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Just as we concluded in our previous letter, the markets entered a period of volatility at the end of the third quarter. Seasonally, the fall months can be more volatile, and because stocks have had a strong recovery from the fastest and sharpest sell-off due to the world-wide pandemic, a pull-back would not be a surprise. Despite hitting a record high on September 2, the S&P 500 Index closed down 4.65% for the month of September but still up a meager 0.58% for the quarter and up 15.92% for the year. The Dow is up 12.12% year to date after a decline of 1.46% for the 3rd quarter. The yield of the ten-year Treasury note is 1.53% at quarter-end after hitting a low of 1.17% on August 2. Both domestic and global stocks face short-term worries which is causing the volatility even though the long-term outlook continues to be more favorable.

There is plenty to unsettle investors as we move into the end of the year. Still lingering is the spread of the Delta variant of the coronavirus and the uncertainty of the need for booster vaccines. Jobs continue to be unfilled which leads to higher wages and pressure on profits. Annualized core inflation measured by the CPI (excluding food and energy) remains higher than usual at 4.0% in August, but a smaller increase from July. The supply chain is worsening, which also affects companies' ability to meet demand and tightens their profit margins. This includes a shortage of semiconductors which has contributed to the slowdown in vehicle production. The trillion-dollar spending and tax proposals and the debt ceiling debate tied up in Congress create more uncertainty for both individuals and businesses. Geopolitical concerns are also adding to short-term worries such as Chinese property developer Evergrande's liquidity problems and its potential world-wide affects, China's President Xi Jinping's roll out of more aggressive policies, and changes to stimulus programs facing the European Central Bank and Japan.

On the other hand, life as we knew it before the pandemic, including travel, is slowly getting back on track. The stimulus checks and enhanced unemployment benefits have created strong consumer demand. Inventories need to be re-built and both household and business formation should boom. The latest retail sales data and durable goods orders are at record levels. Companies are reporting strong earnings and we are starting to see a pickup in dividend hikes. Manufacturing productivity is gaining traction as more companies are reshoring jobs and factories.

The Federal Reserve's recent indication that it will start reversing its pandemic stimulus programs suggests that the economy is healthy. With this comes the end of the Fed's monthly asset purchases as well as future rate hikes toward a normalized range of 1.75%-2.00%. While the inflation picture seems to be most worrisome to the market right now, Fed Chairman Powell's recent assessment is that the "upward pressure on prices…will abate and as (it does), inflation is expected to drop back toward our longer-run 2 percent goal."

We believe the market will grind higher as we obtain more clarity on current issues. However, we will be keeping our eye on the health of the economy which may dictate that we take a more defensive posture. Our focus is on high-quality companies that had excellent balance sheets both before the pandemic and coming out of the recession, and that can withstand an uncertain rate of GDP growth and interest rate hikes, as well as more short-term volatility.

Thank you for your continued confidence in us and we look forward to visiting with you soon.

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