WEEKLY MARKET INSIGHTS

October 4, 2021

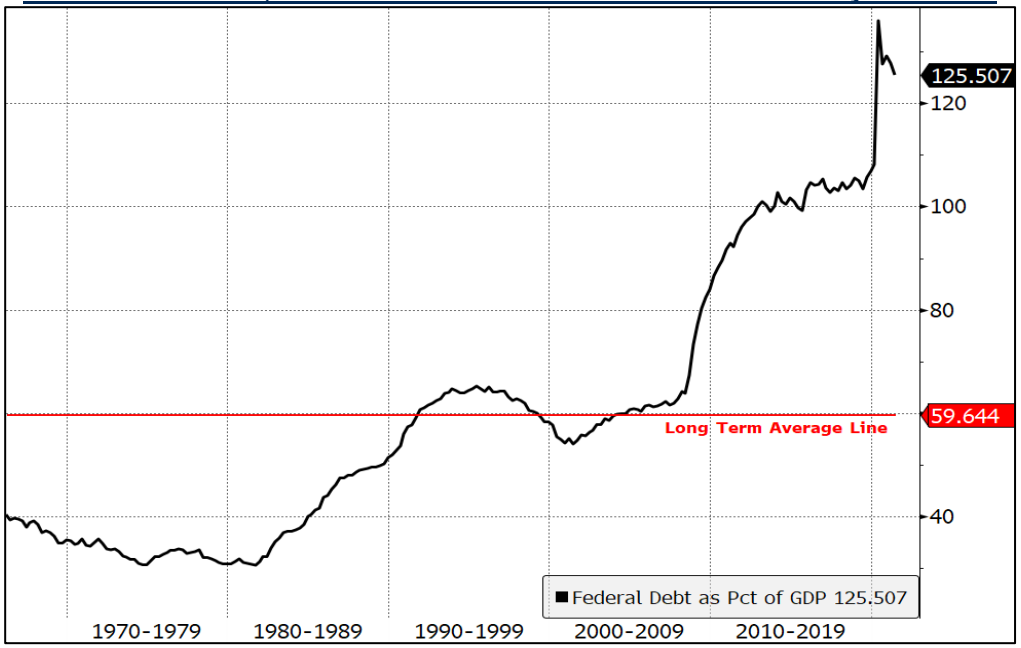
INVESTMENT MANAGEMENT GROUP | ARVEST

"It's very common to be utterly brilliant and still think you're way smarter than you actually are" – Charlie Munger

It seems odd that citizens of the richest country in the world are subjected to an arcane procedural debate over a federal "debt ceiling" every few years that puts our financial markets on edge and worries millions of people dependent on government support about the timing of their next check. Even worse, the only purpose of the debt ceiling in modern times is mainly for political gamesmanship of pinning the growing US debt on the opposing political party. Both parties have run up federal debt (see chart, top right), both parties have pushed this debate to the final seconds to score political points in the past, and both parties realize (but won't publicly admit) that this is more of a distraction than a constructive use of time. Despite knowing that it's a distraction, no politician wants to campaign on "remove the debt ceiling" because that is the equivalent of serving your opponent's next political attack advertisement on a silver platter. I can see it now. *"Congressman Smith wants to bankrupt our country by running up the country's credit card bill beyond our credit limit. As your congressman, I will make sure your tax dollars get spent responsibly"*. It's silly (and entirely disingenuous), but that's reality. If there is a better example of why you should never make investment decisions based off politics, I haven't found it yet. When these debates happen, the debt ceiling often gets suspended or raised at the last second, averting a crisis (see timeline, bottom right). In 2011, credit rating agencies decided to downgrade US Government debt based on what Standard & Poor's called "political brinksmanship". This led to brief market correction and higher interest rates (i.e. higher borrowing costs for the US Government). To understand the dangerous game our politicians are playing, it makes sense to clear the air about the whole procedural policy first.

No, the US Government is not running out of money. However, once the US debt ceiling is hit and the Treasury exhausts all emergency measures, the US Government is technically no longer allowed to issue debt to pay for ***already approved*** expense obligations. Not raising the debt ceiling before that point then results in a government default on current debt obligations. The already approved part is crucial to understanding the absurdity of the procedure. It is also what differs the "debt ceiling" default from a "government shutdown". A shutdown occurs when Congress fails to pass bills that allow government agencies to obligate ***new*** spending. That results in the government temporarily not paying federal employees and contractors. Government shutdowns are disruptive, but debt ceiling defaults can be worse because they involve ***(cont.)***

Over Last Decades, US Gov't Total Debt-to-GDP Ratio Has Notably Increased



Debt Ceiling History and Timeline of Recent Debates

1917 – Debt ceiling created during wartime to expedite government funding process.

1979 – Gephardt Rule created to tie debt ceiling increase to gov't budget approval.

1995 – Gephardt Rule repealed, paving the way for the recent partisan debt fights.

2011 – Standard & Poor's downgrades US debt, due to debt ceiling brinksmanship.

2013 – Debt limit impasse led to partial gov't shutdown and short-term market turmoil.

2019 – Debt ceiling increase suspended until July 31, 2021, which was then delayed.

Overall: Debt ceiling has been raised nearly 100 times since 1917, mostly bipartisan.

Sources: Top – Bloomberg LP; Bottom – NPR, BBC, WSJ, Committee for Responsible Federal Budget

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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current US Government financial obligations to our creditors around the world. As of Dec. 2020, ~$7 trillion (or 32%) of the ~$21.6 trillion in US federal debt was held by non-US investors. Besides an incredibly small and isolated technical default in 1979, the US has never truly defaulted on their debt obligations. Doing so now would be an unnecessary and self-inflicted wound.

To be clear, we do not believe that Congress will allow such a disastrous result simply for the sake of making a political point. The alternative is being blamed for an unprecedented fiscal calamity that was entirely procedural and politically motivated, while at the same time increasing our government's borrowing costs by creating the impression within the global debt markets that our funding decisions for ***existing*** financial obligations are political, not practical. Bond investors often see things in black and white more than equity investors do. Borrowers either make good on all promised payments, or they don't. Before our fixed income team throws tomatoes at me, it is certainly more complex than that, but the point is that equity investors must guess uncertain futures more frequently than bond investors. The US Government is accustomed to incredibly cheap, unlimited access to the bond markets. When you play games, don't be surprised if those lenders then ask for higher income yields in the future to make up for the added risk. To some extent, this is currently happening right now in the US Treasury markets. In short maturity Treasury Bills, investors have sold off the bonds maturing after October 14th (see chart, top right), resulting in higher yields. That's the day that the US Treasury noted it would likely run out of money if the debt ceiling was not raised. This reflects that the market believes this to be a real threat, but only for the next month or so. If the bond market saw this as a bigger issue, this "hump" in short term Treasury yields would be larger and extend much further into the future. The Federal Reserve and US Treasury do have emergency measures that can help alleviate the issues, but those don't solve the root of problem. Only politicians can end this madness for good.

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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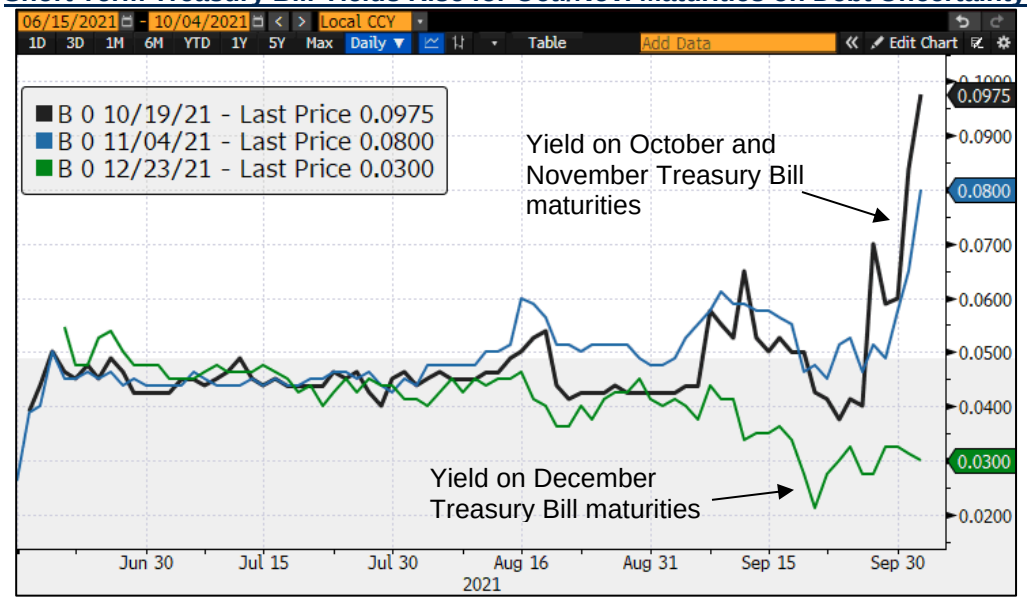
Alex supports the portfolio management team through market research that aids asset allocation decisions and due diligence on third party investment managers. He has a BSBA in finance, as well as a certificate in integrated investment management, and holds the CFA designation as a member of the Chartered Financial Analyst Institute and the Kansas City Society of Chartered Financial Analysts.

Short Term Treasury Bill Yields Rise for Oct./Nov. Maturities on Debt Uncertainty



Source: Bloomberg LP

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 10/1/2021)

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	17.24%	30.77%	16.27%	17.24%	17.09%	18.39%
Equity	U.S. Mid Cap Equities	S&P 400	17.41%	44.18%	11.94%	13.48%	15.43%	13.65%
Equity	U.S. Small Cap Equities	Russell 2000	14.31%	47.83%	11.64%	13.92%	15.45%	19.93%
Equity	Developed ex. U.S. Equities	MSCI ACWI ex U.S.	5.62%	23.35%	8.38%	9.31%	8.25%	11.23%
Equity	Emerging Markets Equities	MSCI Emerging Mkts	-1.67%	17.60%	8.78%	9.28%	6.74%	18.79%
Fixed Income	Broad Aggregate	BB Aggregate	-1.28%	-0.65%	5.48%	3.01%	2.99%	7.51%
Fixed Income	U.S. Treasury	BB U.S. Treasury	-2.22%	-3.02%	5.03%	2.31%	2.16%	8.00%
Fixed Income	U.S. Treasury Inflation Prot.	BB U.S. Inflation Linked	3.80%	5.51%	7.87%	4.50%	3.14%	11.54%
Fixed Income	U.S. Investment Grade	BB U.S. Invest. Grade	-0.88%	2.02%	7.61%	4.70%	4.85%	9.89%
Fixed Income	U.S. High Yield	BB U.S. High Yield	4.54%	11.09%	6.84%	6.49%	7.51%	7.11%
Fixed Income	U.S. Leveraged Loans	CS Leveraged Loan	4.66%	8.37%	4.07%	4.63%	5.07%	2.78%
Fixed Income	U.S. Municipals	BB Municipal Bond	0.78%	2.68%	5.06%	3.27%	3.86%	5.21%
Fixed Income	Non-U.S. Gov't Bond	FTSE Non-U.S. WGBI	-7.47%	-3.03%	3.16%	0.91%	0.54%	10.78%
Fixed Income	Emerging Markets Debt	JPMorgan EMBI	-1.56%	3.67%	5.68%	3.56%	5.47%	5.88%
Real Assets	Real Estate	FTSE NAREIT	25.05%	36.11%	10.91%	7.55%	12.00%	-8.00%
Real Assets	Master Limited Partnerships	Alerian MLP	41.16%	88.30%	-4.69%	-2.03%	1.56%	-28.84%
Real Assets	Broad Commodities	Bloomberg Commodity	29.30%	43.67%	5.33%	3.35%	-3.24%	-3.50%
Real Assets	Oil	WTI Crude	56.39%	95.97%	0.26%	9.48%	-0.43%	-20.54%
Real Assets	Gold	Gold COMEX	-7.29%	-7.93%	13.96%	5.99%	0.81%	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%	0.06%	0.07%	0.09%
Secured Overnight Fin. Rate (SOFR)	0.05%	0.05%	0.05%	0.05%	0.01%	0.01%	0.08%
90-Day Treasury Rate	0.02%	0.03%	0.03%	0.04%	0.01%	0.01%	0.08%
2-Year Treasury Rate	0.26%	0.21%	0.17%	0.23%	0.15%	0.16%	0.13%
5-Year Treasury Rate	0.93%	0.77%	0.65%	0.86%	0.84%	0.90%	0.27%
10-Year Treasury Rate	1.46%	1.29%	1.18%	1.42%	1.63%	1.67%	0.68%
30-Year Treasury Rate	2.03%	1.91%	1.85%	2.04%	2.30%	2.33%	1.46%
3-Mon/10-Yr Treasury Spread	1.44%	1.26%	1.14%	1.39%	1.62%	1.66%	0.60%
2-Yr /10-Yr Treasury Spread	1.20%	1.08%	1.01%	1.19%	1.47%	1.51%	0.55%
6-Month CD Rate	0.16%	0.15%	0.15%	0.16%	0.16%	0.18%	0.30%
1-Year CD Rate	0.29%	0.29%	0.29%	0.30%	0.30%	0.33%	0.44%
2-Year CD Rate	0.33%	0.33%	0.33%	0.33%	0.34%	0.37%	0.48%