Hemenway Trust Company LLC

Fall 2021 Investment Report

In Q3 2021, US and European stocks rallied during July and August, but gave back these returns in September and ended the quarter flat. Emerging market stocks saw more volatility (-8.1%) as increased regulatory pressure from the Chinese government hurt major sectors across China/Hong Kong. The price of the 10-year Treasury bond also varied considerably during the quarter, only to end where it began as investors sought safety from rising COVID-19 infections and inflation fears, ending at 1.49%.

Delta Variant, Rising Inflation, Fading Stimulus and Supply Chain Bottlenecks
Throughout much of 2021, the pace of the US economic recovery accelerated as earnings growth (not valuation expansion) rose and was the primary factor for the 16% rise in the S&P through the end of the quarter. However, in September, profit estimates declined for the first time in 15 months. The primary drivers were the COVID-19 Delta variant, rising inflation, and fading stimulus. Consequently, GDP growth for 2022 was revised down (from an elevated 4.4% to 4%) during the quarter, as there was a recognition that there will be a longer lasting drag on virus-sensitive consumer services and recognition that supply chain bottlenecks likely will not improve until the first half of 2022. As we wrote in Q2, the pace of the recovery was the fastest on record, but one downside to the fast recovery is that demand is bouncing back faster than supply, triggering bottlenecks and price pressures. As a result of the supply chain bottlenecks, companies are experiencing slower sales, depressing growth. The positive news is that demand remains strong and these supply chain disruptions are expected to remain temporary; while spending is deferred in the short-term, it fuels longer-term growth.

Furthermore, the short supply of goods and services has led to higher prices, with input and output price indices accelerating at record speed this year. Persistent inflation continues to be a risk for financial markets, however, inflation readings have moderated from earlier this year. The Federal Reserve acknowledges inflation is running above its long-term target, but has maintained its stance that the pressures are transitory. What constitutes "transitory" is a debated question among economists and investors, but the Fed cites an economy that restarted almost as quickly as it stopped, and advises that it will take time for the bottlenecks to resolve. Should higher inflation readings persist and require sooner-than-expected Fed intervention in the form of higher interest rates, economic growth could be disrupted. Investors now expect that the Fed will begin to raise the benchmark interest rate as soon as the middle of next year - a timeline that has been pulled forward in reaction to unfavorable news about inflation, which is running above the Fed's 2% target.

How does this affect our thinking?

We continue to favor companies that have pricing power and can offset rising costs to maintain profitability, as well as those that have solid balance sheets, an essential element of our investment thesis, should borrowing costs increase. In fact, many of the companies we hold are growing their dividends and should be able to withstand rising inflation expectations better than companies that are not earnings positive and have high debt/leverage. We are watching this very closely as extremely low interest rates have supported the rise in value of many assets, most importantly, stocks and real estate.

Even though headwinds to growth have emerged, the economy remains on solid ground. Additionally, equities should be supported by encouraging trends for continued economic growth and profits and at the same time offer better long term return potential versus fixed income. Bonds continue to have a negative real rate of return this year due to rising inflation expectations, which results in a loss of purchasing power. As a result, we continue to favor equities, but due to the economic cross currents, we are taking capital gains on appreciated equities and also balancing portfolios with reserves of cash and stable fixed income, which act as the ballast in your portfolio and are a source of liquidity during periods of unrest or volatility.

With the end of the year quickly approaching, now is a good time to review your long-term investment goals. Please contact your HTC advisor with any questions regarding your account, portfolio changes or trends in the market.

Mark B. Bartram Joins Hemenway Trust Company

Please join us in welcoming Mark B. Bartram, Esq. to Hemenway Trust Company. Mark joins the firm as Deputy General Counsel, Compliance Director and BSA Officer. He oversees and reports on the adherence to the compliance and risk functions of Hemenway Trust Company, in addition to mentoring the trust administration team.

Mark B. Bartram
Deputy General Counsel, Compliance Director and BSA Officer

"This new role is part of our ongoing commitment to providing the highest standards of service to our clients," said Stephen W. Kidder, President and Managing Director. "With his legal background and regulatory expertise, Mark is a valuable addition to our firm."

At the outset of his career, Mark served in the United States Coast Guard and later worked for U.S. Senator James M. Jeffords of Vermont before earning his J.D. at Vermont Law School. He spent eight years as a trusts and estates lawyer working with private clients. Read more about Mark's experience here.