EAGLE RIDGE
INVESTMENT MANAGEMENT, LLC

Investment Commentary

September 30, 2021

HIGHLIGHTS

- Even though growth has been slower than expected this Fall, the economy is still recovering from last year's contraction as the country has recouped over 580,000 jobs per month this year.
- China is now the world's second largest economy, and its policies will have global repercussions. We have tried to insulate our portfolios (both equity and fixed income) from the effects of contagion as much as possible since we have recognized the fragility of the foundation of the country's economy.
- We are pleased to announce the addition of a new team member during the quarter. Alex Velazquez, CFP®, joined Eagle Ridge in August as a Financial Planner.

Ripple Effects of Interest Rate Increases

The stock market rallied consistently this year until the past month when the S&P 500 fell 5% due to several concerns. The Delta variant of COVID has slowed the economic rebound down due to less demand and persistent problems in supply chains. China also indicated that it would not financially support Evergrande, a financially unstable real estate development company, and the markets were spooked by fears of financial contagion. Finally, the Federal Reserve signaled that it would begin tapering its bond purchases as soon as November.

Many economists predicted that the US economy would grow close to 10% in the second half of the year as an increasingly vaccinated public resumed eating out, congregating for entertainment and traveling. However, the Delta variant is more than twice as contagious as the Alpha variant of COVID-19, which swept over the world last year. Slower rates of "returning to normal" have impacted the real economy leading many forecasters to reduce their third quarter growth estimates. For example, JP Morgan recently revised their estimate down to 4% from 5%.

Supply chains throughout the world are still a mess. For instance, Nike reported recently that factory closures in Vietnam will limit sneaker and apparel production. The COVID disruptions in the developing world are more drastic than those here and in Europe since far less of its populations are vaccinated. For instance, Reuters estimates that only 21% of Vietnam's population is vaccinated. Low inventory levels, combined with intricate supply chains has produced a fragile manufacturing rebound. We expect this situation to improve but have been surprised by the lingering problems in these networks.

Even though growth has been slower than expected this Fall, the economy is still recovering from last year's contraction as the country has recouped over 580,000 jobs per month this year. In its last meeting, the Federal Reserve (Fed) indicated that it may begin tapering its quantitative easing program starting in November. This adjustment makes sense since the bond purchasing program has been used to maintain very low interest rates to stimulate the economy. Too much stimulus has led to inflation which the Fed realizes needs to be addressed.

Interest rates for both shorter and longer term bonds have increased over the past few weeks. The benchmark 10-year Treasury interest yields increased from roughly 1.3% to 1.5% and the 2-year Note increased more on a percentage basis from 0.2% to 0.3%. Since stock valuations have risen, any change in rates will have a large impact on stock prices and that is what we have seen recently.

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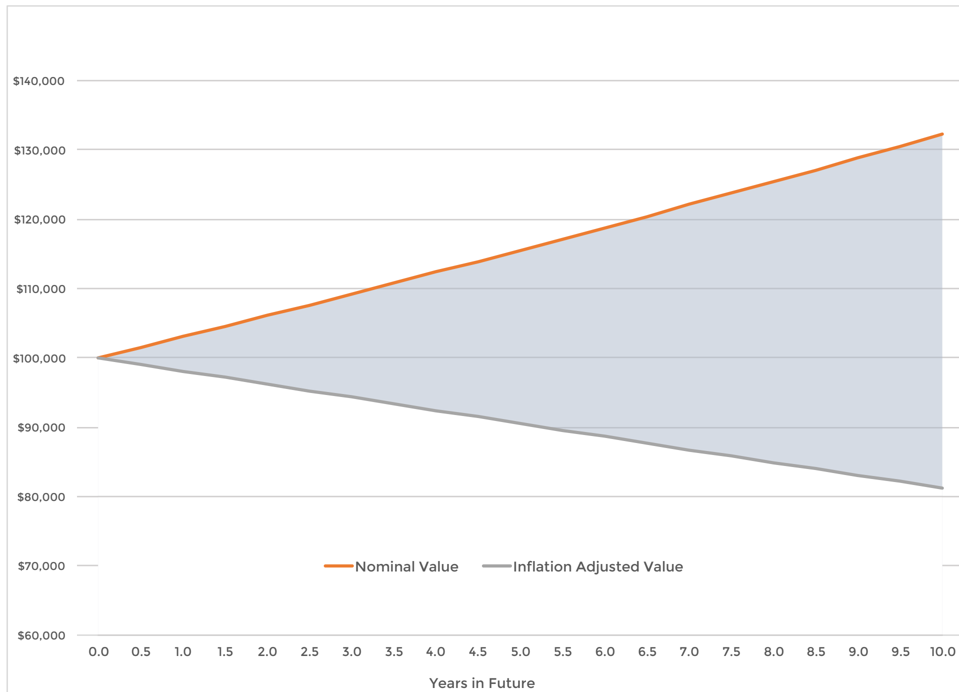
Ripple Effects of Interest Rate Increases continued

Regardless of these recent changes, interest rates are extremely low. With a nominal yield of 1.5% on the 10-year Treasury, an investor buying this Note should expect to lose 0.5% per year of buying power if inflation reverts to the Fed's target of 2%. However, if inflation remains at its current level of 4-5%, that same investor would lose 2.5-3.5% every year lending money to the US Treasury. Assuming this experience persisted over a full 10-year period, that investor would lose about 20% of their investment in real terms.

The above commentary is a long-winded way of saying that bonds are not attractive investments to achieve long-term returns. The math gets much more complicated for determining stock returns since there are so many unknown variables. However, while stocks are still better long-term investments than bonds, they are much riskier. As seen over the past few weeks, small changes in rates can lead to large changes in stock prices, especially for aggressive growth companies.

$100, 000 Investment in 1.5% 10 Yr Treasury with 5% Inflation Rate

Nominal Re-Investment Value vs. Inflation Adjusted Value



Unease in China

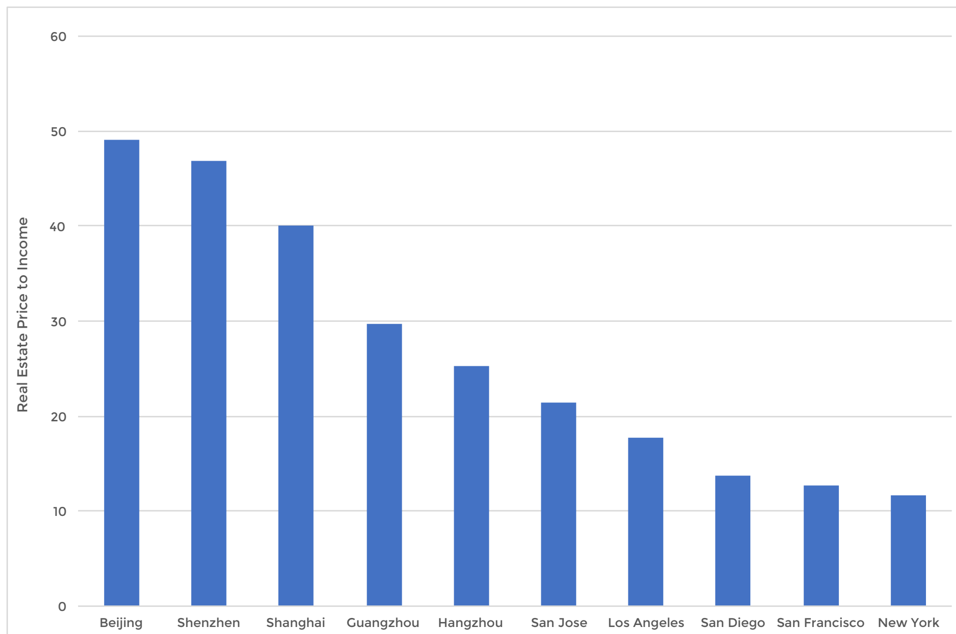
One of the contributors to market unease recently has been news that China will not support the debts of Evergrande, a large real estate development company. The company owns over 1,300 real estate projects in 280 cities throughout China. Evergrande has $300 billion in liabilities and faces imminent bankruptcy. Commentators have referred to this potential default as China's "Lehman Moment" since there is the fear that losses could spread throughout China's financial system and cause a panic similar to the one we experienced in 2008.

Unease in China continued

Like conditions preceding the Great Financial Crisis, China has an extremely inflated real estate market. In Beijing, the average home/apartment is worth about 50 times the median salary in that city. By comparison, in New York City, a notoriously expensive real estate market, the similar ratio is only 12 times. Evergrande rode this real estate boom by taking on increasing debts to acquire properties which they expected to sell at ever higher prices. As the real estate market in China stagnates, Evergrande has been unable to pay its liabilities.

It is impossible to determine the spillover impacts if Evergrande were to default. While US and European banks are less than transparent, financial reporting in China is poor. While the government could support the debt, it has indicated it would not protect the company from bankruptcy.

Most Expensive Cities in China and the United States



The Evergrande crisis is one of many threats to the financial markets in China that have arisen this year. Others include the following:

- **Jack Ma's Disappearance:** Alibaba's founder, Jack Ma, criticized the Chinese financial system in a speech in late October of 2020. Ma then disappeared until late January of 2021 as rumors swirled that he was killed or detained. The flamboyant Ma has kept a low profile since his reappearance.
- **Banning Online Tutoring:** In July of this year, China banned for-profit tutoring and caused huge losses in a $120 billion/year business. The government's goal was to restore work life balance in households and ease the pressure that families feel to prepare their children for competitive schooling and careers.
- **Computer Game Dictates:** In late August, China outlawed computer gaming by children under 18 from Monday to Thursday and only allowed 3 hours of gaming per week. The goals from this order were to reduce addiction to computer games and to encourage health in children.

The above events have combined to cause significant losses in China's stock market. Since its peak in February, the iShares MSCI China ETF has lost 1/3 of its value and is down 9% for the year. For comparison, the S&P 500 is only down 6% from its peak and up over 14% year-to-date.

Unease in China continued

China's harsh policy dictates need to be understood in the light of the Communist Party's priorities. Social cohesion and control of the population are the most important governing priorities. Economic development is much further down the list. All the above actions are the government's attempts to reassert the country's social order in a direction that aligns with its worldview.

Hopefully, for its people, the above polices are not the beginning of another Cultural Revolution. Mao Zedong launched the Cultural Revolution in 1966 to purge the society of capitalist elements that he believed were trying to infiltrate the country. Intellectuals and capitalists were sent to re-education camps in China's countryside to experience the People's work. The experiment led to a decade of economic decline and resulted in mass starvation and human suffering.

China is now the world's second largest economy, and its policies will have global repercussions. We have tried to insulate our portfolios (both equity and fixed income) from the effects of contagion as much as possible since we have recognized the fragility of the foundation of the country's economy. The current policies' impacts may be limited but is impossible to predict if future moves are more destabilizing.

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Keep It or Shred It?

Guidelines for Eliminating Paper Clutter

Being at home more has led many of us to realize that we're keeping a lot of papers that perhaps can be tossed or shredded. Below is a general guideline on what to keep and what to shred. Let's start with the presumption that you own a decent cross-cut shredder as well as a fire-proof, water-proof safe box. If you have a bank safety deposit box, that's OK for jewelry and such, but this home-based box will be accessible to you and your heirs 24/7 in case of emergency.

Keep in mind that many of the guidelines for keeping paper documents depend on their use. For example, you normally keep utility bills for a year. However, if you've taken a home office deduction that includes part of your utility bill, you need to hold onto those bills for 3 years, or the time in which the IRS may challenge it.

Generally, you'll want to hold onto the following documents forever:

- Birth Certificates
- Death Certificates
- Marriage Licenses
- Divorce Decrees
- Adoption Records
- Wills
- Trust Documents
- Estate Planning Documents

Keep It or Shred It? continued

Also consider keeping major loan payoff letters so that there's a clear record in the event of identity theft. Tell a trusted person who doesn't live with you where to locate these records. If they're in a bank vault, make sure that someone other than you is allowed access.

Documents you want to hold onto while still relevant to your life:

Insurance Policy Documents for your home and auto. If you have expensive big-ticket items such as jewelry, paintings or antiques, along with the purchase receipts, consider snapping a photo of them or videoing them in your residence; Property Records, Pension and Retirement Plan Records; Stock certificates, especially for non-publicly-traded stock; Home Improvement Records to be used to add cost basis to your home; Contracts that are still in-force;

Documents you want to keep for three (3) years:

Your tax returns (with a few exceptions we'll explain below) along with supporting documentation; Records of selling a house; Records of stock sales reported on your tax return; Anything that provides documentation of income or deduction on your tax return from up to 3 years ago; sales receipts for items that have 3-year warranties.

Note that the IRS suggests saving records of filings for 3 years EXCEPT for employment tax records (4 years), substantially under-reported income (6 years), or when there may be potential fraud (forever).

Documents to keep for 1 year:

Pay stubs and social security statements (once you get your W-2 or annual statement you can shred these); utility bills (except if you take a deduction for part of them as a business expense); credit card statements (except if there are business-related expenses on them); bank statements, canceled paper checks, and brokerage statements.

Note that a lot of these documents are now available online, and you can easily download monthly statements and save them in a pdf file. Returned canceled checks are rare these days, but photocopies of them are also available online. Another note is that if you are looking for mortgage financing or refinancing, many lenders want at least two years of bank documents.

Documents you can shred:

If you still get those pesky ATM withdrawal slips, shred them once you see the debit on your account. The same goes for charge slips from the supermarket or gas station...once you see the charge correctly posted on your credit card account, shred them.

Trying to go fully electronic with your bills and statements will eliminate most of these papers entirely. Even your insurance documents can be safely downloaded to your computer and printed out if needed.

With the winter coming up, clearing out old papers and storing others in a fireproof, waterproof box at home can be a great rainy-day project!

Alex Velazquez joins Eagle Ridge

We are pleased to announce the addition of a new team member during the quarter. Alex Velazquez, CFP®, joined Eagle Ridge in August as a Financial Planner. He brings a focus on comprehensive planning and experience in risk management to all Eagle Ridge clients.

Alex adds depth and capacity to our financial planning capabilities and will help our clients better understand their financial circumstances.

Prior to joining Eagle Ridge, Alex was a Director of Financial Planning Services at Northwestern Mutual. Previously, he was a Client Service Associate with Raymond James – Wright & Associates, LLC. Alex received his B.S. degree in Political Science from SUNY College at Oneonta.

About Eagle Ridge

Eagle Ridge Investment Management is an independently owned, SEC-registered investment advisory firm. Our goal is to provide superior investment performance and a high level of service to a select group of clients, unencumbered by the need to sell products or meet corporate goals. We strive to help our clients meet their needs and compound their wealth through a disciplined investment process.

For more information, please contact Alie Hamilton at **a.hamilton@eagleridgeinvestment.com** or **203-227-4515**.