Q3 21 WEALTH MANAGEMENT QUARTERLY INVESTMENT LETTER

Households Are in Great Shape

Quick Look

- » U.S. household net worth hit a record $142 trillion last quarter.
- » At 20% growth over the past year, net worth is growing at its fastest pace of the post-war era. $31 trillion has been added to household net worth in the past five quarters.
- » Cash balances have risen by more than $3 trillion since the end of Q1 2020, which amounts to a 23% gain over the last five quarters.
- » During COVID, home prices have soared, gaining 20% over the past year to the highest annualized increase on record for the Case-Shiller Home Price Index.
- » The outsized return investors have received from stocks above cash over the past ten years falls within the 1st percentile of rolling 10-year periods dating back to 1963.
- » Over the past decade, total household debt has grown at just over 2% annualized and fallen back below 100 percent of total disposable income.
- » Currently, household net worth is at its highest level in 15 years and above historical median levels over rolling 10-year periods.
- » If controlled for inflation, household net worth is currently at its highest 10-year rolling return on record.
- » Consumer balance sheets are well fortified, and this might be the biggest positive going for our economy.

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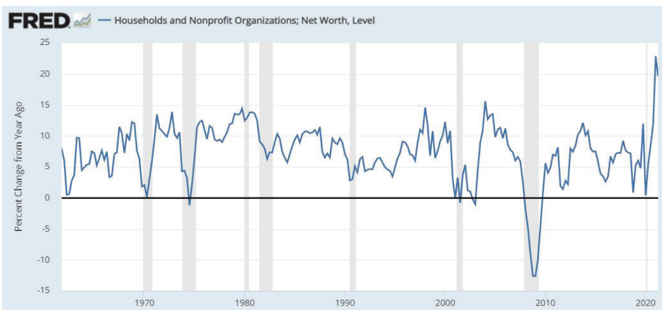
Opus Capital is an evidenced-based investment advisory firm driven by our overriding mission to help people. We believe the marriage of comprehensive financial planning + statistically proven investment principles creates the clearest roadmap to long-term success.

We are independent and transparent in all aspects of investment management decision making and financial planning. We selectively partner with like-minded individuals and families, endowments, foundations, and 401(k) plans in 30 states.

Quarterly Investment Letter, Q3 2021

It is an interesting phenomenon that in the middle of an ongoing health crisis, Americans have never been more financially fit.

U.S. household net worth hit a record $142 trillion last quarter. Setting a new record is not unique; since clawing out of the Great Financial Crisis hole, net worth has been on an upward trajectory, setting all-time highs in 31 of the last 34 quarters. Rather, it is the sudden verticality in the change of net worth that is notable. At 20% growth over the past year, net worth is growing at its fastest pace of the post-war era. $31 trillion has been added to household net worth in the past five quarters.



Source: Federal Reserve Bank of St. Louis

Net worth = your assets (cash, real estate, stocks, etc.) – your liabilities (mortgage and other loans, credit card debt)

Let's explore some of the major components, both through the lens of the change during the pandemic, as well as over the last 10 years.

Cash: Balances in checking accounts, savings accounts and money-market funds have risen by more than $3 trillion since the end of Q1 2020, which amounts to a 23% gain over the last five quarters (which we will categorize as the COVID period). The primary driver of the cash surplus stems from three separate fiscal pandemic-relief packages, the first of which occurred at the onset of COVID, and two that arrived in consumers checking accounts in January and March of this year. Collectively, stimulus checks have added nearly $900 billion to consumers' pockets. States issued another $800 billion in unemployment benefits, but most of this should be presumed spent, as it was used to replace lost wage income to the 46 million people (roughly one in four overall workers) who received at least one week in benefits. The surge in cash

U.S. Household Net Worth
Source: Federal Reserve

	Q2 2021	Q1 2020	Covid 5 Qtr % Change	Q2 2011	10 YR Change
Total Assets	$159.3	$127.1	25.3%	$81.6	95.2%
Deposits	$17.1	$13.9	23.0%	$8.6	98.8%
Total Stock Inv.	$47.0	$26.5	77.4%	$15.7	199.4%
Other Fin'l Assets	$49.2	$46.1	6.7%	$31.9	54.2%
Real Estate	$34.9	$30.6	14.1%	$18.4	89.7%
Other Non-Fin'l Assets	$11.6	$10.0	13.0%	$6.9	63.8%
Less: Total Liabilities	$17.7	$16.6	6.6%	$14.1	25.5%
Total Net Worth	**$141.6**	**$110.5**	**28.1%**	**$67.5**	**109.8%**

balances can also be attributed to reduced spending during the pandemic. This is particularly true of the highest earning 20% of households, who own $11 trillion of the $17 trillion in cash, and have a lower proclivity to spend excess cash than median households.

Collectively, this combination of stimulus and reduced consumption has caused a surge in the personal savings rate. Though well off its pandemic high of 35%, the U.S. savings rate is still elevated at 10%, above the 5% level it hovered around prior to COVID. Prior to COVID, excess savings steadily averaged $100 billion a month. Since March 2020, monthly savings has exceeded the previous average in every single month. The expectation is that most of this recent cash surplus will be spent once the economy returns to normal and pent-up demand can be met. A survey of household spending plans for the upcoming year are well above prior norms.

Interestingly, the trend in higher cash reserves predates COVID, as household deposits have more than doubled over the past ten years, despite cash paying 0% for most of the decade. One would think that high returns in other asset classes would have reduced cash allocations, but deposits currently represent the same 15% of total household financial assets as ten years ago.

Real Estate: Real estate price gains over the past decade have had an outsized impact on the change in net worth, though with a caveat. The housing bubble had a lasting im

U.S. EQUITY RETURNS (%)

As of 09/30/2021	Q3 2021	1-Year	3-Year	5-Year	10-Year
S&P 500	0.6	30.0	16.0	16.9	16.6
Russell 1000 (Large Cap) Growth	1.2	27.3	22.0	22.8	19.7
Russell 1000 (Large Cap) Value	-0.8	35.0	10.1	10.9	13.5
Russell 2000	-4.4	47.7	10.5	13.5	14.6
Russell 2000 (Small Cap) Growth	-5.7	33.3	11.7	15.3	15.7
Russell 2000 (Small Cap) Value	-3.0	63.9	8.6	11.0	13.2

Source: Morningstar

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pact on real estate prices; after peaking in 2006 at $24 billion, real estate went through a lengthy drawdown period before finally bottoming at $17 billion in 2012. While home prices have nearly doubled over the past decade, that time period is starting from nearly the exact bottom of the housing market. It took until 2016 for prior-decade homebuyers, on aggregate, to finally recover their 2006 purchase price, so homebuyers may be justifiably anchored to the 15-year annualized return of 2.6% rather than the 10-year annualized return of 6.6% when judging their real estate returns.

During COVID, home prices have soared, gaining 14% in value over the past five quarters and sending their year-over-year price change of 20% to the highest on record for the Case-Shiller Home Price Index. However, unlike the overbuilding that occurred during the housing bubble, price gains during COVID have been driven by a lack of supply, as the current supply of homes for sale in the U.S. is about one-third of the number of homes for sale at the housing bubble peak. The lack of supply explains why the typical home is on the market for just 17 days and why half of homes are being sold above their list price. The median price for a home is currently $360,000, while the median new home now sells for $390,000.

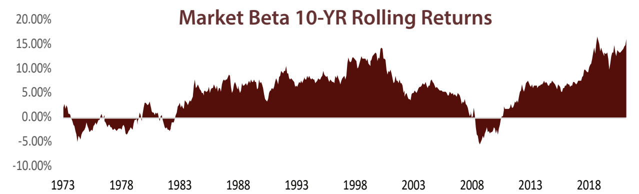
Households waiting for a decline in prices may be waiting a while. While the number of homes sold has declined a bit from its peak last fall, it has mostly been due to supply constraints, as demand remains high. Additionally, rents are rising rapidly, with single-family home rental prices up 12% over the past year.

Stocks: The value of corporate equities has been the biggest driver of household net worth during the COVID period, gaining a cumulative 77% over the last five quarters ending Q2. Over the past ten years, total stock investments have added 11.6% annualized to household balance sheets, tripling in total value.

Similar to real estate, massive losses during the Great Financial Crisis left equity valuations trading at depressed valuations in 2011, setting the stage for a decade of above-average returns thanks to the combination of good earnings growth and the doubling of the price investors were willing to pay for those earnings. The 11.6% annualized gains from households fell short of the nearly 15% annualized returns of the S&P 500; this can be attributed to the sluggish returns of international stocks, along with net outflows from equities by households over the past decade.

The outsized return investors have received from stocks above cash (known as market beta) over the past ten years falls within the 1st percentile of rolling 10-year periods dating back to 1963. Simply put, the past ten years has rewarded households with arguably the best stock return spreads of their lifetime.

Stock returns during COVID have been even more rewarding. As of the end of Q2 2021, U.S. total stock returns have exceeded cash by 45% over the past 12-months, representing another 1st percentile ranking within historical rolling 12-month periods.



Source: Fama French

Whereas the prior 10-year rally climbed the proverbial wall of worry, recent outsized returns have finally attracted some speculation among households, as first half inflows into global equity funds were the largest on record. The S&P 500 Index closed the quarter with more than 200 consecutive days of trading within 5% of its all-time high, the 8th longest run-on record, as any slight pullback this year has quickly recovered thanks to a fervent buy-the-dip mentality.

Liabilities: Household debt rose by 8% last quarter, making headlines because it was the strongest debt growth in 14 years and a new all-time record in total debt at over $17 trillion. These numbers sound alarming in a vacuum, but a deeper dive shows consumers have made noticeable improvements to the liabilities side of their balance sheet.

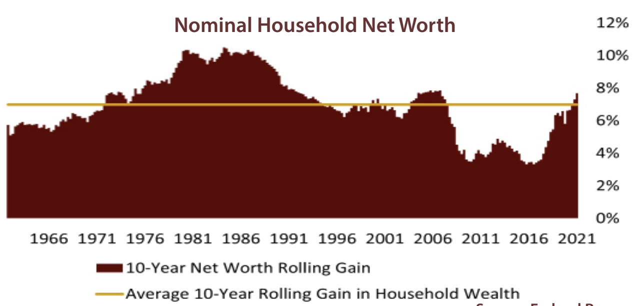
The first place to start is mortgage debt, which makes up the majority of household debt and was the catalyst of the 2008 financial crisis. Leading up to the crisis, the ratio of debt to total income rose by one-third from 2000 to 2007 as borrowers piled up unsustainable levels of debt.

At the peak of the housing bubble, home mortgage debt had grown to nearly 74% of all liabilities. Since that time, home mortgage debt as a percentage of total liabilities has been on a steady decline, now standing at 64% and completely unwinding the excesses of the 2000s housing bubble. Additionally, home equity percentage, which is the difference between a home's value and its remaining mortgage balance, fell to 45% at the housing bottom, as homeowners were increasingly underwater on their mortgages. Over the past 10 years, home equity percentage has climbed to 68%, which is the highest since 1989. While the average size of a mortgage is now above $400,000, the statistics still suggest a healthy home borrowing environment overall. Currently, three out of every four mortgage originations are issued to borrowers with very good to excellent credit scores. Additionally, thanks to record low mortgage rates, monthly mortgage payments for a 30-year, $400,000 loan are 36% lower than what they would have been 15 years ago. In dollar figures, the monthly payment for a $400,000 30-year mortgage has fallen from $2,594 in 2006 to $1,665 at today's current mortgage rate.

Credit card debt has declined 10% since the onset of COVID as borrowers have used their stimulus checks or reduced consumption to pay down revolving debt. Total household debt service ratio, which is the share of household income being spent to pay debts, fell to its lowest level on record going back to 1980.

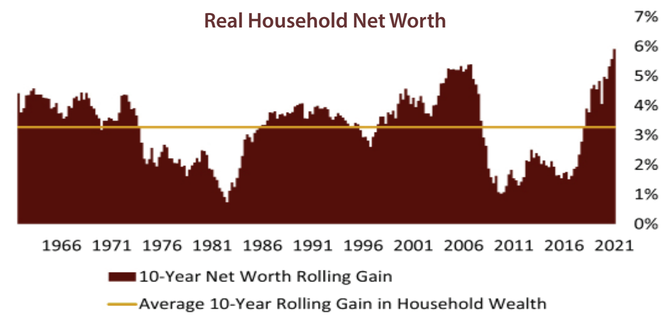
The origins of liability improvements date back to 2008 when household debt peaked at about 130 percent of disposable income. Tighter lending standards, coupled with household preference to deleverage, resulted in an eight-year period in which total liabilities in the U.S. did not grow. Over the past 10 years, total household debt has grown at just over 2% annualized and fallen back below 100 percent of total disposable income.

Total Net Worth: Households came out of the wreckage of the Great Recession and, thanks to an increased savings rate, deleveraging, reflated home prices, and above average stock returns, have slowly repaired their balance sheets.



Source: Federal Reserve

With 25% cumulative gains in total net worth, the COVID period has ironically provided an additional financial booster shot, sending household net worth to its highest level in 15 years and above median levels over rolling 10-year periods. Historically, the highest 10-year rolling periods for household net worth were the early-1980s, but that is misleading, as households at the time were dealing with persistently high inflation. Therefore, let's adjust the data for inflation.



Source: Federal Reserve

Eureka! We find that we are currently at the highest level of 10-year rolling real household net worth on record. This may come as a surprise at first, but helps in part explain why retirements are running at twice the amount prior to COVID. Yes, the pandemic has been the primary driver, but retirements often only occur if someone feels financially secure. Anecdotally, Opus has seen client retirement and cash flow models well above their linear targets. In short, amid all the country's divisiveness surrounding the pandemic, households are feeling surprisingly good about their finances.

How long will this last? Well, for starters, inflation is running well above the 1.8% average of the past 10 years. Supply chains are a mess and staffing levels have created challenges across many industries. The Delta variant has ensured that the summer's transitory price pressures will persist longer than initially expected. Both monetary and fiscal policy makers appear ready to move on from highly accommodative pandemic-relief policy. As a result of these pressures, stocks posted their weakest quarter since the COVID drawdown and economic growth cooled in the third quarter.

As we were reminded by COVID, knowable and unknowable risks remain and the macro future is impossible to predict. That said, U.S. recessions are almost always related to the consumer, as 70% of GDP comes from consumer spending. As outlined in this commentary, consumer balance sheets are well fortified and flush with cash - ready to spend when supply chain and virus risks ease.

As always, please contact us to discuss in further detail. We appreciate your confidence in our firm and value your partnership.

INTERNATIONAL RETURNS (%)

As of 09/30/2021	Q3 2021	1-Year	3-Year	5-Year	10-Year
Int'l Developed ex US	-0.5	25.7	7.6	8.8	8.1
Emerging Markets	-8.1	18.2	8.6	9.2	6.1

Source: Morningstar

FIXED INCOME RETURNS (%)

As of 09/30/2021	Q3 2021	1-Year	3-Year	5-Year	10-Year
Aggregate Bond	0.1	-0.9	5.4	2.9	3.0
Muni	-0.3	3.1	4.5	2.7	3.3
Int'l Bonds	-1.1	0.8	3.4	1.8	1.5
High-Yield	0.6	10.6	5.7	5.4	6.3
Short-Term	0.1	1.7	3.4	2.4	2.1
90-Day T-Bill	0.0	0.1	1.1	1.1	0.6

Source: Morningstar

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