KMR Financial Advisory, Inc.

Market Commentary

3rd Quarter 2021 Review & Outlook

3rd Quarter 2021 Market Review

2021	1 qtr	2 qtr	3 qtr	Year-to-Date
Dow Jones Industrial Index	7.8 %	4.6 %	(1.9)%	10.6 %
Nasdaq Composite Index	2.8 %	9.5 %	(0.4)%	12.1 %
S&P 500 Index	5.8 %	8.2 %	0.2 %	14.7 %
Russell 2000 Index	12.4 %	4.1 %	(4.6)%	11.6 %
iShares Core US Aggregate Bond ETF	(3.4)%	1.8 %	(0.0)%	(1.7)%

Price Return, As of September 30, 2020

The 3rd quarter in the market continued its grind higher for the most part for the first 2 months of the quarter, but after a steady drop in September, the major indexes ended up about where they started. The S&P 500 suffered a 5% drop in September after hitting an all-time high at the beginning of the month (see graph on page 3). Still, the markets have had a strong 12 months, with the S&P up over 25%, but this is in contrast to some corners of the bond market where investors faced losses.

The equity markets climbed higher in July and August on ptimism about the U.S. economic recovery. However, shares fell back from their highs amid worries about the impact of the coronavirus's Delta variant on the economy, supply chain slowdowns leading to shortages across a number of key industries, and a regulatory crackdown in China. A jump in U.S. Treasury yields also weighed on the market. For 2021 the S&P 500 is up almost 15% and the NASDAQ up 12%.

	Return %		
Equities	Q3 2021	Q2 2021	1-Year
U.S. Market	0.03	8.37	31.26
Dividend Focus	-1.60	2.69	21.45
Global ex-U.S.	-2.38	5.49	25.11
Developed ex-U.S.	-0.27	5.54	27.13
Emerging Markets	-7.58	5.53	20.21
Fixed Income			
U.S. Core Bond	-0.07	1.87	-1.13
U.S. Government	-0.08	1.91	-3.62
U.S. High-Yield	0.95	2.71	11.57

Source: Morningstar Direct.

With the excitement happening across the globe and rising U.S. bond yields, it was a rather tame quarter in the U.S. markets. The S&P 500 moved more than 2% only on 1 day, and it moved more than 1% on only 8 days, down from 12 times in the quarter prior and 18 times in the 1st quarter.

In the bond market, the 3rd quarter began with a rally as the prospect of a slower recovery pushed the yield on the 10-year U.S. Treasury note to its lowest level since February. But after a higher-than-expected inflation forecast from the Federal Reserve and an indication that it could raise interest rates next year, bond prices fell back and yields rose.

Riskier high-yield bonds fared better than safer core and Treasury bonds in the sell-off. But as a result, only high-yield bonds and Treasury Inflation-Protected Securities are positive on the year. Most bond sectors are on track for a negative year.

For the Morningstar US Core Bond Index--which tracks the largest sectors of the investment-grade U.S. bond market--it would be the first year since 2013 that ended in the red. For U.S. Treasuries, it would be the worst year since 2017.

For more conservative portfolios with higher levels of fixed income positions to minimize volatility, the returns have paled compared to more aggressive portfolios with higher equity allocations. With negative returns for the year for fixed income (as represented by the Aggregate Bond index of *minus* 1.67%), the 30% equity/70% fixed income & cash portfolios are up a little over 3% for the year compared to a 70% equity/30% fixed income & cash portfolio return of almost 9.5% (see page 6 for details).

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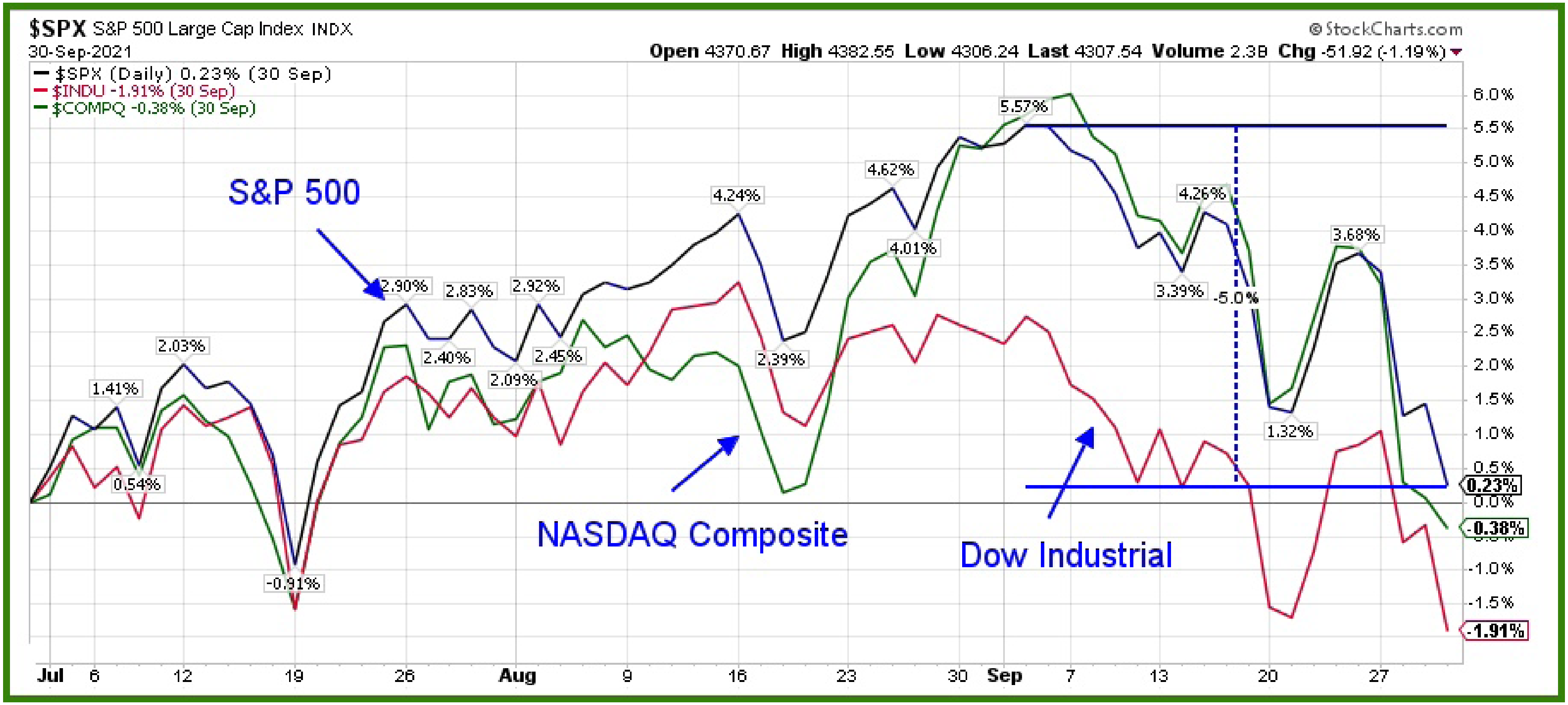
Major Index Changes over the 3rd Quarter



Market Outlook

KMR View's Summarized	
Economy	GDP growth projections have definitely come down as the consequences of the Delta variant, supply chain issues, higher unfilled job openings and higher inflation has hampered full throated economic growth. Now it's looking like 5.7% for 2021, but this could be lower as these consequences fully play out. Nonetheless, the economy has a lot of pent-up demand ready to be fulfilled, which is a better situation than trying to get demand up in the 1st place.
Market View	The fear mongering from inflation, supply-chain backups, and fiscal incompetence has been a bit overblown. After a 5 % pullback in September (these kinds of pullbacks are normal and ultimately a good thing), we may have better sailing for the rest of the year. Recent index record highs indicates that.
Asset Allocation	Portfolios to be fully at the risk-tolerance allocations.
Equity Style Bias (Growth vs. Value)	Growth had a better quarter in Q3 than value, but for the longer haul I'm still positive on value as a winner in a recovering economy with above-average inflation.
Capitalization Bias (Large, Mid & Small Cap)	Small-caps under performed larger-caps in Q3, but after a pause they should still be a good place for exposure in the near future.
International Equities	Blackrock is still bullish on European and other developed economies going forward.
Bonds-domestic and international	Fixed income investments will have a hard time going forward. With rates so low, there's only one way to move, and that it higher rates. And with inflation as high as it is, we may have negative real returns in bonds for some time. Blackrock is strategically under-weight on government debt and prefer inflation-linked bonds (TIPS).
Cash	Cash continues to have no return now, but is used as a no-risk ballast plus a way to prepare for buying opportunities as appropriate.
Sectors (11 S&P)	↑ health care ↔ communication services, materials, industrials, consumer discretionary, energy, real estate, technology, financials , consumer staples ↓ utilities

September was an interesting month, one that had a lot of pessimism in it as pundits took turns speculating on the effects of the Delta variant, the supply chain challenges, why people were not going back to work, and especially inflation. My humble opinion is that these concerns, though valid, were overblown. Each one, in time, will self-correct itself, and the underlying problems are not as bad as these folks made it to be. Concerning the supply chain and inflation issues, some of the main contributing factors are that there is a lot of demand in the economy, the consumers want a lot of stuff, and the supply chain can't handle it. We need to go back what seems like a hundred years ago (January 2020) and remember that the economy was humming along just fine. Put on top of that the enormous cash infusion from the federal government in the form of stimulus payments and other incentives, it becomes more apparent that we should be where we are now. There is uncertainty about the on-going pandemic and how long it will be until the "all clear" horn is sounded, but these will resolve themselves and it will, someday, be behind us. And these medical issues will cease to have such a direct impact on the economy as it has been since early 2020.

So, where do we go from here? If I'm somewhat right about the impact of the above factors and how they will change over the near future, we will have favorable stock market conditions into next year. However, we need to remember that our portfolios are diversified, meaning that they have fixed income (bond) investments in them and not just equities (stocks). And the fixed income investments, which have done well for a long time as interest rates have steadily dropped (see the 30-year Treasury yields over the last 15 years chart below), and rates are at a place to go nowhere but up (and fixed income investments lose value as rates go up). And if inflation stays up at 2.5% to 3% for a while, and corporate bonds are returning 1.5%, then you have negative real returns, not helping overall portfolio returns for that portion of the portfolios. So, while the stock portions may continue to do well, the bond portions of our portfolios may be where the challenges are. Bonds serve a purpose in portfolio construction, lowering volatility and being a counter to the directions of the stock market. But to counteract the potential negative effects of bond returns, alternatives may be needed. And whatever they may be, the associated risks must be weighted, as bonds are supposed to be less risky. For portfolio managers, this will be a primary challenge going forward for some time. Stay tuned for more interesting times in the investing world!

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Frank Brannon, CFP®
October 23, 2021

KMR Financial Advisory, Inc.

Recommended Long-Range Asset Allocation Targets & Benchmark Returns

A benchmark return is the return that a hypothetical portfolio that exactly matches the asset allocation targets for the portfolio (as defined in the Investment Policy Statement for each portfolio), and each component returned the same as the index for that component (see below). It is important to have a diversified portfolio, spread across multiple asset classes to reduce risk and increase the likelihood of optimal returns. Below are the Investment Models that KMR uses in its managed portfolios, the allocation targets for each asset class, and the year-to-date returns for each style as of **September 30, 2021**.

Investment Model	Large-Cap Equity	Mid-Cap Equity	Small-Cap Equity	International Equity	Fixed Income	Other	Cash	Total	YTD Return
Target Allocation 30/70	21%	0%	2%	10%	63%	4%	2%	100%	3.18 %
Target Allocation 40/60	30%	0%	2%	13%	51%	4%	2%	100%	5.01 %
Target Allocation 50/50	35%	0%	3%	16%	41%	3%	2%	100%	6.44 %
Target Allocation 60/40	42%	0%	4%	19%	31%	3%	2%	100%	7.93 %
Target Allocation 70/30	49%	0%	4%	22%	22%	2%	2%	100%	9.42 %
Target Allocation 90/10	62%	0%	5%	28%	3%	1%	2%	100%	12.38 %
Target Allocation Tax-Aware 70/30	48%	0%	5%	22%	22%	3%	2%	100%	8.10 %
CRSP Series 70/30	36%	0%	5%	27%	29%	0%	2%	100%	7.92 %

Here is each component's return for the year-to-date period as of **September 30, 2021** (and the source of the data):

Large-Cap Equity	**15.09 %**	Morningstar US Large Cap PR USD
Mid-Cap Equity	**15.47 %**	Morningstar US Mid Cap PR USD
Small-Cap Equity	**12.40 %**	Morningstar US Small Cap PR USD
International Equity	**9.19 %**	MSCI World ex USA NR USD
Fixed Income	**(1.67)%**	iShares Core US Aggregate Bond ETF
Other	**29.13 %**	Bloomberg Commodity TR USD
Cash	**0.03 %**	Bloomberg Short Treasury 1-3 Mon TR USD

KMR News & Reminders

1. A reminder for **RMDs (Required Minimum Distributions for IRAs)**, the SECURE Act changed the age that owners of IRAs must begin taking RMDs to 72 (from 70 ½). Those who turned age 70½ in 2019 or earlier still fall under the old pre-SECURE Act RMD rules. Although RMDs were not required last year, <u>they will be required again in 2021.</u>
2. For those in the Required Minimum Distribution phase of life with their IRAs, and you also do charitable contributions each year, there is a way to fulfill both the RMD requirements plus exclude the RMD from your taxable income at the same time. These are called **Qualified Charitable Distributions**.
3. Be sure that **beneficiaries** for your retirement accounts (including 401-ks) are up-to-date.
4. There is much debate in Washington these days about the very large social program plan and the changes to our tax laws to fund it. Much has been written regarding the possibility of these changes, which include changes to individual income tax rates, capital gains rates, changes to Roth conversions, taxes on unrealized gains for high income taxpayers, and significant changes to estate tax law. However, much is unknown about what will actually make it into law. Certainly, the original $3.5 trillion proposal will not survive, but what -if any- does survive is very much up in the air. Hopefully clarity will arrive soon.

Model Portfolio News

Blackrock, the largest asset manager in the world, and also who KMR uses to define model portfolios, made some allocation changes as of **October 21, 2021**. Here is a summary of their commentary:

- Expecting higher inflation, and over-weighting equities but reducing sensitivity to sector bets.
- Further under-weighting Emerging Market equities due to lower earnings expectations as regulatory and debt crisis continues.
- Adding to fallen angel debt (former investment grade bonds downgraded to speculative grade), expecting this slower-than-usual upgrade cycle to begin to pick-up as business conditions continue to improve.
- Increasing exposure to U.S. Treasury inflation-protected securities (TIPS), seeking to mitigate equity risks with the relative quality and resilience of government bonds, but with a hedge to rising inflation expectations.

They expect above-average inflation data over the medium term, but this will be transitory, and expect the continued deployment of record amounts of consumer savings to increase demand of goods. They maintain their affinity for stocks over bonds and styles that benefit from rising rates, rising inflation, and higher oil prices (small cap, energy, value factor stocks).

They are selling Emerging Market stocks to buy U.S. equities. This is due to a weakening earnings picture and increase regulatory oversight and real estate crises in China.

A record amount of investment grade bonds were downgraded to junk following the onset of the pandemic, creating a potential universe of so-called “rising stars” (junk bonds eligible to be upgraded to investment grade-also know as “Fallen Angles”) . They believe that a sizable amount of downgraded bonds are now upgrade candidates following balance sheet revitalizations. These facts create conditions for potential future upside performance.

About KMR Financial Advisory, Inc.

KMR Financial Advisory is an independent, fee-only registered investment advisor specializing in the development of comprehensive financial plans and developing & managing investment portfolios.

Frank R. Brannon, CFP ®, is the president of KMR Financial Advisory, Inc. Frank's educational background includes:

- **The Lovett School**
- **Tulane University,**
  BA, Economics
- **Georgia State University,**
  Master of Decision Sciences

Frank is a Certified Financial Planner™ professional and achieved his license in 1996. Frank has worked most of his career in corporate financial planning for a Fortune 200 company. He has lived his entire life in Atlanta.

CFP

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