



Stocks closed out the quarter on a tumultuous note as shares of large, fast-growing companies experienced their worst month since the start of the pandemic. Just when it seemed that the pandemic was waning, the Delta variant popped up. The good news is that it's unlikely to derail the economy as its predecessor did earlier; the even better news is that economic fundamentals continue to remain strong.

Despite a 4.5% decline for the quarter, the S&P 500 is still up 15.9% for the year. Similarly, the Russell 2000 index of small-cap companies lost 2.7% this quarter but remains up 12.41% this year. Some key economic fundamentals buoying the markets are low interest rates, high consumer demand and strong corporate earnings. American consumers are emerging from a year of lockdown and isolation with their wallets out, fueling a spending spree. But some economists warn that a part of the increase in spending comes from rising prices, as the global logistics chain stretches to meet demand and shortages of items like semiconductors and home building supplies. At this point, more S&P 500 companies are beating their earnings-per-share estimates than average, and by a wider margin than average.

There were three key issues that weighed on investors' minds this past quarter. The first is inflation and, in particular, whether it will wind up being a short-term phenomenon or persist. Central bankers attribute the rise in the price of durable goods to the supply-chain bottlenecks and expect prices to stabilize next year. That said, the Federal Reserve is still planning to reduce its purchases of securities and bonds in its effort to pull back the stimulus they provided during the pandemic. Some investors worry that such a shift in monetary policy will lead to a rise in interest rates. This could put pressure on bonds, whose prices generally fall when rates rise. The consumer-price index rose 5.4% in September from the year-earlier level.

The second is government policy. The President's infrastructure plan has bipartisan support; however, it is tied to a budget reconciliation bill that includes a significant (US \$3.5 trillion) increase in long-term spending. Some moderate Democrats are concerned about the amount of spending involved given the current \$28 trillion federal debt. The tax proposals within the bill would increase the progressivity of the tax code by raising marginal income tax rates faced by higher earners and corporations. Our forecast is for the infrastructure plan to pass, but the budget reconciliation bill to be more modest than the current proposal.

Third is the Delta variant and how it surprised us this summer. Pandemic-sensitive sectors such as restaurant reservations and air travel trended down. Spending on consumer services decelerated too. But the economy didn't shut down like it did in March 2020. Sporting events are still taking place, religious services are happening, and while the number of air travelers may be falling, people haven't stopped flying. In short, the Delta variant is not going to derail the economic recovery, but it definitely clouds the near-term outlook and serves as a reminder that disciplined investing requires vigilance and maintenance.

As always, we will continue to monitor these economic, legislative and tax developments on your behalf and inform you of potential impacts to your investment portfolio.



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Sources:

- WSJ, Stocks End Quarter in Turmoil, Worst Month Since March ;20
- Horseshot, Tax Changes Proposed in American Families Plan
- Valmark –TOPS Quarterly Update Q3 2021

Past performance is not a guarantee of future results. It is also important to note that one cannot invest directly into an index. Diversification cannot assure a profit or guarantee against a loss of value.

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