As of 9/30/2021

Q4 2021

Spectrum Investor® Quarterly Newsletter

SPECTRUM INVESTMENT ADVISORS

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Newsletter Summary:

Economic Rebound Expected to Continue
Supply Chain Issues and Delta Reset Expectations
Stimulus Changes Coming From Fed and Congress

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The S&P 500 US stock index was up just 0.58% in the third quarter, but finished up a strong 15.9% year-to-date through September 30, 2021. Bonds and international stocks also finished nearly flat for the quarter at 0.05% for the Bloomberg US Aggregate Bond Index and -0.45% for the MSCI EAFE international stock index.

Better than expected earnings from S&P 500 companies propelled the index higher by another 5% through the end of August. However, those gains were undone in September over concerns around supply chain issues, the US debt ceiling, and trouble with China real estate developer, Evergrande. In the big picture, September's pullback seems to be a reset of expectations, rather than the beginning of something more ominous. The global economy is still expected to grow at a faster pace in 2022 than what we saw in the 10 years pre-COVID.

Delta Variant. Delta was also part of the reset in expectations. The chart on the lower left shows a clear third wave of cases and fatalities in the US as the Delta variant of COVID-19 swept across the country. Unlike the first two waves, this occurred with over half of the US population vaccinated against COVID-19. As such, reopening slowed, but did not reverse. Data shows vaccines have been effective in saving lives. In 2021, more than 350,000 Americans have died from COVID complications through mid-October. According to CDC data, 98% of those lives lost were unvaccinated.

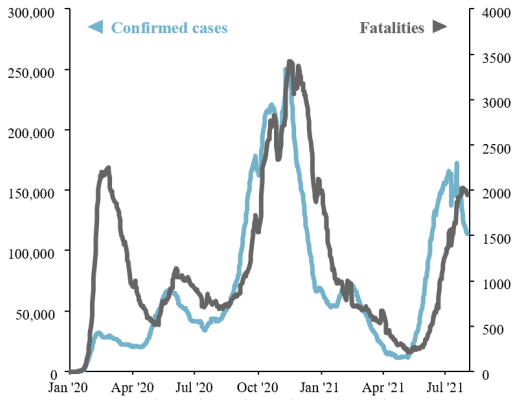
Help Wanted. The middle chart below shows overall employment is still down about five million workers from pre-pandemic levels. At the same time, government stimulus and the unlocking of pent-up demand has pushed overall economic output (bottom right) to all-time highs. The economy added over 1 million workers in July, but added just 366,000 and 194,000 in August and September respectively, as Delta cases peaked, missing expectations for new workers by a combined 750,000. The good news is, initial unemployment claims through early October dropped below 300,000 for the first time since 2019. In comparison, it took five years to go below that level following the financial crisis.

Supply Chain. Dr. David Kelly, Chief Global Strategist at JPMorgan, predicted the economy would go through a "fall, stall, and surge" from the start of the pandemic to the reopening. The surge in demand has exceeded expectations and capabilities of suppliers and the delivery systems they depend on, like truck drivers and ports. Employers cannot hire fast enough, with more than 10 million job openings in the US through August (Bureau of Labor Statistics). In addition to labor, the virus is disrupting the global supply chain with countries reopening at very different speeds. The effects of supply and demand imbalance are showing up in higher prices, and delayed or partially filled orders.

Stock Market Impact. While this all sounds like bad news, the fact remains that demand is very strong and that has been great for stocks. So far this year, companies have been able to post robust profits, despite rising costs for raw materials and increasing labor costs. Earnings growth for 2021 is expected to finish up 44% and up another 9% in 2022 (FactSet Earnings Insight, 10/22/21). While next year's earnings are still expected to grow, the slow down from 44% to 9% may lead to an increase in volatility, compared to what we've seen during the reopening. Our advice, as always, is to choose a level of risk that fits your goals and risk tolerance.

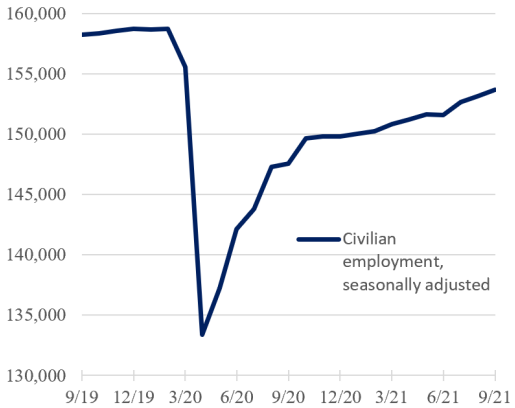
The good news is that for 2022 earnings, S&P 500 companies have beaten analysts estimates by double-digit percentages each quarter since the 2nd quarter of 2020. Inflation is expected to be the biggest challenge. FactSet reports that 224 S&P 500 companies mentioned inflation on their 2nd quarter earnings calls between June and September. According to Morgan Stanley Equity Strategist Michael Wilson, historically, when a relatively high number of companies have mentioned inflation, profit margins have shrunk.

COVID-19: New Cases and Fatalities
7-day moving average



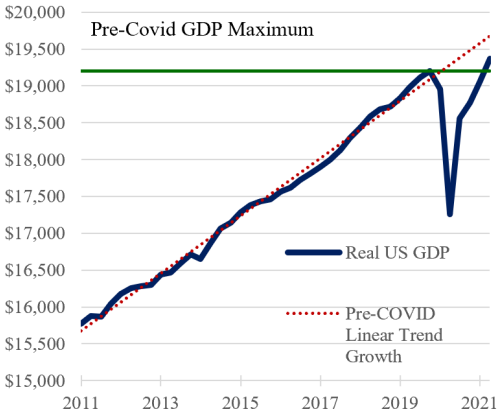
Source: JPMorgan Guide to the Markets (9/30/21)

US Number of Employed Workers
in Thousands, Seasonally Adjusted



Source: Bureau of Labor Statistics (10/8/21)

Real US GDP
(Billions)



Source: Bureau of Economic Analysis (10/1/21)
Seasonally adjusted, 2012 chained dollars

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Quarterly Economic Update Continued

Federal Reserve and Interest Rates. The Fed has acknowledged that inflation has been higher and more persistent than expected. By this time next year, it is generally expected that the Fed will no longer be making emergency asset purchases and will have raised short-term interest rates by 0.25%. This is a very gradual removal of accommodation. By comparison, over 20 central banks around the world have already raised interest rates in 2021. Some say it is overdue and are concerned the Fed will act more aggressively if inflation does not begin to cool off. The dilemma is that inflation issues are mostly supply chain related. Raising interest rates can only help by cooling demand.

The yield on the benchmark 10-year treasury note finished the quarter at 1.53% after spending most of the summer around 1.3%. Higher yields are attracting investors to the US dollar, pushing up the value of the dollar vs. a German Bund yielding -0.3%. A stronger dollar makes US stocks more attractive. A weaker dollar tends to make international stocks more attractive.

Digital Currencies. According to CoinMarketCap.com, there are over 12,000 cryptocurrencies collectively valued at over $2 trillion. We continue to suggest caution if considering an investment in cryptocurrency. The Federal Reserve (and IRS) are working on plans to review and potentially regulate this market. For the Federal Reserve, that also means reviewing the potential benefits and risks of issuing its own digital currency as China has done. Unlike crypto-currencies such as Bitcoin, a Fed version would be issued and backed by the US central bank, similar to US paper dollars and coins.

Fed Chairman Powell has indicated caution on a digital dollar. He said, "It's more important to get the digital dollar right, than to be the first to market." El Salvador became the first country in the world to adopt Bitcoin as a national currency. According to Mark Skousen from *Forecasts & Strategies*, most analysts think it was a major blunder because prior to that, El Salvador had adopted the far more stable US dollar as its currency. Powell's four year term expires in February 2022. In the interest of keeping the markets steady, President Biden is likely to re-appoint the dovish Chairman for another 4-year term.

Evergrande in China. Evergrande, a real estate development company in China, is now among the world's most indebted property companies. Evergrande has been too aggressive in developing properties, launching hundreds of projects across more than 200 Chinese cities, racking up more than $300 billion in liabilities and recently missing a scheduled interest payment. Evergrande's troubles are among the impacts unfolding since Beijing began forcing developers to start cleaning up their balance sheets last year over concerns in the country's financial sector. Dr. Kelly does not think the problems Evergrande is having will cause a Chinese recession and is unlikely to spill over into US markets.

The Chinese economy grew 4.9% in the third quarter on a year over year basis. The IMF (International Monetary Fund) forecasts 5.6% growth for the Chinese economy in 2022.

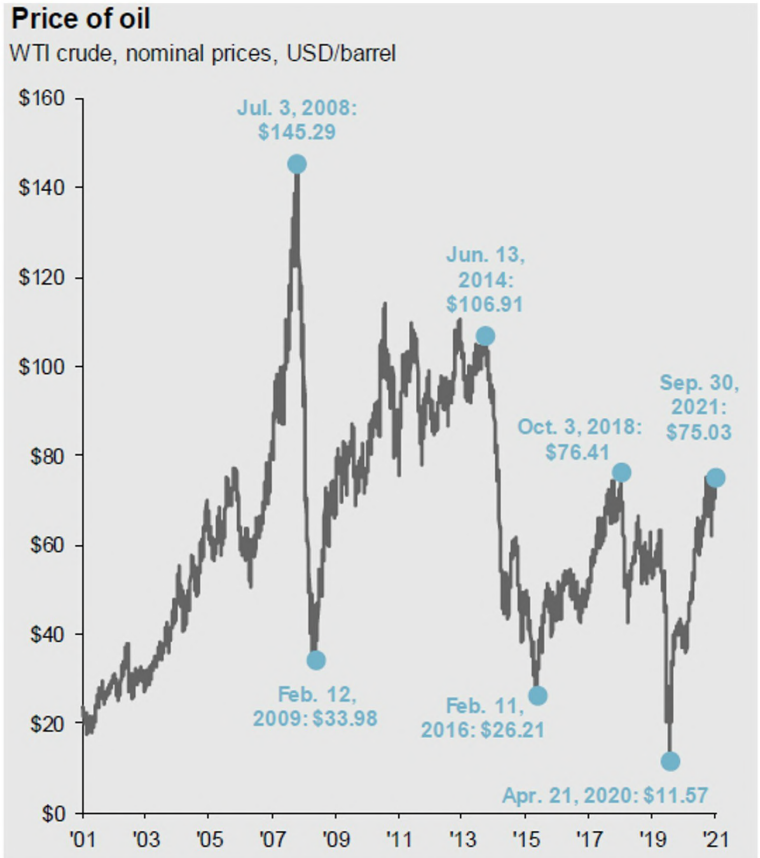
Infrastructure, Reconciliation and Debt Ceiling. In the depths of the pandemic, our government acted quickly and was mostly unified in providing emergency support. Now that we are on stronger footing, that cooperation has deteriorated. The Senate recently approved a $1 trillion infrastructure package, but Democrats are holding off on approving the package until the larger Build Back Better plan is approved. This plan was originally proposed as a $3.5 trillion deal but is being negotiated down towards $2 trillion. Unlike the CARES Act of 2020, these proposals are to be spent over the next five to 10 years.

Our self-imposed debt ceiling currently stands at $28.4 trillion. Congress had to raise the US debt ceiling before October 18 to prevent default. For now, Congress has "kicked the can" to December, which means the US would not default on its obligations but will need a longer term solution. According to Dr. David Kelly, Congress has raised the debt ceiling 57 times since 1950 and needs to raise it again to keep our country operating.

Oil Markets & Inflation. The price of a barrel of oil jumped significantly from $11.57 on April 21, 2020 to $75.03 on September 30, 2021, adding to inflationary pressures. Fracking technology should provide a governor on increasing oil prices as new supply comes back on line. Oil rig counts in the US have doubled since September, at 442 as of October 22, 2021, but are still about 200 rigs shy of pre-COVID levels.

The Bureau of Labor Statistics said last September's consumer-price index (CPI), which measures what consumers pay for goods and services, rose by 5.4% from a year earlier. It was the fourth straight month CPI was above 5%. The core price index, which excludes the often-volatile categories of food and energy, climbed 4% in September from a year earlier. Over the past 50 years, the consumer price index has averaged 3.9% per year, but struggled to cross 2% in the last 10 years before COVID (JPM, 9/30/21).

Oil Markets



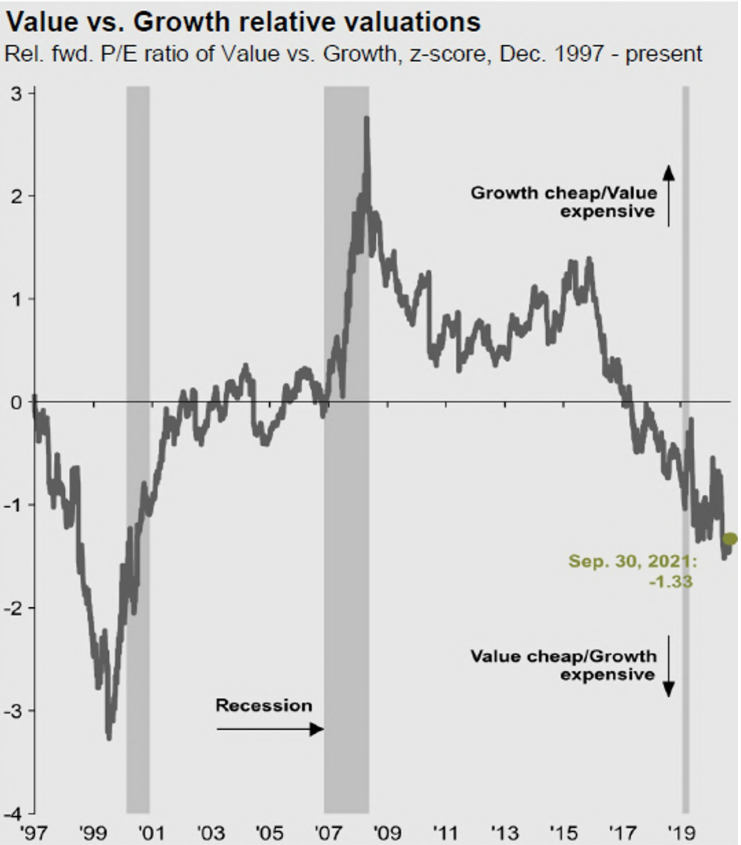
Source: FactSet, FTSE Russell, NBER, J.P. Morgan Asset Management. FactSet; WTI crude prices are continuous contract NYM prices in USD. Guide to the Markets – U.S. Data as of 9/30/2021.

Relief for Retirees. Roughly 70 million people, including retirees and the disabled who rely on social security, will receive a 5.9% cost of living adjustment next year due to higher inflation. It is the biggest jump in social security payments in 40 years.

Quarterly Economic Update Continued

Value vs. Growth. Growth and value have rotated in leading the markets higher throughout the pandemic. Value has generally been favored when the reopening outlook improved, and vice versa with growth. The next phase may be more related to the direction and magnitude of inflation. Generally value stocks outperform growth in periods of higher inflation. Growth stocks tend to have relatively high valuations that can be dented by higher interest rates. According to Dr. Kelly, value stocks continue to look cheap, especially when the focus is on financials, where higher interest rates help their earnings. Long-term, we believe it's best to invest in a mix of both value and growth stocks.

Value vs. Growth



Source: FactSet, FTSE Russell, NBER, J.P. Morgan Asset Management. Growth is represented by the Russell 1000 Growth Index and Value is represented by the Russell 1000 Value Index. Guide to the Markets – U.S. Data as of 9/30/2021.

The economy continues to wrestle with the new reality of COVID-19. We are currently in the surge phase and reopening should continue to lift economic growth and the stock market, but David Lebovitz of JPMorgan cautions that the following headwinds remain for stocks:

1. Less fiscal stimulus as compared to what our nation spent on fighting COVID over the past two years. Even if the Build Back Better plan is passed at an estimated $2 trillion, spending on the new bill is over 10 years, which means $200 billion in spending per year vs. the past two years fighting COVID at $2.75 trillion spending per year.

2. Corporate taxes will likely increase to 25% per year in 2022 vs. 21% currently. The top marginal income tax bracket would be potentially increased from 37% to 39.6%, which would apply to taxable income in excess of $509,300 for married couples and $452,000 for unmarried taxpayers. Capital gains tax for taxpayers with adjusted gross income of more than $1 million would be taxed at ordinary income tax rates of 39.6% under the new budget proposal. Adjusted Gross Income (AGI) of $1 million capital gains would likely remain at 20%.

3. With the Fed likely beginning to taper in November 2021, we may see borrowing costs increase. Something to watch for is if the European central bank wants to taper alongside the Federal Reserve. Importantly for financial markets, both central banks will be pulling back at the same time in late 21-22, which will be the largest global liquidity drain on the market in a decade (*WSJ*, 10/9/21).

The takeaway is to be a long-term investor, stay the course, and do not let your emotions take over your investment decisions. In the past three years, household net worth has gone up 29%, so there is not a major need to take on more risk. If you haven't rebalanced in the last two to three years, you may want to think about doing so. Should you need help rebalancing, please call our office at 800-242-4735.

Spectrum Investor® Update

Morningstar Category Averages	3rd Qtr	1 Year	3 Year
Intermediate-Core Bond	0.01%	**0.27%**	**5.29%**
Allocation 50%-70% Equity	-0.71%	20.04%	9.65%
Large Cap Value	-1.04%	24.79%	9.62%
Large Cap Blend	-0.18%	29.94%	14.34%
Large Cap Growth	-0.07%	26.60%	**19.75%**
Mid Cap Value	-1.49%	46.91%	9.41%
Mid Cap Blend	-1.65%	38.83%	10.94%
Mid Cap Growth	-0.86%	33.09%	18.19%
Small Cap Value	-2.08%	**62.35%**	8.20%
Small Cap Blend	-2.23%	51.11%	9.47%
Small Cap Growth	**-2.57%**	39.55%	15.66%
Foreign Large Cap Blend	-1.90%	23.96%	7.55%
Real Estate	**0.65%**	34.73%	10.86%
Natural Resources	-1.51%	49.06%	9.33%

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.

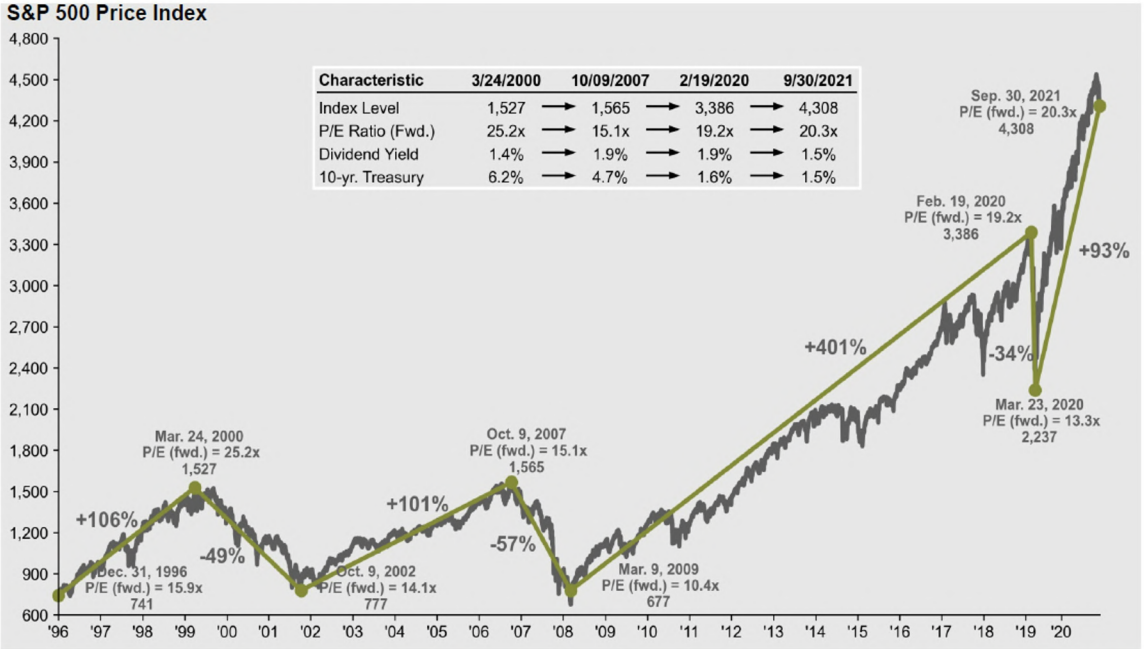
DOW: 33,844
NASDAQ: 14,449
S&P 500: 4,308
10 Yr T-Note: 1.53%
Inflation Rate: 5.4% (9/21)
Unemployment Rate: 4.8%

Data as of 09/30/21 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.

S&P 500 Index at Inflection Points: The chart below illustrates the performance history of the S&P 500 from 12/31/96 to 9/30/21. 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% year-to-date as of 9/30/21. As of 9/30/21 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 1.5%. When the current yield on bonds is even with the yield on stocks, we continue to suggest slightly over-weighting stocks.

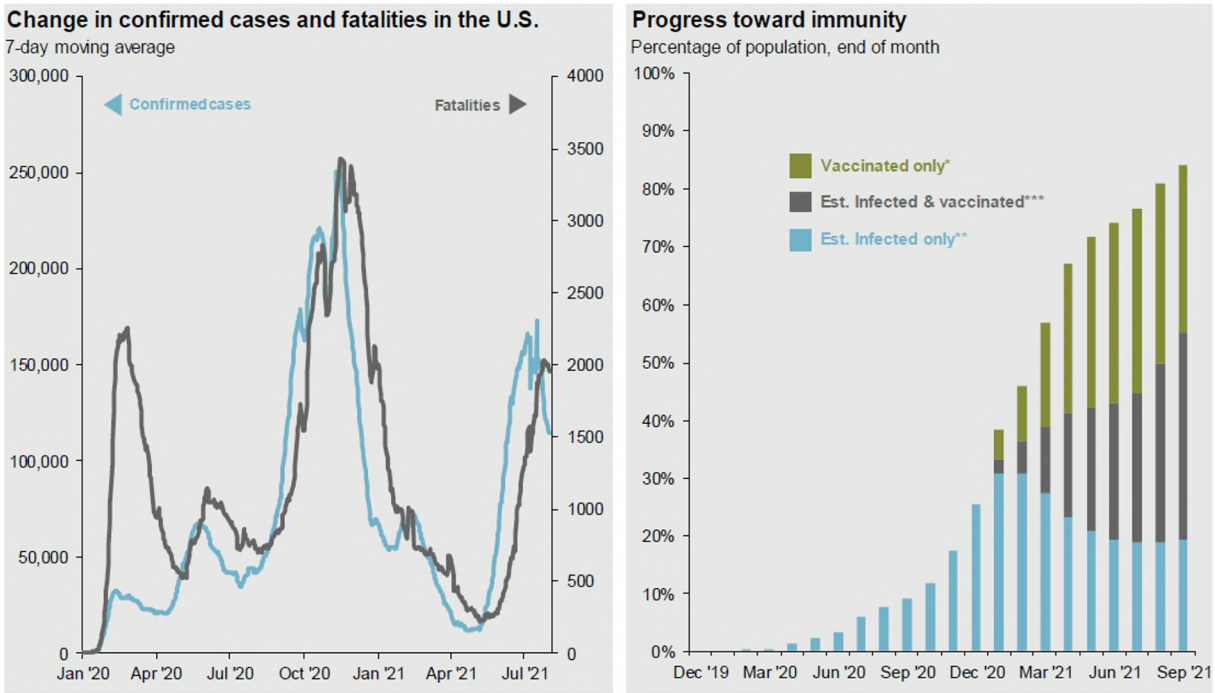
S&P 500 Index at Inflection Points



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 9/30/2021.

COVID-19: Cases, Fatalities and Immunity: According to Dr. Kelly at JPMorgan, the goal of fighting COVID in the United States was to get to 80% herd immunity, where people have actually had COVID or received vaccinations. With the Delta variant, the new herd immunity target is closer to 90%.

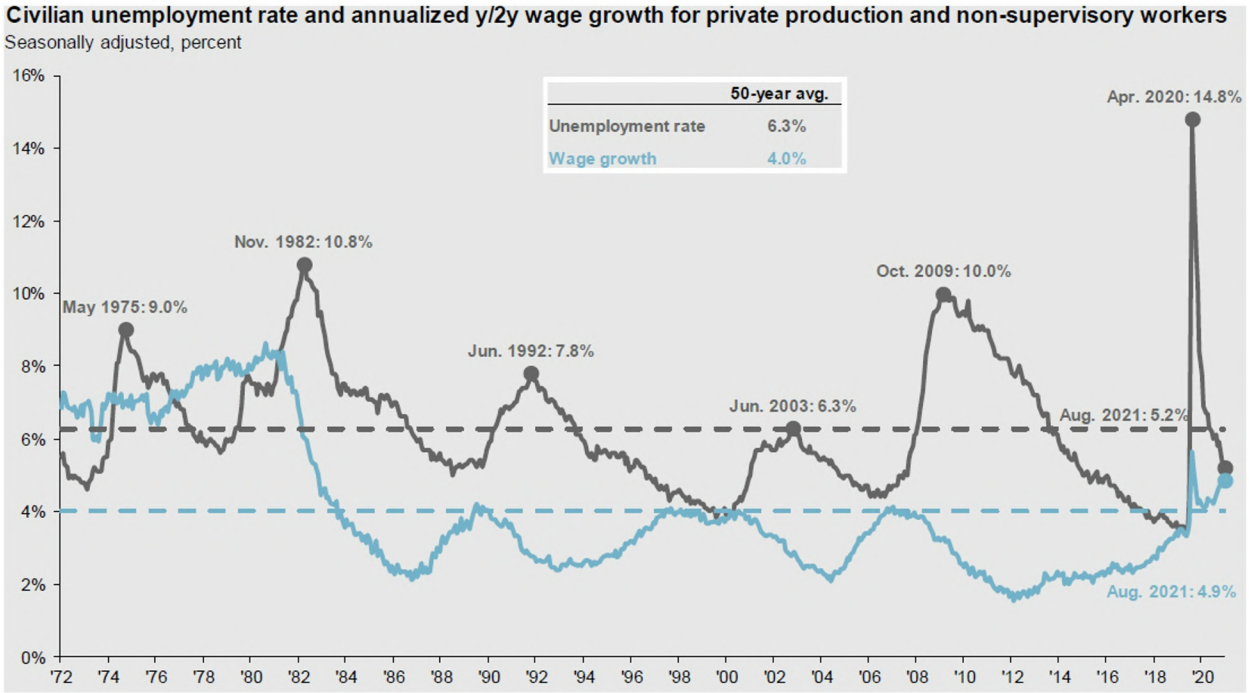
COVID-19: Cases, Fatalities and Immunity



*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 4.2 COVID-19 infections were reported. ***Est. Infected & vaccinated assumes those infected equally likely to be vaccinated as those not infected. Guide to the Markets - US Data as of 9/30/21.*

Unemployment and Wages: US unemployment spiked to 14.8% in April 2020, but has settled back to 4.9% as of Sept. 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 5.2% as of 9/30/21. Wage growth can be an issue regarding potential inflation that the Fed will need to monitor.

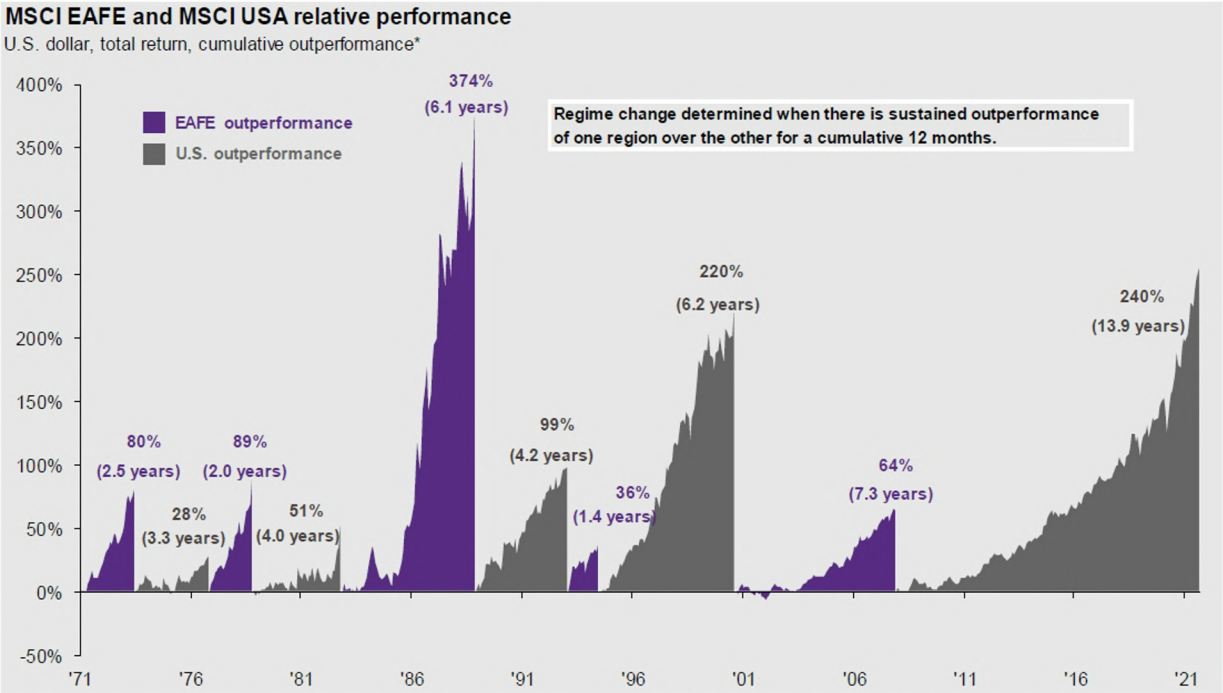
Unemployment and Wages



Source: BLS, FactSet, J.P. Morgan Asset Management. Guide to the Markets – U.S. Data as of 9/30/21.

Cycles of U.S. Equity Outperformance: A major contributing factor as to whether US stocks outperform international stocks is the value of the dollar. When the value of the dollar is strong, US stocks tend to outperform. When the value of the dollar is weak, international stocks outperform, as was the case in the late 80s and early 2000s after 9/11. Currently, the value of the dollar is strong, especially if US interest rates rise, which would continue to favor US equities. Long-term, because of the below investment cycles, we continue to suggest some exposure to international stocks in a diversified portfolio.

Cycles of U.S. Equity Outperformance



*Source: FactSet, MSCI, J.P. Morgan Asset Management. *Cycles of outperformance include a qualitative component to determine turning points in leadership. Guide to the Markets – U.S. Data as of 9/30/2021.*

Spectrum Wealth Management

Year End

Brian White, CFP® | Wealth Manager

The arrival of fall in 2021 has many people excited. Football fans are back in the stadiums, baseball playoffs are back, also with fans, and the ever-polarizing Pumpkin Spice is back in everything from lattes to breakfast breads. To top off the excitement, required minimum distributions are back!

OK, maybe it's not that exciting for everyone, but 2020 saw the suspension of Required Minimum Distributions (RMDs) from retirement accounts. Those who did not need the income were able to allow their retirement accounts to continue to grow tax deferred. In many cases, people performed Roth IRA conversions to achieve a more tax-favored status for future generations. We're back to reality now and ready to return to the usual routine. As we ease into the 4th quarter of 2021, here are some items to consider before we turn the calendar over to 2022:

Qualified Charitable Distributions (QCD). Individuals who are over the age of 70 ½ can contribute to a qualified charity directly from their IRA account. We often bring this up to clients who are currently taking Required Minimum Distributions and giving to charitable organizations and have written about this topic in past newsletters. Why are we obsessed with it? Well, maybe obsessed is a little strong. We do, however, feel that it is very important to take advantage of this provision of the tax code. Individuals who are forced to take a RMD from their IRA account will be taxed on the amount withdrawn. By utilizing the QCD, that individual's income is reduced by the amount of the QCD.

For example, Jane Smith is required to take out $25,000 from her IRA in order to satisfy her RMD. That's an additional $25,000 that is added to her taxable income for the year. If she were to utilize the QCD by giving $5,000 directly to her local 501(c)3 charity, she would only need to withdraw $20,000 to satisfy her RMD. Her taxable income from the IRA would be $20,000 instead of $25,000. Be sure to consult with your tax advisor, of course.

Tax law changes? As of this newsletter, we don't have a full picture of the upcoming changes to income taxes. On May 27, the US Treasury's "Green Book" revealed administration proposals for those tax increases and changes. Change is inevitable, and the areas most expected to change include capital gains and corporate income taxes. We could also see updates to estate and gift taxes, along with restoring deductions for state and local taxes (SALT).

Thousands of articles have already been written about the subject of taxes in the near future, however, nothing is set in stone. We do know what the current tax code looks like for the rest of 2021 though. Decisions for 2021 can be made based on that knowledge and should NOT be made based on speculation for 2022.

As 2021 comes to a close, we are likely to see more mergers and acquisitions among corporations trying to close deals before the end of the year. Many business owners are looking to realize their capital gains prior to any tax law changes. The same can be true of anyone who owns stocks or mutual funds with long-term capital gains. Individuals and couples who fall into the higher income tax brackets could be subject to a higher capital gains tax in 2022. Be sure to review your personal situation with your tax advisor to determine if 2021 is the year for you to realize long-term gains in your portfolio.

Roth Conversions. The SECURE act of 2019 made some significant changes to beneficiary (or inherited) IRAs. Non-spouse beneficiaries are now required to take a complete distribution of the IRA account within 10 years of the original owner's death. For traditional IRAs, those distributions are taxed at ordinary income rates. Distributions from beneficiary Roth IRAs are made tax-free. Many current IRA account holders are considering converting traditional IRA assets to a Roth IRA. The assets converted to a Roth IRA are taxed at the account holder's income tax rate.

The saying goes "don't let the tax tail wag the dog." In other words, don't let the potential tax implications affect your investment decisions. Paying taxes, while never particularly fun, is often necessary to achieve the end goal. If your end goal is to provide a legacy for your children and grandchildren, paying income taxes now could make sense. because those who do will be paying taxes now in anticipation of future growth and possibly higher tax rates for their children and grandchildren. As you save for retirement, you invest in a way that says "this money is not mine, but my future retired self." A Roth conversion is similar. You're effectively viewing this money not as yours but as the next generation.

All decisions regarding the tax implications of your investments should be made in consultation with your independent tax advisor or real estate planning attorney. Spectrum is not a tax advisor or estate planner. ***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: Bloomberg 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.*