Colorado Capital
MANAGEMENT

QUARTERLY MARKET UPDATE / OCTOBER 2021

Economic Outlook

Overview

What a difference a year makes! Last year at this time, the economic rebound from the pandemic was at full throttle, unemployment remained quite high, and inflation, interest rates and oil prices were all relatively low. Today our economic environment is quite different. Most Notably:

- Annualized GDP growth in the U.S. dropped to an estimated 1.3% in the third quarter, a steep decline from last quarter and far below the record-setting pace of last year.
- Unemployment has improved, in large part due to rising retail sales, but hiring has recently slowed, particularly in the hospitality industry.
- Consumer confidence is up from a year ago but down sharply in the last quarter, while business confidence continues to improve.
- Oil prices, which crashed during the early stages of the pandemic, are now approaching their highest level in many years.
- The stock market has risen dramatically, with valuations that are improving but remain well above historical norms.

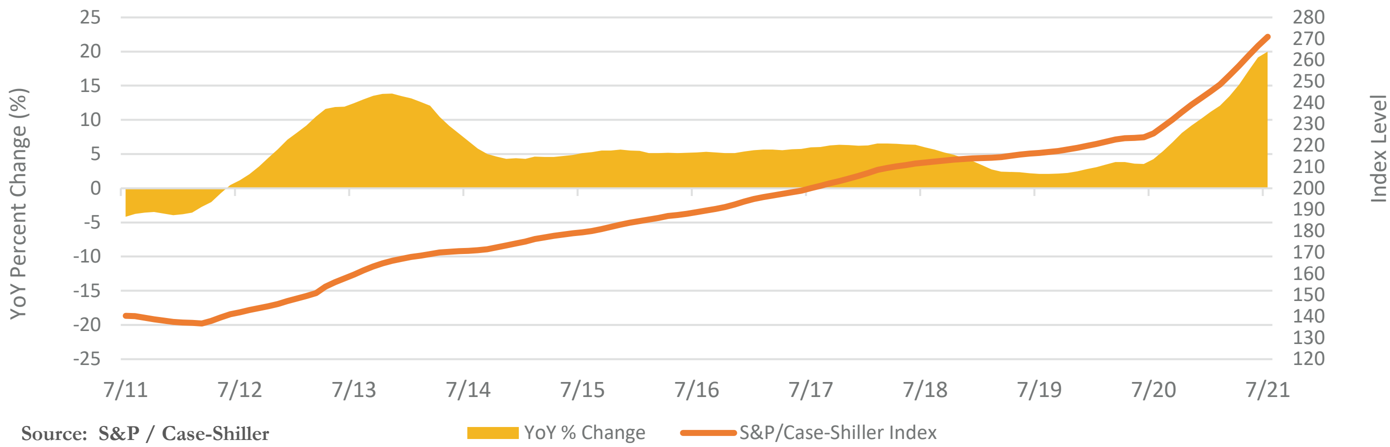
CCM Key Economic Indicators

Indicator	9.30.21	6.30.21	9.30.20
U.S, Economy			
Quarterly GDP Growth	Est. 1.3%	6.7%	33.1%
Unemployment Rate	4.8%	5.9%	7.8%
U.S. CPI (Core)	4.0%	4.4%	1.7%
Interest Rates			
Fed Funds Rate	0.0%	0.0%	0.0%
10-Year Treasury Rate	1.37%	1.52%	0.68%
Currency & Commodities			
Crude Oil (WTI)	$ 75.22	$ 73.52	$ 40.05
Gold Price	$ 1,731	$ 1,758	$ 1,883
Trade Weighted Dollar Index	113.8	111.9	116.6
Confidence			
Consumer Confidence Index	109.3	127.3	101.8
ISM Purchasing Managers Index	61.1	60.6	55.4
Stock Prices			
Dow Jones Industrial Average	33,844	34,506	27,781
S&P 500 Forward P/E ratio	20.3	21.9	21.5

Housing

Home buying activity cooled off in recent months after a period of soaring prices (see chart) and shrinking inventories. Supply chain delays have also contributed to rising prices and the reduced availability of new construction. The housing market is now beginning to move back into balance. The recent surge in prices has brought out more sellers and inventories have improved to a 2.6 month supply.

S&P Case-Shiller 20-City Home Price Index

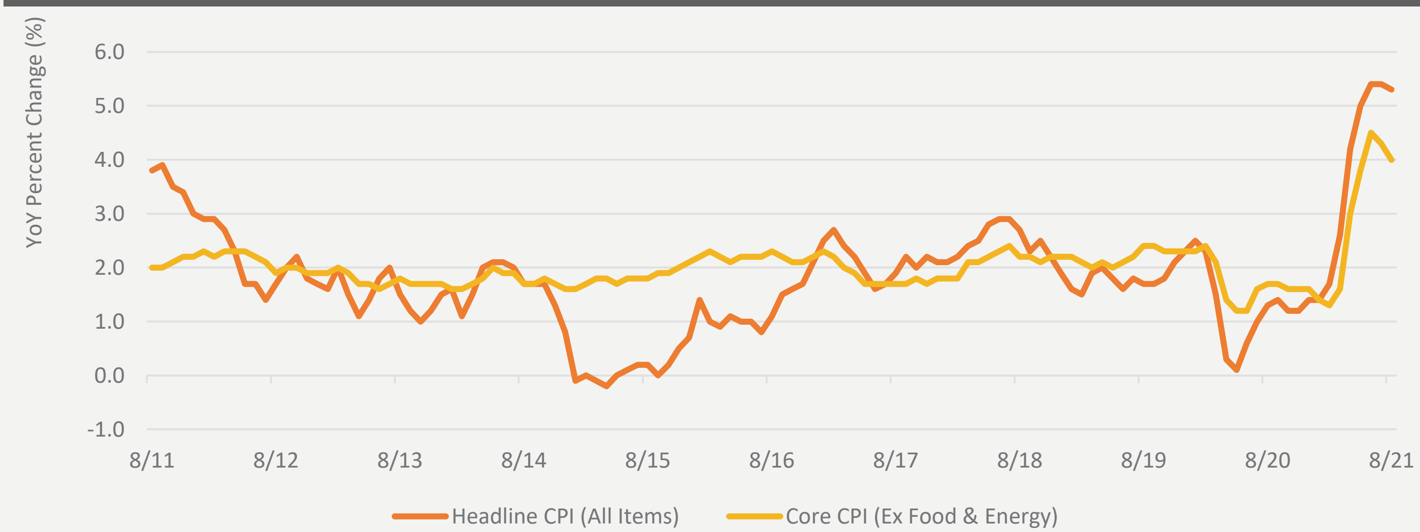


Source: S&P / Case-Shiller

Inflation

The rapid price hikes associated with the post-vaccine surge in services activity and supply shortages look to be over, suggesting slower but still elevated inflation levels ahead. Although rising COVID concerns should lead to some near-term softness in travel-related prices, that is likely to be more than offset by renewed strains on the global production and transportation of goods. With supply bottlenecks worsening over the past two months and inventory restocking further pushed out, the "transitory" period of above-target inflation has appeared increasingly long. Given current levels, together with expected ongoing strength in wages and home prices, core inflation may not be as low as the Fed expects (2.2% in 2022 and 2023).

Inflation (Consumer Price Index)



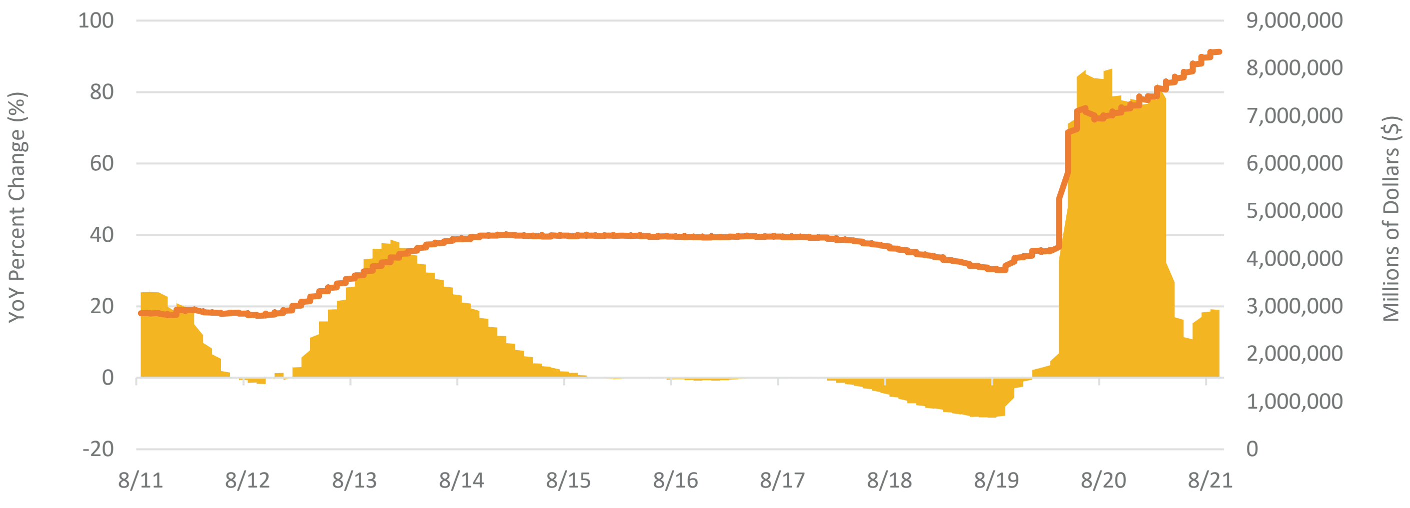
Source: U.S Bureau of Labor Statistics

Interest Rates

The Federal Reserve is expected to announce the tapering of its asset purchases at its November or December meeting, which would be expected to lead to higher long-term interest rates as it pares its bond holdings. The Fed's stricter criteria for raising the short-term federal funds rate will likely be met in 2023, so several rate hikes should be expected then, perhaps totaling ¾ of 1%.

We expect the 10-year U.S. Treasury bond yield will reach 2.00%-2.25% by the end of next year. In 2023, the Treasury curve could flatten considerably as longer-term rates remain relatively stable while short-term rates increase. Longer-term yields may drift higher in 2023, but only modestly, as additional demand for higher yielding notes kicks in.

Federal Reserve Banks: Total Assets

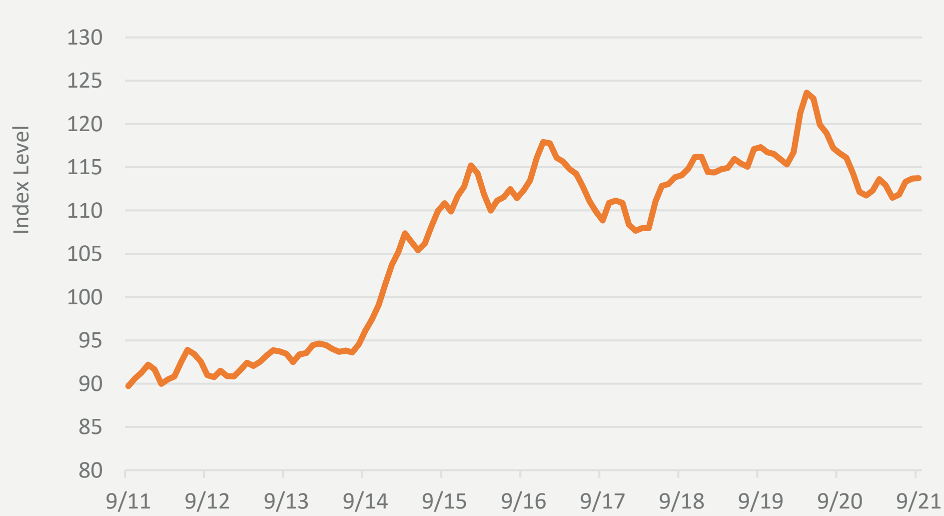


Source: Board of Governors of the Federal Reserve System

U.S. Dollar

The U.S. dollar has recently appreciated against a basket of foreign currencies. Demand for the dollar has come from investors seeking a safe haven. In the near term, we expect this demand to continue as investors adjust to a less optimistic outlook for the global economy and as virus concerns persist. But next year we expect the dollar to weaken as foreign central banks will likely tighten monetary policy sooner than the Fed. The improving interest rates offered abroad should place depreciation pressure on the dollar through much of 2022.

U.S. Dollar Trade-Weighted Index

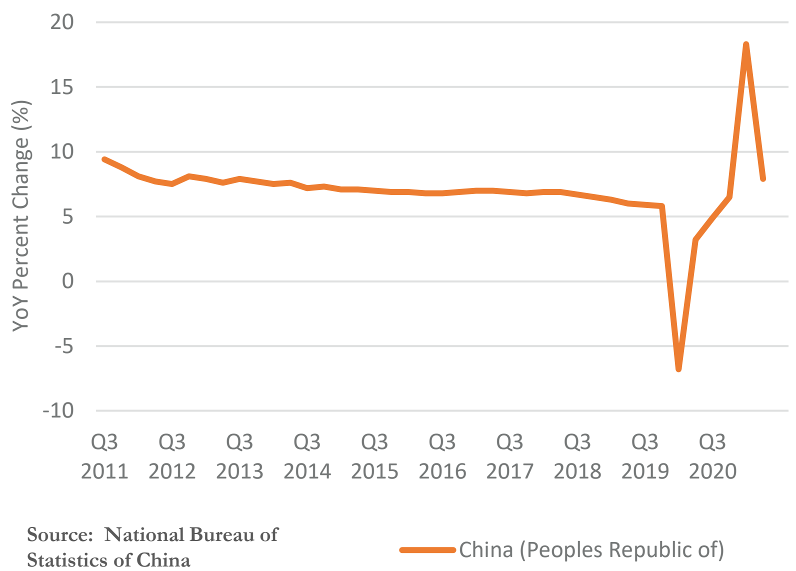


Source: Board of Governors of the Federal Reserve System

China

Although the Chinese economy was projected to grow at an 8% rate this year, growth has slowed sharply in recent months and this target may not be reached. A renewed outbreak of COVID and subsequent restrictions have weighed on economic prospects and have placed uncertainty over China's economic outlook, while a severe flood has also put downward pressure on economic activity. Retail sales have declined. In addition, Chinese authorities have embarked on a regulatory crackdown targeting a wide array of sectors including the real estate sector. The combination of these events has resulted in a noticeable decline in both economic activity and investor sentiment. China's stock market fell 18% in the third quarter. Looking forward, we will be watching to see if China devalues its currency and how it resolves the financial difficulties of real estate giant Evergrande.

Real GDP Growth



Source: National Bureau of Statistics of China

Economic Outlook

The most important development in the U.S. economy in the last quarter was the continued spread of the Delta variant. Although Americans generally became more cautious, new restrictions were limited and vaccination rates continued to rise. As a result, significant retrenchment in consumer spending does not appear likely. Real GDP in the United States may grow as much as 6.0% in 2021, which if realized, would mark the strongest year of U.S. economic growth since 1984.

Looking forward, the Delta variant is expected to eventually become less disruptive, which may set up renewed growth in consumer spending for a few "catch-up" quarters. Given the unpredictability of the virus, when this might happen is difficult to know, but a reasonable estimate is the first and second quarters of 2022.

Given our strong economic fundamentals—including supportive government policy and solid household and business balance sheets—the economic expansion should remain intact for some time. Real GDP is expected to grow by 4.5% in 2022, well above trend levels.

As the unemployment rate continues to fall in 2023 and inflation likely remains above the committee's target of 2%, the Fed is likely to begin raising short-term interest rates. Specifically, the Fed is expected to raise its target range for the fed funds rate 75 bps in the second half of 2023.

Annual inflation rates are expected to top out in Q4-2021 as consumer spending begins to decelerate and supply bottlenecks ease. Thereafter, consumer price inflation should gradually subside. However, the trickle-down effects of higher wages and housing prices will likely keep inflation rates higher than the Federal Reserve's target of 2% in the coming quarters.

Market Outlook

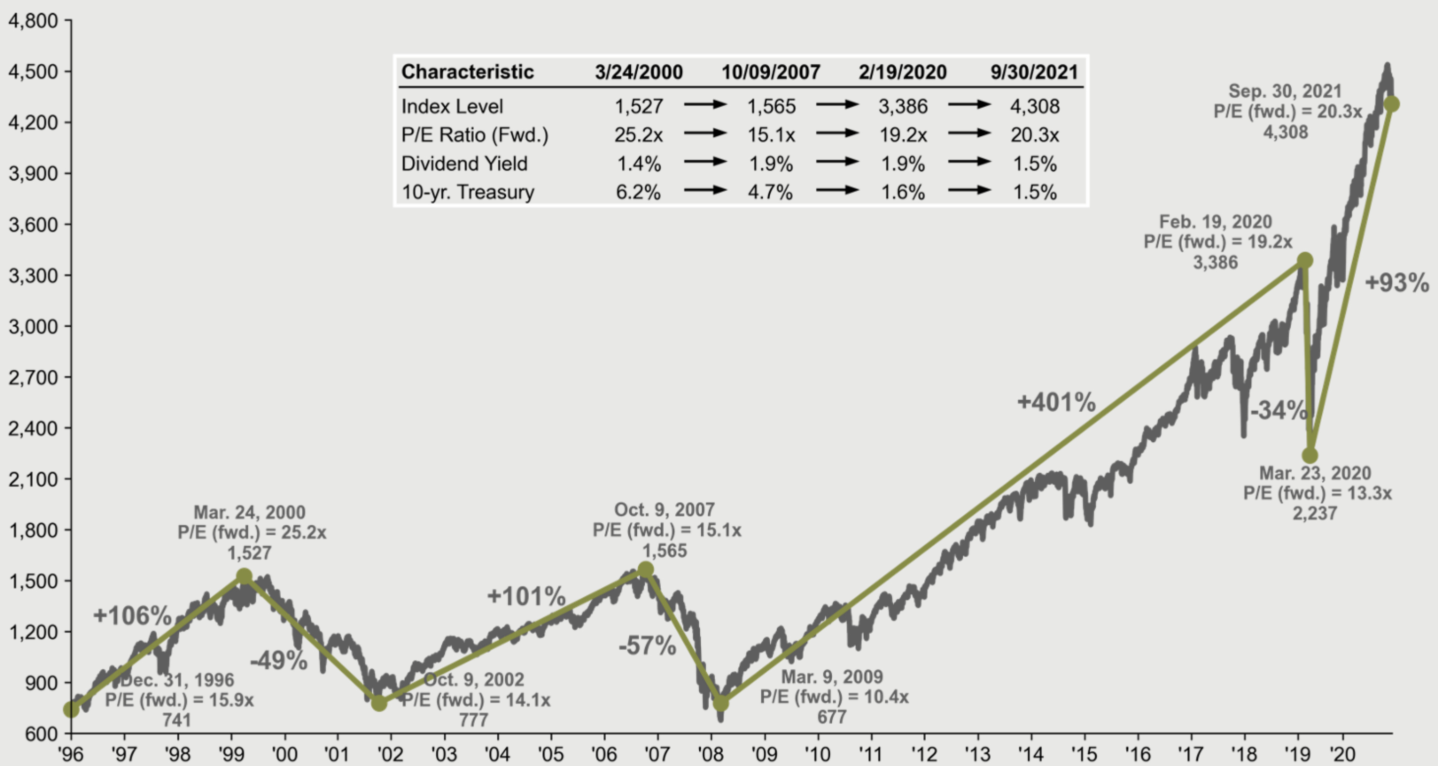
Recap

Developed market equities were essentially flat for the third quarter after a decline in September erased gains earned the prior two months. Equities held up over the quarter despite concerns about the rate of economic growth slowing, supply chain disruptions and rising inflation. The expectation of ongoing earnings growth in the coming years was supportive and seemed to offset other potentially negative issues. U.S. small caps lagged mid- and large-cap stocks, while developed international names modestly underperformed U.S. issues. For the quarter, the S&P 500 rose 0.58%. Overseas, the MSCI EAFE Index lost 0.45%, and the MSCI Emerging Markets Index fell 8.1%, largely due to weakness in China and Brazil. The U.S. aggregate bond market was flat.

Domestic Equities

The U.S. stock market was supported by strong earnings growth (87% of S&P 500 companies exceeded second quarter earnings expectations) and an accommodative Federal Reserve (which affirmed its reluctance to raise interest rates anytime soon). In September, the S&P 500 had roughly a 5% pull back, its first down month since January, and the first of this magnitude since last October. Investor concerns included the slowing rate of economic growth, the rise in Delta cases, the Evergrande real estate crisis in China, and the potential outcome of political gamesmanship in Washington. The S&P 500 index (not including dividends) is now up 93% since its low in March of 2020 and over 600% since its low in March of 2009.

S&P 500 Price Index (Source: JP Morgan)



International Equities

European stocks (the S&P 350) had a negative quarter, falling 1.4%. In Japan, the MSCI Japan index gained 4.6%. Emerging market stocks fell sharply during the third quarter. Amongst the BRICs, India and Russia produced strongly positive gains while Brazilian stocks fell more than 20% and Chinese equities dropped more than 18%.

Fixed Income

Broad bond market indexes generated mixed results during the third quarter with U.S. issues posting an essentially flat return while international bonds lost 1.6%. Bond yields ended the quarter not far from where they began, but this understates the volatility experienced during Q3. Yields initially fell as the rapid economic recovery appeared to be moderating. However, as the market's focus turned to rising inflation and the prospect of the withdrawal of monetary policy support, yields rose.

Market Outlook

In the near term, we expect economic growth to remain strong and monetary policy to be accommodative. This creates a supportive fundamental backdrop for equities. However, the easiest gains may have already been realized as the recovery phase of the business cycle matures. The possibility of a more robust economic recovery is supported by greater vaccine access for children and early indications that the Delta variant threat may be fading. One risk facing the market is the prospect of rising inflation and interest rates. The outcome of heated fiscal policy debates in Washington D.C. also has the potential to impact markets. Higher corporate taxes would certainly put downward pressure on earnings growth, although new spending measures would be stimulative.

Developed international equities appear attractive relative to U.S. equities. They are supported by solid growth expectations and lower valuations. Signs that the Delta variant may not derail progress could mean a rotation back to cyclicals this fall. Cyclical stocks, which tend to dominate international stock indexes, often perform best when the outlook improves. In Europe, growth slowed through the third quarter but looks to be on track for a return to an above trend level during the fourth quarter and into 2022. Vaccination rates are high, and the region has more catch-up potential than some other major economies. Europe is also expected to receive more fiscal support than other regions, with the EU's pandemic recovery fund only beginning to disburse stimulus. In Japan, the economy should benefit from rising vaccination rates and political leadership changes that may result in more fiscal stimulus.

Emerging market stocks have been poor performers since the announced development of vaccines, but there are some encouraging signs. Initially, this asset class was held back by a slow vaccine rollout. More recently, developing market stocks have come under pressure from a slowing Chinese economy. Currently, however, the vaccine rollout across emerging nations has accelerated. Additionally, if the dollar weakens, that would also be a positive for these markets. Risks to these markets include a delayed exit from the pandemic and a difficult transition back from ultra-accommodative government policies.

For fixed income investors, government bonds are expensive and yields may come under upward pressure. Longer term Treasury yields will probably rise given Fed tapering and market expectations for inflation and economic growth. A 10-year U.S. Treasury yield approaching 1.75% in the coming months would not be surprising. Investment grade and high-yield corporate bonds are also relatively expensive (as yield spreads are lower than normal), but profits are strong and default rates are low. High quality bonds should continue to serve as ballast, providing relative safety in equity-heavy portfolios.

Sources: Capital Market Consultants, JP Morgan, Department of Labor, Department of Commerce, Conference Board, Bloomberg, Morningstar, Peoples Bank of China, Johns Hopkins University

INVESTMENTS / PLANNING / IMPACT

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