As of 6/30/2021

# Q3 2021

## Spectrum Investor® Quarterly Newsletter

SPECTRUM INVESTMENT ADVISORS


**Jonathan Marshall**
Chief Investment Officer

**James Marshall**
Chairman/Founder


### Newsletter Summary:

Economic Surge
Inflation Challenges Federal Reserve
Delta Variant Challenges Vaccines

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*See important disclosures on Page 6*
*Our ADV Part 2A-2B & privacy notice can be found on our website.*

Major stock market benchmarks continued higher in the second quarter, powered by strong earnings and economic growth. The S&P 500 had an 8.5% total return for the quarter, adding up to 15.25% year-to-date as of June 30, 2021. It was the fifth straight quarterly gain for the S&P 500, as the economy continues to rebound from the onset of COVID-19 in 2020.

**Surge economy:** Last year, JPMorgan's Chief Market Strategist, Dr. David Kelly, said the economy would go through a "fall, a stall, and a surge" in dealing with COVID. With the arrival of vaccines and additional government stimulus, a surge is exactly what happened. Second quarter economic growth is estimated at 9% real gross domestic product (GDP), the second fastest quarter of growth since 1983.

This was the quarter restaurants and stadiums once again filled to capacity. Air travel also returned in a big way, doubling from one million passengers per day in March to two million daily passengers by July.

**What next?** The economic expansion probably peaked in the second quarter, but it is expected to remain strong into next year. Consumer balance sheets remain healthy, and with pent up demand, there is a willingness to spend. That should provide a positive backdrop for stocks, but as always, we suggest keeping your long-term goals in mind when making investment decisions. Choose a portfolio you can stick with no matter what tomorrow's headlines may read. Inflation, high valuations, and taxes remain headwinds that may cause volatility along the way.

**Inflation:** The chart on the lower right shows that as recently as February of this year, inflation was near decade lows. Four months later, Core CPI (Consumer Price Index) hit 4.5% in June, the fastest reading since 1991. The Federal Reserve has taken the stance that the rise in inflation will be temporary as COVID-related supply chain issues will unwind with the economy reopening. Lumber prices, for example, had skyrocketed 140% through April, but are now down 33% year-to-date. (See chart, lower left).

Here are a few other reasons inflation may cool over time:

1. More oil: In July, OPEC agreed to gradually re-instate 5.8 million barrels of oil production per day by September 2022. The cuts were made last year when oil inventories hit record highs. In the US, gas prices may stabilize as refinery inputs are back to pre-COVID production levels.

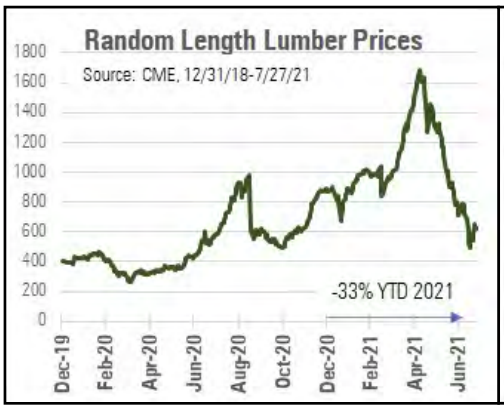
2. More workers: The US economy is expected to add over 400,000 employees per month over the next year. As of June, there were a record 9 million job openings. Filling jobs may be easier as schools reopen and additional COVID-related unemployment benefits expire in September.

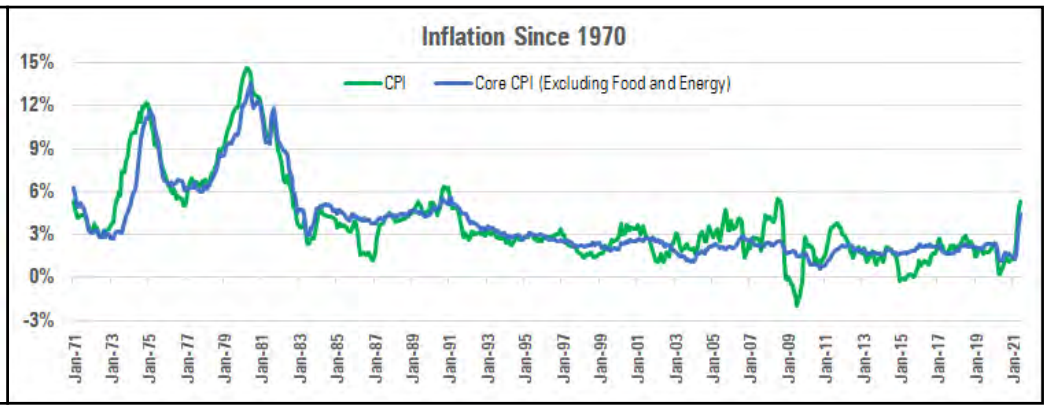
3. More autos: Semi-conductor shortages are to blame for a freeze in auto production. As a result, one-third of June's increase in Core-CPI was due to rising used auto prices. The *Wall Street Journal* reported that one year old cars sold for the same average price as brand new vehicles in June. Semi-conductor suppliers believe the shortage has bottomed and will improve from here, meaning more cars will become available.

4. More options: Consumer spending was centered on goods, as social distancing limited things to do. Through the first quarter this year, recreation services spending was down 28% vs. pre-pandemic levels compared to a 30% gain for spending on recreational goods. That trend may shift to services as the economy opens up.

**Persistent inflation and potential risks:** Mohamed El-Erian, Chief Economic Advisor at Allianz, argues that this is a new cycle with fundamental challenges that simply did not exist in the last 10 years. "This is not the 1970s and 80s, but it is 3-4% inflation that will last for much longer than people expect." Why does this matter? The near-term risks for stocks are lower profits due to higher input costs. Further out, Dr. El-Erian believes the Federal Reserve could make two policy errors: providing too much accommodation for too long, and being forced to react too quickly too late, raising risks of a recession in the next two or three years.

**Federal Reserve reaction:** Most agree that the Federal Reserve did a tremendous job in lifting the economy out of extreme recession due to COVID shutdowns. But the critics are coming back. In June, the Federal Reserve revised their forecast to include two interest rate hikes in 2023.




## Quarterly Economic Update Continued

The 10-year treasury yield dropped from 1.6% to 1.44% in June and stock leadership rotated from value to growth, signaling that the Fed was reacting too soon and would slow the recovery.

**Fed tapering:** At the same time, more are calling on the Federal Reserve to end its emergency purchases of $120 billion per month. There is growing belief that this is adding pressure to the housing market by keeping mortgage rates artificially low, hovering around 3% or less for a 30-year fixed rate mortgage. The Case-Shiller home price index rose by 16.6% in May, the fastest annual growth rate since the index began in 1987. The Fed is expected to announce a plan to reduce its purchases in August and actually start reducing them in the fourth quarter or early next year. The Fed does not directly control mortgage rates, but these purchases are an influence. If your mortgage is above 3.25%, you may want to consider refinancing.

**Taxes:** Higher taxes may be tied to an infrastructure package with any approved deal likely to be smaller than originally proposed by the Biden administration. David Lebovitz from JPMorgan is predicting the US corporate tax rate will likely increase from 21% to 25%. The minimum global tax rate of 15%, which was agreed to by 130 countries, is scheduled to take effect in 2023 and is not a major concern for markets.

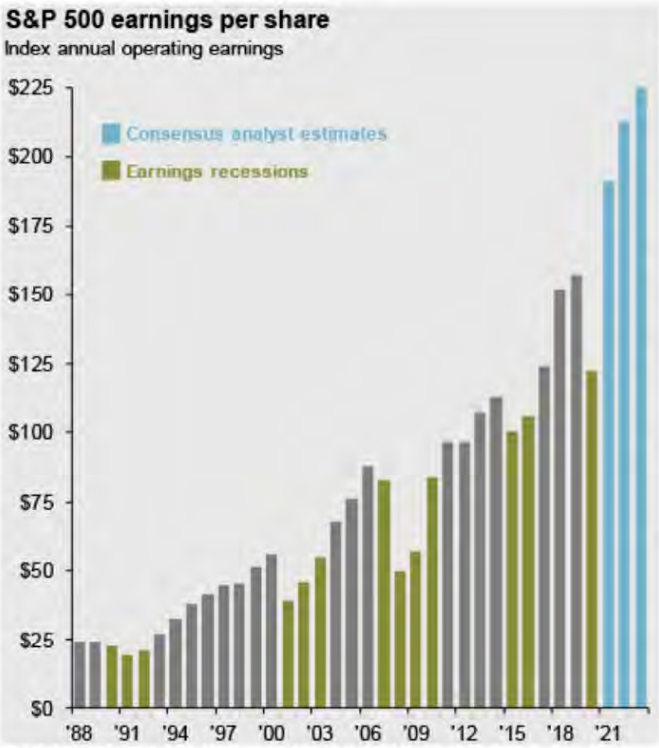
**Valuations and earnings:** The main thing to know on stock valuations is that they are above average, but not necessarily any more expensive today than they were a year ago. As long as interest rates remain low and the outlook for earnings is strong, valuations may hold steady. The chart on the lower left shows in blue that S&P 500 earnings are expected to grow significantly in 2021 (38% according to FactSet) with follow-up growth in 2022 and 2023. The chart on the right shows how falling valuations (multiple expansion) can be a headwind for stocks. The key is to understand that valuations can fall even as stock prices rise. Year-to-date, earnings growth (grey line) contributed a 19.7% gain for the S&P, but falling valuations (multiple expansion, blue line) reduced the return by 5.3% for a net return of 14.4% (green line).

**Vaccines vs variants:** During our webinar with Dr. Kelly in March, he predicted that with the help of vaccines we would see less than 500 COVID deaths per day by June in the US. He was correct. Now this summer, the arrival of the Delta variant is the first new wave of infections since vaccines were rolled out. Rising cases in the US are a reminder that we may very well continue to deal with COVID for some time to come. The good news is that 161 million Americans have been vaccinated and only 0.0036% have seen breakthrough infections that have resulted in death or hospitalization. So far, new cases in the US have risen from 12,000 per day to nearly 50,000 per day, but new deaths have remained well below 500 deaths per day vs. a peak of 4,000 deaths per day in January.

The UK, which has a slightly higher vaccine participation than the US, has seen similar results. New case counts there have risen to 46,000, while death rates have stayed below 100 per day.

**Value vs. growth:** Throughout COVID, value and growth have traded places in market leadership. When the outlook is weaker, growth does better (lead by technology). When the outlook is stronger, value does better (lead by financials, energy and industrials). Historically, value also tends to outperform when inflation and interest rates are rising, which helps financials. As we continue to exit COVID-related impacts, the outlook will likely continue to rotate between low growth or high growth. Our suggestion is to stay diversified and continue to own both growth and value stock in your portfolio.

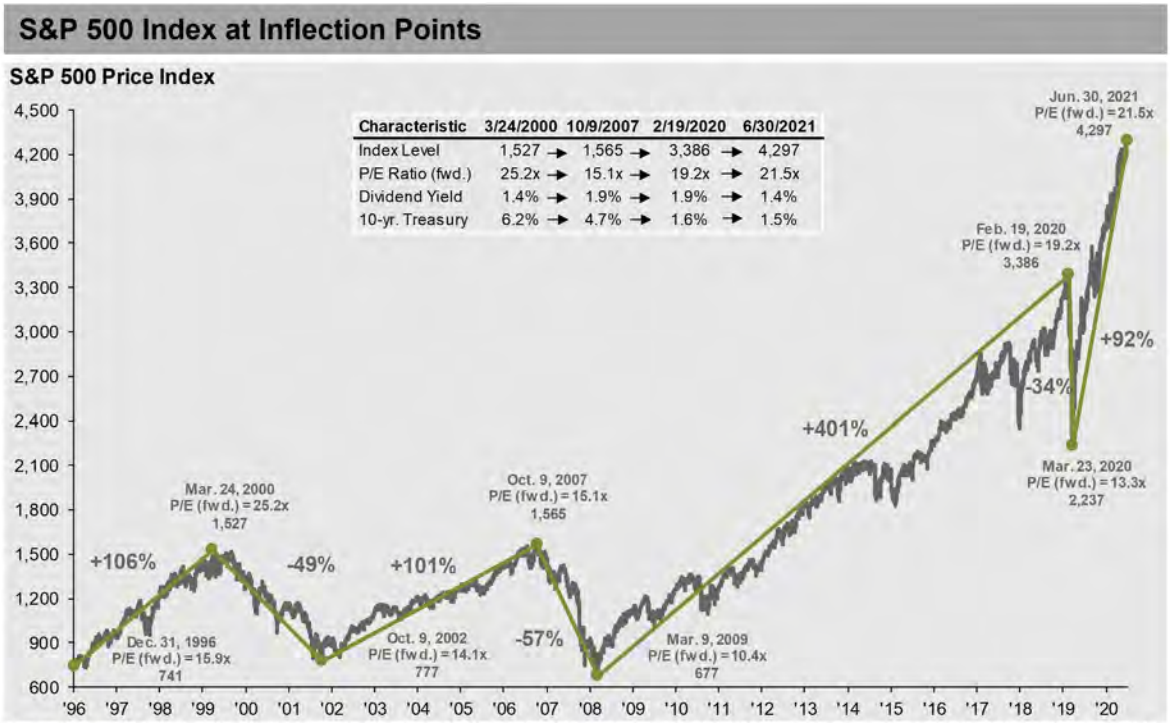
**More resources:** Finally, as a reminder, in the last year we launched our newly redesigned website at **www.spectruminvestor.com.** Under Resources/Events you can view recordings of our webinars, including our full conversation with Dr. David Kelly. Should you wish to speak to an advisor at Spectrum, please call us at 1-800-242-4735 or email us at sia@spectruminvestor.com.





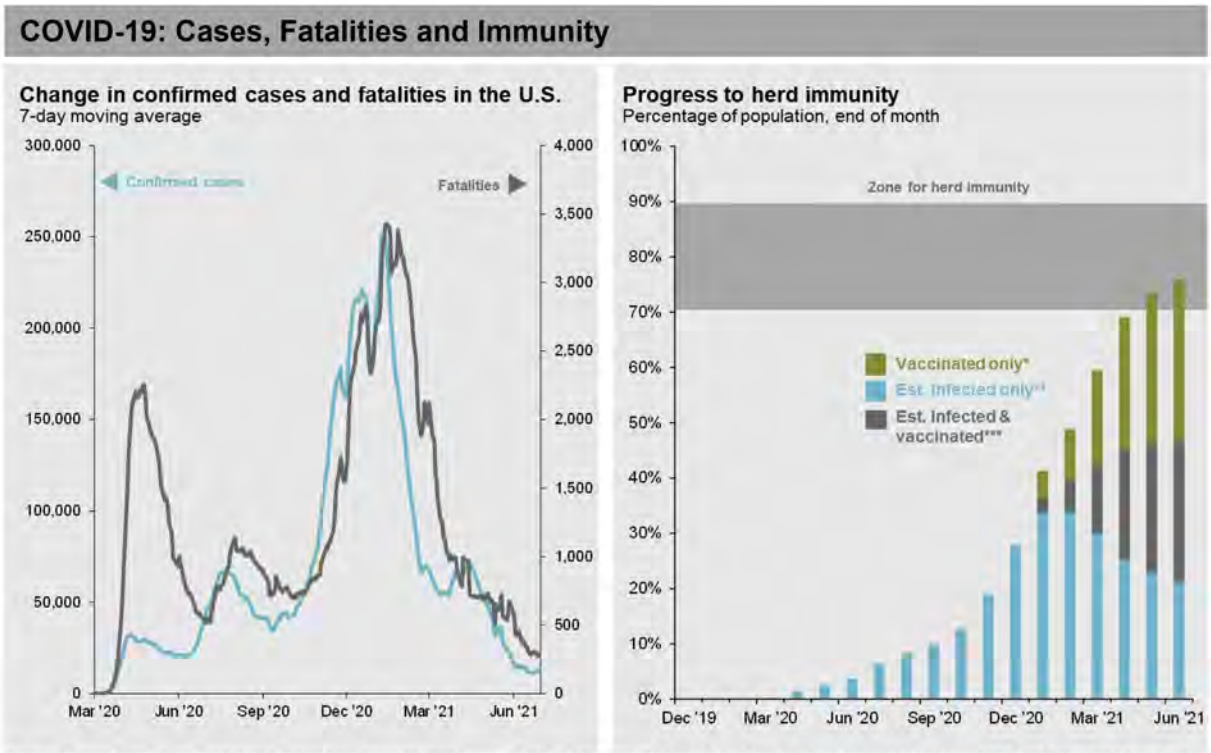
Source: FactSet, Compustat, Standard & Poor's, J.P. Morgan Asset Management.
Historical EPS levels are based on annual operating earnings per share. Earnings estimates are based on estimates from Standard & Poor's and FactSet Market Aggregates. Past performance is not indicative of future returns.
*Guide to the Markets – U.S.* Data are as of June 30, 2021.

**S&P 500 Index at Inflection Points:** The chart below illustrates the performance history of the S&P 500 from 12/31/96 to 6/30/21. As of 3/23/20, the S&P had dropped 30%, but recovered, down 8% as of 6/30/20. The S&P finished up 18.4% as of 12/31/20 and is up 15.25% year-to-date as of 6/30/21. As of 6/30/21 the 10-year treasury rate is now 1.5%, down from 1.7% as of 3/31/21, which compares to the dividend yield of the S&P 500 at 1.4%. When the current yield on bonds is higher than the yield on stocks, it can be a warning sign for stocks, but there is currently not a significant enough difference to sell stocks and buy bonds.



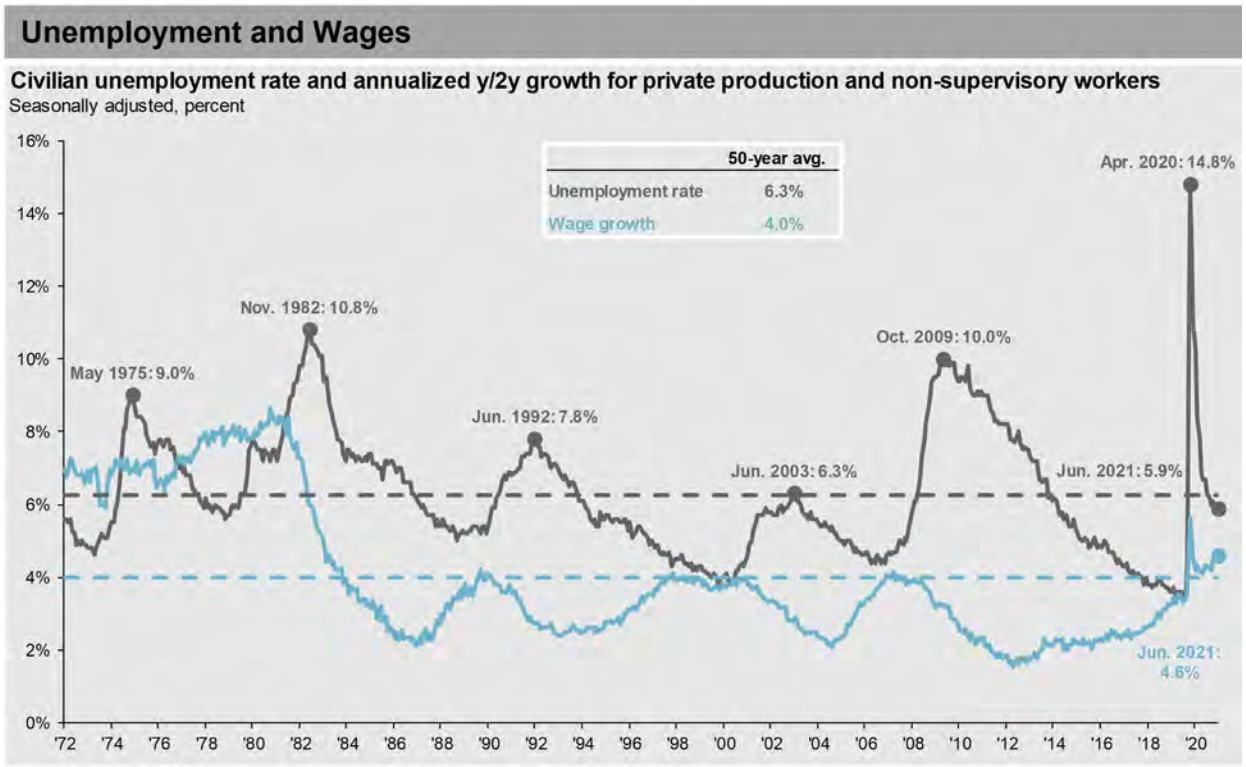

*Source: Compustat, FactSet, Federal Reserve, Standard & Poor's, J.P. Morgan Asset Management. Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price to earnings ratio is a bottom-up calculation based on J.P. Morgan Asset Management estimates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns. The S&P 500 Index is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenue are based in the US. Guide to the Markets – U.S. Data as of 6/30/2021.*

**COVID-19: Cases, Fatalities and Immunity:** According to Dr. Kelly at JPMorgan, the goal of fighting COVID in the United States is to get to 80% herd immunity, where people have actually had COVID or received vaccinations. Dr. Kelly says that a 80% herd immunity target is projected to happen by Fall 2021. Rising from 35% in January, to 43% in February, to 53% in March, to 65% in April, to 75% in May/June.




*Source: Centers for Disease Control and Prevention, Johns Hopkins CSSE, Our World in Data, JPMorgan Asset Management. *Share of total population that has received at least one vaccine dose. **Est. Infected & vaccinated assumes represents the number of people who may have been infected by COVID-19 by using the CDC's estimate that 1 in 4.6 COVID-19 infections were reported. ***Est. Infected & vaccinated assumes those infected equally likely to be vaccinated as those not infected. On 5/6/21, we moved up our threshold for herd immunity from 60-80% to 70-90% based on the comments by Dr. Anthony Fauci that the prevalence of more contagious variants have pushed up the target herd immunity threshold for the US. Guide to the Markets - US Data as of 6/30/21.*

**Unemployment and Wages:** US unemployment spiked to 14.8% in April 2020, but has settled back to 6.2% as of June 30, 2021. Dr. David Kelly predicts that unemployment is likely headed to 5% by the end of 2021 and close to 4% by the end of 2022, which should be good for stocks. The chart below provides a look at previous high unemployment numbers. According to JPMorgan, economic data, like unemployment, historically lags the stock market performance by an average of four and a half months. Due to the shortage of employees, the US has experienced significant wage growth, up to 5.1% as of 6/30/21. Wage growth can be an issue regarding potential inflation that the Fed will need to monitor.




*Source: BLS, FactSet, J.P. Morgan Asset Management. Guide to the Markets – U.S. Data as of 6/30/21.*

**Value vs. Growth:** The price of growth stocks, led by technology, is currently more expensive than value stocks, led by financials, energy and industrials. A good reason to have a balanced portfolio of value and growth stocks, vs. just chasing growth stocks. **Oil Markets:** The price of a barrel of oil has jumped significantly from $11.57 on April 21, 2020 to $73.47 on June 30, 2021. Fracking technology should provide a governor on increasing oil prices, which would be good for stocks.



*Source: FactSet, FTSE Russell, NBER, J.P. Morgan Asset Management. (Left) Growth is represented by the Russell 1000 Growth Index and Value is represented by the Russell 1000 Value Index. (Right) FactSet; WTI crude prices are continuous contract NYM prices in USD. Guide to the Markets – U.S. Data as of 6/30/2021.*

# In Other Words

## Normalize Retirement Security

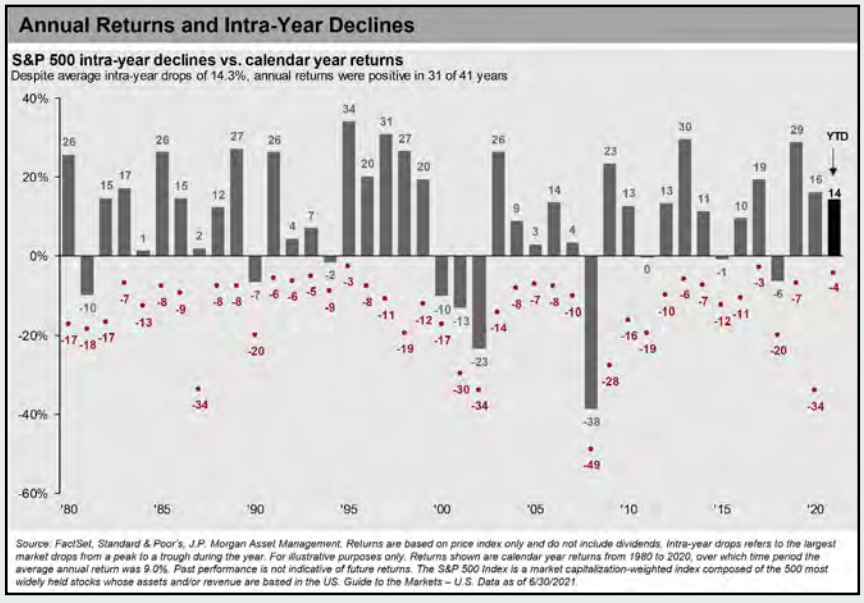
**Angie Franzone** | Newsletter Editor

When I was in middle school I had a pin that I used to wear on my jean jacket (talk about aging myself) that said, 'Why be normal?' I tell you what, being normal feels pretty good right now. All the things we took for granted before the pandemic are slowly but surely returning. Back yard BBQs, concerts, sporting events, festivals, all those normal things. Unfortunately, one bit of normalcy that was created by the pandemic is retirement uncertainty.

According to a new report from the National Institute on Retirement Security, which surveyed more than 1200 working adults in December 2020, 67% of Americans say the nation faces a retirement crisis and 56% are concerned they won't be able to achieve a financially secure retirement (Retirement Insecurity 2021, Greenwald Research). In addition, according to the report, among Americans who have changed or considered changing when they will retire, 67% say they are planning for retirement later than originally planned because of COVID.

If you panicked and moved completely to stable value last March, you likely did yourself a disservice. Not only is it difficult then to figure out when to get back into the market, but the market has fully recovered since March 23, 2020, in what was the shortest downturn in US history. "Stocks are a forward-looking mechanism. They don't care about what is happening right now or what happened in the past," said Ryan Detrick, chief market strategist for LPL Financial. "So much of why stocks have done so well this year is looking ahead to a really significant economic bounce in 2021 as the economy opens up due to the vaccines."

As the below chart illustrates, the S&P 500, which is essentially a gauge of the stock market itself, had positive annual returns in 31 of 41 years, despite average intra-year drops of 14.3%. While past performance is no indication of future results, this is a pretty good case for staying in the market instead of panicking and selling out at the first sign of volatility.




# Spectrum Investor® Update

| Morningstar Category Averages | 2nd Qtr | 1 Year | 3 Year |
|---|---|---|---|
| Intermediate-Core Bond | **1.77%** | **0.77%** | **5.26%** |
| Allocation 50%-70% Equity | 5.21% | 27.06% | 11.00% |
| Large Cap Value | 5.51% | 42.88% | 11.93% |
| Large Cap Blend | 7.55% | 40.47% | 16.77% |
| Large Cap Growth | 10.28% | 41.70% | **22.56%** |
| Mid Cap Value | 4.90% | 55.83% | 11.08% |
| Mid Cap Blend | 5.47% | 50.44% | 13.15% |
| Mid Cap Growth | 7.00% | 48.17% | 21.26% |
| Small Cap Value | 4.45% | **71.02%** | 9.35% |
| Small Cap Blend | 4.36% | 60.18% | 11.32% |
| Small Cap Growth | 4.88% | 55.69% | 19.34% |
| Foreign Large Cap Blend | 5.12% | 33.76% | 8.50% |
| Real Estate | **11.34%** | 36.79% | 10.81% |
| Natural Resources | 7.31% | 63.77% | 9.96% |

**Source: Morningstar, 3 yr return is annualized. Morningstar classifies categories by underlying holdings and then calculates the average performance of the category. Past performance is not an indication of future results. Returns in Blue = Best, Returns in Red = Worst. Please see Benchmark Disclosures on pg. 6.**

**DOW: 34,502**
**NASDAQ: 14,504**
**S&P 500: 4,297**
**10 Yr T-Note: 1.44%**
**Inflation Rate: 5.4% (6/21)**
**Unemployment Rate: 5.9%**

Data as of 06/3/21 unless otherwise noted. The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors. The S&P 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. Barrel of Oil: West Texas Intermediate. Inflation Rate: CPI. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index. Indices cannot be invested into directly.

*To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.*

The point is not to shame you if you did happen to sell out of the market, but to help you prepare for the next time of uncertainty and to reinforce that you did the right thing if you stayed put.

Three strategies to help you stay on track are 1. Developing a plan, 2. Diversifying your portfolio and 3. Reviewing your plan regularly.

Some important things to consider when developing a plan are: what age you are likely to retire, what you will do in retirement, how much it will cost and where the money will come from. Once you determine these things, you can set retirement goals and work towards them. Diversifying your portfolio as part of your plan can help stop you from making emotional investment decisions during uncertain times. Everyone has a unique set of circumstances that determines what the right mix of investments is for them.

By assessing your risk tolerance and reviewing your investing time horizon and retirement goals, an advisor at Spectrum can help you choose the right mix of investments for your individual situation. Once your strategy has been determined, reviewing your portfolio regularly (we suggest at least annually) is important to help ensure you stay on track to meet your goals. If you make this a normal part of your investment process, you will at least have one answer to the question of 'Why be normal?'.

# Spectrum Wealth Management

## Internet Security and Safety

**Brian White, CFP®** | Wealth Manager

During the last 15 months we've seen and experienced a number of unique situations. Whether it's the shortage of labor or the shortage of microchips, this has been a challenging time. Cyber crime, however, has blossomed during the global pandemic. There's no shortage or supply chain disruption when it comes to cyber crime. In fact, Google Data says that phishing sites increased by 350% from 1/1/2021 to 3/31/2021. The FBI says that total losses for cyber crimes are greater than $4.2 billion for 2020.

Cyber crimes can most often target seniors, but the entire population is vulnerable. Scams can come in all shapes and sizes, from inheritances and lottery winnings, to extortion and the promise of romance. We will go over some proactive steps to take on your own and how we work to protect the assets of our clients.

**Passwords and Two Factor Authentication**

There's a meme going around social media that states, "I still remember my childhood phone number, but can't remember the password I set up yesterday." We have so many passwords to remember and they all have different requirements to create a strong password. There are secure password tools available to help with this, including 1Password and KeePassXC. This can eliminate the Excel file full of passwords, or worse, that sticky note stuck to your computer screen or keyboard. Do your research to see which password software is best for you.

Apart from a strong password, be sure to utilize a two-factor authentication when you can. According to a 2019 report from Microsoft, 99.9% of automated attacks are blocked with two-factor authentication measures. Most financial websites require this to access your personal information. This is a tool that sends a verification code via text, email or phone call. If the website detects a browser that has never been used, you're required to verify through one of those three methods. While not impossible, it makes unauthorized access to your accounts very difficult.

**Email Security**

Spectrum has a communication security policy in place that prevents employees from sending personally identifiable information (PII) outside of a secure email service. We must use an encrypted email service to send any account statements, tax documents or other information that contains PII such as social security or account numbers. We place a high value on electronic communication security when it comes to email.

In your personal email communications, be careful with the information you share. Financial documents that include PII should only be shared through an encrypted email service or some sort of secure connection. Most financial websites that have two-factor authentication will also have a secure document sharing vault or communication section. Whether it's working with a financial advisor, tax advisor, or banker, don't share information by attaching a document to a standard email. Ask your financial professional to establish a link through a secure (encrypted) email service.

Beware of phishing scams through email. Hackers can get into email accounts and start writing to recent contacts to ask for money. We occasionally get emails from our clients that give some story about being in an accident and needing cash or requesting gift cards. Those threats are real, so be skeptical when it comes to people asking for money, even if it's someone you know well.

**Social Media**

If you're on Facebook, you've probably received friend requests that turn out to be cloned accounts of your friends. You may also get contacted or followed on other platforms like Instagram and Twitter. Cybersecurity firm Bromium released a report stating "nearly 1 in 5 organizations are infected by malware that was distributed by social media." Criminals can use multiple techniques to gain access to social media accounts, ultimately getting their hands on money. These can be through the prospect of romance, fake charities or lottery winnings.

Facial recognition software has caused criminals to contact you through social media in order to obtain pictures of you. This may help them to access accounts that require facial recognition through your phone. They may pose as an attractive young man or woman and ask for your picture. It's best to delete/unfollow/block these fraudulent requests.

**Vigilance**

Spectrum is committed to our client security. We have internal policies in place to protect our clients and employees. Our employees go through mandatory training on those policies annually. We have cyber insurance coverage as a firm and our wealth management clients custody assets through TD Ameritrade, which has an asset protection guarantee. TD Ameritrade states that any losses due to unauthorized account access will be refunded, no matter the amount.

Stay alert when it comes to anything suspicious. Take the proper steps to create secure passwords, utilize two-factor authentication and carefully monitor your social media. You can never be too careful in the digital age we live in.

***Benchmark Disclosures: Morningstar Category Averages:*** *Morningstar classifies mutual funds into peer groups based on their holdings. The Category Average calculates the average return of mutual funds that fall within the category during the given time period. The following indexes and their definitions provide an approximate description of the type of investments held by mutual funds in each respective Morningstar Category. One cannot invest directly in an index or category average.* ***Intermediate-Term Bonds: Barclays US Agg Bond Index****–Measures the performance of investment grade, US dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS, ABS and CMBS.* ***Allocation 50%-70% Equity****–These funds invest in both stocks and bonds and maintain a relatively higher position in stocks. These funds typically have 50%-70% of assets in equities and the remainder in fixed income and cash.* ***Large Cap Value: S&P 500 Value Index****–Measures the performance of value stocks of the S&P 500 index by dividing into growth and value segments by using three factors: sales growth, the ratio of earnings change to price and momentum.* ***Large Cap Blend: S&P 500 Index****–A market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenue are based in the US.* ***Large Cap Growth: S&P 500 Growth Index****–Measures the performance of growth stocks drawn from the S&P 500 index by dividing it into growth and value segments by using three factors: sales growth, the ratio of earnings change to price and momentum.* ***Mid Cap Value/Mid Cap Growth: S&P MidCap 400 Index****–A market cap weighted index that covers the complete market cap for the S&P 400 Index. All S&P 400 index stocks are represented in both and/or each Growth and Value index.* ***Mid Cap Blend: S&P MidCap 400 Index****–Measures the performance of mid-sized US companies, reflecting the distinctive risk and return characteristics of this market segment.* ***Small Cap Value: Russell 2000 Value Index****–Measures the performance of small-cap value segment of Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.* ***Small Cap Blend: Russell 2000 Index****–Measures the performance of the small-cap segment of the US equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.* ***Foreign Large Cap Blend: MSCI EAFE NR Index****–This Europe, Australasia, and Far East index is a market-capitalization-weighted index of 21 non-US, developed country indexes.* ***Small Cap Growth: Russell 2000 Growth Index****–Measures the performance of small-cap growth segment of Russell 2000 companies with higher price-to-value ratios and higher forecasted growth values.* ***Real Estate: DJ US Select REIT Index****–Measures the performance of publicly traded real estate trusts (REITs) and REIT-like securities to serve as proxy for direct real estate investment.* ***Natural Resources: S&P North American Natural Resources Index****– Measures the performance of US traded securities classified by the Global Industry Classification Standard (GICS) as energy and materials excluding the chemicals industry and steel but including energy companies, forestry services, producers of pulp and paper and plantations. Past performance is no guarantee of future results. This report is for informational purposes only and should not be construed as a recommendation or solicitation to buy or sell any security, policy or investment.* ***PE Ratio*** *is the measure of the share price relative to the annual net income earned by the firm per share.* ***Consumer Price Index:*** *A measure of the average change over time in the prices paid by urban consumers for a market of consumer goods and services.*

***IRS Indexed Limits for 2021:***
*401(k), 403(b), 457 Plan Deferral Limit is $19,500.*
*Catch-up Contribution limit is $6,500. Source: www.irs.gov*