J.W. Burns & Company

Investment Counsel

Quarterly Update - October 2021

A Constructive Outlook With Muted Expectations

"The individual investor should act consistently as an investor and not as a speculator."
- *Ben Graham*

Dear Clients and Friends,

Stocks took a breather in the third quarter of 2021 from an otherwise very impressive year. The S&P 500 Index finished up 0.58%, the Dow Jones Industrial Average down -1.46%, and the NASDAQ down -0.23%. Bonds were essentially flat for the third quarter and international stocks continued to lag the U.S. with the MSCI All World Ex-USA Index down -3.65%.

However, the top line numbers don't tell the whole story. In fact, it was shaping up to be a great quarter until September. For the month, the S&P 500 fell over 4.5% on the heels of rising inflation, concerns over the Delta variant, and uncertainty in Washington around stimulus and raising the debt ceiling.

After a superb multi-year run in our portfolio holdings, and the market overall, it should not be surprising – and almost expected – that stocks are due for a correction(s) to shake out excesses and temper investor's expectations. When that will inevitably occur is anyone's guess; and, besides, we don't play that short-term game anyway. Instead, we will continue to focus on managing your portfolio assets with the utmost care while also researching dynamic companies with superior long-term growth prospects.

Looking ahead to the end of the year and into 2022, our view is largely unchanged. We remain constructive on the outlook for stocks but acknowledge that volatility and more muted returns are to be expected during midcycle growing pains.

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On a technical level, stocks are entering historically their best time of the year. On average, the stock market returns over 4% during the fourth quarter and is positive 79% of the time.[1] As we mentioned in our July Client Letter, strong starts to calendar years – like we have seen in 2021 – usually end with excellent returns. As such, I would expect something close to that range this year as well.

On a fundamental level, we are heading into the heart of third quarter earnings season. A full 80% of your portfolio companies will be reporting this month, which could set the tone for the rest of the year and into 2022. S&P 500 earnings are expected to grow a very strong 27.6% year over year, which will be the third highest results since 2010 and would mark the third consecutive quarter of 25%+ growth.[2]

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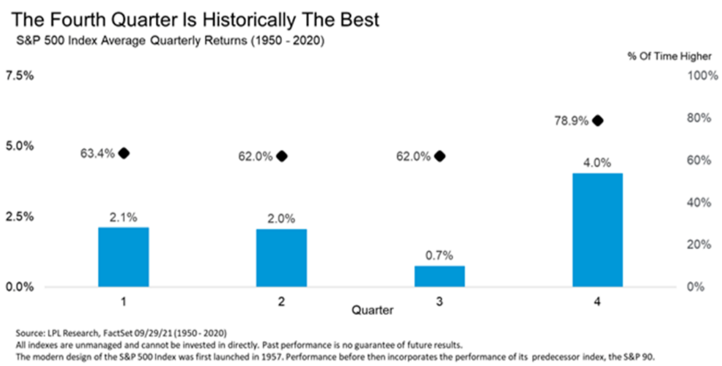
Since the pandemic, corporate earnings results have consistently come in above expectations, and I believe numbers in line or above the 27.6%

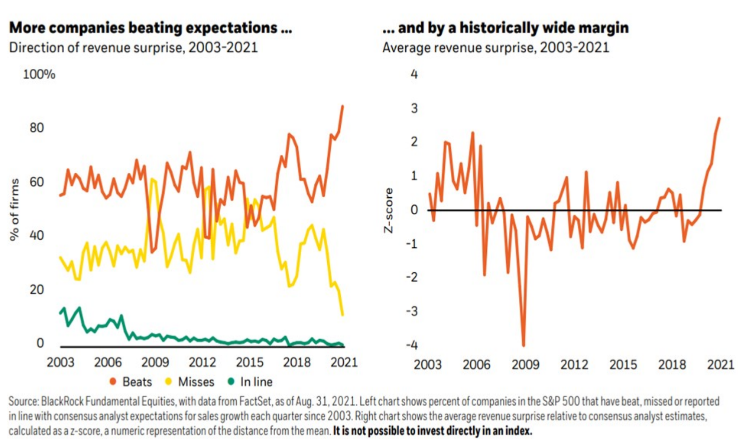
growth estimates will be a major positive for equities heading into 2022.



In fact, as I write this, the earnings results for the large banks have come in well-above expectations and the stock market is responding favorably. This, despite rising inflation concerns, and the October 13th Federal Reserve comments to taper bond purchases (which has the effect of decreasing financial market liquidity). This implies not only did the market expect the taper but that it believes the economy is achieving "escape velocity" from the pandemic driven recession – a major support for stock prices.

"While most large Wall Street firms are consistently - and incorrectly - forecasting when corrections will occur, we believe the fundamental backdrop for stocks remains positive."

While most large Wall Street firms are consistently – and incorrectly – forecasting when corrections will occur, we believe the fundamental backdrop of earnings and the economy remain positive for stocks.



At this time, we do not believe that the conditions exist for a major market decline.

Bottom line, we believe the next 6-12 months should be solid for stocks, but do acknowledge the risks present in this market ***and likely more muted returns than the recent past.***

Now, let's get to some of your questions.

Q: Jerome Powell and the Federal Reserve have repeatedly stated that the current rise in inflation is transitory; but other economists disagree with this assessment. What is your view?

A: Of course, we watch economic data closely and follow the Federal Reserve's statements and the opinions of other economists whom I respect. However, I am reminded by the quote from John Kenneth Galbraith: "The only function of economic forecasting is to make astrology look respectable."

On a serious note, not to sound wishy washy, but I believe the ultimate inflation result will land somewhere in between the transitory and permanent camps.

The recent inflation data has been in a clear trend: upward. Last week, the Labor Department reported that the Consumer Price Index (CPI) rose by 5.4% year over year, and it was also announced that retirees on Social Security will get a large 5.9% boost in benefits for 2022, due to a major increase in "cost-of-living adjustments."

Inflation is evident in other areas of the economy as well; including supply chain issues, rising rents, and sharply rising gas prices.

However, as I mentioned last quarter, I believe the supply chain issues that businesses are having are largely due to the pandemic induced shutdown of the economy, and now we are witnessing various industries having difficulties getting back up and running.

To quote Jamie Dimon, CEO of J.P. Morgan, who said last week: "This will not be an issue next year at all. This is the worst part of it. I think great market systems will adjust for it like companies have."

Where more permanent change is happening is in the labor market. The U.S. economy is still short a startling 5 million jobs. While the exact reason is unknown, I would suggest the following factors: people have reassessed their priorities and lifestyles and want to work less, forced or encouraged early retirements for many workers, a subsequent spike in wages which has more households electing to work on a single income, and unprecedented government stimulus. Together, these factors have created a labor shortage.

So, while I believe the supply chain issues will be worked out and help ease some of our current inflation, higher wages and work-lifestyle changes are here to stay.

"In the short run, higher inflation is a negative for stocks. But over time, the best hedge to inflation is owning high quality stocks."

Remember, in the short run, higher inflation is a negative for stocks. But over time, the best hedge to inflation is owning high-quality stocks – which is exactly where the J.W. Burns & Company client is positioned.

Q: Do you believe stocks are overvalued? Are we in an equity bubble?

A: In our July client letter, I stated that many of the high-flying meme stocks, SPAC's, cryptocurrencies, and other speculative investments were in a bubble. At this time, I was correct, as many of these investments have seen dramatic drops in the third quarter – which I view as a positive for the overall market, an indicator that some speculative excesses have cooled.

As to whether stocks as a whole are overvalued, I don't believe we should just look at the equity asset class on its own. While it's certainly true that the S&P 500 P/E (price to earnings) ratio is elevated on a historical basis, when we compare it to things like the bond market and interest rates, we see a much different picture.

Look at it this way: 20 years ago, your average bond investor could easily expect 7-8%+ on your basic, low risk corporate bond. Today, anything above 2% is viewed as a great deal! For institutions like pension funds, endowments, and nonprofits, this is an unacceptable rate of return in order to achieve their investment mandates. To compensate, these large institutional investors are continuing to turn to stocks to achieve adequate returns, despite their higher volatility.

Furthermore, there remains record levels of cash on the sidelines that are clearly losing money to the current inflation rate. Today, there is more than $16.5 trillion in cash and money market funds on household balance sheets that could be invested.[3]

Bottom line, no question, stocks have had a wonderful run and are probably due for more volatile next 12 months; but I do not believe we are in an equity bubble and am confident that stocks remain the best place to be over time on an absolute and relative basis.

To close, I believe stocks should have a solid end to 2021. We view the outlook for the markets as favorable and the risks of a bear market decline (20% or more) as low. That said, the S&P 500 is up more than 90% since the March 2020 lows and without a 10% correction.[4] So, I would be surprised if we do not see a sharp correction sometime over the year.

At the end of the day, our foremost job as your investment advisor is to keep you focused on your long-term investment goals and to keep you invested in great businesses. Exiting stocks is one of the biggest risks investors can take and are usually a significant setback for long-term wealth creation.

As we have done for the last 4+ decades, here at J.W. Burns & Company, we will continue to favor stocks in order to capture the benefits for our clients.

After all, Wall Street is littered with the bones of people who called the bear market too early.[5]

Thank you for your continued confidence and have a great fall.

Best Wishes,

Jim

James C. Burns, CFA
President & Chief Investment Officer

P.S.

I am very pleased to share that over the summer, one of our Portfolio Managers, Drew Derrenbacker, received his Chartered Financial Analyst (CFA) designation.

For those who don't know, the CFA is widely regarded as the most prestigious and rigorous post-graduate designation one can achieve in the field of finance. The CFA exams stress many financial topics related to portfolio management, equity & bond valuation, financial analysis, and private wealth management.

Candidates around the world must pass three exams which have a combined success rate of less than 10%. It's no joke; earning the CFA charter requires brains, energy and massive effort.

Drew passed Levels I, II, and III consecutively, which is an even rarer feat. In fact, it's one better than me. I failed Level II in 1990, before roaring back to win the designation in 1992.

I was only the 15,574 CFA charter holder in the world. Thirty years later, Drew is just 302,616. Considering the (literally) millions of people around the world who have desperately attempted to get this designation, that should show you how tough as nails this challenge is.

I am excited to add a second charter holder to our team as we continue to enhance our experience and expertise to better serve you, our valued clients.

Join me in congratulating Drew for this accomplishment!

J.W. BURNS & COMPANY, INC.

INVESTMENT COUNSEL
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1 LPL Research, Factset, 29 September 2021.
2 FactSet Earnings Insight, 8 October, 2021.
3 Wall Street Journal, 23 September 2021.
4 Haverford Fall 2021 Outlook, September 2021.
5 Fisher Investments, 2nd Quarter Outlook, 2021