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Q3 2021 NEWSLETTER

JULY 2021

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<u>**With YOUR help**</u>, we raised over $16,000 this year bringing our multi-year total to over $100,000 raised to the <u>**Food Bank of Larimer County**</u>!

ACCELERATION. BRAKING. 1-PEDAL DRIVE.

In March, we got a new car for Stephanie. It was her first new car in 10 years. We decided to go electric (and she decided to go "bold and bright"). She was set on the new Mustang Mach-E. Even while considering the delay times and shortage in computer chips that we've all heard about, our local Ford dealership had two First Editions on the lot when Stephanie went to find out what kind of charging station we would need to install in our house.

Personally, we prefer to accumulate *moments* and *experiences* over *things,* (she'll say she's a striving "minimalist") so a new shiny car is a pretty big deal. After a few months, Stephanie absolutely loves it, while still figuring out all of the nuances (ask her about rolling in neutral at the car wash!). I am sharing this with you today because there is one feature that I believe is a perfect summation of what is happening in the economy right now; it is called "1-Pedal Drive." Basically, it stops a vehicle without the driver touching the brakes; it was designed for use in heavy traffic. When this feature is engaged, you are either accelerating or you are braking. There is no coasting.

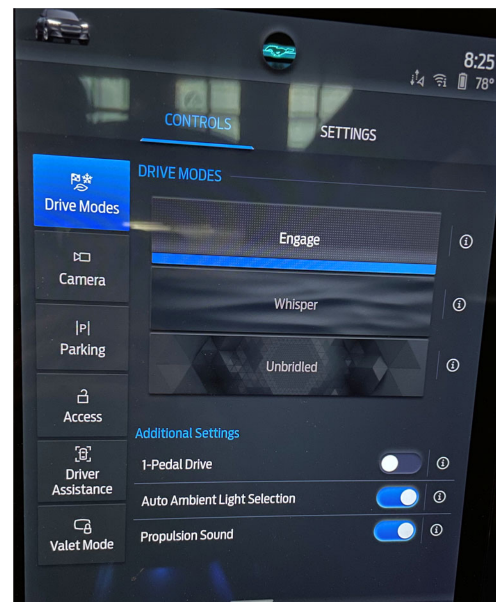
Traffic as an economic indicator? When considering the amount of pent-up demand, or delayed activities, you need not look further than the roads. Even with gas up close to 50% in many areas, traffic is as bad as I can remember it. Whether running to the local grocery store or heading out on summer road trip, the roads are seemingly always jammed. Every part of the economy seems to be expressing this same demand; airline flights, furniture, new car orders, new homes, even getting a dinner reservation can be a struggle right now. Summer is in full swing as we are almost "fully reopened" after the pandemic lockdowns of 2020. On any road these days, the 1-Pedal drive mode has come in quite handy.

ACCELERATION. BRAKING. 1-PEDAL DRIVE. (CONT'D)

The amount of new cash the US government has printed, the quantitative easing measures, even the stimulus checks and new tax credits implemented are all unprecedented in size and scope. The measures taken by so many governments, including ours, in order (hypothetically) to prevent collapse and panic is like "putting the pedal to the medal" on the fastest car in the world and we are all feeling that acceleration. A byproduct of these measures that is starting to appear is the speed at which the US economy is moving through a full business cycle (we may have had experience the shortest recession since 1854 last year). Traditionally, a full business cycle is anywhere from 5 to 8 years. While we have not reached a new peak yet, we may be in the shortest business cycle in history. I suppose the transition from a true multi-month economic lockdown, followed by the largest stimulus package the world has ever seen is an environment that justifiably throws even the best economists into a tailspin. Does it work, and what happens next?

Those questions have the Fed walking a tight rope of targeting lower unemployment and at the same time not allowing inflation to run too hot for too long or letting economy get too hot, too fast. The problem is, there are not many tools that the government has left, and the market is questioning whether or not they can pull this off without falling off. What tools they do have are equivalent to "putting the brakes on" for the economy. And every Economic report, or Fed comment, or piece of data is acting just like a 1-Pedal brake; every day a new headline seems to have the effect of either slamming on the gas or jamming the brakes. There is no coasting. There's not a lot of time to digest. And that is why I expect more volatility for the remainder of this year in the market.

Ultimately, our economy is more like a freight train than it is an electric vehicle with linear acceleration. Stephanie's electric car can accelerate linearly from 0 to 60 in approximately five seconds. Economies don't grow linearly, and they can't grow forever. We need to be cognizant of how to slow it down once it gets going. It would be nice if there was some more time for it to coast.



ON AN IFS PERSONAL NOTE

Thank you for taking the time to read; I hope it gives you clarity on our perspective and our expectations. The details of what transpired in Q2, and our expectations moving forward follow. Until we speak again, I do hope you are out and enjoying a wonderful summer with loved ones and friends, without masks, and enjoying smiles that have been hidden for too long. Stay safe and enjoy the moments…

Sincerely,

Justin

Stocks Hit New Highs as the Pandemic Recedes

The S&P 500 rose to another record high during the second quarter as a substantial decline in U.S. COVID-19 cases combined with a near-total economic reopening across the country led a surge in economic growth that helped stocks rally to new highs over the past three months.

The S&P 500 had a strong start to the second quarter thanks to numerous positive developments. First, the pace of vaccinations in the U.S. accelerated meaningfully in April, with daily vaccinations hitting a peak of more than three million per day by the middle of the month. At the same time, the number of new COVID-19 infections fell from approximately 77,000 daily new cases at the beginning of April to less than 60,000 daily new cases during the last week of the month. The increased pace of vaccinations combined with a decline in COVID-19 cases helped numerous states more fully reopen their economies or prompted the announcement of plans to do so in the near future. That served as a positive signal to investors that a return to pre-pandemic normal was now likely just a matter of time.

Meanwhile, the Federal Reserve reiterated its support for the economy and promised not to remove any accommodation in the near term. That continued "safety net" gave investors confidence in the future economic outlook and the sustainability of the economic recovery. Finally, first-quarter corporate earnings were very strong, as the vast majority of U.S. companies beat earnings estimates. These positive factors helped stocks rally throughout the month, as the S&P 500 hit a new record above 4,200 during the final days of April.

The rally paused in May, however, thanks to uncertainty regarding inflation, the labor market and when the Federal Reserve would begin to reduce, or taper, its quantitative easing (QE) program. A disappointing jobs number in early May implied the labor market might not be recovering as quickly as expected. That, combined with inflation metrics hitting multi-decade highs, elicited some concern the economic recovery might not be as strong as forecasted, and that a return of inflation might make the Federal Reserve begin to reduce accommodation earlier than previously expected. But after some volatility early in the month, it became apparent that the lackluster job growth was more a function of a labor supply issue rather than there not being enough jobs available, and investors came to believe that issue will resolve itself as the economy and society continues to return to pre-pandemic "normal." Meanwhile, Federal Reserve officials reiterated their long-held position that any increase in inflation would be temporary and due to pandemic-related supply chain disruptions and not the return of 1970's style inflation problems. Investors were comforted enough for stocks to rebound in mid-May and close the month with a small gain.

Stocks resumed the rally in early June, as more state economies returned to pre-pandemic normal (most notably California), measures of economic activity remained strong, and certain inflation statistics implied that inflation pressures were starting to ease, possibly validating the Fed's belief that surging inflation is just temporary. The June Fed meeting provided a small surprise to markets, as it revealed that Federal Reserve officials began discussions about when to reduce the current quantitative easing program, while Federal Reserve forecasts showed interest rates could start to rise late in 2022, sooner than previously expected. Those two surprises caused some mild market volatility late in June, although ultimately investors remained confident that the Federal Reserve will not remove economic support too quickly and the S&P 500 hit another record high during the last few days of the quarter.

In sum, the strong gains of the second quarter and the first half of 2021 reflected continued government support for the economy combined with a material improvement in the pandemic in the U.S., and as we start the second half of 2021, we are happy to say the world looks a lot more like it did pre-pandemic than it did for most of 2020, and that sentiment is supportive of risk assets going forward.

2nd Quarter Performance Review

U.S. STOCKS

In a reversal from the first quarter, the Nasdaq outperformed both the S&P 500 and Dow Jones Industrial Average thanks to a June rally in technology shares, as investors began to consider that the intensity of the economic recovery had possibly peaked now that virtually all state economies had fully reopened. Additionally, the Federal Reserve signaling that it has begun discussions to reduce its QE program made some investors nervous that economic growth could slow in the future, contributing to that rotation back towards technology stocks, which tend to be less sensitive to changes in economic growth compared to other market sectors.

By market capitalization, large-cap stocks outperformed small-cap stocks, which was a reversal from the previous two quarters. Small-cap stocks tend to outperform during periods of accelerating economic growth, like we saw in the fourth quarter of 2020 and the first quarter of 2021. But with investors considering that the intensity of the economic recovery may have peaked in the second quarter and that the Fed may reduce QE in the future, they rotated back into large caps as the outlook for future economic growth became slightly less certain.

From an investment-style standpoint, growth handily outperformed value thanks to the aforementioned tech sector rally, as again investors positioned for the possibility that the intensity of the economic recovery may wane in the coming months.

On a sector level, 10 of the 11 S&P 500 sectors realized positive returns in the second quarter with real estate and tech outperforming. The real estate sector was boosted by a decline in mortgage rates combined with consumers returning to malls and shopping centers, while a drop in Treasury bond yields helped fuel the rotation back to tech stocks.

Sector laggards last quarter included consumer staples and utilities as the former registered a small gain while the latter was the only S&P 500 sector to finish negative for the quarter. Those traditionally defensive sectors outperform when investors expect an outright economic slowdown, and while some investors believe the acceleration in the economic recovery may have peaked, most analysts are expecting the economic recovery to continue, just at a moderating pace, making defensive sectors such as utilities and consumer staples less attractive.

Source: YCharts

US Equity Indexes	Q2 Return	YTD
S&P 500	8.95%	15.25%
DJ Industrial Average	4.81%	13.79%
NASDAQ 100	13.07%	13.34%
S&P MidCap 400	3.57%	17.38%
Russell 2000	5.47%	17.54%

INTERNATIONAL MARKETS

Internationally, foreign markets saw positive returns in the second quarter thanks to further declines in COVID-19 cases, rising vaccination rates, and more widespread economic reopenings across the EU and UK. Emerging markets also rallied in the second quarter on hopes of a global economic recovery, although they slightly underperformed foreign developed markets as the Chinese government reduced support for its economy following a large increase in inflation indicators. Foreign developed markets again lagged the S&P 500.

Source: YCharts

International Equity Indexes	Q2 Return	YTD
MSCI EAFE TR USD (Foreign Developed)	5.03%	9.17%
MSCI EM TR USD (Emerging Markets)	4.88%	7.58%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	5.38%	9.45%

COMMODITIES

Commodities posted strong gains for the third quarter in a row and once again outperformed the S&P 500 over the past three months. Major commodity indices were led higher by another large rally in crude oil futures as demand rose for both oil and refined products following the U.S. and European economic reopenings. Additionally, despite the resumption of nuclear negotiations between the U.S. and Iran, sanctions remained in place preventing Iran from selling oil on the global market while compliance to self-imposed production targets by members of "OPEC+" remained historically high, keeping global oil supplies subdued. Gold, meanwhile, posted a small gain as investors rotated back to gold following a spike in inflation metrics, combined with an increase in volatility in Bitcoin, which sent money back into more traditional non-correlated, safe-haven assets.

Source: YCharts

Commodity Indexes	Q2 Return	YTD
S&P GSCI (Broad-Based Commodities)	15.34%	31.40%
WTI Crude Oil	27.29%	51.53%
Gold Price	3.41%	-6.74%

FIXED INCOME

Switching to fixed income markets, second quarter total returns for most bond classes were positive, a reversal from the first quarter. Despite inflation indicators surging to multi-year highs in recent months, investors viewed those increases as temporary phenomena related to the global economic reopening and short-term supply chain issues. As such, investors took advantage of relatively higher bond yields in the second quarter.

Looking deeper into the bond markets, longer-duration bonds outperformed those with shorter durations in the first quarter. That substantial outperformance was driven by the market's view that the increase in inflation was indeed temporary, combined with effective messaging by the Fed that interest rates would remain near 0% for the foreseeable future.

In the corporate debt markets, investment grade bonds solidly outperformed lower-quality, higher-yielding bonds. That investment grade outperformance reflects confidence in the sustainability of the U.S. economic recovery but also acknowledges that the pace of economic growth may moderate in the coming months.

US Bond Indexes	Q2 Return	YTD
BBgBarc US Agg Bond	1.82%	-1.60%
BBgBarc US T-Bill 1-3 Mon	0.00%	0.02%
ICE US T-Bond 7-10 Year	2.50%	-3.30%
BBgBarc US MBS (Mortgage-backed)	0.36%	-0.77%
BBgBarc Municipal	1.40%	1.06%
BBgBarc US Corporate Invest Grade	3.70%	-1.27%
BBgBarc US Corporate High Yield	2.96%	3.62%

Source: YCharts

Q3 Preview

Markets reflected a legitimate improvement in the macroeconomic outlook during the second quarter as substantial progress against the pandemic helped underwrite the gains in stocks over the past three months. But that strong performance should not be taken as a signal that risks no longer remain, and in fact the next three months will bring important clarity on several unknowns including inflation, future Federal Reserve policy, and the pandemic.

Regarding inflation, some metrics in June implied that the spike in inflation during the second quarter is starting to reverse, but that debate is far from settled. To that point, no one knows what the trillions in pandemic stimulus combined with 0% interest rates and the Fed's ongoing QE program will do to inflation over the longer term. If this sudden surge in inflation is indeed just temporary, we should see more conclusive evidence of that during the third quarter.

The Federal Reserve, meanwhile, has started the process of communicating how it will begin to reduce support for the economy via "tapering" or reducing, its quantitative easing program. The last time the Fed had to deliver that message, they triggered the "Taper Tantrum" of 2013, which saw stock and bond market volatility rise significantly; and it remains to be seen how expected removal of accommodation and an eventual increase in interest rates will impact markets.

Finally, despite significant progress against COVID-19 here in the U.S., the pandemic is not over. Vaccination rates for most countries are well behind that of the United States, and the second quarter saw an explosion of COVID-19 cases in India, and an outbreak in China. Meanwhile, England delayed its planned economic reopening over concerns about the spread of the "Delta" COVID-19 variant that was behind the surge in cases in India. Then, late in the month, both Australia and South Africa reimplemented local lockdowns due to rising cases of the Delta variant. Point being, there remains a possibility that a new COVID-19 variant appears and renders the vaccines less effective. If that happens, markets will become concerned that progress towards a return to economic "normal" will be reversed, and that will cause volatility.

Impact Financial Strategies

3711 JFK Pkwy, Suite 340 | Fort Collins, CO 80525 | T 970.829.1240

Justin G Davis, MBA, CFP® | Deborah Lacey, CPA, CFP®, MST

Keysha Estabrook | Stephanie Davis

INVESTING IS A MARATHON, NOT A SPRINT

In sum, while there has been material progress made in the United States against the pandemic, and life as we know it has thankfully returned mostly to normal, now is not a time to become complacent as numerous economic and pandemic-related risks remain. As such, while the macroeconomic outlook is still decidedly positive, we should all remain prepared for bouts of market volatility.

Yet while risks remain to the markets and the economy, as they always do, it is important to remember that a well-executed and diversified, long-term-focused financial plan can overcome bouts of even intense volatility, like we have seen over the last 18 months.

At Impact Financial Strategies, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this still-challenging investment environment. Successful investing is a marathon, not a sprint, and even temporary bouts of volatility like we experienced during the height of the pandemic are unlikely to alter a diversified approach set up to meet your long-term investment goals. All of this is powered by The IFS Way.

Therefore, it's critical for you to stay invested, remain patient, and stick to the plan, as we've worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

The economic and medical progress achieved so far in 2021 notwithstanding, we remain vigilant towards risks to portfolios and the economy, and we thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

Justin, Deborah, Keysha, and Stephanie

Justin G. Davis, MBA, CFP®
Founder/CEO & Managing Director,
Impact Financial Strategies
3711 JFK Parkway, Ste 340 | Fort Collins, CO 80525
970.829.1240 office | 800.630.2799 toll-free
970.829.0350 fax
Justin.Davis@ImpactFinancialStrategies.com

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"HELPING YOU HAVE THE CLARITY AND CONFIDENCE TO RETIRE AND LIVE YOUR IDEAL LIFE IS ***WHAT WE DO***...INSPIRING YOU TO CREATE MOMENTS OF IMPACT FOR YOUR FAMILY AND YOUR COMMUNITY IS ***WHO WE ARE***."
~Impact Financial Strategies ~

A GAME OF MULTIPLES

A Game of Multiples (Updated 7/6/2021)			
Market Influence	**Current Situation**	**Things Get Better If...**	**Things Get Worse If...**
Fed Tapering Timeline	Tapering announcement in August/September, with tapering of $15 billion month beginning in December or later.	The Fed signals it will taper QE starting in 2022, slightly delayed from the current expectation.	Markets begin to expect the Fed to taper QE in November or price in a larger than $15 billion monthly reduction.
U.S. Labor Market	Weekly jobless claims have fallen to the lowest levels of the pandemic and job numbers are moving higher as benefits expire. But it's not where the Fed wants it to be yet.	We get a series of strong jobs report that brings the labor market close to pre-pandemic normal.	There is another dismal job growth number while wages increase due to low labor supply, stoking inflation fears.
Inflation Expectations	Inflation statistics are showing some signs of leveling off. For now, the Fed is adamant about it being "temporary" and there's no convincing evidence they are wrong.	Inflation increases stay temporary, and we do not see longer-term inflation expectations rising above 3.0%.	Inflation expectations continue to rise, breaching 3% for longer-term expectations and challenging the idea that rising inflation is temporary.
10-Year Treasury Yield	The 10-year yield has stopped rising and is currently chopping sideways broadly between 1.35%-1.70%.	Treasury yields do not restart the Feb/March rally and stay below the 2021 high of 1.74%.	Treasury yields accelerate and move to new highs above 1.74% in the next few months.
Expected 2022 S&P 500 EPS	$215	$225	$200
Multiple	19.5X-20X	20X	17X-18X
S&P 500 Range	4192-4300	4500	3400-3600
S&P 500 Target (Midpoint)	4246	4500	3500
Change from today	-2.0%	4.0%	-19%

DISCLAIMERS

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The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market. The Dow Jones Industrial Average (DJIA), commonly known as "The Dow" is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal. The NASDAQ Composite Index is an unmanaged index of securities traded on the NASDAQ system. The S&P MidCap 400® provides investors with a benchmark for mid-sized companies. The index, which is distinct from the large-cap S&P 500, measures the performance of mid-sized companies, reflecting the distinctive risk and return characteristics of this market segment. Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index.

The S&P GSCI is a composite index of commodities that measures the performance of the commodity market. S&P GSCI Gold is an index tracking changes in the spot price for gold bullion. S&P GSCI Crude Oil is an index tracking changes in the spot price for crude oil. GLD is a gold index fund based on gold and holds gold and/or cash as its only assets, but shareholders are not guaranteed to receive physical gold in exchange for their shares.

The MSCI EAFE (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 22 developed nations.

The MSCI Emerging Markets is designed to measure equity market performance in 25 emerging market indices. The index's three largest industries are materials, energy, and banks.

The MSCI ACWI (All Country World Index) is a free floating-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets.

The Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed rate taxable bond market.

The Barclays US T-Bill index measures the performance of public obligations of the U.S. Treasury that have a remaining maturity of greater than
or equal to 1 month and less than 3 months.

The ICE U.S. Treasury 7-10 Year Bond Index is market value weighted and is designed to include U.S. dollar denominated, fixed rate securities with minimum term to maturity greater than or equal to seven years and less than ten years. Barclays Capital U.S. MBS Index measures the performance of investment grade fixed-rate mortgage-backed pass-through securities of GNMA, FNMA, and FHLMC.

The Barclays Capital Municipal Bond is an unmanaged index of all investment grade municipal securities with at least 1 year to maturity. The Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

END OF NEWSLETTER