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Annual Market Insights & Looking Ahead

A Grand Economic Reopening, a Gilded Age for Investors

The reopening of the economy, new vaccines, the pandemic, strong economic growth, rising oil and home prices, and a burst of inflation were among the major events last year.

For investors, 2020's advance spilled over into 2021. The S&P 500 Index rose 28.71%, including dividends. In fact, this was the best performing of the major stock indices listed below.

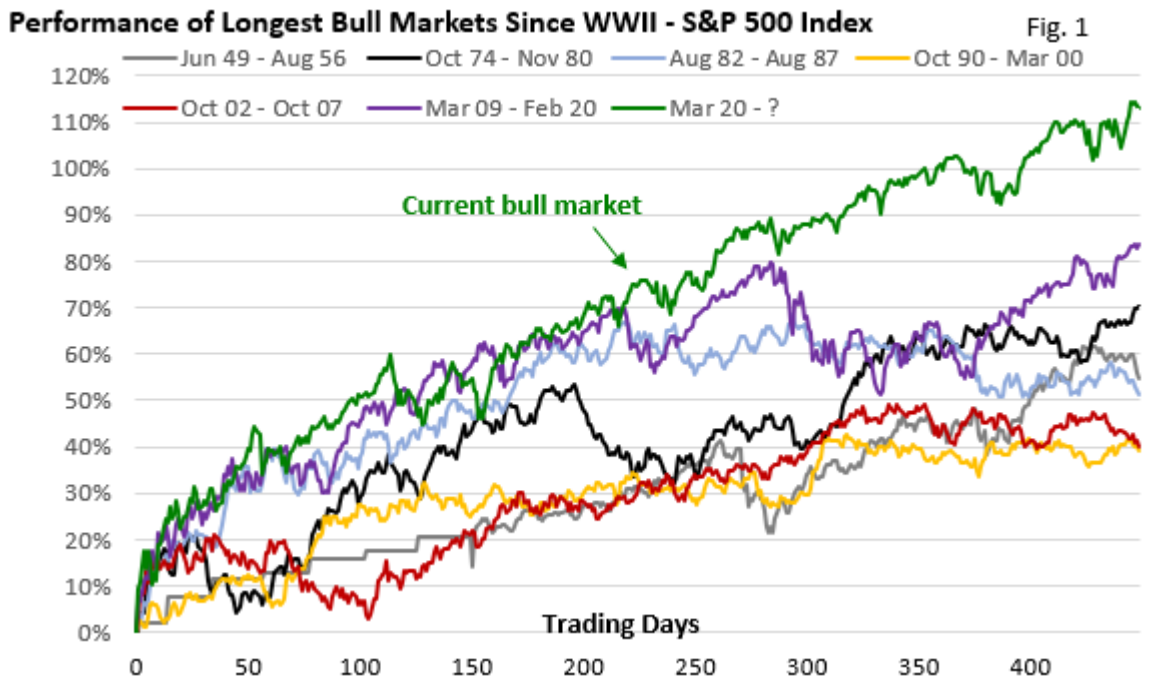
Stock Indices	4th Qtr. 2021 Return %*		YTD Return %*
S&P 500 (large)	+11.03%		+28.71%
S&P 400 (midsize)	+8.00%		+24.76%
Russell 2000 (small)	+2.14%		+14.82%
MSCI EAFE (intl.)	+2.69%		+11.26%
Bond Yields	**12/31/2021 Yld. & Yrly. Change**		**Dec 31, 2020 Yield**
3-month T-bill	0.06%	(-0.03%)	0.09%
2-year Treasury	0.73%	(+0.60%)	0.13%
10-year Treasury	1.52%	(+0.59%)	0.93%
30-year Treasury	1.90%	(+0.25%)	1.65%
Commodities	**12/31/2021 Price & Annual Change**		**Year end 2020**
Oil per barrel	$75.21	(+$26.69)	$48.52
Gold per ounce	$1,828.60	(-$66.50)	$1,895.10

*Stock indices include reinvested dividends and are not annualized for the 4th quarter.

Simply put, economic growth translated into much better-than-expected corporate profits. Low interest rates and low Treasury yields added to the luster of equities if for no other reason than there were few competing investments that offered reasonable returns.

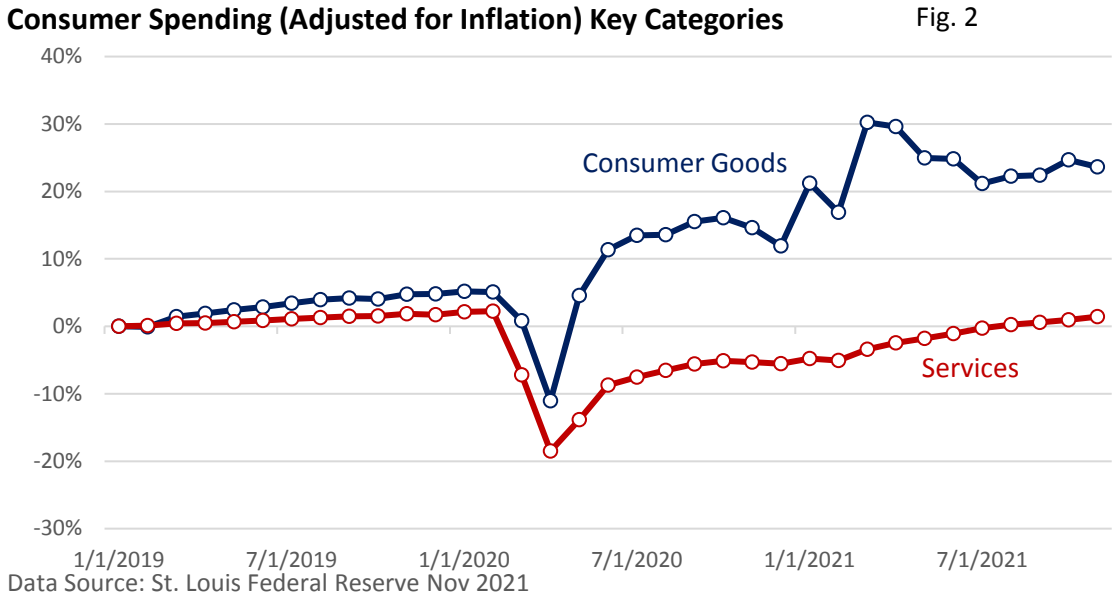
Fig. 1 reviews the best performing bull markets since WWII, including the current run. As the graphic illustrates, the current bull market, which began in late March 2020, is off to a fast start.

Ultra-low interest rates, very easy monetary policy from the Federal Reserve, and stellar corporate profits have more than offset inflation fears and economic worries about the ongoing pandemic.



Data Source: Yahoo Finance, St, Louis Federal Reserve, S&P Capital IQ 12/31/2021 (449 trading days)
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

Overall, the economic expansion has been robust, but it has not benefited all sectors equally, as highlighted in Fig. 2.



Data Source: St. Louis Federal Reserve Nov 2021

Stimulus money favored consumer goods. Pent-up demand is aiding services, such as recreation and travel, but it continues to lag. All of this has led to this year's burst of inflation.

We Haven't Seen This Type of Inflation Since the Late 1940s

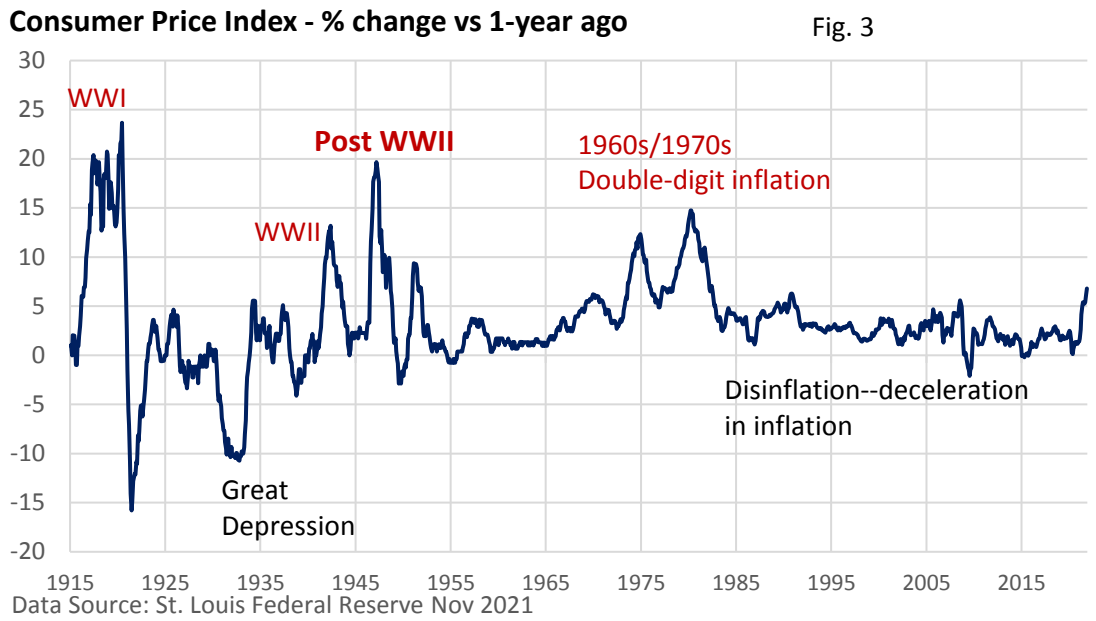
This is not your father's inflation. It's your grandfather's inflation.

When millions of troops came home after World War II, they demanded everything from appliances to clothing.

Further, a wartime economy that favored production of military equipment over consumer items led to rationing and pent-up demand for consumer goods after the war.

The shift to peacetime production didn't occur overnight, and prices temporarily spiked.

Today, we have trillions in stimulus, a reopening of the economy, and a shortage of some goods tied to global supply-chain woes. In other words, strong demand collides with supply shortages. Mix in a very accommodative Fed, and inflation hit its fastest pace in 40 years.



Peeking Ahead at 2022

"It's tough to make predictions, especially about the future."
—Baseball manager/philosopher Yogi Berra

Including reinvested dividends, the S&P 500 Index has doubled over the last 3 years. It's natural to ask if this can continue into 2022. Recognizing the obstacles faced when peering into the future, let's dust off our crystal ball and touch on some of the key issues as we move into 2022.

China's fast-growing economy has been fueled by debt, and real estate is no exception. During the fall, cracks appeared. Real estate is a big part of China's economy. If it crumbles, expect it to ripple through the global economy. However, that's a big 'if.' Odds of a 2022 real estate collapse in China probably aren't high, but what happens in China bears watching.

Inflation is uppermost on the minds of many folks. Is inflation set to peak early in the year? Peaking isn't the same as price stability. It simply means price hikes aren't accelerating as quickly. Depending on the trajectory of Covid and lockdowns in various countries, most

analysts believe supply-chain problems will ease sometime this year. Rising wages, however, may become a problem. If so, businesses could raise prices to compensate for higher costs.

If we avoid a wage-price spiral, economic growth moderates, and supply-chain woes recede, the rate of inflation will probably slow at a quicker pace. It would also ease pressure on the Fed.

The **Federal Reserve** has taken notice of price increases. It is unwinding its bond buying program at a faster pace and is considering three rate hikes in 2022. Could we see more than three rate hikes? Inflation will play a big role in the Fed's stance.

Despite much higher inflation this year and talk of a more hawkish Fed (i.e., less likely to be accommodative in keeping interest rates low), the yield on the 10-year Treasury remains quite low, finishing last year at 1.52%, per the U.S. Treasury Department.

Robust economic growth, higher inflation, and a less dovish Fed (and fewer Treasury bond buys by the Fed) should be translating into much higher yields. That hasn't happened – see Fig. 4.

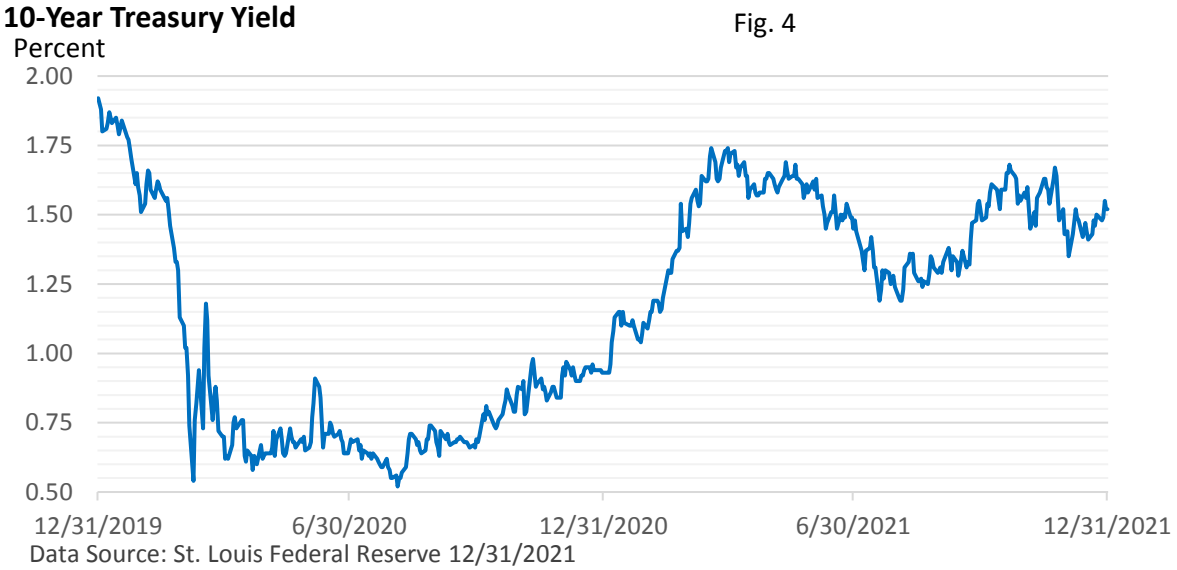


Fig. 4

Either bond investors are expecting inflation and the economy to slow next year, or there have been fundamental changes in the bond market that are holding down yields.

Whatever the cause may be, low yields are supportive of stocks in an expanding economy. However, a large increase in yields could create some market volatility and a possible sell-off in the stock market.

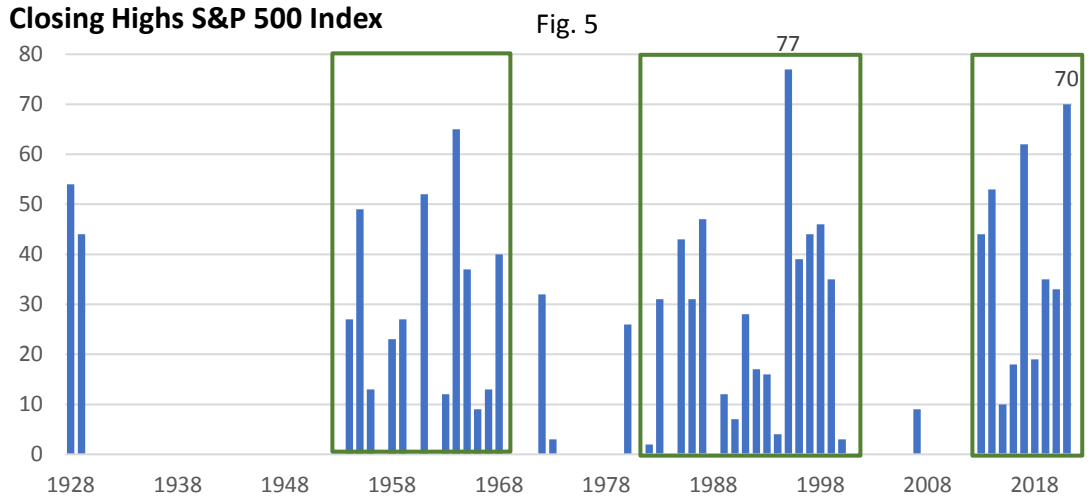
Finally, **how will the pandemic play out**? Will new variants surface? The Delta variant temporarily slowed growth in the late summer, but market reaction was muted.

As we enter 2022, Omicron is getting attention. U.S. cases are rising, and some folks may hesitate to congregate in public places, which could dampen growth. Yet, we've seen limited market reaction so far. A late December survey by the Wall Street Journal reflected concerns of

a temporary global slowdown in early 2022. Local and state governments, however, have been reluctant to impose significant new restrictions considering their potential consequences.

New Highs and Perspective

Fig. 5 illustrates the number of new closing highs for the S&P 500 Index in each respective year. In 2021, we had 70, which is on top of 33 new highs in 2020.



Data Source: LPL Research, St. Louis Federal Reserve, WSJ 12/31/2021

New highs can tempt some investors to back away from equities or wait for a big pullback to put new cash to work. Others are tempted to become aggressive. We may see a pullback, but new highs are typically the hallmark of a bull market, as illustrated by Figure 5.

Yet, we recognize that downturns are a part of investing. Based on your goals, circumstances, time horizon and risk tolerance, we craft portfolios to help manage risk, but we can't eliminate risk.

If one trades the fear of sell-offs for a savings account, one won't participate in the long-term returns that stocks have historically offered. Conversely, take on too much risk and you may experience sleepless nights in a swift downturn. This is where a well-diversified portfolio that is customized to your specific situation is so important.

If life events have forced you to rethink your goals, let's talk. If not, adherence to one's financial plan and a long-term focus have historically been the straightest path to reaching one's financial goals. While we expect greater volatility this year, we understand that predictions are simply educated guesses. If history is our guide, however, sell-offs are followed by rebounds.

From all of us, we wish you the best of health and happiness throughout 2022.

Hopwood Financial Services, Inc.