FLIPPIN, BRUCE & PORTER

A BUSINESS OF CANTOR FITZGERALD INVESTMENT ADVISORS

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The third quarter ended in a turbulent manner with broad market indexes retreating from all-time highs reached earlier in the quarter. With a -4.7% return for the month of September, the S&P 500 notched its worst monthly number since the onset of the pandemic in March 2020. The Russell 1000 Value index also declined during the month; in fact, the value benchmark generated its first negative quarter since the first quarter of last year.

Occasionally there is an obvious single reason for market weakness, but more often several factors work together to move the market. The most recent selloff tends to fall into the second category. First, rising interest rates and persistent inflationary pressures certainly contributed. With the Federal Open Market Committee signaling that one of its accommodative policies, the outright purchasing of bonds, is likely to be curtailed in the coming months, the yield on the 10-year US Treasury bond moved from below 1.2% to above 1.5%. Rising rates tend to have an especially negative impact on the segment of the market where valuations are the highest. That is why the technology-heavy Nasdaq Composite lagged other stock market benchmarks recently. Also contributing to market weakness was the rise of the Delta variant of Covid-19. As case levels rose over the summer, there were signs that the reopening of the economy stalled. This is evident in mobility data that showed hotel occupancy rates declining and TSA checkpoint numbers dropping to 25% below 2019 baseline levels in September after reaching 11% below at the end of July. Supply chain disruptions also threatened to derail economic growth, which likely added to the selling pressure on the stock market. Market sectors impacted the most by these factors tended to be more economically sensitive groups like Consumer Discretionary and Industrials. The factors listed above created an environment where market leadership rotated back and forth between growth and value with no clear style bias evident.

While the challenges facing the economy listed above are very real, we believe that above-average economic growth is likely to persist for some time. The Fed has said it is not likely to increase the fed funds rate until 2023, meaning monetary stimulus should remain in place for some time. Corporate earnings continue to surprise to the upside with estimates for S&P 500 earnings in 2021 near $200 per share, 22% above 2019 levels. 2022 also appears to be another year of record profits with estimates topping $220 per share. The unemployment rate has dropped to near 5%, still above pre-pandemic levels, but down sharply from 2020. There appears to be strong pent-up demand by consumers despite the temporary impact to spending related to the Delta variant. Government assistance, including PPP loans, stimulus checks, and enhanced unemployment benefits provided a backstop for the economy. Financially, many Americans find themselves in better shape post-pandemic than had been feared, which is good news for the economy. We expect to see a boost from inventory rebuilding as supply chain bottlenecks clear going forward. And finally, with continuing vaccine uptake and news of more post-infection treatments on the horizon, we are optimistic that the worst of Covid-19 may be behind us.

Our equity market outlook is positive given our views on the economy. Valuation levels for the market, specifically the S&P 500 at around 20 times forward earnings, appear to be somewhat elevated. However, these valuations can be justified given the very low level of interest rates and the very high earnings growth we see today. We also believe that corporations will move to return more cash to shareholders (via dividends and share buybacks) as we move into 2022. Corporate earnings growth has significantly outpaced cash returned, which is understandable given the uncertainty created by the coronavirus. Dividend increases did accelerate in 2021, but the gap in corporate income earned and payouts to shareholders creates the potential for additional boosts in future cash returns.

The total return from your Equity & Dividend Plus strategy outpaced the value benchmark for the quarter. Year-to-date returns remain strong as well, ahead of both the Russell 1000 Value and the S&P 500. We are also pleased to report that cash flow generation for 2021 is ahead of our targets. We have seen more than 35 dividend increases by companies in the portfolio so far this year, and cash flow from option premiums is running at a 2% annual run rate, ahead of our 1.5% target. During the quarter, we added to our holdings of Tyson Foods and ConocoPhillips. Also, we added a new position in Atmos Energy, the largest natural gas-only distribution company in the U.S., operating in 8 states and headquartered in Dallas.

We encourage you to contact us with any questions you may have. For additional firm wide information please visit our website at www.fbpinc.com or call us at 1-800-851-3804. As always, we appreciate your continued interest in our firm.