Investor Insights & Outlook

October 2021 3rd Quarter Concorde Investment Management

Domestic Economic Overview

A Message from Concorde Investment Management

We have an app for your smartphone or tablet that allows you to view your entire portfolio and includes a vault where you can access your quarterly reports, billing summaries, and share documents with Concorde from a secure portal. If you are not yet set up with the app and would like to utilize this feature, please contact Barbie Spicer for assistance.

We mentioned in our last letter that we expected the Delta wave to recede fairly quickly given our analysis of other countries and their experiences with the variant. As of this writing the U.S. is averaging 79k cases a day and declining. The peak was September 1st at 166k. So we are down 50%. Interestingly, the waves tend to hit different areas of the country at different times due to weather and behavior. In the South, during hotter months we tend to stay inside and in air conditioning which facilitates spread whereas the northeast is starting to go inside more now due to the colder weather and they'll be dealing with case increases over the next couple of months. Regardless, the U.S. consumer is learning to deal with Covid-19 and the economy is being affected less and less by each subsequent wave or variant. We won't make any predictions about the pandemic going forward however we are hopeful and optimistic that it will be in our rear view mirror in the near future.

The economy is continuing to grow but inflation is starting to eat into any real growth. The Atlanta Fed just lowered their estimate of Q3 real GDP to .5% while consensus of other forecasters is between 3% and 5%. Every article or discussion has mentioned inflation as temporary or transitory and due to supply chain issues. Those supply chain issues are not going to be getting better anytime soon given there are over a 100 cargo ships waiting to unload cargo at the Port of Los Angeles. We recommend early Christmas shopping this year!

While we agree that the aforementioned supply chain is contributing to inflationary pressure, wage inflation is real and stickier. The total nonfarm job openings are at an all-time high of 11 million since 2000. The previous high was just below 8 million in 2017.

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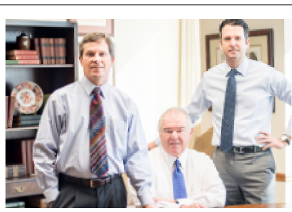
The Concorde Team



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Domestic Economic Overview (continued)

The percentage of small business firms with 1 or more jobs they are unable to fill is at an all-time high going back to 1975 of 50% (previous peak was just below 40% in 2017). The primary way these jobs get filled is by offering higher wages. Anecdotally, in our private investment portfolio we are seeing hiring costs for highly technical jobs increase dramatically. The U.S. unemployment rate is at 5.2% and annualized wage growth is at 4.9% which is the highest it has been since 1982! Actual printed inflation numbers are as high as they've been in 30 years. Headline CPI is at 5.2% and Energy CPI is at 24.9%. Some of our clients might have notice that social security cost of living increases will be 5.9% which is the highest increase in 40 years. All of these numbers are higher than what they were in Q2 so it looks like inflation is accelerating. Our concern is that the inflation may not simply be primarily a one-time price reset of goods and service, and likely transitory in nature stemming from the Covid disruptions, but the beginning of a trend. It goes without saying that the ramifications on investment asset allocations are quite different for each.

What is important to understand, regardless of what anyone writes or discusses, inflation is generally what the government wants in order to get the debt to GDP ratio back in line. Nominal GDP growth (even if real GDP is flat) decreases the debt to GDP ratio. This is effectively a reduction in debt, even if the static number of nominal total debt outstanding is not changing. We also expect inflation to stick around for some time until it no longer benefits the government. One thing all Federal reserve board members understand is how to tamp down inflation.

International Economic Overview

Not unexpected, given the discussion around inflation and supply chain issues in the domestic economy, the international economy is having lots of issues delivering goods. Global PMI (Purchasing Manager's Index) suppliers' delivery times index is at the lowest on record which indicates slower delivery times. This is just one question HIS Markit's PMI business survey in which participants are asked if delivery times are slower, faster, or no change. The PM input and output prices are both high, however they've ticked down very recently (which could indicate supply chain issues are subsiding). Essentially, everyone is trying to catch up to changing consumer behaviors after a collapse in demand in 2020. These other manufacturing-based companies are dealing with lack of vaccines and combat any type of infection with a lockdown of their plant which is also contributing to the issues. Either through vaccination or multiple infection acquired immunity, supply chain catch up won't happen until companies and countries operate in a consistent manner.

One development we found interesting, and indicative of a broader issue, was China restarting its import of coal from Australia. In late 2020 China stopped buying coal from Australia due to 'political tensions', mainly driven by the Australians backing a call for a full international inquiry into China's handling of the coronavirus. Now the Chinese are facing a power shortage. Alongside a global surge in commodity prices, thermal coal, the primary fuel for electricity production, saw prices soar by more than 40% over 12 months at the end of last year. That lack of coal plus a demand for power and surging exports have caused power rationing in country. This is going to further exacerbate supply issues globally and China is putting aside its ego in order to ease some of the power pressure as the globe heads towards December.

Equity Markets

Large cap growth stocks generated small positive gains for the quarter as almost all other size and style segments had small losses. Investors reverted back to the group of companies that held up well during the height of the pandemic sell off as the outlook beyond the completion of the economic return to "normal" is becoming more uncertain. Valuations on the cyclical, value and recover stocks have reached a level where short-term activity is now mostly reflected and further upside must depend on conviction of growth beyond 2022. Higher than normal uncertainty in global economies, likely rising interest rates and increasing debt levels at the government and corporate level are concerns flaming the doubts. International equity markets results were very diverse for the quarter ranging from double digit losses in Hong Kong to a double-digit gain in India. Most European indices were essentially flat, similar to the U.S.

As we have commented in recent quarters, despite the market recover since the middle of last year, we still find a number of individual domestic equities that have valuations that warrant either new investment or holding positions. Our valuation analysis includes higher bond rates over the next several years and conservative assumptions beyond 2022. We are still hesitant to commit significant capital to internally focused businesses, although we maintain some revenue exposure via U.S. based corporations.

		Q3 2021	YTD 2021
S&P 500	U.S. Large Cap	1.13%	14.3%
Russell 2000 Growth	U.S. Small Cap Growth	-4.4%	12.4%
Russell 2000 Value	U.S. Small Cap Value	-3.0%	22.9%
MSCI EAFE	Developed Market Large Cap	-0.3%	8.8%
MSCI EM	Emerging Markets	-8.0%	-1.2%
Hong Seng	Hong Kong	-13.9%	-7.5%
India S&P BSE		12.9%	24.9%

Source: Morgan Stanley; FactSet

Fixed Income

Base ten-year U.S. Treasury note yields finished the quarter slightly higher compared to June 30 as they hit their lowest levels since February at around 1.20% before finishing at 1.49%. Rates have been rising the last two months as inflation concerns persist and market participants have begun to believe that Federal Reserve tapering and federal funds rate increases will occur sooner than many had expected earlier in the year. Fundamentally, yields are still artificially low as compared to time periods with similar growth and inflation. Investment and non-investment grade corporates saw yields also rise modestly as spreads to Treasuries widen.

Despite these changes, investments in all but shorter maturity issues appear to be at risk of principal loss if these trends continue. If spreads in middle quality corporates widen, select short to medium maturity bonds could become attractive. Commentary from large institutional banks and fixed income advisors states that demand from domestic and international buyers would increase if yields across the board only rose another 25-75 basis points. Our focus in current holdings continues to be in higher quality primarily short-term corporates, agency and non-agency mortgage-backed securities, revenue backed municipals and floating rate institutional preferred stocks.