Quarterly Investment Report
September 30, 2021

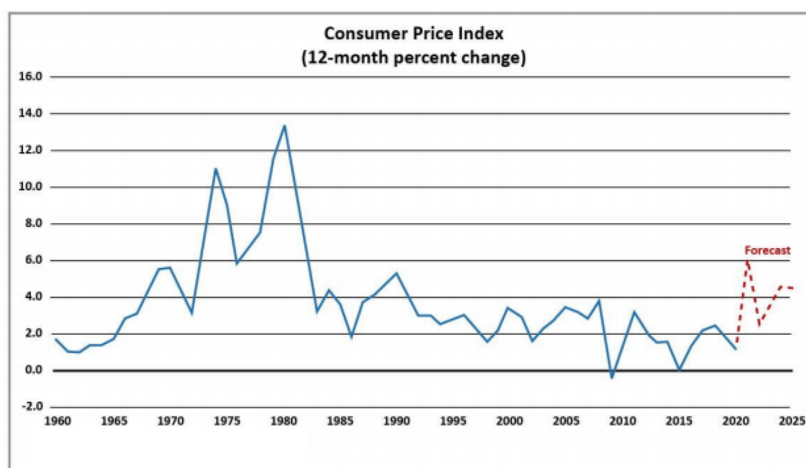
ASCEND Investment Management, Inc.

Dear Investor:

I fondly remember the excitement, after finishing an intensive E.F. Hutton training program in 1982, of being let loose to make cold calls to sell 13% government bonds. How silly with hindsight to think it seemed like a challenging task at the time. But I suppose shooting fish in a barrel can seem like a daunting task depending on the experience of the shooter. It was a 6% inflation world at that time with memories of 13% inflation just one year prior still vivid in most everyone's mind. Through most of the 1980's, until 1987, it was a heady time for the stock market thanks to Fed Chairman Paul Volcker raising the Fed Funds rate by 1981 to 20% to successfully stanch inflation.

My point is that while inflation can get out of hand, and we'd be surprised if it got anywhere near the late 1970's level, our central bank is adept and fearless to put their monetary tools to work. And though the stock market faces temporary challenges from higher interest rates, stocks with pricing power and low leverage will fare much better than bonds.

INFLATION SINCE 1960



Source: Bureau of Labor Statistics

The Fed has communicated that they will begin tapering back their monthly $120 billion of asset purchases shortly after their November meeting, and perhaps end purchases altogether by the end of 2022. Withdrawing that pandemic economic stimulus means that higher interest rates are around the corner. This is their recognition of the fact that economic growth and inflation are going to be pretty strong through 2022. On top of that, most of the Fed officials have now said they expect to raise interest rates (the very short Fed Funds interest rate) by at least a half a percentage point by 2023. While inflation will dictate the longer parts of the yield curve, ultimately it will also drive the flatness or steepness shape of the curve as well since the Fed may have to react more aggressively on the short end.

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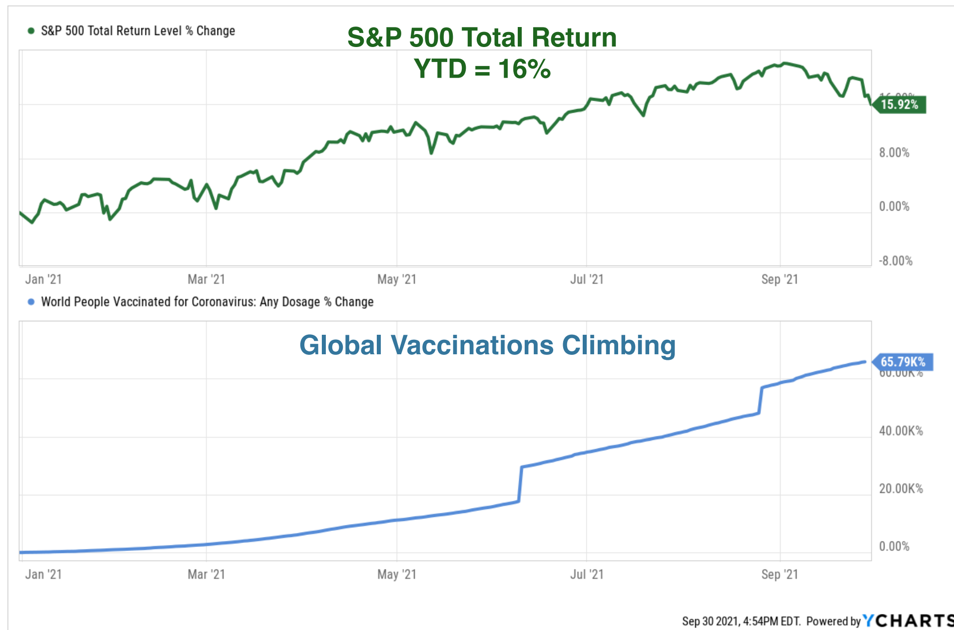
As we wrap up the third quarter of 2021, next steps for the economy and stock market are complicated. But, there's a growing feeling that we are gathering steam towards approaching the other side of this pandemic as evidenced by an accelerating uptake of vaccinations across the globe. We may finally be kicking some Covid butt! By now, it's estimated that over 80% of Americans have some degree of immunity to Covid-19 either through vaccinations or infection, and vaccinations for children aged 5-11 could be approved for use next month. And from an economic perspective, the pandemic is now less of a drag on consumer spending as consumers have largely either decided to get back to normal or figured out how to operate in a pandemic environment.



September is a month that is typically down for stocks; the average September decline since 1945 is .56%. One theory is that after summer ends portfolio managers start harvesting tax losses. This September outdid itself with the S&P 500 falling 4.7%! Cheer up though since stocks are typically positive in the 4th quarter.

Over the last four months over a billion doses of Covid vaccine have been given. That's within 16 months of identifying this novel virus!

The Fed's monetary policy will affect stocks more than it will affect economic growth because higher interest rates have a deleterious affect on corporate earnings. Whereas, government fiscal policy can have a more powerful affect on both economic growth and stocks. The 2020 and 2021 stimulus packages gave huge amounts of money directly to consumers but that has now been wound down.

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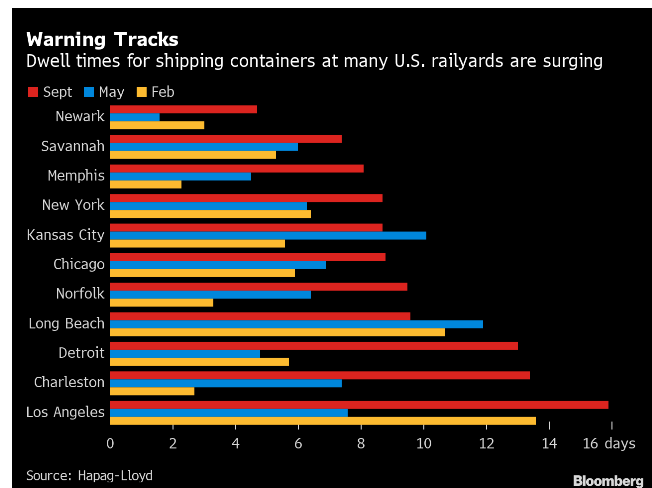
The new government fiscal policies being debated are massive. Over $1 trillion (about $550 billion of new spending and $450 billion already earmarked) is for the bipartisan physical infrastructure bill to build out our roads, bridges, electric grid, airports, broadband, etc. And over $3.2 trillion for the budget reconciliation bill is for a board range of social spending on healthcare, childcare, jobs, affordable housing, climate, etc. The devil is in the details and assuredly much of what has been proposed will be on the chopping block. The spending plans will create some jobs and some growth but will mostly be adding to our public debt. Some of the ways that this will be slightly mitigated will be through higher corporate taxes and higher taxes on the wealthy.

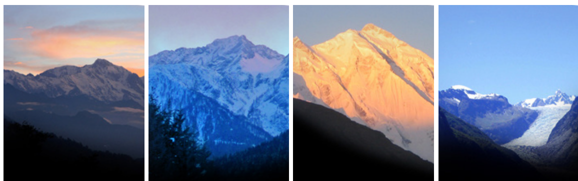
It's always a question of whether or not more federal debt will be a drag on economic growth or not. One argument is that as long as inflation can be held in check then debt doesn't have to be a drag. But more often it is understood that when inflation gets too out of control and very high interest rates follow, then it's more probable that the burden of rising interest payments will crowd out more productive spending and investment. Herein lies a fine-line as to what level of interest rates is too high and counter-productive to growth.

All eyes are focused on the path of inflation that is and will continue to result from pandemic induced supply chain disruptions. Disruptions are across the board sparing only very few industries such as finance, insurance, and education, while manufacturing, construction, retail and wholesale trade, and food services have been hugely affected. Additionally, natural gas shortages threaten to drive up energy prices which will pile on even more pressures to supply chains and prices. Most large ports are currently operating at only 60%-70% of capacity primarily due to a shortage of workers. Here's a snapshot of added supply chain pressures caused by a shortage of workers at the railyards, where ship container goods are transported onto trains for distribution across the country. Surely, there's no question that the situation will improve but it won't be overnight.

When we think about the investment portfolios we manage for growth and protection over longer timeframes for our clients, today's transitionary environment urges us to lean more into protection. The pandemic seems whipped by and large but we can't be sure. The economy continues to strengthen and we expect it to continue well into 2022, yet inflation and higher interest rates may pose a threat. Congressional spending hopes to create jobs and support growth, yet has many moving parts with potential unintended consequences and tax burdens that could overwhelm job growth and business gains.

"Dwell" ("delay") Times for Shipping Containers at Railyards





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Despite all of the pushes and pulls, we never ever take all our chips off the table. We firmly believe that many American companies will continue to grow and be innovative and productive. But, being cautious now is in order. Individual and corporate investors alike are addicted to cheap money and lots of leverage. Valuations are very stretched and anything, and we mean anything, could trigger a major correction. We'll only know the reason for the correction after it's happened. Waiting for a correction may mean missing out on some gains, but better to whimper now than wail later.

We like to think of stock investing as climbing a mountain. Investors can ascend slowly by taking lateral traverse routes towards the peak. Those routes aren't as steep and risky but they get us where we're going. Such routes mirror those companies that are leaders in their industries due to service or product innovations. Those leading companies have steady relative stock returns thanks to consistent revenues and earnings that result from solid operations rather than excessive borrowing and financial shenanigans. Alternatively, certain climbers, i.e., daredevil risk takers, may opt for a straight shot up that mountain which necessarily invites sharper turns and surprising drop-offs. That kind of company poses considerably more risk from too much debt, investor hype, and too little real operating earnings. We prefer the first route and will enjoy the sedate view along the way.

It's the beginning of autumn, the leaves will begin to change, and hopefully the economic changes in store will be gradual and not excessively disruptive for too long.

Sincerely,

Ellen P. Le, CFA
President