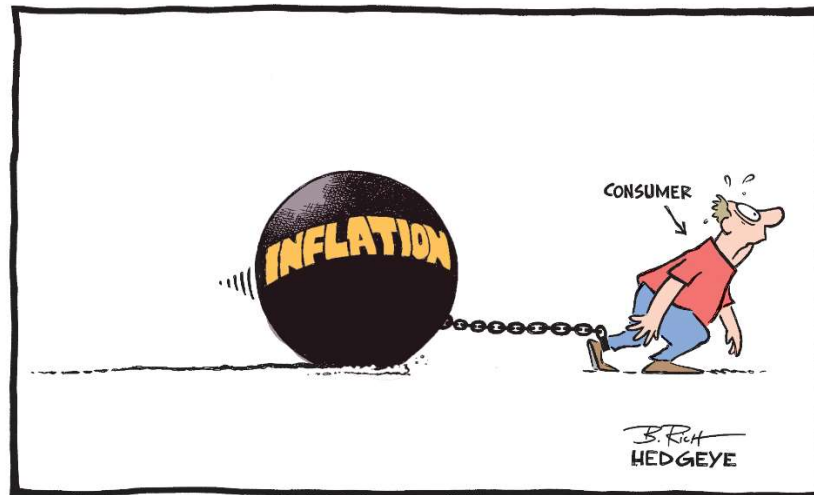




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Archer 4th Quarter 2021 Outlook:

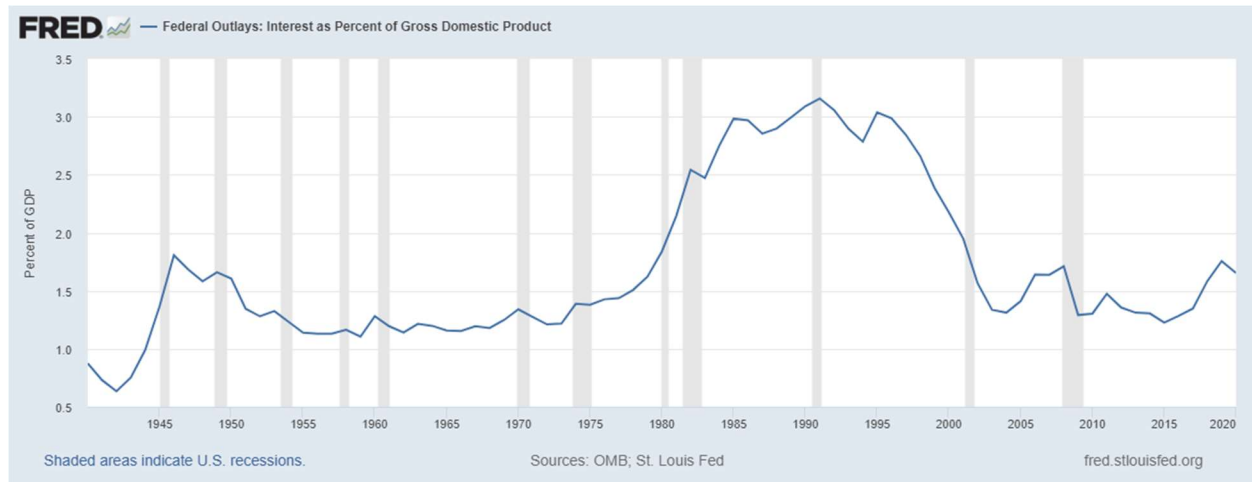
"Inflation is taxation without legislation." – Milton Friedman



The cartoon may have caught your attention, but I want to use it to explain what is happening and what is likely to happen in the market. We all know by this point that the Federal Government has begged, borrowed, and stolen to “juice” up the market. Whether you felt this was necessary during the pandemic or not, there are consequences to all of the spending in Washington. Our national debt has grown tremendously. However, we have been here before. During WWII, as you can see from the numbers in the chart below, we also borrowed more than 100% of our national GDP. The good news is the interest we are paying now as a percentage of our total debt is still below what it was during the 80’s and 90’s.

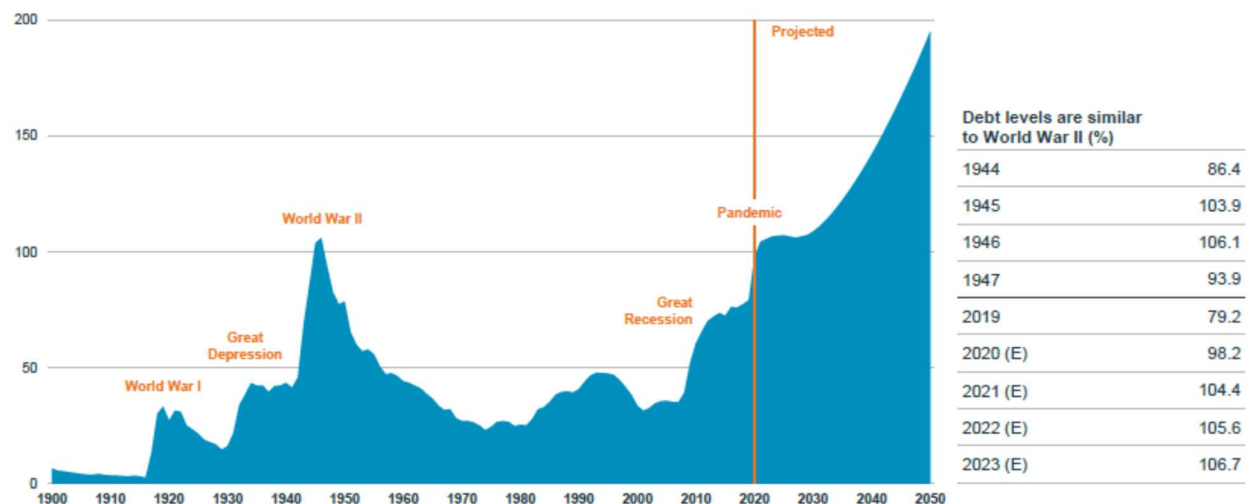
The money that was borrowed during the pandemic is still working its way through the system, thanks to supply chain problems created by shutting down and trying to restart the economy. We have not spent the \$5 Trillion doled out by the U.S. Government no matter how hard we may try. There is not enough product to spend it on. We have a record numbers of container ships and tankers on the West Coast and East Coast that are waiting at sea to unload cargo. If you can imagine closing a factory that

sells a frequently purchased product and continuing to pay employees while simultaneously providing consumers enough cash to purchase 3 times what they normally would, you would create inflation.



Growing deficits could drive federal debt held by the public to unprecedented levels

Federal debt held by the public as a percentage of GDP (%)

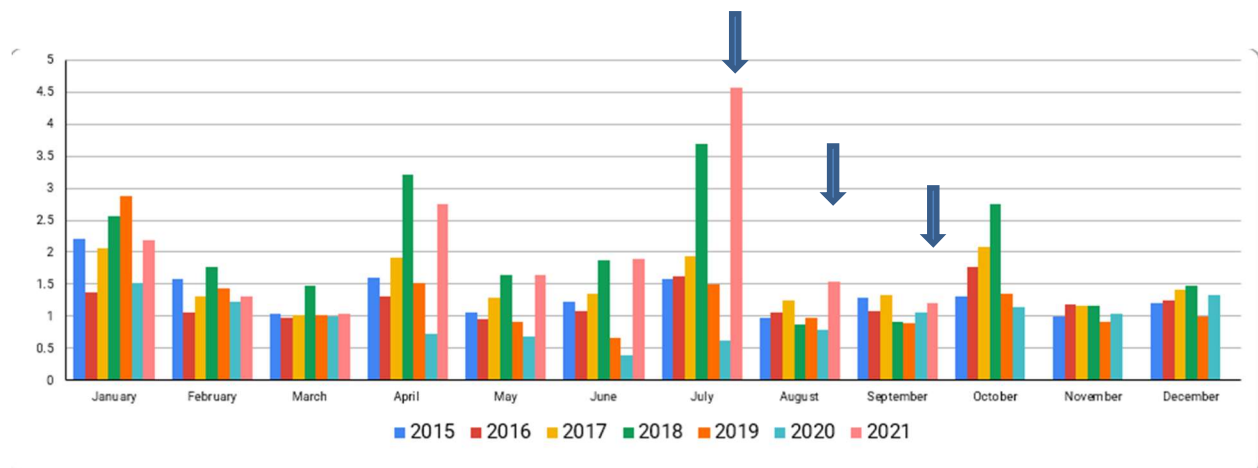


Data source: Congressional Budget Office, 01 Jan 1900 – 31 Dec 2050.

This inflation is causing commodities such as oil, gas, and groceries to move much higher in price. Generally, we would be very cautious in such an inflationary environment. However, because interest rates are still near all-time lows and unlikely to move meaningfully higher in the near-term, corporate earnings are likely to keep moving higher. Over the last decade, many companies have refinanced their debt and created efficiencies which increased margins. Even if the 10-year Treasury were to climb to 2%, the cost of debt does not become overly burdensome to corporations flush with cash. Cash on corporate

books globally is at an all-time high of \$6.84 Trillion according to data from S&P Global. This is 45% higher than the average in the five years before the pandemic and up 2.6% from the previous quarter.

Earnings are still on the rise and showing solid numbers so far. We track the ups and downs of earnings over the previous quarter, and we are still in positive territory, although September was slightly lower than August as this month tends to report a bit more muted earnings annually. The chart just below these earnings number shows how the market, still up in double digits for 2021, has become cheaper based on forward price-to-earnings; not because the market has declined by 20%, but because earnings are expected to continue to increase.



S&P 500 forward price-to-earnings ratio

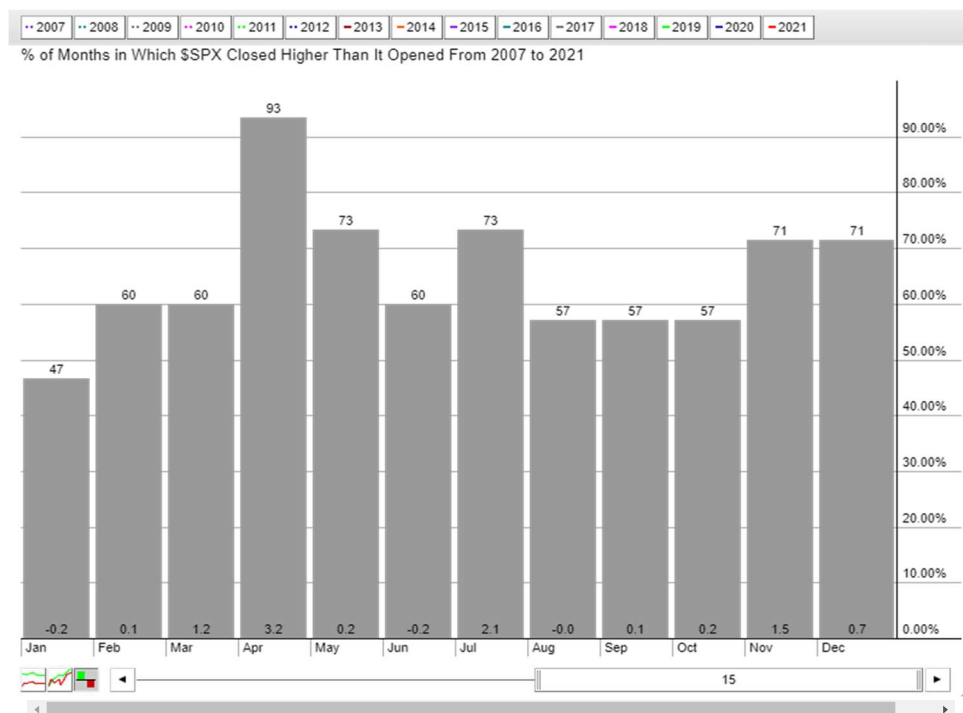
The forward P/E ratio based on next-12-month earnings; August 2020 to July 2021



Data: [FactSet](#); Chart: Axios Visuals

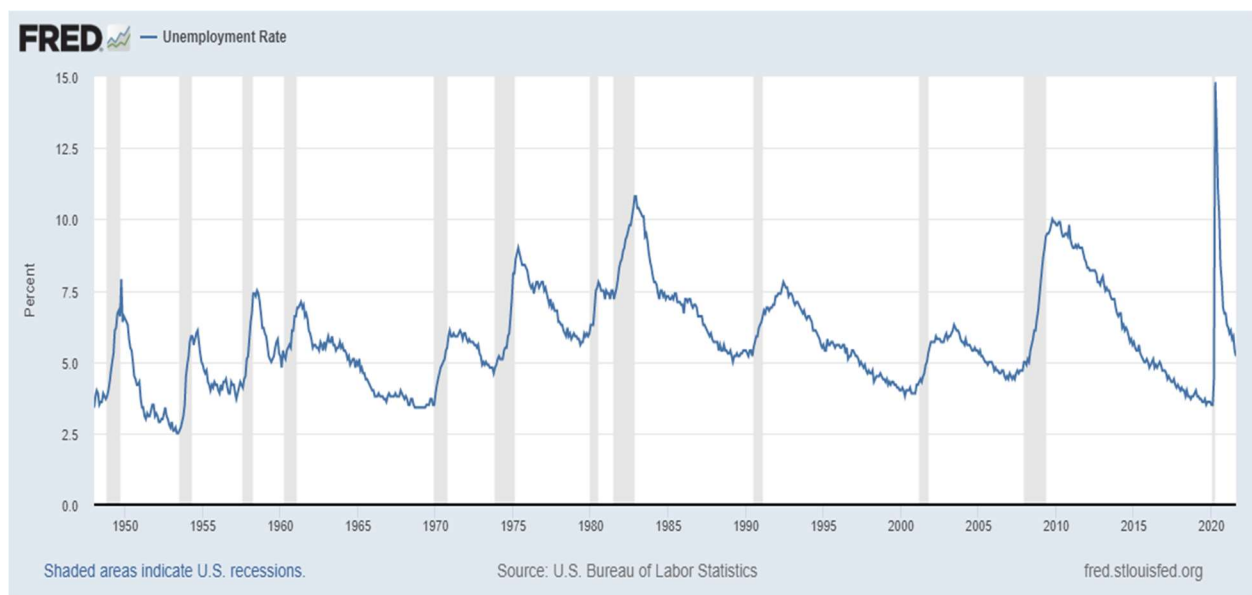
If we think about the inflation conundrum discussed above, there is plenty of pent-up demand for goods and services. Consumers and corporations have record amounts of cash available and continue to place additional orders for products as backlogs and bottlenecks continue to grow. You have probably witnessed this firsthand if you have tried to purchase a car or truck recently. There are nearly finished automobiles sitting idle waiting for computer chips, while dealer inventories are sparse. In response, car and truck prices continue to move higher. What will likely happen is prices will stagnate or even come down as the supply side of the equation is remedied. This supply chain issue is going to take time to work out, but ultimately it will be fixed and will likely drive innovation and efficiency in the global markets.

October is potentially another difficult month as we wrestle with the debt ceiling in Washington and the infrastructure bill is put through the ringer by both sides. It may take well into 2022 to work through getting the economy fully up and running. Shipping and deliveries by FedEx and UPS, as well as the postal service, are still very high as the holiday season gets under way. We think strong consumer demand and healthy balance sheets should help lead to a year-end bounce in the equity markets after digesting a few scares in October.

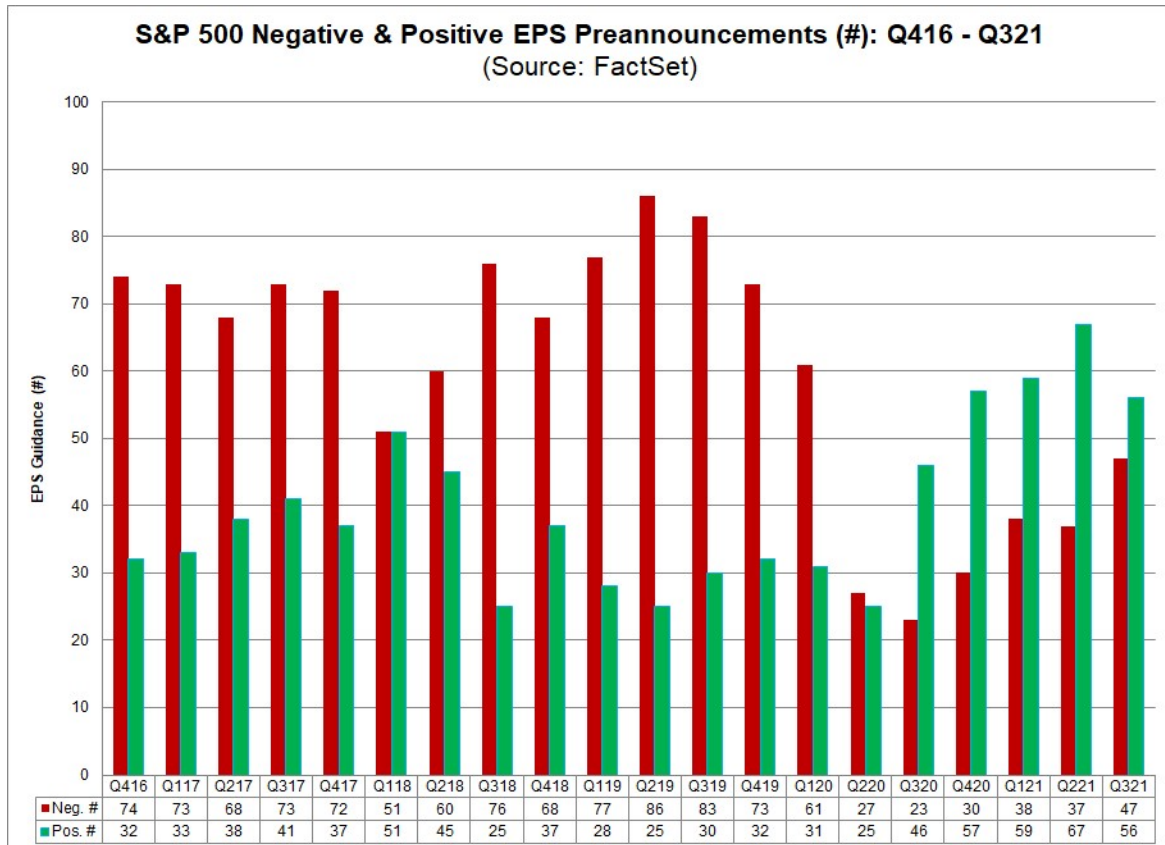


Inflation seems to be the topic du-jour on Wall Street and is scaring many into thinking we are heading into a recession. If we have long-term inflation, that would be cause for concern. If it turns out to be transient as wages and other prices are currently moving higher because of shortages, transfer payments from Washington, and temporary supply issues, then we are unlikely to have recession and

the markets should continue to march higher, albeit at a potentially slower pace. There is too much cash on the sidelines and pent-up demand. The following chart shows the long-term U.S. unemployment rate. We are currently hovering around a 5.2% unemployment rate. Unemployment is trending lower and normally we see a recession around rising unemployment, not the opposite. This is another positive indicator for the stock market. One riddle to be solved in the labor markets is the mismatch between job openings and unemployed workers. While the most recent Bureau of Labor Statistics report shows that there are roughly 8 million unemployed workers in the U.S., they also note that there are a reported 11 million job openings. While some of this may be due to a lag effect as government transfers work through the system, it is also likely that an equilibrium will be found as workers begin to burn through savings and fears over Covid variants subside.



Lastly, as we always say, earnings will drive the market. If we have higher earnings, then the market is likely to move higher. If they begin to stagnate or drop, the market will then adjust accordingly, and unemployment may tick higher. We have seen quite a few positive announcements surrounding earnings the last several quarters and we think earnings are going to continue higher as we get more people back to work and the supply of goods and services gets back to normal. Inflation may temper earnings somewhat in 2022 as margins could compress a bit, but an increase in sales may more than offset any prospects of inflation.



Some things to think about:

1. Interest rates are still very low relative to history.
2. Interest as a percent of Gross Domestic Product is still lower than the 80's and 90's.
3. Cash on hand for consumers and corporations is at an all-time high.
4. Merck and other drug companies continue to advance the fight against Covid.
5. Governments are willing to keep cash flowing freely and appear determined to keep interest rates low. Ten-year German government bonds continue to have negative yields in spite of rising inflation.
6. For better or worse, Washington beauracrats are investors too.

We have some hills to climb, but at some point the innovation of the United States will likely lead the global efforts to correct the supply chain woes and create a better system for purchasing and distribution. Ultimately, this will lead to greater efficiencies and in turn should help keep inflation in check.

Regards,

THE ARCHER TEAM