July | 2021

WEALTH MANAGEMENT | ARVEST

INVESTMENT MANAGEMENT GROUP | ARVEST

Viewpoint

Executive Summary

Editor's Note: There is no Federal Reserve Watch Commentary this month.

- Politically charged emotions should never dive changes to any investor's investment portfolio (Page 2), We aren't likely to ever make politics a focal point when talking about investment positioning, but at times we still do have to talk about the potential impact that political decisions have on an economy.

-This objective need to continuously improve and mitigate crumbling infrastructure is partly why we believe in global infrastructure as a somewhat distinct asset class (Page 3), We had previously added an allocation to global infrastructure withing our asset allocation portfolios as part of the Real Assets bucket.

- The Delta variant of COVID-19 is starting to cause some issues around the globe, despite vaccinations. (Page 3), . . . risks of a COVID-19 variant spreading combined with employment issues adds downside risks to economic forecasts in the second half of 2021.

- Similar to the global supply chain issues causing global inventory problems, (Page 5), we continue to believe that these employment issues are short term in nature as firms and workers adapt to new opportunities.

- The reopening outside of the US comes with less investment market valuation concerns. (Page 6), It's why we have continued to preach about diversifying portfolios globally.

- The yield curve has experienced some dramatic shifts in recent weeks. (Page 7), . . . The consequence was a rather notable flatting of the Treasury yield curve.

- We believe that the market has pushed intermediate and long-term rates too low. (Page 8), As a result, we recently reduced our duration band target for accounts managed . . . to a new band of 82.5%-92.5%.

- The stock market at midyear is at or near all-time highs. (Page 10), New risks to the market include changes in interest rates, surges in inflation . . . and a political logjam on infrastructure stimulus.

- The S&P 500 trades at a 12-months forward P/E of 21.5, (Page 10), This would imply a negative repricing return of about 20%.

- We believe that stocks are poised for a muted second half. (Page 11), as the reopening process continues and earnings advance, balanced with a fall in valuation multiples.

Asset Class Outlook

Equity	Current	Previous
U.S. Equity	Slightly Unfavorable	Slightly Unfavorable
Int'l Equity	Neutral	Neutral
Emer. Mkts	Slightly Favorable	Slightly Favorable

Real Assets	Current	Previous
Real Estate	Slightly Unfavorable	Slightly Unfavorable
Infrastructure	Neutral	Neutral
Commodities	Neutral	Neutral

Fixed Income	Current	Previous
Invest. Grade Credit	Slightly Unfavorable	Slightly Unfavorable
Treasury/Agency	Slightly Unfavorable	Slightly Unfavorable
Mortgage Backed	Slightly Unfavorable	Unfavorable
Commercial MBS	Slightly Favorable	Slightly Favorable
High Yield	Unfavorable	Unfavorable
Emer. Mkts Debt	Neutral	Neutral
Taxable Muni	Slightly Favorable	Slightly Favorable
Tax-Exempt	Unfavorable	Unfavorable
TIPS	Neutral	Neutral

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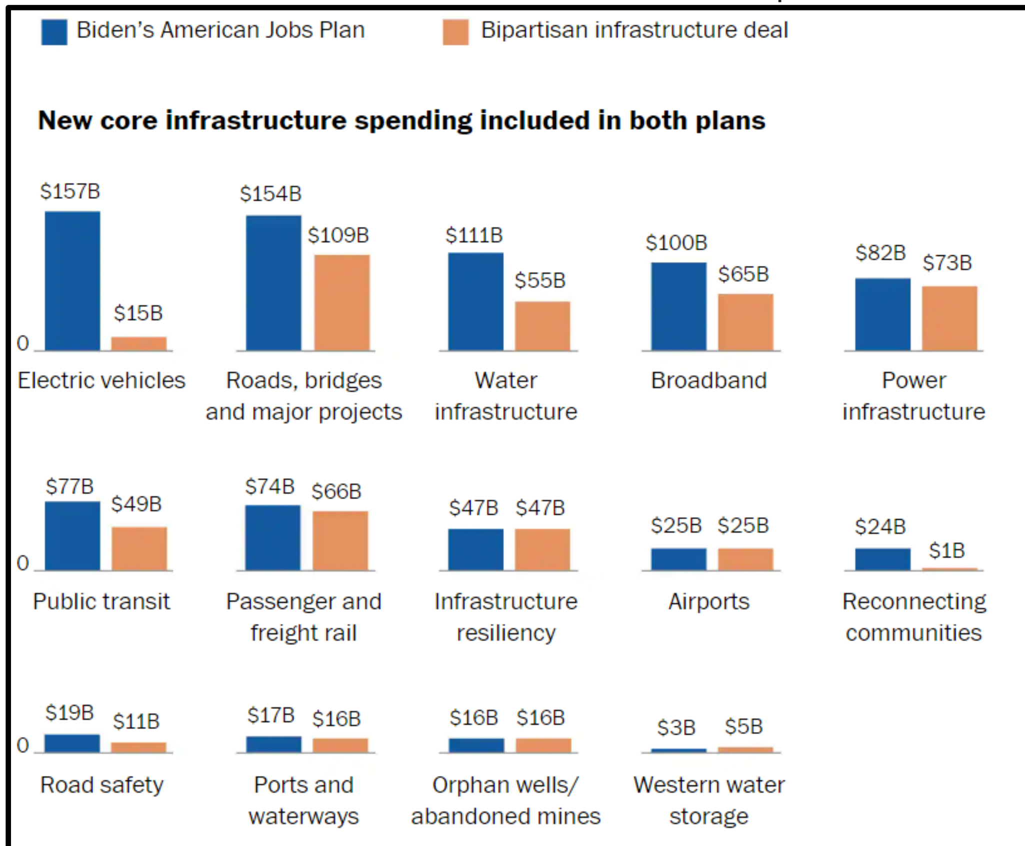
Let the Partisan Games Begin (Again)!

"This country has come to feel the same when Congress is in session as when the baby gets hold of a hammer" – Will Rogers, "Oklahoma's Favorite Son"

We've talked a lot about interest rates, inflation, and tax policy in the past few months. With the usual caveat that politically charged emotions should never drive changes to any investor's investment portfolio, these are important things to focus on to varying degrees. We aren't likely to ever make politics a focal point when talking about investment positioning, but at times we still do have to talk about the potential impact that political decisions have on an economy.

The most prominent one right now is infrastructure. Last month saw a counterproposal to Biden's initial $2.7 trillion American Jobs Plan. This $579 billion proposal was the result of a deal struck between The White House and a bipartisan group of Senators to help attract Republican and some moderate Democrat support. The deal stripped out around $1.7 trillion in spending that almost all Republicans deemed as not pertaining to the traditional definition of infrastructure (housing, schools, long term care, clean energy tax credits, and clean energy research and development). What was left was the more traditional areas of infrastructure, known as "core" infrastructure (roads, bridges, public transit, power, water, wastewater, broadband, etc.). When focusing on just these core components, here's how the two plans compared on spending.

How the Infrastructure Plans Stack Up



Source: The Washington Post

It is easy to spot the biggest discrepancy, spending on infrastructure for electric vehicles. The White House only agreed to drop or minimize most of the environmentally focused wish list because Biden wants to pass a separate bill to address those issues. Progressive Democrats will not support any infrastructure plan that does not help further the adoption of electric, wind, solar, etc., so breaking the bills in two makes sense. Pass the spending bill for infrastructure areas that most everyone agrees needs more help and argue over the massive legacy projects later. Doesn't that sound reasonable? Not so fast. Progressives want to loosely tie the two bills together, which caused Biden to do some damage control to keep the bipartisan bill alive. Additionally, the House of Representatives recently passed a $760 billion transportation and water infrastructure bill that also mainly focused on core infrastructure. It garnered some modest Republican support too. Then comes another wet blanket statement that seems to put us back at square one.

"The era of bipartisanship on this stuff is over — this is not going to be done on a bipartisan basis." – Mitch McConnell, on July 6, 2021

Politics complicate everything. Democrats know that if they don't include some of their environmental agenda in the initial bill that it's less likely to pass on its own. Republicans know that and won't allow it. The gamesmanship is obviously not new, but it's exactly why the richest and most technologically capable country in the world falls behind many other develop countries when it comes to core infrastructure. No need to belabor the point on partisan politics.

Infrastructure has been hotly debated for decades now with little to show for it, and there is every indication is that it will continue to be in the limelight, and rightfully so. According to The American Society of Civil Engineers (ASCE), there are 2,300 dams in the US that are classified as "high-hazard-potential" dams, meaning they will result in loss of life if they fail. Collectively, ASCE gave those dams, and the related levee systems a D grade. Additionally, we don't even need to go back to the New Orleans levee failures to see the flood infrastructure risks. In 2019, more than 80 Army Corps of Engineers levees were breached with ~700 miles of levees damaged throughout the Midwest. Those issues caused around $20 billion in damages, and the band-aids that repaired them cost $1 billion (meaning true fixes will cost far more). This objective need to continuously improve and mitigate crumbling infrastructure is partly why we believe in global infrastructure as a somewhat distinct asset class. To that end, we had previously added an allocation to global infrastructure within our asset allocation portfolios as part of the Real Assets bucket.

To be clear, we were planning and implementing these moves prior to any discussion of the current infrastructure proposals. Far too many infrastructure plans have died in Congress in prior decades to make investment decisions based on partisan politics. It is the nature of these global infrastructure companies, and the stable cash flows that define their business models, that are the driving point behind increasing allocations to these companies, not politics. Yet, politics will still influence the earnings prospects for these companies. It's a bonus, not the main thesis.

Lastly, the Delta variant of COVID-19 is starting to cause some issues around the globe, despite vaccinations. Most of the concerning outbreaks are happening in countries with lower vaccination totals, but it can still cause disruption regardless of vaccination levels. CoxHealth, a six-hospital system based in Springfield, MO, is bracing for a 50% increase in COVID-19 hospitalizations over the next few weeks and they don't have the staff to help. They have started transferring patients to hospitals in Kansas City, St. Louis and Columbia due to staffing issues. The variant effects still seem muted comparatively, but the risks of a COVID-19 variant spreading combined with employment issues adds downside risks to economic forecasts in the second half of 2021.

Economic Indicators

Alex Jantsch, CFA, CAIA

Current Economic Snapshot

Quarterly & Fiscal Year GDP Growth (Average Annual)

Source	1Q21 (Actual)	2Q21 (Forecast)	3Q21 (Forecast)	4Q21 (Forecast)	FY21 (Forecast)
Bloomberg	**6.4%**	**10%**	**7.0%**	**5.0%**	**6.6%**
AWM/IMG	**6.4%**	**9.5%**	**8.5%**	**4.5%**	**6.8%**

Sources: Bloomberg, Bureau of Economic Analysis; Methodology: Average Annual Return

Investment Management Group's Recession Indicators

Indicator*	Current	Previous	Short Term Trend	Long Term Trend
CB Leading Econ. Indicators	+14.7%	+17.0%	Positive	Positive
3–Mon./10–YR. Yield Curve Spread	+1.39%	+1.62%	Positive	Positive
New Orders–to–Inventories	+14.9	+16.2	Positive	Positive
Cap. Goods New Orders	+24.0	+27.1	Positive	Positive
Initial Jobless Claims	364k	498k	Positive	Neutral
New Building Permits	1,681k	1,760k	Neutral	Positive

Sources: Bloomberg
**See the Appendix for description of each indicator*

Now Comes the Hard Part

Over the course of the last few months, we've seen most of our economic indicators start flashing positive signs and by all estimates GDP is set to grow relatively rapidly (from a COVID-19 induced low base). This is by no means a measure of current economic risks that are still very present, such as the threat of more COVID-19 variants. Rather, it is a measure of which direction the health of the economy is trending. We slightly reduced our full year GDP forecast due to lingering risks, but it is not hard to see why the U.S. economy is trending so positively. If last weekend's Independence Day festivities were any indication of how much money consumers are ready to spend to forget about the trials of the last year, then it's safe to say that the reopening process in the US looks to be going as well as it could. Valuations continue to get more stretched as a result, and that will continue to be a focal point for Arvest's portfolio management team.

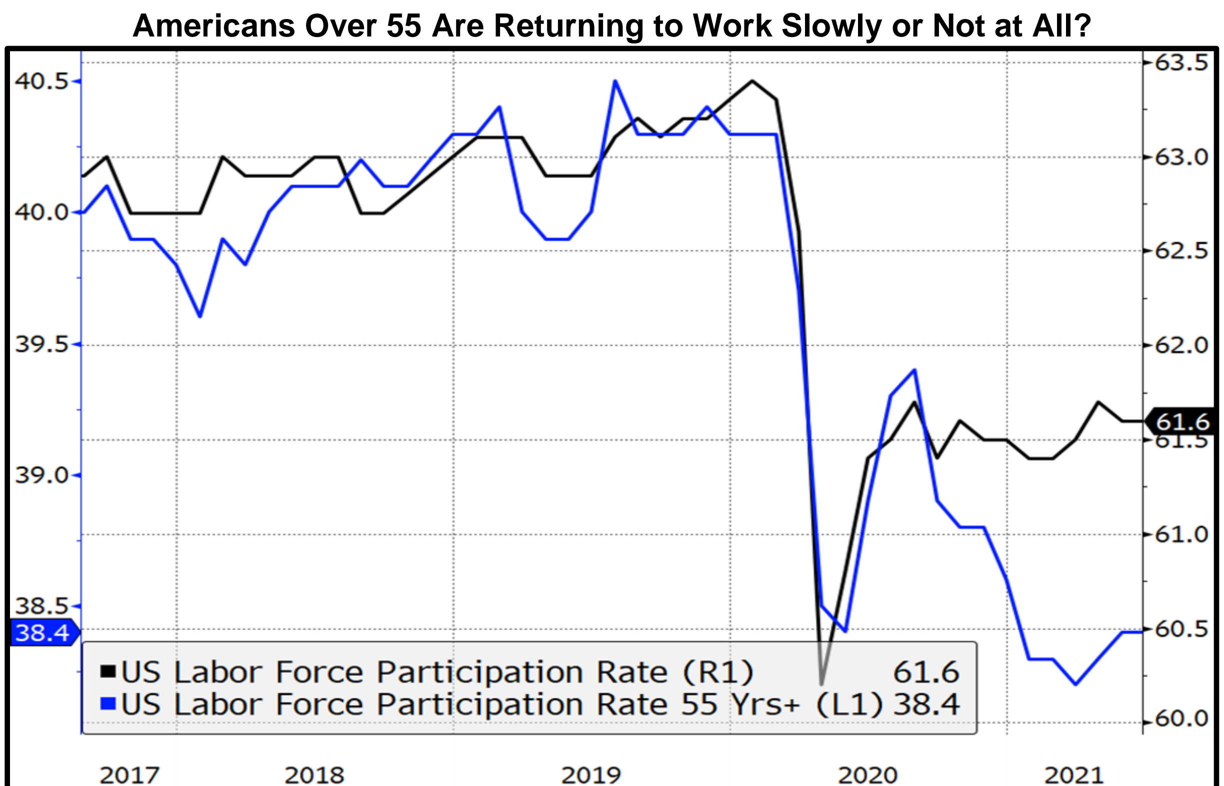
The major impediment to "full steam ahead" on the economic recovery seems to be employment. Last week's jobless claims report shows that they are still higher than average, which means there is still work to do in returning to pre-pandemic unemployment trends. Initial jobless claims came in lower than expectations (364k vs. 388k expected), which means less people are initially filing for unemployment. The miss was within continuing jobless claims, which came in higher than expected (3,469k vs. 3,340k expected). This means more people are staying on unemployment benefits. You can probably see where this is going, but it might not be the direction you expect.

This data led to an unexpected increase in the unemployment rate, despite the increasing pace of the reopening process around the country. In our opinion, this is a temporary setback, but it does throw a wrench in the idea that ending the extended unemployment benefits will completely solve the rampant "help wanted" problem, particularly in the service industry. As of the end of last week, extended unemployment benefits had already ended in about half of the states, including Missouri (ended June 12), Arkansas (ended June 26), and Oklahoma (ended June 27). It's been almost a month since Missouri (where I live) ended the expanded COVID-19 unemployment benefits and I still see "help wanted" signs pretty much everywhere I go. So, while expanded unemployment benefits are certainly causing labor force problems, it's not the only issue.

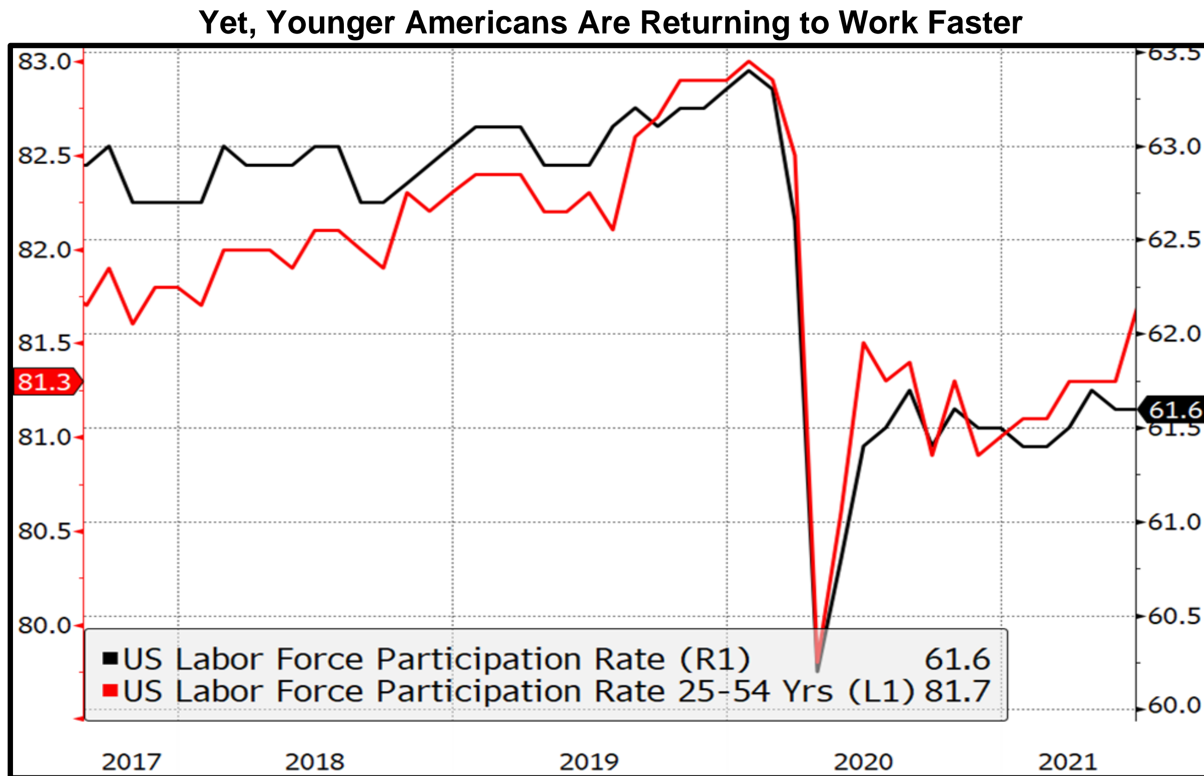
Some industries just naturally take longer to get back to trend following such a massive disruption. Others are having supply chain issues that keep them from ramping up activity. Additionally, some families are still having issues finding daycare, which also keeps some from returning to the labor force. Then there is one last issue that doesn't seem to be getting a lot of attention. Older Americans are simply not returning to the workforce as quickly. Maybe they used the COVID-19 recession to call it a career or maybe they have enough in savings to wait for the job they really want before returning to the labor force. The employment situation is certainly more than just expanded benefits, despite the focus on that narrative. Workers seem to have the upper hand for now, and we will see how strong that hand is in the next month or two.

For these economic indicators to continue to trend positively, the economy must figure out solutions to the harder problems now. The initial pickup in employment as the world began to reopen represented the easier problems on the employment front. Now, per the JOLTS job openings report, we have more job openings than people unemployed and the NFIB small business jobs report is reporting that 48% of firms are having trouble filling jobs, by far the highest reading since they started keeping track in the 1970s. Similar to the global supply chain issues causing global inventory problems, we continue to believe that these employment issues are short term in nature as firms and workers adapt to new opportunities, but there are still notable risks to that assumption that are hard to pinpoint. The uncertainty caused by employment and supply chain issues are the main sources of the downside risk to the GDP estimates, with the possibility of COVID-19 variants a secondary source if they cause restrictions to be reinstated or lead to more hospitalizations.

Americans Over 55 Are Returning to Work Slowly or Not at All?



Source: Bloomberg; Copyright 2021 Bloomberg Finance L.P.



Source: Bloomberg; Copyright 2021 Bloomberg Finance L.P.

These employment issues will likely play out all over again in some form as the rest of the world starts to reopen as well, particularly in developed countries with large social safety nets. The optimism that comes with it should still overcome the issues though, as it has in the US. The European Union, Canada, and Australia have all recently expanded discussions about opening their borders again, with other countries set to follow soon too. As we've noted before, the reopening outside of the US comes with less investment market valuation concerns. It's why we have continued to preach about diversifying portfolios globally.

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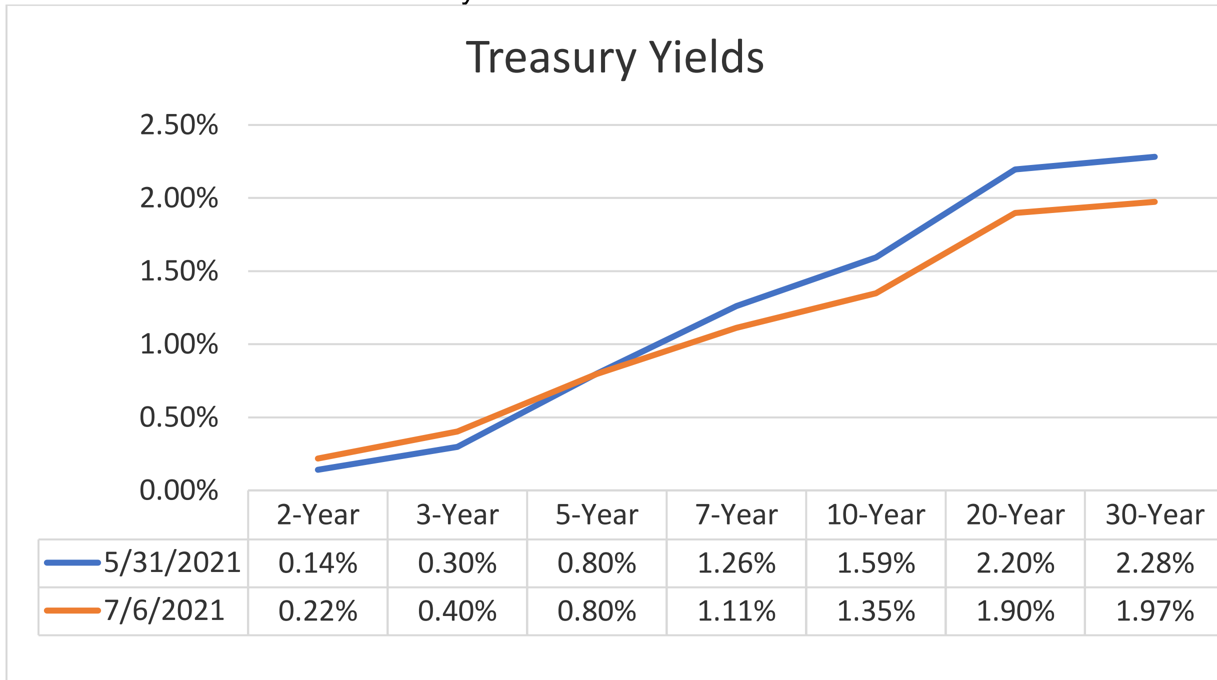
Alex supports the portfolio management team through market research that aids asset allocation decisions and due diligence on third party investment managers as a portfolio analyst II. Prior to joining Arvest Wealth Management in 2017, Alex was an investment manager analyst for an institutional consulting firm. He has a BSBA in finance, as well as a certificate in integrated investment management, and holds the Chartered Financial analyst designation as a member of the Chartered Financial Analyst Institute and the Kansas City Society of Chartered Financial Analysts.

Taxable Bond Market

Dennis Whittaker, CFA

After experiencing little change in yields during the month of May, the yield curve has experienced some dramatic shifts in recent weeks as intermediate and longer-dated Treasury rates declined while the shortest dated maturities experienced an increase in yield. The consequence was a rather notable flatting of the Treasury yield curve.

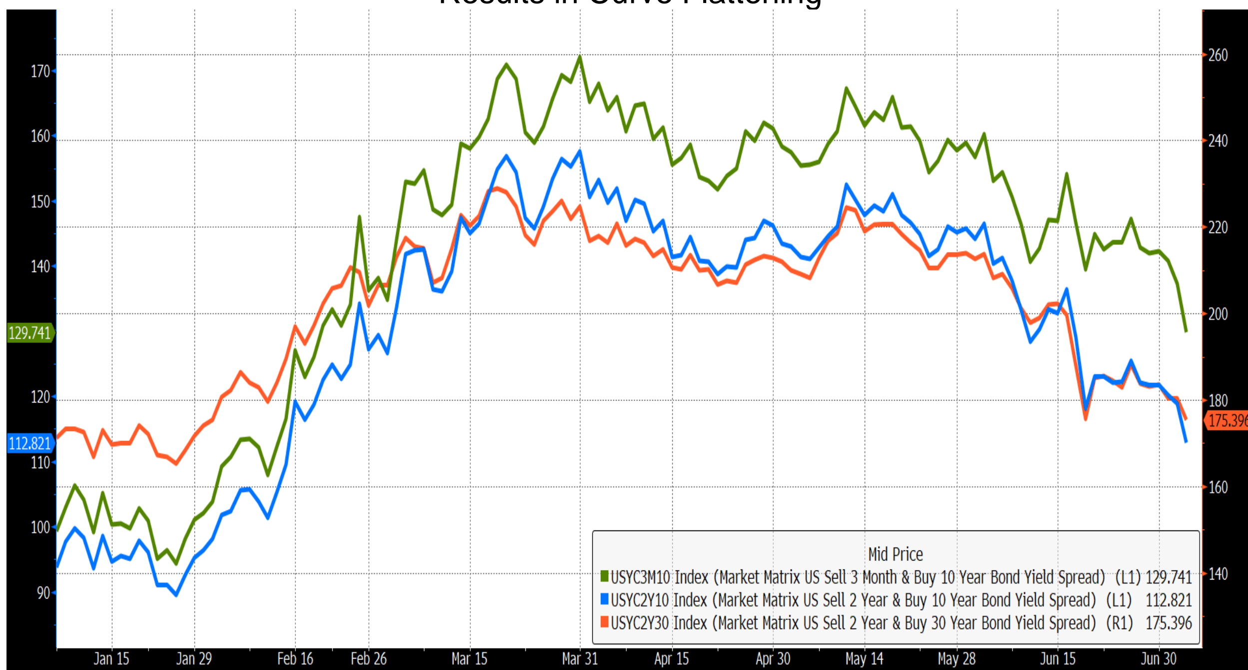
Treasury Curve Shifts in Recent Weeks



	2-Year	3-Year	5-Year	7-Year	10-Year	20-Year	30-Year
5/31/2021	0.14%	0.30%	0.80%	1.26%	1.59%	2.20%	2.28%
7/6/2021	0.22%	0.40%	0.80%	1.11%	1.35%	1.90%	1.97%

Source: Bloomberg

Results in Curve Flattening



Source: Bloomberg

Taxable Bond Market

Dennis Whittaker, CFA

Moreover, the movements experienced in yield levels have resulted in the yield for the 30-year benchmark Treasury bond falling below 2% for the first time since mid-February 2021. Additionally, the 10-year benchmark Treasury yield has broken through its most recent trading range of 1.55% to 1.75%.

10-Year Treasury Yield Has Broken Through the Lower End of Prior Trading Range

Source: Bloomberg

The recent movement in Treasury yields has been tied to a multitude of factors including a perception of a more "hawkish" tone from the Federal Reserve (i.e. dot plot now indicates the potential for two rate hikes from the Fed in 2023, which resulted in some upward pressure on shorter dated rates), a calming in market-based attitudes toward the inflation outlook (i.e. break-even spreads from Treasury Inflation Protected Securities (TIPS) have eased from peak readings), disappointment from the release of the ISM Non-Manufacturing survey (i.e. emerged below consensus expectations with the employment index falling sub-50) and technical pressures (i.e. Deutsche Bank estimated in a recent research note that purchases from the Federal Reserve had fully absorbed the entire net supply of Treasury issuance on a rolling 3-month basis).

Regardless of the rationale, we believe that the market has pushed intermediate and long-term rates too low in light of what we continue to believe is a robust economic environment. As a result, we recently reduced our duration band target for accounts managed versus the Bloomberg Barclays Aggregate and Intermediate Aggregate indices from 85%-95% to a new band of 82.5%-92.5%. Moreover, if we were to see Treasury yields make a sustained push toward even lower yield levels, we are of the mindset that it would likely provide another opportunity to push portfolio duration levels lower, especially as we believe that the ultimate direction for yield levels in the back half of 2021 is higher.

Taxable Bond Market

Dennis Whittaker, CFA

Bond Market Considerations Table and Sector Considerations

	7/6/2021	6/30/2021	6/22/2021	6/17/2021	6/15/2021	6/4/2021	5/28/2021	5/21/2021	5/20/2021
2-Year Tsy	0.22%	0.25%	0.23%	0.21%	0.16%	0.15%	0.14%	0.15%	0.15%
3-Year Tsy	0.40%	0.46%	0.44%	0.43%	0.33%	0.30%	0.30%	0.33%	0.32%
5-Year Tsy	0.80%	0.89%	0.86%	0.88%	0.78%	0.78%	0.80%	0.82%	0.81%
7-Year Tsy	1.11%	1.24%	1.21%	1.25%	1.19%	1.22%	1.26%	1.28%	1.27%
10-Year Tsy	1.35%	1.47%	1.46%	1.50%	1.49%	1.55%	1.59%	1.62%	1.63%
30-Year Tsy	1.97%	2.09%	2.09%	2.09%	2.19%	2.23%	2.28%	2.32%	2.33%
3MO-10YR	129.74	142.24	142.52	146.60	146.94	153.06	157.66	161.40	161.23
2YR-10YR	112.82	121.74	123.11	129.07	132.72	140.28	144.17	146.62	147.78
10YR-30YR	62.24	60.79	61.29	58.37	69.24	67.52	68.47	69.44	70.22
5YR BE	249.80	249.80	246.66	241.24	248.67	256.18	259.54	263.87	261.50
10YR BE	232.81	233.65	232.26	229.31	238.56	242.13	244.82	244.73	245.29
30 Year BE	226.92	228.27	228.60	228.54	236.69	233.45	233.90	231.37	231.69
IG OAS	82.00	80.00	82.00	82.00	83.00	85.00	84.00	86.00	86.00
HY OAS	262.00	268.00	285.00	284.00	286.00	297.00	296.00	307.00	311.00
MBS OAS	31.00	27.00	27.00	28.00	25.00	19.00	16.00	15.00	16.00
MOVE	56.55	57.27	58.64	54.91	52.92	49.78	52.04	54.59	55.04
ABS OAS	23.00	22.00	23.00	23.00	25.00	25.00	25.00	27.00	27.00
CMBS OAS	59.00	59.00	56.00	56.00	57.00	59.00	58.00	60.00	60.00
Agcy	30.00	29.00	24.00	25.00	25.00	27.00	26.00	27.00	27.00
Taxable Muni OAS	88.00	85.00	87.00	87.00	88.00	89.00	89.00	90.00	91.00
EM USD OAS	277.00	269.00	266.00	267.00	267.00	269.00	267.00	270.00	270.00

Source: Bloomberg; Barclays

As can be evidenced from the table above, we have seen some widening in the option-adjusted spread (OAS) level for agency residential mortgage-backed securities (RMBS) in recent weeks. Indeed, the spread has widened enough for us to “upgrade” our valuation opinion on the sector from “unfavorable” to “slightly unfavorable”. Nevertheless, we suspect that it remains too early to lift our allocation to the sector as we worry that the Federal Reserve could utilize the MBS sector to begin its asset purchase tapering given the presently robust level of home price increases the economy is currently experiencing. Still, if the OAS for the agency RMBS index were to push up toward a level between 40 and 50 and if the OAS for the corporate credit indices remain at their presently low levels, we would likely utilize this as an opportunity to rotate dollars out of the investment grade corporate bucket into mortgage securities.

Dennis Whittaker

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Dennis is responsible for the construction and management of several fixed income portfolios. Prior to rejoining Arvest Wealth Management in 2006, he managed a tax-exempt mutual fund for an investment advisory firm and prepared all their fixed income research. Dennis has a BSBA in Economics and holds the Chartered Financial Analyst designation. He is a member of the Fixed Income Analysts Society and the Board of Directors for the Southern Municipal Finance Society, previously serving as chair, and a former member of the Board of Governors of the National Federation of Municipal Analysts.

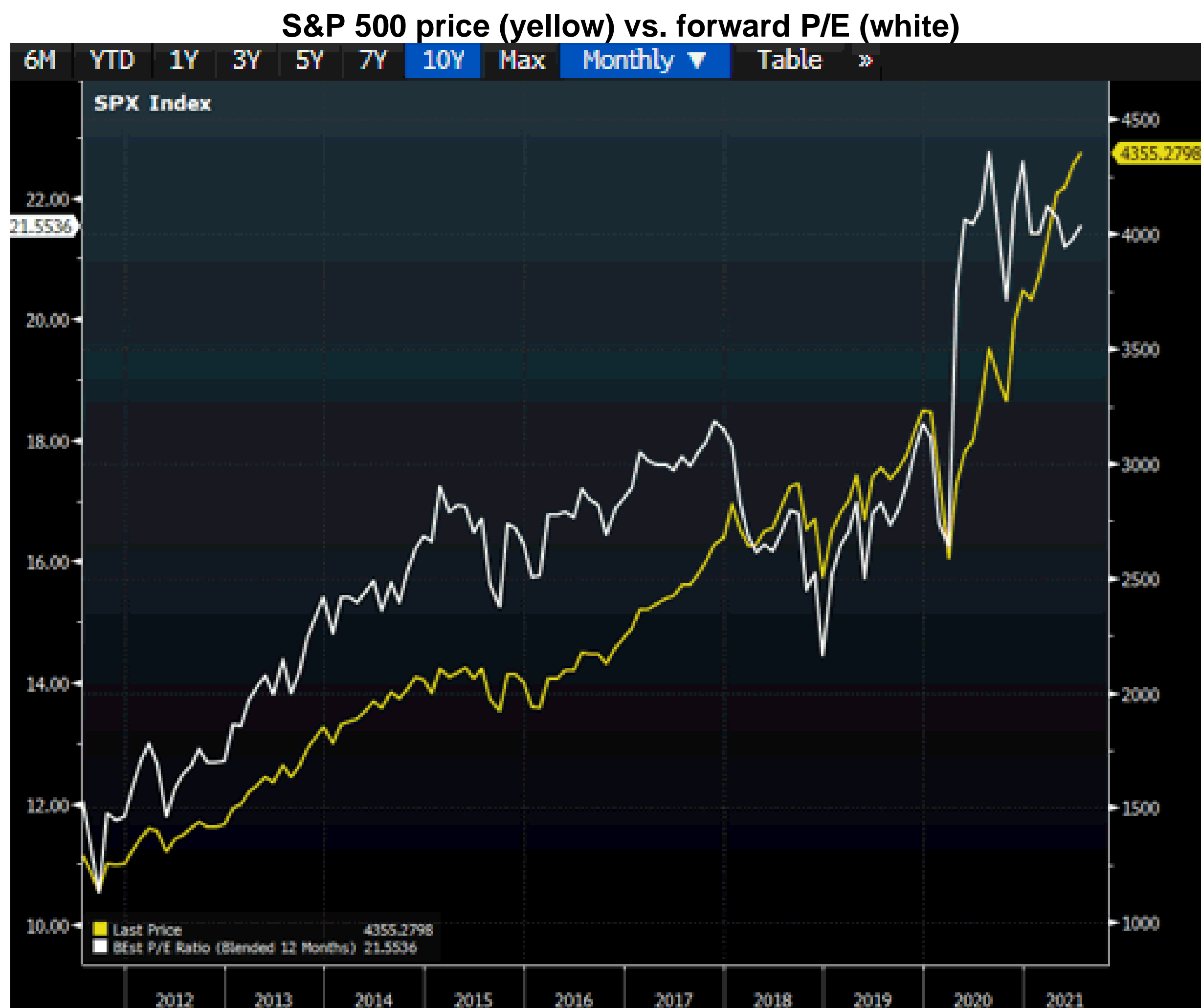
U.S. Equity Market

Christopher Magee, Ryan Ritchie, and Bret O'Meara

The stock market at midyear is at or near all-time highs. New risks to the market include changes in interest rates, surges in inflation that may (or may not) be reopening-related, and a political logjam on infrastructure stimulus that may (or may not) be breaking up. The old risk that has been overhanging this market for at least half a year is valuation, which may (or may not) be ameliorated by sector rotation.

Economic growth cures a lot of sins, but it cannot fully cure an overvalued market. The S&P 500 trades at a 12-month forward P/E of 21.5, compared to an average over the last 10 years of about 16-17. This would imply a negative repricing return of about 20%.

S&P 500 price (yellow) vs. forward P/E (white)



Source: Bloomberg; Copyright 2021 Bloomberg Finance L.P.

That does not mean stocks are riding for a fall. Earnings growth will offset some of the inevitable fall in valuations. Also, the stock market can stay at over- and undervalued levels for an extended period, often until some extraneous event triggers a market response.

U.S. Equity Market

Christopher Magee, Ryan Ritchie, and Bret O'Meara

Another factor supporting stocks at current levels is the dearth of attractive alternatives. Bonds are equally overvalued with the prospect of long-term rising interest rates.

Finally, and perhaps most importantly, the broad rotation to cyclical, defensive, and inflation-resistant stocks have enabled a broad advance in which all sectors are in positive territory for the year. An environment in which breadth leads price prevents the market from becoming concentrated and toppy; unlike markets with good breadth, thin-leadership markets tend to topple over.

Summer is now underway, and sizzling weather often coincides with subpar stock returns. The S&P 500 has banked a mid-teens percentage total return heading into the second half. Given positive economic and earnings fundamentals, and notwithstanding any inflation fears, we believe that stocks are poised for a muted second half as the reopening process continues and earnings advance, balanced with a fall in valuation multiples.

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Bret assists and support the management of investment portfolios through research, analysis, and trading of equity securities. He joined Arvest Wealth Management in 2010 as a member of the Retirement Plan Services Group before transitioning to the Investment Management Group. Bret has a BSBA in Economics and Finance and MBA, and taught courses in accounting and economics at Northwest Arkansas Community College for six years.

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Christopher is the lead manager of the Arvest Bank Group Equity Fund and the Investment Management Group DIG Equity Portfolio and is responsible for construction of equity portfolios for institutional and retail clients, including equity research, security selection, sector weightings and trading. Prior to joining Arvest Wealth Management in 1992, he served as a trust investment officer at a national bank in Shreveport, Louisiana and a bank in Amarillo, Texas. He has a BSBA in Finance, with an emphasis in investments, and is a graduate of Cannon Financial Institute's Advanced Trust Investments School.

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Ryan is co-manager of the Arvest Bank Group Equity Fund and co-lead manager of the Investment Management Group's strategic portfolios and is responsible for the construction of equity portfolios for institutional and retail clients, including equity research, sector weightings, and trading. Additionally, he is responsible for directing the implementation of Arvest Wealth Management's equity strategy throughout trust and brokerage relationships. Ryan has a BSBA in Finance with an emphasis in Financial Management. Ryan has been managing portfolios since 2002.

Appendix

Investment Management Group Team Members

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Christopher Magee, Sr Equity Portfolio Manager

Ryan Ritchie, Portfolio Manager

Dennis Whittaker, Sr Portfolio Manager

Alain Monkam, Portfolio Manager

Kevin Woodworth, Portfolio Manager

Alex Jantsch, Portfolio Analyst

Josh Warner, Portfolio Analyst

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Jake Baker, Fixed Income Analyst

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Bret O' Meara, Advisory Solutions Support Specialist

Jennifer Tichenor-Turner, Adv Solutions Support Specialist

Jesica Campbell, Advisory Solutions Support Specialist

Charles Kurtz, Executive Assistant

Description of IMG Recession Indicators

- Conference Board Leading Economic Indicators (LEI) - The indicator tracks the Year-over-Year percentage change in the Conference Board Leading Economic Indicators Index. The index is an American economic leading indicator intended to forecast future economic activity. It is calculated by The Conference Board, a non-governmental organization, which determines the value of the index from the values of ten key variables.

- U.S. Treasury Yield Curve (3-month to 10-year Spread) – This indicator measures the spread between the fixed income yields of the 3-month Treasury Bill and the 10-Year Treasury Bond. The lower this number, the flatter the yield curve is. The flatter the yield curve is, the less longer term investors are getting compensated over shorter term investors for the inherent interest rate risk. If the spread goes below zero, this means that the yield curve has inverted.

- ISM New Orders-to-Inventories Spread – This indicator looks at the spread of reported new order levels versus reported current inventories levels. The Institute for Supply Management (ISM) surveys 300 manufacturing firms on numerous manufacturing data points to get data points for both new orders and inventories.

- Core Capital Goods (New Orders) – This indicator tracks the Year-over-Year percentage change in the value of new orders received during the reference period. Orders are typically based on a legal agreement between two parties in which the producer will deliver goods or services to the purchaser at a future date.

- Initial Jobless Claims – This indicator tracks the number of initial unemployment claims of people who have filed jobless claims for the first time during the specified period with the appropriate government labor office. This number represents an inflow of people receiving unemployment benefits.

- New Building Permits – This indicator tracks the number of construction permits that have been issued and approved for new construction, additions to pre-existing structures, or major renovations.

DISCLAIMER: These are not the only indicators that the IMG team looks at, and no decision should (or will) be made on any single indicator. These are simply what the IMG team utilizes to ***help*** forecast potential for a recessionary environment.

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Not FDIC Insured | Not Insured by Any Federal Government Agency | May Go Down in Value