investors who assume they know exactly what will happen are often tempted into all sorts of dangerous investing behavior. Historically speaking, overconfidence is ***the*** common denominator for every famous investor or trader who fell from grace. So let's look at what we should expect, ignoring specifics for a second. We'll start first with the labor force sentiment before hitting on consumers.

Workers in many industries are fed up with low wages and little respect. They know that they have a window of power right now and they are going to take advantage of that. In some industries, the newest social media mini trend is for workers to post their boss' passive aggressive text messages asking them to do something, followed by some form of "I quit", and then the boss begging them to reconsider their "impulsive" decision. For show or not, it doesn't seem that impulsive. The job "quits" rate, which measures workers who voluntarily quit their jobs, is at all time highs (see chart, top right). The "quits" index is typically well correlated with the number of total job openings, which makes intuitive sense. Workers know they have options, and the COVID stimulus gave many of them breathing room in the form of higher savings. Unions are having a bit of a renaissance of influence too. We've talked in the past about the current skills gap, where workers are not qualified for the jobs that are open. A lot of those jobs are in industries with a bigger union presence. Most notably now are port workers. The National Labor Relations Board also has a pro-union majority for the first time in a while. In one of the worst supply chain disruptions, business and unions should be working together to solve the problem, but instead they are bickering with each other. President Biden's vaccine mandates won't help that situation, at least in the short term. It's hard to use a "get vaccinated or lose your job" incentive when there are plenty of jobs to be had and more workers now have savings to wait it out. This shift in the labor market power dynamic is likely one of the more underestimated aspects of COVID. This is a positive for wage growth (see chart, bottom right), but not great for inflation. ***(cont.)***

The US Job "Quits" Rate is Historically Correlated with Total US Job Openings



Wage Growth Has Shown Signs of "Running Hot", Increasing Inflation Risks



Sources: Top – Bloomberg LP; Bottom – Bloomberg LP, Federal Reserve Bank of St. Louis

ABOUT INVESTMENT MANAGEMENT GROUP

Arvest Wealth Management currently manages over $14 billion in client assets by providing a diverse mix of services including brokerage, trust, investment management, retirement plans, IRAs, custodial accounts, estate settlement and insurance. We are people helping people find financial solutions for life. The Investment Management Group is a registered investment advisory within Arvest Wealth Management, founded in 2011, and responsible for managing approximately $750 million in assets.

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That brings us to the consumer. From a sentiment perspective, inflation is incredibly visible and powerful. Increasing wages and higher savings are great, but if most of those wage increases just get passed down to the consumer then that savings will start dwindling. Consumers will get no help from their savings account interest income either. With interest rates as low as they are now, the gap between income needed to be generated from a savings account and income needed to cover inflation is at unprecedented levels. An $100,000 savings account generates just $70 in interest income, whereas one needs $3,977 to cover inflation (see chart, top right). A negative $3,907 annual gap. It's hard not to see how that will drag on consumer sentiment if inflation continues to grow. The Federal Reserve is now putting on a full court press regarding the transitory inflation narrative, with the assertion that much of this is supply driven and will have worked itself back down by the end of 2022. Wall Street is starting to think otherwise. Reality is likely in between.

In the end, some level of higher wages and higher inflation should be expected in the short-to-medium term but overhauling your investment portfolio based on these current risks is ill advised. There are always risks present that could derail market momentum, but the market is more correlated to overall economic growth than anything else and economic growth is still strong. Investors shouldn't ignore that aspect. Thus, we have been recommending investors stay close to their current asset allocation targets. If this pandemic has changed your ability or willingness to take investment risks, then it might be time to revisit those long-term asset allocation targets rather than trying to time the market. Companies and consumers are astoundingly good at adapting, but that adaptation doesn't go in a straight, neat line. Don't overthink it.

We will be taking a few weeks off from publishing this weekly piece. Publication will resume on Monday, November 8th.

JOIN OUR MONTHLY MARKET CALL

The Arvest Investment Management Group hosts a monthly Market Viewpoint webinar. To join us for our next meeting, please contact Charles Kurtz at ckurtz@arvest.com.

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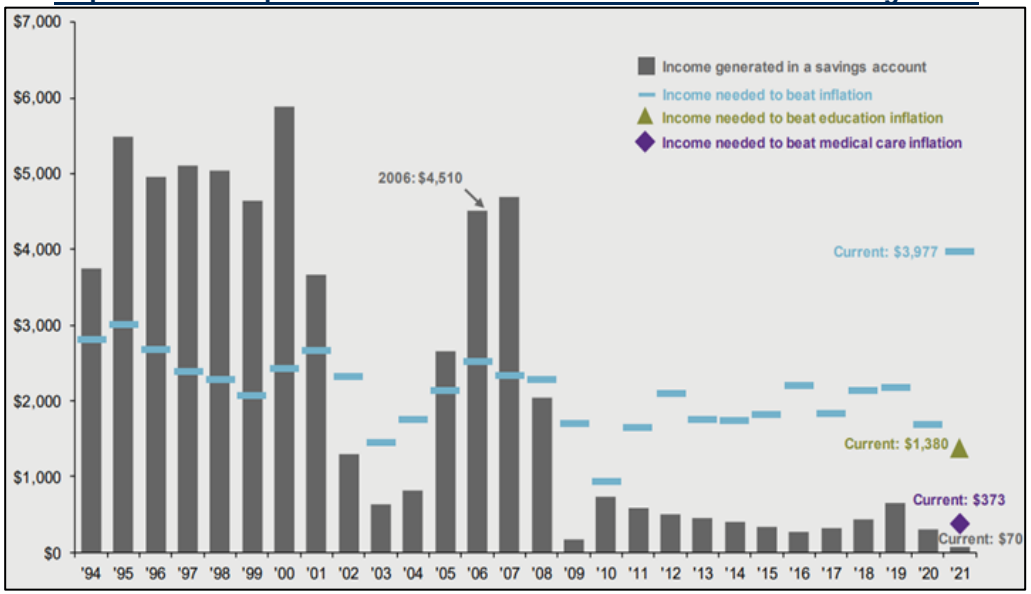
Gap Between Deposit Income and Income to Cover Inflation Is Huge Now



Source: JPMorgan

CURRENT ASSET CLASS OUTLOOK

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

Real Assets	Current
Real Estate	Slightly Unfavorable
Infrastructure	Neutral
Commodities	Neutral

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

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Market Returns & Rates (as of 10/15/2021)

Asset Class	Sub-Asset Class	Index	YTD	1-Year	3-Year	5-Year	10-Year	2020
Equity	U.S. Large Cap Equities	S&P 500	20.38%	30.24%	19.68%	18.22%	16.35%	18.39%
Equity	U.S. Mid Cap Equities	S&P 400	20.28%	38.96%	15.28%	14.37%	14.44%	13.65%
Equity	U.S. Small Cap Equities	Russell 2000	15.56%	39.59%	14.84%	14.83%	14.16%	19.93%
Equity	Developed ex. U.S. Equities	MSCI ACWI ex U.S.	8.91%	25.26%	11.91%	10.51%	7.64%	11.23%
Equity	Emerging Markets Equities	MSCI Emerging Mkts	1.30%	17.21%	12.58%	10.34%	5.99%	18.79%
Fixed Income	Broad Aggregate	BB Aggregate	-1.72%	-1.09%	5.51%	3.02%	3.04%	7.51%
Fixed Income	U.S. Treasury	BB U.S. Treasury	-2.71%	-3.23%	4.99%	2.36%	2.27%	8.00%
Fixed Income	U.S. Treasury Inflation Prot.	BB U.S. Inflation Linked	4.49%	6.13%	8.38%	4.74%	3.32%	11.54%
Fixed Income	U.S. Investment Grade	BB U.S. Invest. Grade	-1.33%	1.12%	7.73%	4.67%	4.89%	9.89%
Fixed Income	U.S. High Yield	BB U.S. High Yield	4.35%	9.66%	7.13%	6.35%	7.18%	7.11%
Fixed Income	U.S. Leveraged Loans	CS Leveraged Loan	4.82%	8.12%	4.07%	4.59%	4.97%	2.78%
Fixed Income	U.S. Municipals	BB Municipal Bond	0.69%	2.86%	5.27%	3.45%	3.95%	5.21%
Fixed Income	Non-U.S. Gov't Bond	FTSE Non-U.S. WGBI	-8.05%	-4.10%	2.92%	1.46%	0.38%	10.78%
Fixed Income	Emerging Markets Debt	JPMorgan EMBI	-1.68%	2.33%	6.02%	3.71%	5.21%	5.88%
Real Assets	Real Estate	FTSE NAREIT	29.85%	39.74%	13.96%	8.86%	11.66%	-8.00%
Real Assets	Master Limited Partnerships	Alerian MLP	52.05%	81.14%	-1.08%	-0.38%	1.57%	-28.84%
Real Assets	Broad Commodities	Bloomberg Commodity	34.17%	42.61%	6.32%	3.93%	-3.34%	-3.50%
Real Assets	Oil	WTI Crude	69.58%	100.88%	4.66%	10.32%	-0.53%	-20.54%
Real Assets	Gold	Gold COMEX	-6.75%	-7.15%	12.95%	7.12%	0.50%	24.42%

Key Market Interest Rates	Current Rate	1 Month Ago	2 Months Ago	3 Months Ago	4 Months Ago	6 Months Ago	1 Year Ago
Federal Funds Rate	0.08%	0.08%	0.10%	0.10%	0.10%	0.07%	0.09%
Secured Overnight Fin. Rate (SOFR)	0.05%	0.05%	0.05%	0.05%	0.05%	0.01%	0.10%
90-Day Treasury Rate	0.05%	0.03%	0.04%	0.04%	0.03%	0.01%	0.09%
2-Year Treasury Rate	0.39%	0.21%	0.21%	0.22%	0.21%	0.16%	0.14%
5-Year Treasury Rate	1.13%	0.80%	0.76%	0.77%	0.88%	0.82%	0.31%
10-Year Treasury Rate	1.57%	1.30%	1.27%	1.29%	1.50%	1.58%	0.73%
30-Year Treasury Rate	2.04%	1.86%	1.93%	1.92%	2.09%	2.27%	1.51%
3-Mon/10-Yr Treasury Spread	1.52%	1.27%	1.23%	1.25%	1.48%	1.57%	0.64%
2-Yr /10-Yr Treasury Spread	1.18%	1.09%	1.06%	1.07%	1.29%	1.42%	0.59%
6-Month CD Rate	0.14%	0.15%	0.15%	0.15%	0.16%	0.17%	0.30%
1-Year CD Rate	0.28%	0.29%	0.29%	0.29%	0.30%	0.32%	0.44%
2-Year CD Rate	0.31%	0.33%	0.33%	0.33%	0.33%	0.36%	0.47%