# C&N VANTAGE POINT

QUARTERLY MARKET RECAP & OUTLOOK | THIRD QUARTER, 2021

## MEET A TEAM MEMBER

### HOLLY YOUNG

*Wealth Management Compliance Officer*

Holly joined the C&N Wealth Management in November 2016 as a Trust Administrative Assistant and now serves as the department's Wealth Management Compliance Officer to ensure the department is operating effectively, efficiently and in compliance with all procedures. This attention to detail helps us to provide unmatched guidance to our clients. She received her undergraduate degree from Mansfield University, post-graduate degree from Southern New Hampshire University, and has attended Trust School and Trust Audit, Compliance, and Risk Management courses through Cannon Financial Institution.

"I am thankful for the advancement opportunities C&N has provided to me and to be part of the C&N Wealth Management Team. We have a unique opportunity to assist our clients in a variety of ways and our team members are dedicated to understanding the needs and interests of our clients. I am truly blessed to work alongside the members of the C&N Wealth Management Team as they drive me to excel in my job and as an individual."

Holly is native to Wellsboro and enjoys all that Tioga County has to offer, such as hiking, hunting, swimming, and getting involved in the community. She recently became Trustee and Co-Treasurer for the West Branch Cemetery. She is an active member of St. Peter's Catholic Church in Wellsboro and assist her family with the maintenance of the Antrim Catholic Cemetery.

| Key Equity Indexes - As of Quarter End | %YTD Return** | NTM P/E** | P/B** | Dividend Yield** |
|---|---|---|---|---|
| S&P 500 | 17.26 | 20.34 | 4.36 | 1.32 |
| Russell 2000 | 14.31 | 25.85 | 2.56 | 0.89 |
| Russell 1000 Growth | 15.48 | 28.90 | 12.28 | 0.68 |
| Russell 1000 Value | 17.59 | 16.00 | 2.53 | 1.87 |
| MSCI EAFE | 7.97 | 15.13 | 1.78 | 2.52 |
| MSCI EM | -1.51 | 12.64 | 1.89 | 2.24 |

Sources: JP Morgan Weekly Market Recap; Northern Trust. Past performance does not guarantee future results, which may vary.
** As of 10/01/2021

| Key Interest Rates | 2021 | | | |
|---|---|---|---|---|
| | 12/31/20 | 4/1/21 | 7/2/21 | 10/1/21 |
| 2-yr Treasury Note | 0.13 | 0.17 | 0.24 | 0.27 |
| 10-yr Treasury Note | 0.93 | 1.69 | 1.44 | 1.48 |
| 30-yr Treasury Note | 1.65 | 2.34 | 2.05 | 2.04 |
| 30-yr Fixed Mortgage | 2.86 | 3.33 | 3.2 | 3.1 |
| Corp. Bond Index | 1.79 | 2.28 | 2.08 | 2.13 |
| High-Yield Bond Index | 4.97 | 4.91 | 4.57 | 4.68 |

Sources: JP Morgan Weekly Market Recap & Oppenheimer Markets Review At-a-Glance
Past performance does not guarantee future results, which may vary.

## 2021 YTD STYLE PERFORMANCES**

| | US Equity Style | | | MSCI World Style | | | US Fixed Income Maturity*** | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Equity Size | Value | Core | Growth | Value | Core | Growth | Short | In-termed. | Long | Quality |
| Large | 17.59% | 16.51% | 15.48% | 14.05% | 13.90% | 13.49% | -0.36% | -0.98% | -6.83% | Government |
| Medium | 19.99% | 16.62% | 10.56% | 15.90% | 12.45% | 8.26% | 0.34% | -0.23% | -1.91% | Corporate |
| Small | 25.25% | 14.31% | 4.36% | 17.86% | 14.07% | 10.08% | 5.32% | 4.33% | 7.31% | High Yield |

Source: Goldman Sachs Asset Management Market Monitor & Oppenheimer Markets Review At-a-Glance US Equity Style Returns - Russell Indices Past performance does not guarantee future results, which may vary.
**As of 10/01/2021

# GRADUALLY, THEN SUDDENLY

***"How did you go bankrupt?"***
***"Two ways. Gradually, then suddenly."***

So goes the line from Ernest Hemingway's *The Sun Also Rises*. Politicians likely share a similar sentiment as to how quickly they've been confronted by the debt ceiling, which must be raised to prevent a U.S. government technical default. A deal is expected, but concern remains that ongoing government fiscal deterioration will follow Hemingway's prose; that government debt will *gradually* rise until it *suddenly* becomes a big problem. For those alarmed at current debt levels, know that debt to U.S. net worth has actually fallen over the past decade and — thanks to low interest rates — the cost to service the national debt is far below that of the 1980s.

**For Whom the Bill Polls.** While current national debt levels may not be of immediate concern, many still fear excessive government spending is. Progressive law-makers are pressing those buttons, pushing $5 trillion worth of infrastructure and social spending bills. But even if passed, the bills do not increase debt levels as one may think (pay-fors and a 10-year-plus timeline mute their impact). How the bills impact the 2022 midterm results may be more consequential. Progressives believe passage will help 2022 reelection bids while moderates fear excessive spending will return the legislative branch to Republican hands. This political outcome may have a bigger market impact than the spending bills themselves.

**A Farewell to Cars?** This play on words of another Hemingway classic cuts two ways. Near-term inflation is being pressured by supply chain disruptions, with cars in the crosshairs. A lack of parts (notably semiconductors) have led to sparse dealer lots, pushing new and used car prices higher. Eventually, however, we may not need as many cars given autonomous driving and more ride sharing. These technological advancements are coming quicker than ever anticipated, exerting deflationary forces.

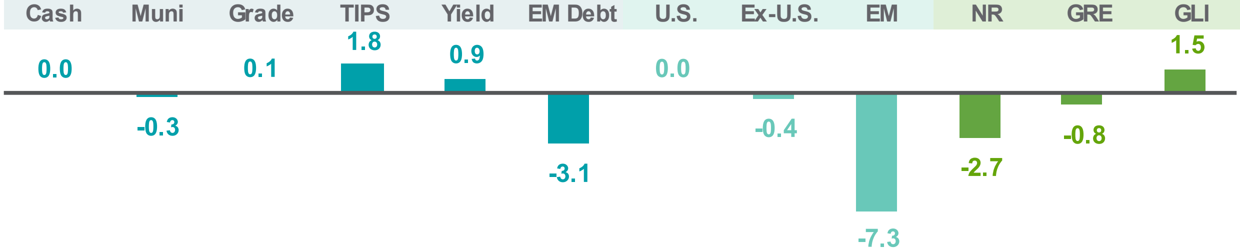
**Old Man and the QE.** Forgive us (Federal Reserve Chair Jerome Powell is still a sprightly 68), but it was too good to pass up. And Powell has certainly shown the wisdom of age as he navigates the messaging around the end to pandemic quantitative easing (QE) and the path to future Fed actions. He has convincingly maintained a message that inflation is transitory and that the end of QE does not mean the start of rate hikes. Indeed, investors remain mostly satisfied with his handling of monetary policy.

**Suddenly, then gradually.** The economy may actually be better described by the inverse of this report's title. The pandemic *suddenly* changed the global economy, which is *gradually* returning to equilibrium. For investors, *gradual* is less a construct of time and more a construct of progress. Investors (and central bankers) simply want to see a path to normalcy and a steady reduction in price gains back toward the 2% target. So long as the economy shows signs of *gradually* recalibrating supply and demand, financial markets may *suddenly* regain momentum.

## THIRD QUARTER 2021 TOTAL RETURNS (%)

After a torrid first half of the year, financial markets cooled down in Q3; emerging market equities were especially hit.

| | RISK CONTROL | | | | | RISK ASSETS | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | FIXED INCOME | | | | | | EQUITIES | | | REAL ASSETS | | |
| | Cash | Muni | Inv. Grade | TIPS | High Yield | EM Debt | U.S. | Dev. Ex-U.S. | EM | NR | GRE | GLI |




| | Cash | Muni | Inv. Grade | TIPS | High Yield | EM Debt | U.S. | Dev. Ex-U.S. | EM | NR | GRE | GLI |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| YTD | 0.0 | 0.8 | -1.6 | 3.5 | 4.5 | -6.4 | 15.3 | 9.9 | 1.0 | 16.7 | 13.3 | 7.0 |

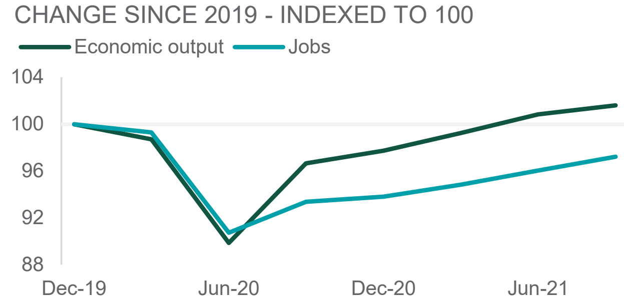
Source: Northern Trust Asset Management, Bloomberg. NR: Natural Resources; GRE: Global Real Estate; GLI: Global Listed Infrastructure. Indexes are gross of fees.

**KEY DEVELOPMENTS**

## Rising Productivity

A big reason to believe that currently elevated inflation is a transitory issue is the productivity we are witnessing across the global economy and in earnings reports. We offer two data points to support our productivity point. First, U.S. economic output, in real terms (removing inflation effects), has surpassed pre-pandemic levels; it achieved this with over six million (4%) fewer workers. Second, S&P 500 revenues grew 25% year-over-year last quarter. Impressive. But, thanks in large part to higher margins, earnings growth has been over 90%.

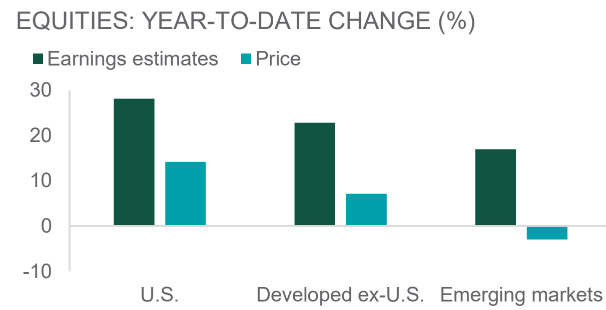
**ECONOMIC OUTPUT VS. JOBS GROWTH**




## Falling Valuations

Given strong equity markets year-to-date — especially U.S. equities, where markets are up over 15% — one could be forgiven for thinking valuations have moved higher this year. In fact, valuations (based on price-to-forward earnings) have actually fallen — as earnings revisions have moved higher at a faster pace than prices. This is true in major markets globally. Reasonable minds can view valuations as rich; but, if investors were able to swallow beginning-of-year valuations, surely they can still do so today.

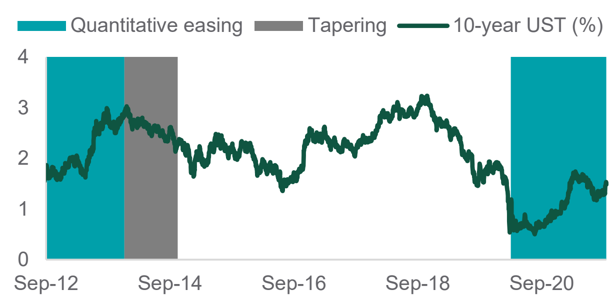
**PRICES VS. EARNINGS**




## Decreasing Monetary Policy Uncertainty

One thing that has become clearer over the past quarter is the path the Federal Reserve intends to take with its monetary policy. Fed Chair Powell has done a masterful job communicating his view on both the end of the fourth installment of quantitative easing (tapering beginning in November and wrapped up by mid-2022) and the expected start to rate hikes (not likely until 2023). Interestingly, past tapers (including the most recent one, see chart) have counter-intuitively led to lower — not higher — longer-term interest rates.

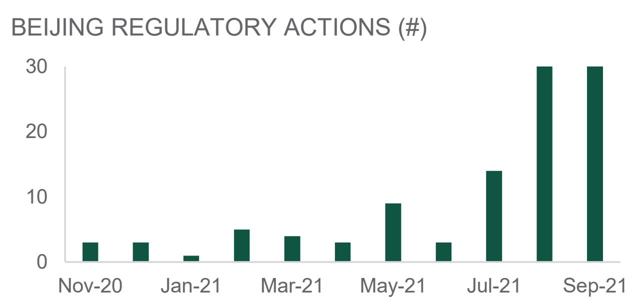
**THE LAST FED TAPER**




## Increasing China Regulatory Scrutiny

China has added a new act to the regulatory crackdowns they have selectively implemented over the past few years. After laying low for much of the past year, the Chinese government has ramped up its regulatory crackdown across several industries (see chart). This has investors rightly concerned. With real estate developer Evergrande's financial distress, regulatory concerns are coming to a head. Bull case: China halts regulatory crackdown to stabilize markets. Bear case: China does even more to prevent excesses.

**CHINA'S REGULATORY CRACKDOWN**



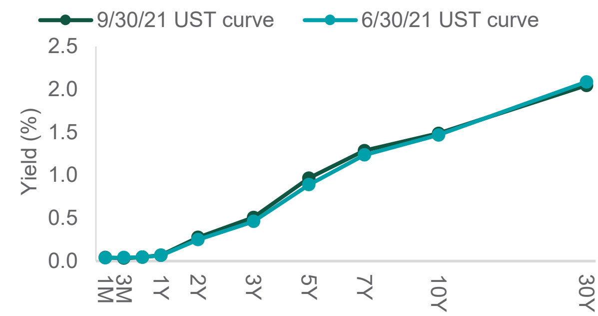

Source: Northern Trust Asset Management, Bloomberg, Cornerstone Macro. Productivity estimated for 9/30/2021. Data as of 9/30/2021.

**MARKET REVIEW**

## Interest Rates

A multi-month Treasury rally brought the 10-year Treasury yield to its lowest level since early 2021. Lower rates reflected strong technicals and to a lesser extent concern on slowing economic growth. The battle was not over as Treasuries gave up those gains in the days following the Federal Reserve's signal that taper time is imminent. Investors bought into central bank confidence in the economic recovery alongside waning COVID-19 headwinds, supporting slightly higher Treasury yields heading into the fourth quarter of 2021.

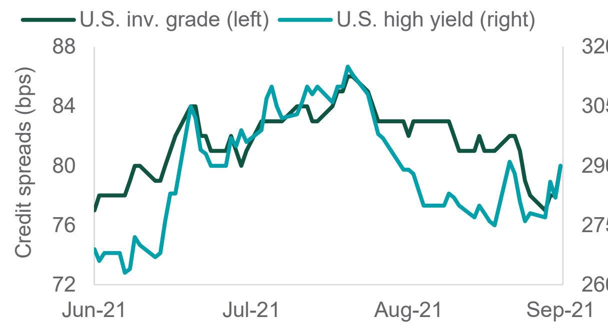
**U.S. TREASURY YIELD CURVE**




## Credit Markets

Credit conditions deteriorated during the first half of the quarter, albeit from overall strong levels. Delta variant uncertainty and massive new issuance led to credit spread widening in the fixed income markets. That spread widening created opportunities for investors to step in as virus fears waned and seasonal liquidity factors reversed – and step in they did. Still, investment grade and high yield spreads ended the quarter 3 basis points (bps) and 21 bps higher, respectively, marking the first quarter of spread widening since early 2020.

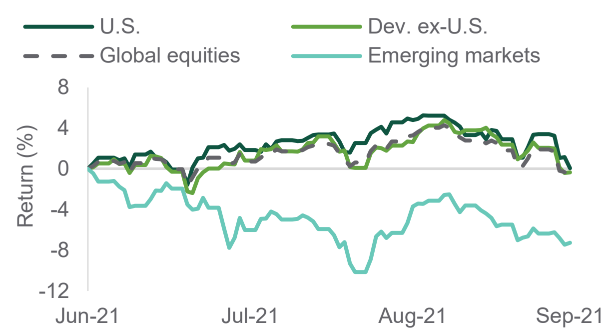
**CREDIT SPREADS**




## Equities

Global equities posted their first quarterly loss (-1.0%) since the pandemic decline. U.S. and developed ex-U.S. earnings growth mostly offset lower valuations, but emerging market (EM) earnings lagged. EM equities fell 7.3%, bogged down by China's regulatory clampdown and credit concerns. Developed ex-U.S. equities lost 0.4% and U.S. equities were flat. Strong corporate profitability and easy monetary policy lifted developed equities, but concerns on peak growth, inflation and unwinding stimulus built a wall of worry in September.

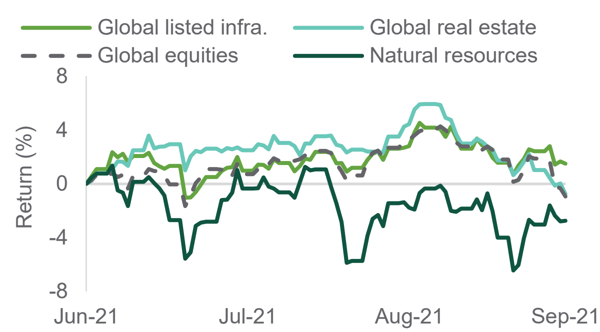
**REGIONAL EQUITY INDICES**




## Real Assets

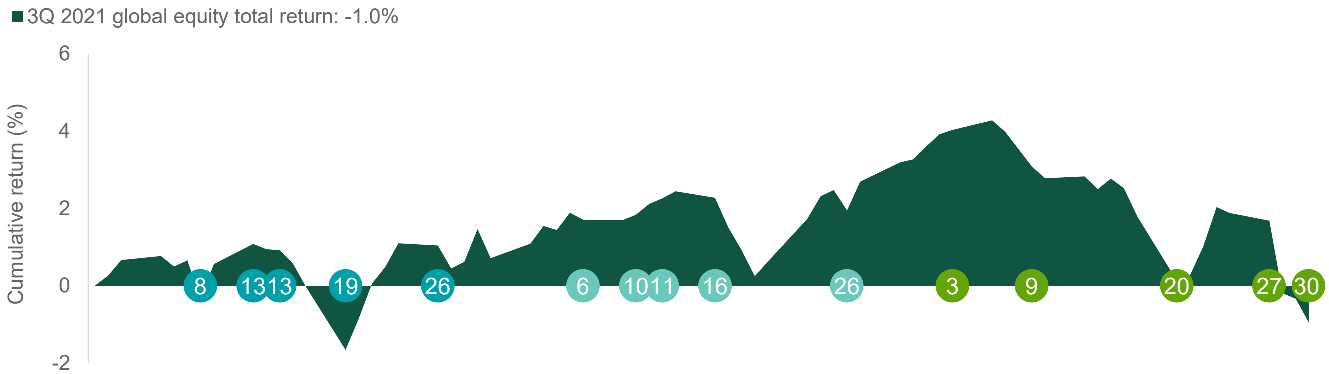
Global listed infrastructure gained 1.5% — more than global equities but not nearly enough to recover its double-digit underperformance since the pandemic drawdown. Global real estate lost 0.8%. It gained as much as 5.9% before falling on rising interest rates and fears of broader contagion from China's Evergrande crisis. Global natural resources (GNR) trailed the other major real assets we track (-2.7%). Solid fundamentals and a constrained global commodity supply failed to add to GNR's year-to-date market return leadership.

**REAL ASSET INDICES**




Source: Northern Trust Asset Management, Bloomberg. Returns in U.S. dollar terms. UST = U.S. Treasury. Indexes are gross of fees.

## MARKET EVENTS




| JULY | AUGUST | SEPTEMBER |
|---|---|---|
| **8** European Central Bank announces results of its strategy review; changes inflation target to a symmetric 2% level. | **6** July U.S. jobs report shows 943k payroll gain — the strongest gain in nearly a year. | **3** Japanese Prime Minister Suga announces plans to resign. |
| **13** U.S. headline inflation comes in at 0.9% month-over-month — the largest monthly increase since 2008. | **10** Senate passes $1 trillion bipartisan infrastructure bill, but progressive Democrats in the House vow not to vote until a reconciliation bill is approved. | **9** European Central Bank moderately slows pandemic emergency purchases in a move President Lagarde defines as "recalibration," not "tapering". |
| **13** Senate Budget Committee Democrats agree to a $3.5 trillion spending plan that triggers the reconciliation process. | **11** China's State Council releases a five-year blueprint for increased government control across its private economy. | **20** Global equities fall 1.6% amid concerns that Evergrande's financial distress will spill over to global financial markets. |
| **19** 10-year Treasury yield falls below 1.20% on concerns of the spreading Delta variant. | **16** Taliban takes over Afghanistan; U.S. proceeds to withdraw most of its troops/citizens but President Biden's approval rating falls. | **27** Germany's Social Democratic Party begins negotiations to form a ruling coalition after narrowly winning German federal election. |
| **26** Chinese authorities clamp down on the private education sector and sweeping crackdowns trigger a selloff in China stocks. | **26** Bank of Korea raises its benchmark interest rate, becoming the first major Asian central bank to pump the brakes on pandemic relief. | **30** Congress passes stopgap funding bill to avoid a government shutdown, but debt ceiling deadline looms in October and infrastructure bills face gridlock. |



**Prepared by Northern Trust Asset Management for Citizens & Northern Wealth Management.**

Indexes used: Bloomberg Barclays (BBC) 1-3 Month UST (Cash); BBC Municipal (Muni); BBC Aggregate (Inv. Grade); BBC TIPS (TIPS); BBC High Yield 2% Capped (High Yield); JP Morgan GBI-EM Global Diversified (Em. Markets Fixed Income); MSCI U.S. Equities IMI (U.S. Equities); MSCI World ex-U.S. IMI (Dev. ex-U.S. Equities); MSCI Emerging Market Equities IMI (Em. Markets Equities); S&P Global Natural Resources (Natural Resources); MSCI ACWI IMI Core Real Estate (Global Real Estate); S&P Global Infrastructure (Global Listed Infrastructure).


C&N Wealth Management

*For more information please contact:*

Philip A. Prough, CFP
*SVP/Senior Investment Officer*
PhilipP@cnbankpa.com

Jay M. Over, CFA, CIPM
*Trust Investment Officer*
JayO@cnbankpa.com

# FUNDAMENTALLY DRIVEN

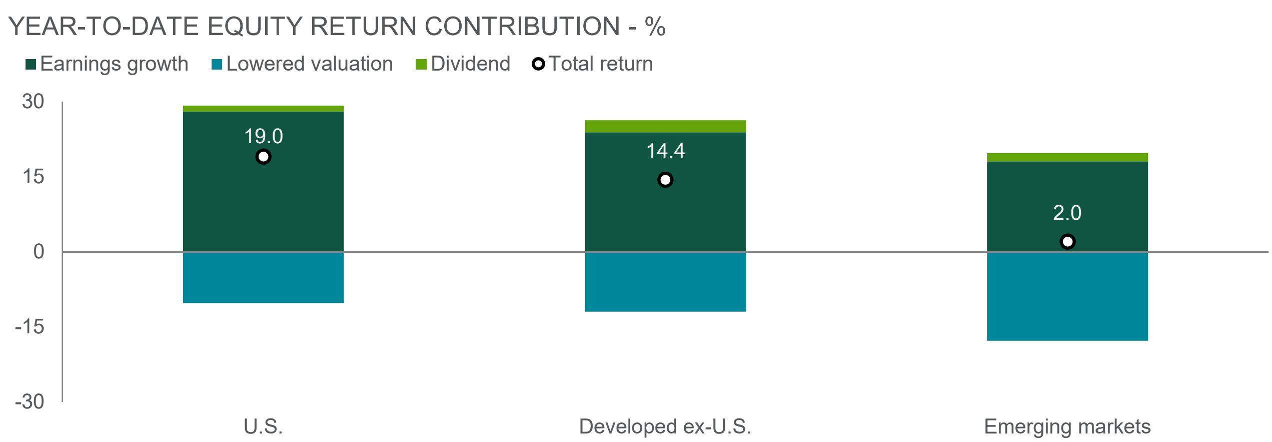
Strong market returns this year have raised questions about their quality. Are they just due to easy money and fiscal profligacy? Earnings this year have handily exceeded investor expectations due to strong operating leverage, and the regional performance has tracked relative earnings growth. As shown below, U.S. equities have delivered the strongest returns and emerging markets the lowest, which correlates with their earnings growth. Valuations have contracted across all regions, as the strong earnings picture was somewhat already discounted in stock prices. Emerging markets, however, did take an additional valuation hit due to concerns about increased regulatory oversight in China. Taking a longer-term view, U.S. equities have delivered an 18% annualized return over the last five years, well above investor expectations. However, 70% of this return was tied to fundamentals and 30% due to expanded valuation.

The current market focus is trained on the outlook for COVID-19, China and U.S. legislative policy. The spread of the Delta variant is clearly slowing near-term growth across the world (interestingly, with Europe seemingly less impacted than the U.S. or developing markets). The negative impact of regulatory change in China has now transitioned from technology and education stocks to the large property sector. The financial difficulties of Evergrande, China's largest property developer, have been brewing for months and the government has stepped back from the level of support given in similar prior episodes. We estimate that 90% of Evergrande's debt is held domestically, somewhat mitigating the contagion effect outside China, but it is usually the unknown risk that creates market turmoil. We changed our outlook for Chinese fiscal policy to stimulative this month as we expect the government will seek to cushion the economy to support job growth and social stability.

The outlook for major legislative progress in the U.S. remains murky. We have more confidence in understanding the potential tax implications (e.g., a potential 5% reduction in S&P 500 earnings) than the economic impact of a spending bill that will be spread out over 10 years. We made no changes to our global policy model this month, remaining overweight stocks and underweight bonds. Our base case rests upon *Slowing but Sustainable Growth*, supported by *Economic-Resistant Companies* that are successfully navigating the changing economy and rising input costs. This is important in the context of our *Stuckflation Tested – and Fails* risk case that we have carried for months. Our other risk case is around a failed transition from stimulus-led growth to organic expansion – a *Dropped Growth Baton*. We may face increased short-term volatility, but we are comfortable being overweight risk with a 12-month outlook.

**MARKET RETURNS SUPPORTED BY EARNINGS GROWTH**

Valuations have contracted this year as earnings jumped and risks in emerging markets rose.




Source: Northern Trust Asset Management, Bloomberg, FactSet. MSCI indexes used. Data through 9/14/2021.

# C&N PORTFOLIO POSITIONING:
## MAINTAIN MODERATE OVERWEIGHT TO RISK

C&N Vantage Point
October 2021

**Market Views:**
Equities Fairly Valued Short Term. Constructive On Equities Long Term.
Diversification Remains Paramount. Markets Will Likely Be Choppy.
Rates Likely Lower For Longer.

**Market Risks:**
Inflation Stays Elevated For Longer Than We Expect.
Federal Reserve Miscalculations Or Miscommunications.
Political Dynamics (Tax, Reconciliation & Infrastructure Bills)

| Risk Type | Asset Class | Sector Category | Under Weight | Neutral | Over Weight | Viewpoints |
|---|---|---|---|---|---|---|
| | Cash/Cash Alternatives | **Ultrashort Bonds** | | ● | | We retain Ultrashort at neutral. This remains a source of funds for a targeted trade should opportunities develop. We trimmed this category in May to fund other category over-weights. |
| Risk Control | Alternatives (Fixed Based) | **Absolute Return** | | ● | | We believe equities represent better value looking out 1 to 3 years. This has been a source of funds during recent rebalancings. We remain neutral. |
| Risk Control | Alternatives (Fixed Based) | **Inflation-Linked Bonds** | | ⊖ | | Inflation expectations impact TIPS pricing more than actual inflation. Expectations were high by this summer. We trimmed to neutral taking our gains. |
| Risk Control | Fixed Income | **US Investment Grade Bonds** | ● | | | IG Corps spreads continue to be tight. We remain underweight to U.S. Govt bonds. Overall, we're underweight but continue to stay neutral on duration being opportunistic on rate rises. |
| Risk Control | Fixed Income | **International Bonds** | | ⊖ | | The yield outlook remains poor. Additionally, rising inflation threatens central banks' accommodative monetary policy. We trimmed our position as part of our underweight to fixed income. |
| Risk Control | Fixed Income | **Emerging Markets Bonds** | | ● | | EM bond yields may have room for additional spread tightening. EM is more correlated to a global recovery. We maintain our neutral allocation. |
| Risk Assets | Fixed Income | **High Yield Bonds** | | ● | | Coupons remain attractive relative to other fixed income. Valuations have risen. We remain neutral to maintain a barbell approach within fixed income. |
| Risk Assets | Equities | **US Large Cap** | | | ● | Value has rebounded this year. We remain overweight to Value for the cyclical trade but added to Growth in May & August taking us to an overweight in this category. |
| Risk Assets | Equities | **Developed Ex-US** | | | ⊕ | Valuations are reasonable compared to the U.S. We added to our position for a slight overweight. We look to add to Large Caps if a pullback occurs and valuations become more attractive. |
| Risk Assets | Equities | **US Mid & Small Cap** | | | ● | These categories finished strong in each of the previous quarters. We trimmed are positions in May to fund our Large Growth and EM positioning, reducing these to a slight overweight. |
| Risk Assets | Equities | **Emerging Markets** | | | ● | EM is more correlated to the global recovery. Vaccination rates and China have been headwinds. EM lagged in 3Q. We used the weakness to rebalance to our position and continue to monitor. |
| Risk Assets | Alternatives (Equity Based) & Real Assets | **Real Estate** | | ● | | The Fed positioning for bond tapering could be a headwind, but strong demand in data centers and the possible end to the eviction moratorium are positives. We remain neutral. |
| Risk Assets | Alternatives (Equity Based) & Real Assets | **Commodities/Natural Resources** | | ● | | Oil prices have surged. Precious metals and natural resources remain elevated too. An infrastructure bill should be a positive. We remain neutral given our overweight to Large Cap Value. |

Wealth Management
90-92 Main Street
Wellsboro, PA 16901

Quarterly Market Recap & Outlook Third Quarter, 2021

# C&N VANTAGE POINT

Wealth Management
90-92 Main Street
Wellsboro, PA 16901

cnbankpa.com | 570.724.0243

Philip A. Prough
SVP/Senior Investment Officer
PhilipP@cnbankpa.com

Jay M. Over
Investment Strategist
JayO@cnbankpa.com

Nicholas P. Cevette
Trust Investment Associate
NicholasPC@cnbankpa.com