Investment Update

October, 2021

2021 Third Quarter Update

Review: The S&P 500 return was only slightly positive in Q3, as a modest selloff in September offset most of the gains from July and August. US equities once again outperformed International equities, particularly Emerging Markets, which was impacted by a downturn in Chinese equities. Bond yields rose near the end of the quarter as the market responded to the news that the Federal Reserve would likely begin to taper their asset purchases in November. This erased most of the gains in the Barclays Aggregate Bond Index for the quarter.

Period	3Q21	2Q21	1Q21	2021ytd	2020
S&P 500	0.6%	8.5%	6.2%	15.9%	18.4%
MSCI EAFE[1,2]	-0.4%	5.4%	3.6%	8.8%	8.3%
MSCI Emerging Markets[2]	-8.0%	5.1%	2.3%	-1.0%	18.7%
Barclays U.S. Aggregate Bond	0.1%	1.8%	-3.4%	-1.6%	7.5%
Barclays Municipal Bond	-0.3%	1.4%	-0.4%	0.8%	5.2%

[1] Europe, Australasia, Far East

[2] MSCI returns are in U.S. Dollars

Separating Signal from Noise

Delta variant, debt ceiling, Fed tapering, inflation/deflation/stagflation, supply chain disruptions, Evergrande... These are some of the issues that investors have had to grapple with recently. If there is one constant in investing, it is that there is never a shortage of issues that are up for debate, regardless of where we are in the economic cycle. However, we believe that it is critical to separate near-term noise from underlying trends, as it is these trends that will drive investment returns once the noise dissipates.

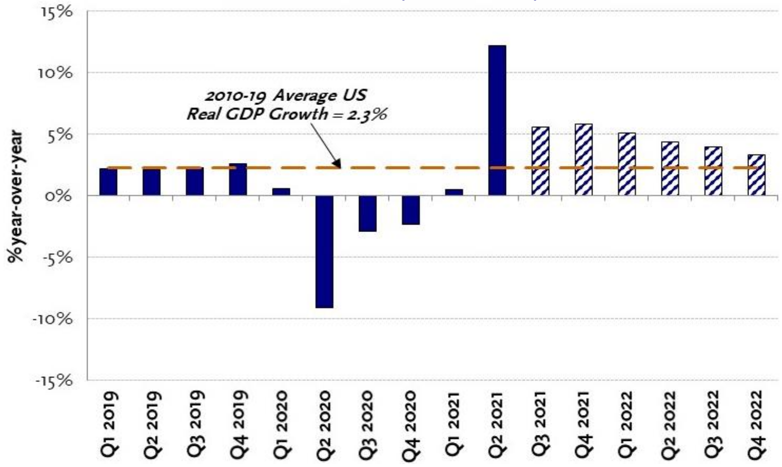
An example of this can be seen by looking at forward estimates for US real GDP growth 2021-22, which is shown on the chart on the next page. The peak growth rate of Q2 2021 received much attention, particularly as the delta variant negatively impacted Q3 growth, but just because growth is expected to decelerate in subsequent quarters, it does not mean that we are nearing the end of an economic (and market) cycle. In fact, if these estimates prove to be accurate, this forecast would be robust compared to the 2010-19 average US growth of 2.3%. Indeed, this economic backdrop coupled with solid earnings growth should be a positive environment for equities. Also, it highlights the importance of stock selection, in that there should be an advantage in owning stocks with secular growth drivers rather than those dependent on a specific economic growth trajectory.

600 Atlantic Avenue
18^tton, MA 02210-2211

Phone: 617-357-5101
Toll-free: 800-357-5101
Fax: 617-357-7199

info@middletonco.com
www.middletonco.com

US Real GDP Growth, %year-over-year, 2019-2022E



Sources: US Bureau of Economic Analysis; Bloomberg for consensus estimates

Outlook: Estimates for Q3 and Q4 US GDP growth have declined over the past few months, primarily due to the recent impact of the delta variant on consumer behavior. That said, as the chart above shows, even these revised estimates still represent healthy growth rates for the US. Additionally, the combination of vaccination-based and infection-based immunity along with a promising therapeutic from Merck—which could receive Emergency Use Authorization very soon—will likely lead to COVID-19 becoming endemic at some point soon, which should be positive for consumer spending.

The outlook for international growth continues to be mixed. This stems partly from lagging vaccination rates in emerging economies, mostly due to vaccine availability. This led to waves of infections in countries such as Malaysia and Vietnam in recent months, which has affected certain supply chains. Additionally, China is faced with a number of headwinds, some fundamental in nature (faster than expected deceleration of economic growth) and some self-inflicted (government overreach into private enterprise leading to volatility in financial markets).

Potential risks to our near-term outlook include:

- Signs that inflation may not be transitory, leading to faster than expected monetary tightening by the Federal Reserve
- Greater than expected economic impact from supply chain disruption in various products and industries

Strategy: The deceleration in economic and earnings growth will likely make stock selection increasingly important in the near term, and broad-based upside to earnings estimates and valuation multiples is unlikely at this point in the market cycle. Therefore, we prefer higher quality companies that can provide sustainable earnings growth not entirely dependent on economic growth. We also continue to favor the risk-reward in equities over fixed income given our outlook for robust economic growth, which will likely result in higher bond yields (lower prices) over the next year.