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4TH QUARTER
2021

COLONIAL TRUST *Quarterly*

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IN THE SPOTLIGHT

Ellen Taylor
Assistant Trust Administrator

ELLEN TAYLOR joined Colonial in 2019 after three years of service at Haynsworth Sinkler Boyd, P. A. where she served as a legal assistant. A native of Columbia, SC, Ellen earned her bachelor's degree in Accounting and Business Administration from The College of Charleston in 2015. Ellen works in our Columbia office, where her primary responsibilities include trust administration, client services, and operations.

Ellen lives in Florence, SC with her husband, John. On the weekends, they enjoy spending time with Charlie, their spoiled Golden Retriever, at their family's farm just outside of Florence. After work, you can find Ellen staying in shape with her kickboxing workout class at 9round, which she has attended over 800 times since 2016! Ellen also stays active by playing tennis and the occasional round of golf at the Florence Country Club.

Ellen also enjoys shopping, spending time with family, and traveling. On vacation, you might find her at a concert in Nashville or on a white sandy beach somewhere in the Virgin Islands.

THIRD QUARTER BY THE NUMBERS

The S&P 500 provided a total return of 0.58% for the quarter, with a 5.85% increase from June 30th to an all-time high on September 2nd. The market fell 5.06% from that level through month-end. After eight consecutive months of gains, the markets were negative 4.65% for September. For the quarter, the S&P 500 outperformed other domestic indices, with the tech-heavy Nasdaq down 0.22% for the quarter and the DOW down 1.46%. International indices were in the red and the MSCI Emerging Markets Index fell 8.00% for the quarter as China's Hang Seng index fell 14.75%. The US Aggregate Bond Index provided returns of 0.05% for the quarter and the 10yr US Treasury yield increased 2 basis points during the quarter to close at 1.49%

Index	3Q %	YTD %
S&P 500	0.58%	15.91%
Nasdaq Composite	-0.22%	12.67%
DJIA	-1.46%	12.12%
Russell 2000	-4.36%	12.40%
MSCI EAFE	-0.32%	8.81%
MSCI Emerging Markets	-8.00%	-1.07%
US Agg Bond Index	0.05%	-1.55%

Source: Bloomberg

MARKET COMMENTARY

The market strength of the first half of the year continued into the third quarter. Mid-July brought earnings from Mega-Cap tech stocks, and while earnings were fantastic (Amazon notwithstanding), stocks sold off due to the lack of earnings guidance. As earnings season continued and results surpassed expectations, the markets rallied into early September. The second quarter earnings results were one of the best on record. S&P 500 earnings grew 91% according to Factset, the highest rate since Q4 2009. Moreover, 87% of companies exceeded analyst's earnings expectations, the highest number since this metric was tracked in 2008. Additionally, 67 companies increased guidance for earnings growth. Cyclical companies fared better than others with the industrial sector reporting 413% earnings growth.

After earnings season and the market high in early September, focus turned to macro-economic data and public policy (Fed and fiscal) causing increased volatility. The last two weeks of September proved to be the most treacherous as the market wrestled with the possible default of Chinese property developer Evergrande, debates in Washington, and a possible change in Fed policy. Longer term, investors are forecasting a deceleration in economic and earnings growth, after reopening induced snapback. Growth is also being hindered by supply chain issues, inflationary pressures, and a moribund labor market.

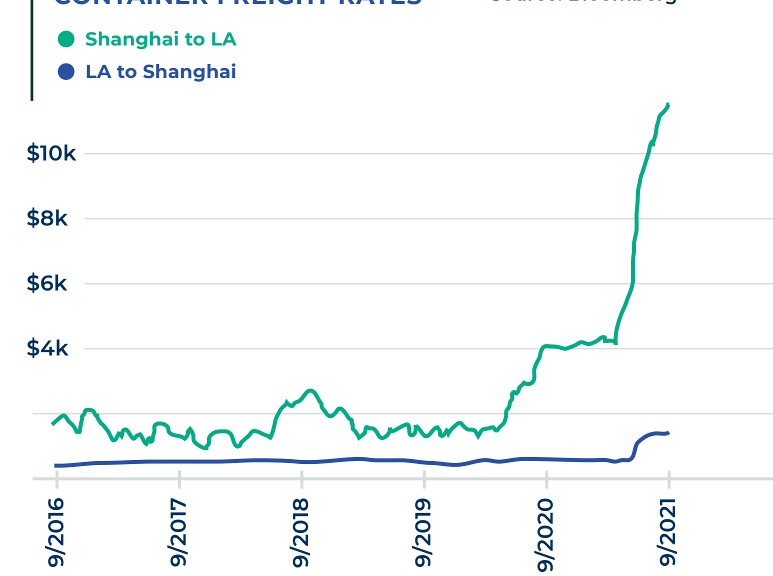
WE BELIEVE INFLATION WILL ULTIMATELY BE TRANSITORY; HOWEVER, INFLATIONARY PRESSURE WILL BE WITH US INTO 2022.

This is pressuring the Fed to act to prevent higher inflation from taking hold in consumer expectations. Fed policy is a key determinate in asset prices and these inflationary pressures increase the risk of a Fed policy error.

The problem facing the economy is not a lack of demand. Rather, the economy is facing supply constraints which are causing higher prices. The chip shortage is well documented and is evident in the lack of new cars on dealer lots. It was reported that Ford is stock piling its nearly finished Super Duty trucks at the Kentucky Speedway. The stockpile has grown so large it is now visible in satellite images from space. Customers can either wait for chips to be delivered to finish production or choose a model with fewer tech options and therefore fewer chips

The supply issues are not limited to chips and transportation itself has become problematic. In late September, there were more than 70 ships off the ports of Los Angeles and Long Beach waiting to unload goods. Most of these goods are from China and US demand seems insatiable. This has caused freight rates from Shanghai to LA to increase nearly 200% since year-end. These high rates have resulted in empty containers returning to China to be reloaded rather than remain the US to be filled and deliver agriculture products to Southeast Asia. This leaves agriculture goods in railcars and warehouses, rather than on ships to Asia, reducing the availability of storage space and railcars to transport imports throughout the US. Congestion in the rail system, further delaying shipments, and increasing costs are the result of this shipping problem.

CONTAINER FREIGHT RATES Source: Bloomberg

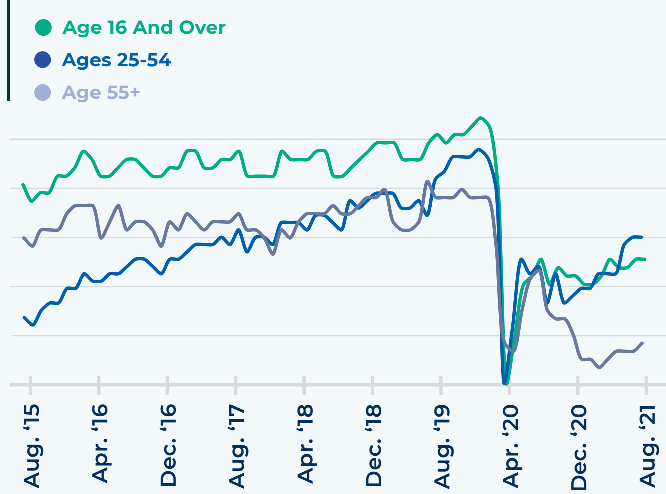


IMPACTS ON THE ECONOMY

LABOR FORCE

Perhaps the most critical supply issue facing the economy and corporate margins is labor. In January 2020, the labor force participation rate (LFPR) was 63.3% and fell to 60.2% in April 2020. While it has rebounded, it remains 1.6% below pre-pandemic levels. The LFPR of prime working year employees (ages 25-54) was 83% in January 2020 and fell to 79.8% in April 2020. This has rebounded, but at 81.8% remains below pre-pandemic levels. In January 2020, the LFPR for the 55yr and older cohort was 40.3% and fell to 38.5% in April 2020. Unlike their younger countrymen, older Americans have not returned to the workforce and their LFPR remains 38.5%.

LABOR FORCE PARTICIPATION RATE



Source: Bloomberg

Economists expected Americans to return to work as expanded unemployment benefits ended, vaccination rates roses, and children returned to school. While there has been improvement, the total number of employed Americans remains 5.3mm people below the pre-pandemic levels. It is clear many older Americans have opted for retirement during the pandemic. The weakness in prime age workers is likely a combination of skills mismatch, childcare, and government largess. It is certainly not for a lack of job openings, with the July job openings standing at 10.9 million. The lack of workers has forced companies to offer signing bonuses, raise wages, and reduce capacity.

SUPPLY & DEMAND

We have seen energy prices increase globally due to increased demand and supply issues. Domestically, we have seen higher prices for oil and natural gas partially due to production shutdowns from Hurricane Ida. Energy companies reduced their investment budgets in 2020 and are not expected to increase production dramatically in the near-term. In Europe, carbon policy has increased reliance on green sources of energy. This has proven difficult due to lower winds in the North Sea, where many wind farms reside. Europe has been forced to import natural gas from Russia and the US to offset lower wind farm production causing US natural gas prices to increase 124% year to date.

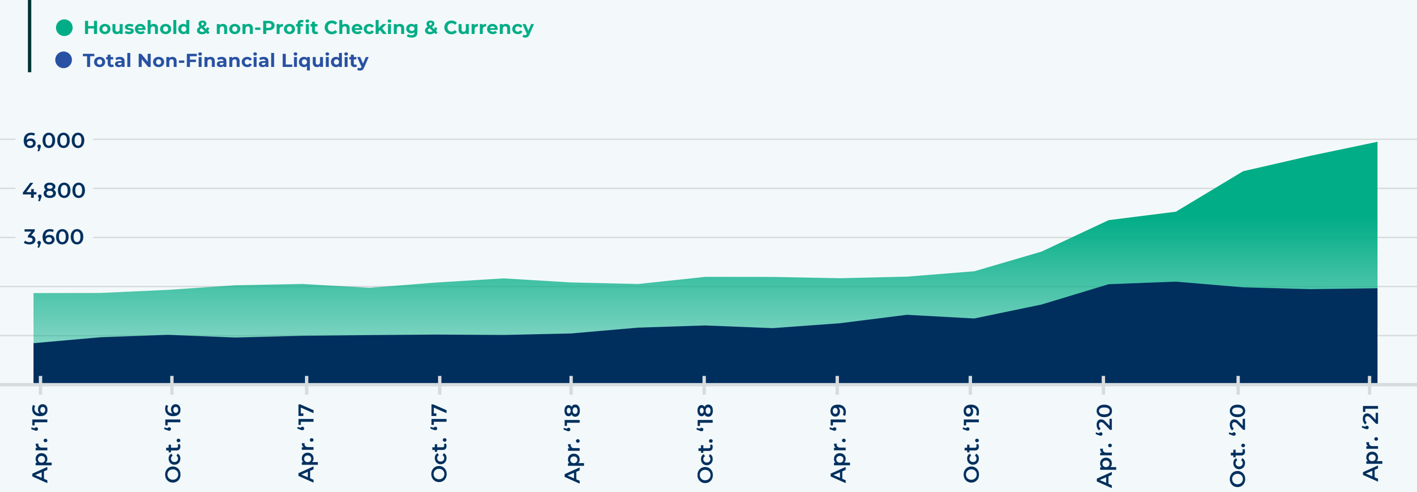
THESE SUPPLY-INDUCED INFLATIONARY PRESSURES ARE FORCING THE FED TO RESPOND.

In their September 22nd meeting, Chairman Powell signaled the Fed would soon begin to taper their monthly $120 billion bond purchases. Fed Governors also guided the market to expected rate increases in 2022. This caused interest rates to move higher across most maturities of the Treasury curve. The benchmark 10yr Treasury rose from 1.3% to 1.51% during the last two weeks of the quarter. While interest rates remain low on a historical basis, they increased rapidly as the quarter ended in anticipation of a less dovish Fed. This quick increase in yields pressured stocks during September.

NEW BUSINESS FORMATION & INVESTMENT

While there are concerns in the market, there are also tailwinds heading in the fourth quarter and 2022. Non-financial companies and households are flush with cash. Fed data shows households ended the first quarter with $3.6 trillion in checking accounts, a 177% increase from the beginning of last year. Non-financial companies increased their liquidity by 21% over that same period to $2.4 trillion. Consumer spending represents 69% of GDP and the consumer is well positioned.

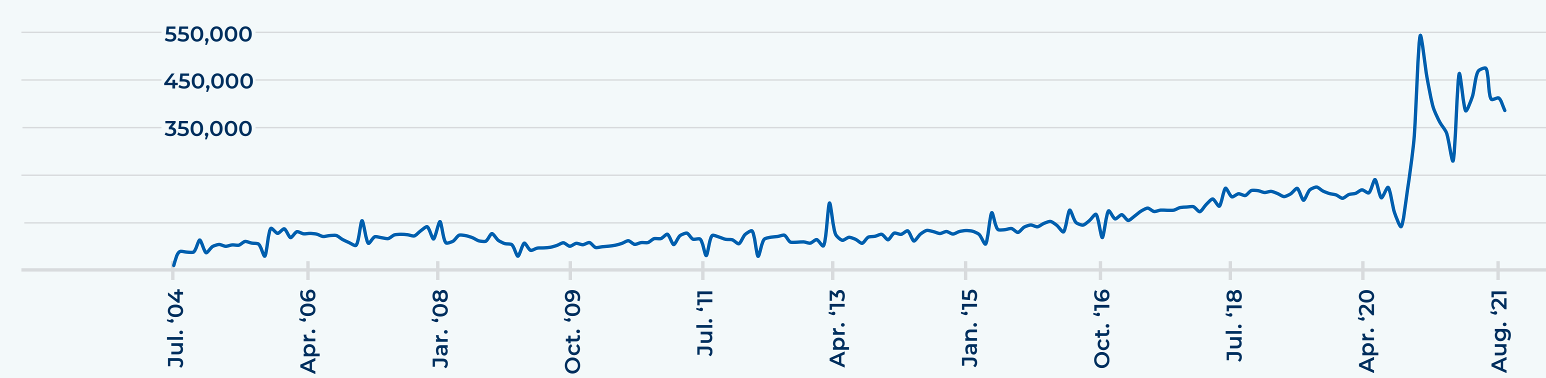
NON-FINANCIAL & HOUSEHOLD LIQUIDITY



Source: Federal Reserve

Another interesting occurrence post-pandemic is the increase in new business formation. According to the Census Bureau new business formation averaged 292k in 2019. Formation fell during the lockdowns and moved significantly higher as the economy reopened. For the month of August 2021, the annualized rate of new business formation is 83% higher than April 2020 at 427,842. Individuals choosing to hang their own shingle may explain a portion of our labor shortage. It shows the American Dream is alive and well as entrepreneurs have taken lemons and made lemonade.

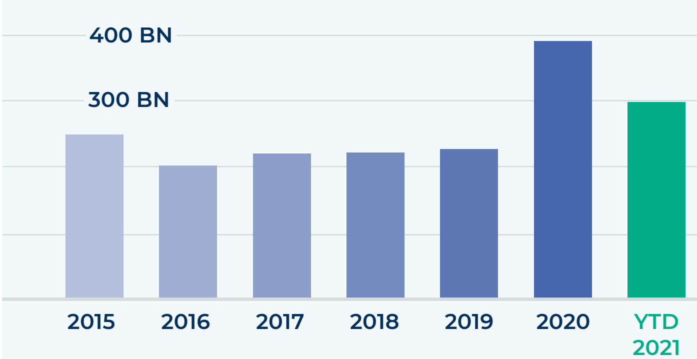
NEW BUSINESS FORMATION



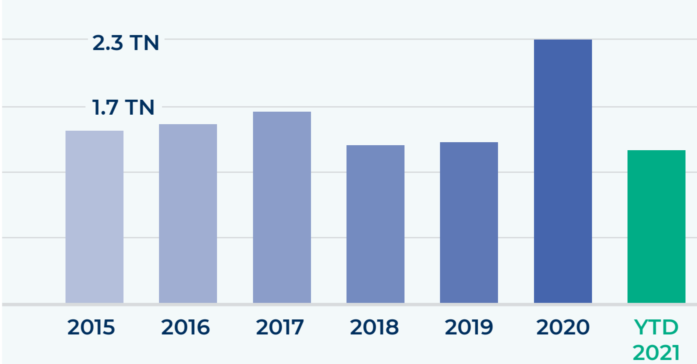
Source: US Census Bureau

The financial system is ready and able to fund business investment and new business creation. Bank loan losses expected during the first half of 2020 were far too pessimistic. Banks balance sheets are strong, and they are flush with deposits to lend. JP Morgan total deposits have increased 47.5% from FYE19. The dollar value of equity issuance increased 71% in 2020 over 2019 and year to date is up 22% over 2020. The bond market has also seen strong issuance since the pandemic. Debt issuance in 2020 increased 60% over the prior year. Year to date debt issuance is below 2020 level, it is 41% above the same period in 2019. The liquidity on bank and consumer balance sheet has proven willing to fund capital formation and economic activity.

US EQUITY ISSUANCE



US DEBT ISSUANCE



TRANSITION PERIOD

The economy and capital markets are in a period of transition. The economy was supported with extraordinary monetary and fiscal stimulus over the last 18 months. As the economy has strengthened, the need for additional stimulus has fallen and the Fed is preparing to become less accommodative. The path of fiscal stimulus is less certain and it appears the $1.5 trillion infrastructure bill will pass, but the additional $3.5 trillion reconciliation will be reduced were it to become law.

THE ECONOMY AND MARKETS ARE MOVING AWAY FROM RELIANCE ON STIMULUS TO A RELIANCE ON ECONOMIC AND MARKET FUNDAMENTALS.

This transition will not always be smooth, and it is complicated by the supply issues outlined above. However, it is necessary and ultimately a positive signal regarding the economy. Growth is slowing from a breakneck pace and GDP growth for the 4th quarter is projected to be 5.1% and 4.2% next year before slowing to the 2.0% range thereafter. S&P 500 revenues and earnings are projected to grow 9.4% and 34.7% in the fourth quarter, with 2022 forecasts of 6.5% and 9.1%. Forecasts could be optimistic if these supply issues persist for longer than expected. We believe supply chains will improve, albeit at different paces. We will continue to watch labor market indicators to determine if employees are returning to the workforce.

Given a choice of an economy with strong demand and insufficient supply or weak demand and excess supply, we prefer the current scenario. We believe the markets will continue to be choppy over the next few months as the supply chain issues are resolved. But we continue to expect revenue and earnings growth which support long-term equity fundamentals.

THE BACK PAGE

When contemplating writing the back page of this letter, we expected to discuss changes in tax policy; however, no bills have passed. Our staff includes a CPA, two CFA Charterholders, a lawyer, a former state chair of a political party, two CFP® Professionals, and decades of experience, yet we are struggling to keep up with the daily machinations of the negotiations in Washington.

As we enter the 4th quarter, we are advising clients to be nimble when considering any changes to tax and estate plans. Congress is debating the debt ceiling, an infrastructure package, and a $3.5 trillion reconciliation package. The draft of the reconciliation bill from the House Ways and Means Committee would have significant implications on tax and estate planning. Certain key tax aspects of the House proposal are:

1. Reduce lifetime exemption to $6 million by year-end
2. Limit use of Grantor Trusts after the Effective Date
3. Elimination of valuation discounts of passive assets
4. Increase in the capital gains tax rate
5. Elimination of step-up in cost basis at death
6. Limitations to Roth conversions
7. Increase in individual and corporate tax rates

The passage of this legislation remains uncertain. If passed, taxpayers would have little time to update planning before it became effective. This leaves individuals, tax attorneys, CPA, and advisors evaluating possible strategies with uncertain information. The supply and demand issues highlighted above also apply to professionals offering tax and estate planning advice.

For that reason, if you are concerned about how possible changes may impact your estate plan, please reach out to Colonial Trust, your CPA, or your estate planning attorney to discuss the implications. Also be aware, no one has a crystal ball to predict changes to the tax law and in that circumstance, it is wise to not let perfection be the enemy of good.

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