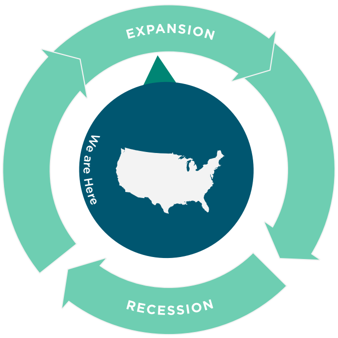
Cycle Watch | November 2021

Supply chains hold down growth



Business Cycle Update

Job gains slowed in September after several months of strong gains. Business surveys continue to show many firms reporting few or no qualified applicants for job openings.

Consumer spending has been solid over the past two months as Delta variant concerns and supply chain problems have had little impact on demand.

Long-term interest rates moved higher as the Fed suggested it is close to announcing tapering of asset purchases and perhaps rate hikes sooner than previously expected.

Volatility in financial markets ticked up on near-term growth concerns but most domestic equity indices are at or near record highs.

Economic Review

EMPLOYMENT | NEGATIVE | POSITIVE

Nonfarm payroll growth slowed again for September, but private payrolls were higher and there were upward revisions to prior months. Lack of workers remains the primary concern for employers.

FINANCIAL | NEGATIVE | POSITIVE

Expectations for rate hikes in 2022 helped send long-term interest rates higher. Broad equity market indices again climbed to record highs on strong earnings data.

CONSUMER | NEGATIVE | POSITIVE

Consumer spending was solid in August and September as Delta variant concerns and supply chain problems have had only a small impact on demand.

BUSINESS | NEGATIVE | POSITIVE

Business surveys showed solid expansion for manufacturing and services despite continued supply shortages, rising prices, and lack of available labor.

INFLATION | LOWER | HIGHER

Higher energy costs helped push up consumer inflation for September with the 12-month trend in both the overall and core CPI measures still high.

Financial Review

EARNINGS | NEGATIVE | POSITIVE

Q3 earnings are better than expected, driving upside to equity prices. Inflation pressure is being absorbed through higher selling prices.

VALUATIONS | NEGATIVE | POSITIVE

Valuations remain well above historic averages, though strong earnings and low interest rates provide justification.

FISCAL/MONETARY BACKDROP | NEGATIVE | POSITIVE

Domestic spending and infrastructure bills are likely to provide stimulus, though taxes a likely headwind. A telegraphed shift in monetary policy has been well received by markets.

CREDIT | NEGATIVE | POSITIVE

Liquidity levels and absorption of new issues remains strong, while credit spreads remain near record lows.

TECHNICALS | NEGATIVE | POSITIVE

After a sluggish September, investor sentiment, momentum and breadth have resumed higher. Record highs for the S&P 500® are a tailwind for markets.

Financial market insight: End of an era?

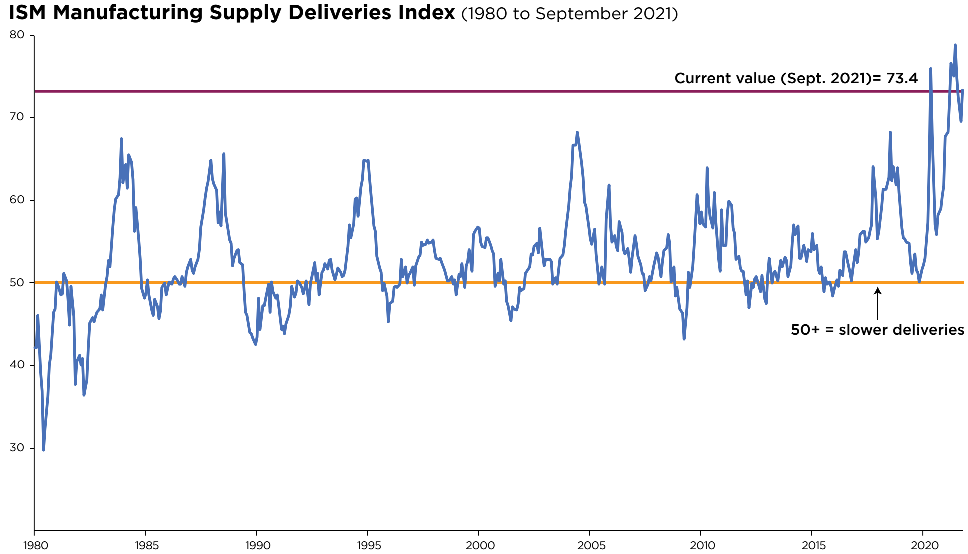
3-year average return for 60/40 portfolio (60% S&P 500® Index/40% Bloomberg U.S. Aggregate Bond Index)

Source for chart data: Morningstar, Nationwide IMG Competitive Intelligence Team

Equity markets performed well in October on solid earnings growth and expanding valuations, with the largest names providing outsized returns. Bonds have benefitted from falling rates and narrowing credit spreads, but these tailwinds may soon change course. Given current valuations and macro-economic challenges, investors may need to moderate their expectations for forward returns. Double-digit returns in a balanced account are not a guarantee. For example, from 2000 through 2010, the average return for the 60% equity/40% bond portfolio was just 3%. After the tremendous run for equities and bonds, a period of more modest returns is not unexpected or unhealthy, but it will likely challenge investors that have become accustomed to consistent double-digit returns.

Economic insight: Little supply chain improvement

ISM Manufacturing Supply Deliveries Index (1980 to September 2021)



Source for chart data: Institute for Supply Management (ISM), Nationwide Economics

Disrupted global supply chains continue to slow supplier deliveries while raising the cost of inputs across many industries. As these primarily Covid-induced impacts have extended into the second half of the 2021, the resulting reduction in production, especially within manufacturing, and higher prices for consumer goods have helped to slow economic activity. Real GDP growth during the third quarter of 2021 was sharply slower as the strong recovery from 2020's downturn has hit some turbulence. Ultimately, supply chains will heal as Covid impacts ebb, but this is likely to occur slowly over the next year. This may mean that faster than average inflation will persist over 2022 and perhaps beyond.

S&P 500® Index: An unmanaged, market capitalization-weighted index of 500 stocks of leading large-cap U.S. companies in leading industries; gives a broad look at the U.S. equities market and those companies' stock price performance.

Bloomberg US Aggregate Bond Index: An unmanaged, market value-weighted index of U.S. dollar-denominated, investment-grade, fixed-rate, taxable debt issues, which includes Treasuries, government-related and corporate securities, mortgage-backed securities (agency fixed-rate and hybrid adjustable-rate mortgage pass-throughs), asset-backed securities and commercial mortgage-backed securities (agency and non-agency).

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