**BLUE GRANITE CAPITAL, LLC**

## INVESTMENT COMMENTARY, OCTOBER 2021

With historically low interest rates, a tailwind from the economic reopening, robust consumer spending, accommodative Federal Reserve policy, government stimulus, and "TINA" (there is no alternative) – how could the stock market fall? Yet in September, the market decided to take a break.

Until the recent 5% pullback, the S&P 500 Index enjoyed an uninterrupted 18-month rally, nearly doubling from a post-pandemic low. Stock market selloffs are a normal and healthy part of economic and market cycles and are at times seemingly overdue. Before this decline, equity markets had enjoyed over 220 trading days without a 5% loss – quite long by historical standards.

Inflation remains a concern as global supply chain shortages and rising demand have led to widespread pricing pressures for both consumers and producers. The recently reported consumer price index (CPI) reached a 10-year high, while the producer price index (PPI) reached its highest pace since 1981. Supply chain problems have become ubiquitous with bottlenecks at US ports and overburdened trucking and railway operations impacting the timing and cost for delivery of products. One notable example is the significant labor shortage of dock workers and truck drivers. Fixing such employment issues doesn't happen overnight, which is why this season stocking up on Christmas gifts may pose a challenge for consumers as many companies have warned of delivery delays. As a safeguard, the Biden administration just announced the California ports, railroads, and delivery companies (FedEx and UPS) will work 24/7 to help alleviate congestion.

The increased cost of energy, raw materials, shipping, and employee wages all impact the prices of products and services we purchase on a regular basis. We disagree with the Fed's assessment that recent inflationary pressures are purely transitory and fear it may not abate anytime soon. Rising prices, not surprisingly, are becoming increasingly politicized as well with recent calls to not reappoint Federal Reserve Chairman Jay Powell. This adds uncertainty to decisions regarding when the Fed's 'tapering' would begin, and interest rate hikes would follow. Both of those measures are necessary to win the fight against inflation.

In such a heightened political atmosphere, it's going to take a major bipartisan effort to pass meaningful legislation that will help stabilize an arguably fragile economy. Debt limit negotiations led to a temporary stop-gap measure which has surely kicked the can down the road. Expect another short-term deal late into the night of the December 2$^{nd}$ expiration. Absent a debt-limit deal, it may be 'déjà vu all over again' as concerns of default have investors nervous, especially Treasury Bond holders who depend on the continuity of interest payments.

Proposed stimulus and infrastructure spending proposals also include tax increases that seem particularly untimely. As both consumers and producers are being hit with higher inflation-driven costs, raising taxes as the economy is beginning to rebound seems counterintuitive. The economy is more likely to thrive with higher employment rather than corporate taxes that will surely raise prices and possibly blunt demand. The risk to the corporate bottom-line is that consumers balk, purchase less, profitability suffers, and stock prices likely fall.

As we head into the third quarter earnings season, current economic pressures are manifesting in changes to stock market leadership. The ‘big tech’ and growth stocks are rolling out of favor while more traditional companies such as banks, consumer staples, and industrials have traded much better. Candidly, we’re glad to see the stock market take a much needed rest which lessens the likelihood of a bigger selloff. Market pauses also provide opportunities to enhance your returns as we add to positions in stocks we like when they temporarily ‘go on sale.’ Looking back a bit further in time, we’re mindful that equities have gained more than 400% since the financial crisis in 2008 and until last year’s decline, stock prices have risen mostly without resistance for over 12 years.

We’ve remained focused throughout on protecting your hard-earned capital. We have confidence in our portfolio diversification discipline to lessen potential volatility that may arise due to the factors outlined above. Your portfolio holdings are well positioned with specific investments such as banks that benefit from inflation and higher interest rates, and consumer stocks which generally withstand changing conditions as the demand for their goods remains stable in all kinds of economic cycles. Technology demand is also steady as evidenced by portfolio stocks Apple and Microsoft. The ‘graying of America’ coinciding with baby boomers retiring will also benefit the investments we hold in healthcare. Coupled with the bond portion of your portfolio that mitigates market risk, we tend to weather unpredictable events in a smoother manner, which is a key to our clients’ long-term success.

Please contact us if you have any questions and, as always, we thank you for your support.

Best regards,

Scott, John, Dave, Richard, & John