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Third Quarter 2021

Urban Cowboy

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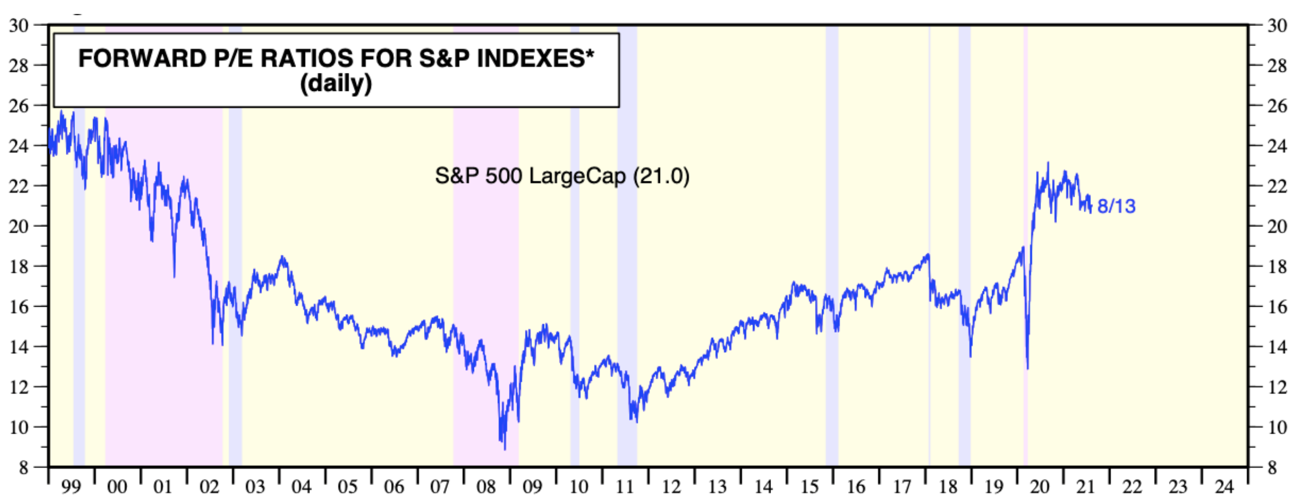
While clicking through channels we stumbled across the classic 1980 romantic Western, *Urban Cowboy*. It's one of those movies you can't help but watch for a few minutes before moving along. The soundtrack from the movie is truly phenomenal. Critics rate the *Sound of Music* soundtrack as superior, but we disagree, and we are likely the only ones that do. The soundtrack made stars out of several local bands while also featuring artists such as the Eagles and the Charlie Daniels Band.

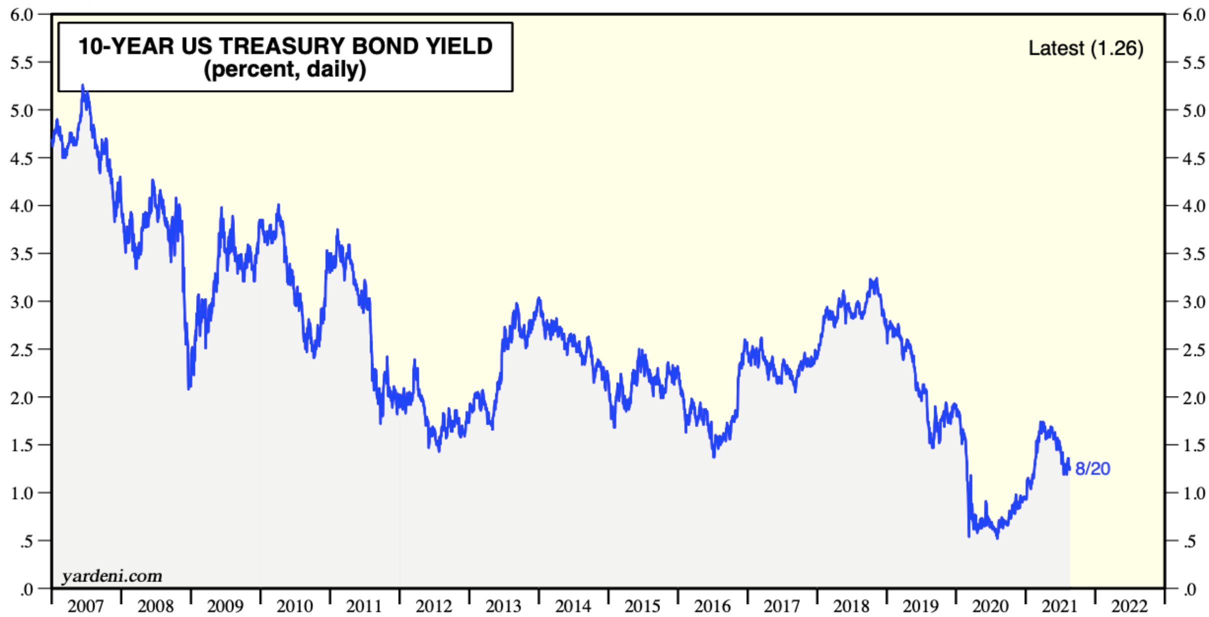
John Travolta (Bud) and Debra Winger (Sissy) fall in love after meeting each other at Gilley's, the now-famous Texas honkytonk. The movie captures the late 70's and early 80's era when cowboys were leaving their farms and ranches and moving to the big city. The oil boom created a financial situation where cowboys could make more money working in refineries and oil fields than working on a farm or a ranch. Traditional cowboys that moved into the cities became known as Urban Cowboys.

Urban Cowboys enjoyed the extra money but longed for the culture they left behind. Urban versions of the honkytonk quickly developed to satisfy this longing. Urban Cowboys could once again enjoy dim lights, thick smoke, cold beer, and country music. Now the only thing missing was a bull to ride. The entrepreneurial Mickey Gilley understood this need and used it as an opportunity. He installed mechanical bulls in Gilley's which made his honkytonk the biggest and most popular nightclub in Texas. Gilley's bulls were made of wood and tin and provided the thrill of riding a bull, while importantly eliminating much of the risk. We wish there were mechanical bulls for investors.

This current bull ride has been thrilling, but it also is becoming increasingly risky. High valuations, inflation fears, and pandemics have this bull bucking hard. Since May the S&P 500 has sold off more than 3% on four separate occasions, including an almost 5% selloff in late May.



Fear has kept many investors from jumping on this bull and has caused even more investors to be thrown off. Mommaerts Mahaney Financial Services continues to ride this bull but it's getting increasingly difficult to hang on. We are constantly searching for ways to decrease the riskiness of this ride. Normally when stock markets become riskier, we dampen the risk by reallocating money from the stock market to the bond market. We don't see that as a viable option this time. The bond market is even more overvalued than the stock market. The Fed has been purchasing bonds (quantitative easing) since the start of the pandemic. $120 billion a month to be exact. Quantitative easing is achieving its desired effect, it has artificially driven interest rates lower and the economy is recovering. 10 Year Government Yields are at 1.26% despite inflation being at 3.4%.



Last week's Fed minutes showed that a majority of the Fed governors now support "tapering" these bond purchases. If, or more likely when, the Fed slows their rate of bond purchases, interest rates are almost certain to rise. That would be the Fed's intention, to gradually raise interest rates so that inflation and the economy don't overheat. As we've often mentioned, we are not foolish enough to fight the Fed.

Instead, to lessen risk we are lowering credit exposure and increasing duration exposure in the Core Portfolios. Credit exposure is positively correlated with stocks while duration exposure is negatively correlated. When stocks go down in value duration increases in value, this helps to lessen losses at the aggregate portfolio level during periods of stress. We expect many more periods of stress in the months ahead. Additionally, credit spreads have become historically tight. This means investors are being compensated very little for taking on the risk of corporate defaults.

High Yield, aka Junk Bonds, currently offer investors less than 3% to take on the risk of default. Our frameworks show us that High Yield and Investment Grade Bonds underperform Treasury Bonds over 1-year periods when spreads are this tight. Additionally, the probability of credit spreads spiking higher and corporate bonds losing significant value is increased.

We've remained fully invested in High Yield Bonds since the depths of this pandemic. This has been beneficial to investors. Since the pandemic lows, High Yield has produced solid returns. High yields outsized gains are due to the credit spread tightening that we are now becoming concerned with. We believe the time has come to materially cut back on this risk.

Asset Class	**Pandemic Lows**	**YTD**
High Yield	37.19	3.32
Gov't Bond	0.74	-0.84

As previously mentioned, the Federal Reserve recently released its Fed minutes. We've been combing through the mind-numbing commentary. It shows the Fed Governors are split on how much, if any, they should taper their current $120 Billion per month in bond purchases. The Fed is desperately trying to prep the markets for the necessity to cut back on the enormous stimulus they are currently providing. They also realize their actions could greatly disrupt the markets and the economy. Our research shows us that stock markets become increasingly volatile during initial tightening periods, which we are likely entering. The initial tightening of monetary policy typically takes about a year or so to rein in inflation and start negatively impacting the economy. Historically that has been the time to decrease equity exposure, not beforehand. To be clear, the Fed has not actually started tightening, they have only started to discuss it. Until they actually start tightening, we expect to continue riding this bull. Our forecast for the rest of this year is for a lot of volatility and very modest stock market returns. We expect fixed income returns to be neutral if the Fed doesn't act, and lower if they start tapering.

One last thought; Through our market commentaries we do our best to communicate our current thinking and how we have your portfolios positioned. Through our individual conversations, we do our best to assess your risk tolerance and position you accordingly. There is always some uncertainty around the economy and expectations of future market returns. Together, it's been a good, albeit stressful, run since March 23rd, 2020.

Asset Class	3/23/20
Small Cap Value	122.81
Small Cap Growth	114.17
Mid Cap Growth	106.41
Mid Cap Value	97.32
Large Cap Growth	96.35
European Equity	82.20
Large Cap Value	73.82
Asian Equity	60.59
High Yield	37.19
Investment Grade	21.32
Gov't Bond	0.73
Cash	0.46

Investor portfolios have done well. If you feel your risk tolerance has waned, or you simply want a smoother ride, now is the time for us to discuss shifting your portfolios into one of our more Conservative Strategies. Investors should not expect portfolio returns anywhere near what we've experienced over the last year and a half. We expect investors will need to tolerate considerably more volatility for far more modest returns.

Cowboy up and hang on tight,

The Mommaerts Mahaney Financial Team

Jon C Mommaerts, CFP®: Jon is a Principal of Mommaerts Mahaney Financial Services, Inc. He has over 30 years of experience working with professionals and those about to retire. He is a member of the Financial Planning Association, as well as a member of the Preferred Financial Advisors.

J. Matthew Tuccini, CFP®: Matt has over 17 years of experience working in the financial services industry with vast experience in retirement planning, tax strategies, and financial planning.

Robert Kea, CFA: Bob has over 30 years of experience in portfolio management. He was a founding member and Co-Head on Putnam's Asset Allocation Group, which managed $12Bn in both retail and institutional assets.

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Mommaerts Mahaney Financial Services, Inc. provides advisory services through ERTS Wealth Advisors, LLC, a registered investment advisor.
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