INVESTMENT TRUST COMPANY

QUARTERLY REVIEW 3Q21

GRADUALLY, THEN SUDDENLY

"How did you go bankrupt?"
"Two ways. Gradually, then suddenly."

So goes the line from Ernest Hemingway's *The Sun Also Rises*. Politicians likely share a similar sentiment as to how quickly they've been confronted by the debt ceiling, which must be raised to prevent a U.S. government technical default. A deal is expected, but concern remains that ongoing government fiscal deterioration will follow Hemingway's prose; that government debt will *gradually* rise until it *suddenly* becomes a big problem. For those alarmed at current debt levels, know that debt to U.S. net worth has actually fallen over the past decade and — thanks to low interest rates — the cost to service the national debt is far below that of the 1980s.

For Whom the Bill Polls. While current national debt levels may not be of immediate concern, many still fear excessive government spending is. Progressive law-makers are pressing those buttons, pushing $5 trillion worth of infrastructure and social spending bills. But even if passed, the bills do not increase debt levels as one may think (pay-fors and a 10-year-plus timeline mute their impact). How the bills impact the 2022 midterm results may be more consequential. Progressives believe passage will help 2022 reelection bids while moderates fear excessive spending will return the legislative branch to Republican hands. This political outcome may have a bigger market impact than the spending bills themselves.

A Farewell to Cars? This play on words of another Hemingway classic cuts two ways. Near-term inflation is being pressured by supply chain disruptions, with cars in the crosshairs. A lack of parts (notably semiconductors) have led to sparse dealer lots, pushing new and used car prices higher. Eventually, however, we may not need as many cars given autonomous driving and more ride sharing. These technological advancements are coming quicker than ever anticipated, exerting deflationary forces.

Old Man and the QE. Forgive us (Federal Reserve Chair Jerome Powell is still a sprightly 68), but it was too good to pass up. And Powell has certainly shown the wisdom of age as he navigates the messaging around the end to pandemic quantitative easing (QE) and the path to future Fed actions. He has convincingly maintained a message that inflation is transitory and that the end of QE does not mean the start of rate hikes. Indeed, investors remain mostly satisfied with his handling of monetary policy.

Suddenly, then gradually. The economy may actually be better described by the inverse of this report's title. The pandemic *suddenly* changed the global economy, which is *gradually* returning to equilibrium. For investors, *gradual* is less a construct of time and more a construct of progress. Investors (and central bankers) simply want to see a path to normalcy and a steady reduction in price gains back toward the 2% target. So long as the economy shows signs of *gradually* recalibrating supply and demand, financial markets may *suddenly* regain momentum.

THIRD QUARTER 2021 TOTAL RETURNS (%)

After a torrid first half of the year, financial markets cooled down in Q3; emerging market equities were especially hit.

	RISK CONTROL			RISK ASSETS								
	FIXED INCOME						EQUITIES			REAL ASSETS		
	Cash	Muni	Inv. Grade	TIPS	High Yield	EM Debt	U.S.	Dev. Ex-U.S.	EM	NR	GRE	GLI
Q3	0.0	-0.3	0.1	1.8	0.9	-3.1	0.0	-0.4	-7.3	-2.7	-0.8	1.5
YTD	0.0	0.8	-1.6	3.5	4.5	-6.4	15.3	9.9	1.0	16.7	13.3	7.0

NR: Natural Resources; GRE: Global Real Estate; GLI: Global Listed Infrastructure. Indexes are gross of fees.

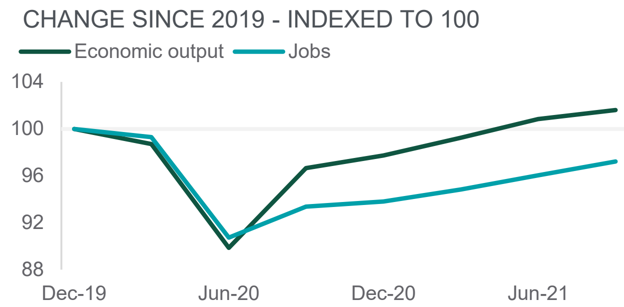
Denver 303.778.6800 | Colorado Springs 719.632.4677 | info@investmenttrust.com

KEY DEVELOPMENTS

Rising Productivity

A big reason to believe that currently elevated inflation is a transitory issue is the productivity we are witnessing across the global economy and in earnings reports. We offer two data points to support our productivity point. First, U.S. economic output, in real terms (removing inflation effects), has surpassed pre-pandemic levels; it achieved this with over six million (4%) fewer workers. Second, S&P 500 revenues grew 25% year-over-year last quarter. Impressive. But, thanks in large part to higher margins, earnings growth has been over 90%.

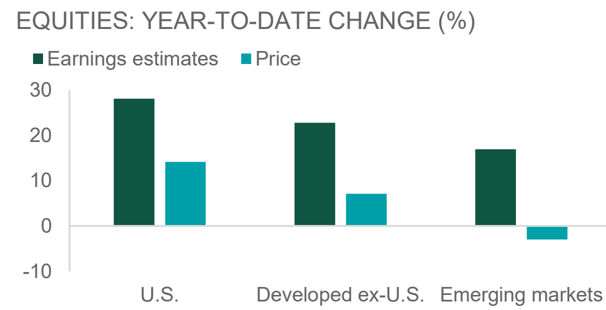
ECONOMIC OUTPUT VS. JOBS GROWTH



Falling Valuations

Given strong equity markets year-to-date — especially U.S. equities, where markets are up over 15% — one could be forgiven for thinking valuations have moved higher this year. In fact, valuations (based on price-to-forward earnings) have actually fallen — as earnings revisions have moved higher at a faster pace than prices. This is true in major markets globally. Reasonable minds can view valuations as rich; but, if investors were able to swallow beginning-of-year valuations, surely they can still do so today.

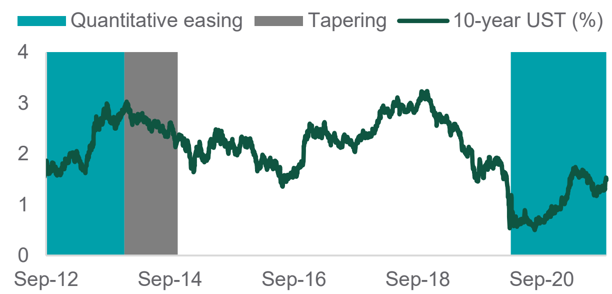
PRICES VS. EARNINGS



Decreasing Monetary Policy Uncertainty

One thing that has become clearer over the past quarter is the path the Federal Reserve intends to take with its monetary policy. Fed Chair Powell has done a masterful job communicating his view on both the end of the fourth installment of quantitative easing (tapering beginning in November and wrapped up by mid-2022) and the expected start to rate hikes (not likely until 2023). Interestingly, past tapers (including the most recent one, see chart) have counter-intuitively led to lower — not higher — longer-term interest rates.

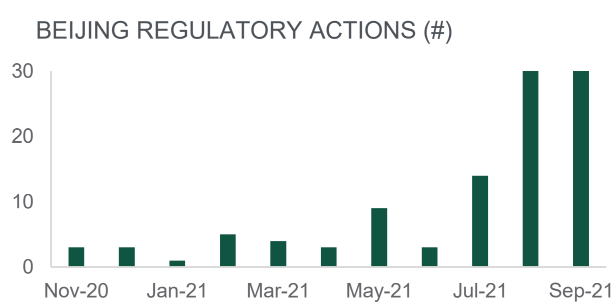
THE LAST FED TAPER



Increasing China Regulatory Scrutiny

China has added a new act to the regulatory crackdowns they have selectively implemented over the past few years. After laying low for much of the past year, the Chinese government has ramped up its regulatory crackdown across several industries (see chart). This has investors rightly concerned. With real estate developer Evergrande's financial distress, regulatory concerns are coming to a head. Bull case: China halts regulatory crackdown to stabilize markets. Bear case: China does even more to prevent excesses.

CHINA'S REGULATORY CRACKDOWN



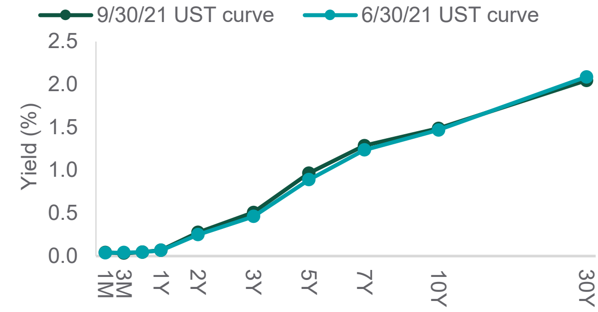
Productivity estimated for 9/30/2021. Data as of 9/30/2021.

MARKET REVIEW

Interest Rates

A multi-month Treasury rally brought the 10-year Treasury yield to its lowest level since early 2021. Lower rates reflected strong technicals and to a lesser extent concern on slowing economic growth. The battle was not over as Treasuries gave up those gains in the days following the Federal Reserve's signal that taper time is imminent. Investors bought into central bank confidence in the economic recovery alongside waning COVID-19 headwinds, supporting slightly higher Treasury yields heading into the fourth quarter of 2021.

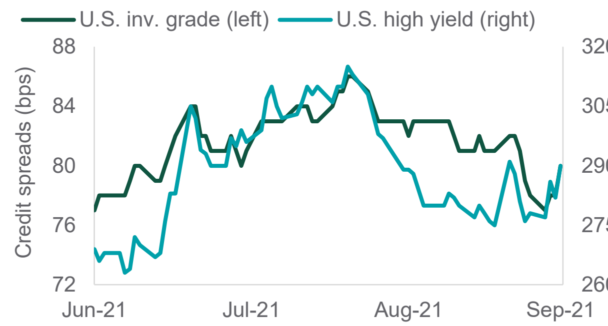
U.S. TREASURY YIELD CURVE



Credit Markets

Credit conditions deteriorated during the first half of the quarter, albeit from overall strong levels. Delta variant uncertainty and massive new issuance led to credit spread widening in the fixed income markets. That spread widening created opportunities for investors to step in as virus fears waned and seasonal liquidity factors reversed – and step in they did. Still, investment grade and high yield spreads ended the quarter 3 basis points (bps) and 21 bps higher, respectively, marking the first quarter of spread widening since early 2020.

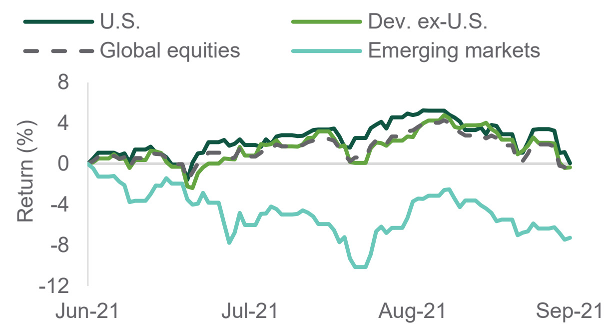
CREDIT SPREADS



Equities

Global equities posted their first quarterly loss (-1.0%) since the pandemic decline. U.S. and developed ex-U.S. earnings growth mostly offset lower valuations, but emerging market (EM) earnings lagged. EM equities fell 7.3%, bogged down by China's regulatory clampdown and credit concerns. Developed ex-U.S. equities lost 0.4% and U.S. equities were flat. Strong corporate profitability and easy monetary policy lifted developed equities, but concerns on peak growth, inflation and unwinding stimulus built a wall of worry in September.

REGIONAL EQUITY INDICES



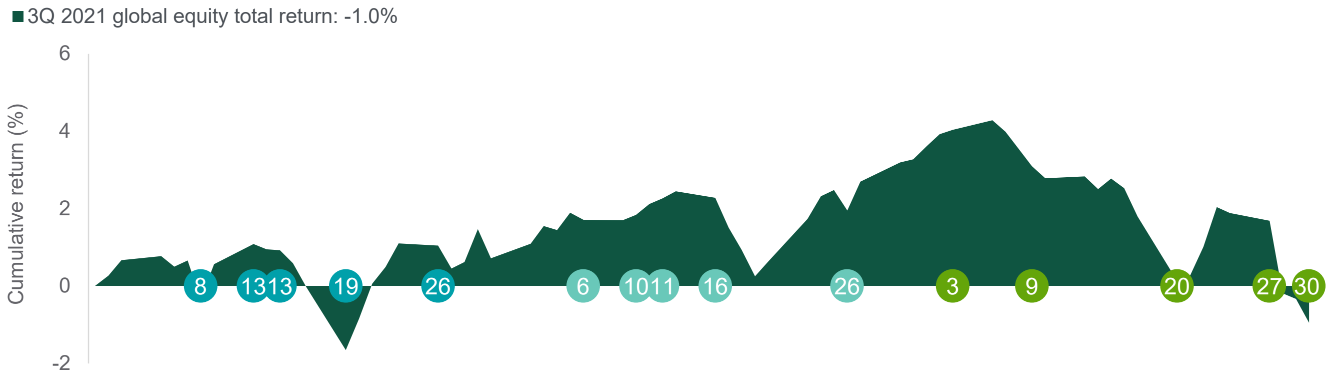
Real Assets

Global listed infrastructure gained 1.5% — more than global equities but not nearly enough to recover its double-digit underperformance since the pandemic drawdown. Global real estate lost 0.8%. It gained as much as 5.9% before falling on rising interest rates and fears of broader contagion from China's Evergrande crisis. Global natural resources (GNR) trailed the other major real assets we track (-2.7%). Solid fundamentals and a constrained global commodity supply failed to add to GNR's year-to-date market return leadership.

REAL ASSET INDICES

Returns in U.S. dollar terms. UST = U.S. Treasury. Indexes are gross of fees.

MARKET EVENTS



JULY	AUGUST	SEPTEMBER
8 European Central Bank announces results of its strategy review; changes inflation target to a symmetric 2% level.	**6** July U.S. jobs report shows 943k payroll gain — the strongest gain in nearly a year.	**3** Japanese Prime Minister Suga announces plans to resign.
13 U.S. headline inflation comes in at 0.9% month-over-month — the largest monthly increase since 2008.	**10** Senate passes $1 trillion bipartisan infrastructure bill, but progressive Democrats in the House vow not to vote until a reconciliation bill is approved.	**9** European Central Bank moderately slows pandemic emergency purchases in a move President Lagarde defines as "recalibration," not "tapering".
13 Senate Budget Committee Democrats agree to a $3.5 trillion spending plan that triggers the reconciliation process.	**11** China's State Council releases a five-year blueprint for increased government control across its private economy.	**20** Global equities fall 1.6% amid concerns that Evergrande's financial distress will spill over to global financial markets.
19 10-year Treasury yield falls below 1.20% on concerns of the spreading Delta variant.	**16** Taliban takes over Afghanistan; U.S. proceeds to withdraw most of its troops/citizens but President Biden's approval rating falls.	**27** Germany's Social Democratic Party begins negotiations to form a ruling coalition after narrowly winning German federal election.
26 Chinese authorities clamp down on the private education sector and sweeping crackdowns trigger a selloff in China stocks.	**26** Bank of Korea raises its benchmark interest rate, becoming the first major Asian central bank to pump the brakes on pandemic relief.	**30** Congress passes stopgap funding bill to avoid a government shutdown, but debt ceiling deadline looms in October and infrastructure bills face gridlock.

For more information please contact:

John P Bohan CFP®
Managing Director

3200 Cherry Creek Drive S.
Suite 730
Denver, Colorado 80209

Direct: (303) 778-6800
Email: jpb@investmenttrust.com
www.investmenttrust.com