

## Year-End Review and Outlook

### Looking back – a review of 2020. Wait - it was 2021!

The upside of our "Groundhog Day" experience was that 2021 looked a lot like 2020 when it came to overall stock market returns. The market's recovery from the lows of 2020 continued into 2021, supported by economic progress as pandemic restrictions started to lift. As expected, there were bumps along the way with the Delta and the recent Omicron variants threatening new lockdowns, while global supply chain disruptions and energy policy fueled fears of inflation. However, a supportive Fed and government spending continued to provide the needed stability, and we ended the year with many indexes reaching all-time highs.

In contrast, fixed income and emerging markets didn't fare as well last year. The accommodating monetary policy that led to strong bond market returns in 2020 has shifted – the Fed slowed down their bond purchases and has already signaled that they will likely start raising interest rates earlier this year. The prospect of higher rates in the U.S. also negatively affected investments in the emerging markets, whose economies have been lagging due to less aggressive fiscal and monetary support, overall slower vaccination rates, and the effects of the global supply chain disruption.

As rewarding as it was to have double-digit returns for equities over the last two years, it's important to remember that such gains are not historically common. 2021 and 2020 market returns have been well above the long-term averages and it's reasonable to expect that going forward returns will be muted in comparison. (The table below shows the returns for the major asset classes for the last two years, along with the average annual returns for the last 25 years.<sup>1</sup>) We are less optimistic about the coming year given elevated valuations, waning policy support, and potentially higher interest rates, all of which will provide headwinds to the equity markets.

	2021	2020	Previous 25 Years
U.S. large cap stocks (S&P 500 Index)	28.7%	18.4%	9.7%
Global stocks (MSCI ACWI IN Index)	18.2%	16.3%	7.5%
Emerging markets stocks (MSCI EM Index)	-0.3%	18.4%	5.3%
U.S. corporate bonds (FTSE U.S.BIG CORP. 3-7Y)	-0.8%	8.3%	5.6%

Q1: What was the best performing S&P 500 sector in 2021?

A: Financials

B. Energy

C. Information  
Technology

D. Real Estate

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<sup>1</sup> Returns calculated by Tamarac Inc. software

## Welcome 2022!

### **Slower, but still growing**

As we said last year, it will take time for the global economy to fully recover, but the initial push provided by fiscal and monetary stimulus was followed by the pull of renewed business investing and consumers returning to prior spending habits. This provided strong momentum for the global economic recovery last year. In the U.S., GDP growth rate is estimated to come in at 5.6% for 2021 and the economy is expected to continue to grow at approximately 3.5% in 2022.

Many jobs continue to come back in developed economies. In the U.S. the unemployment rate fell to 3.9%, down considerably from the highs of the pandemic. At the same time a structural shift is taking place in the labor market – employees are rethinking their priorities, and many are leaving their jobs or deciding to stay on the sideline, a phenomenon dubbed the “Great Resignation”. Yet, consumer confidence has been improving as more people are planning to purchase homes, automobiles, and go on vacation in 2022, which is a good sign for the economy.

Last year we expected interest rates would stay low until inflation rose. And rise it did! Inflation is remaining high across most developed economies driven both by higher demand (as pandemic restrictions were lifted) and by lower supply (resulting from global labor and input shortages). We expect inflation to peak and begin to moderate in 2022 but to remain elevated through year-end. We will continue to watch the inflation data – sharply increasing prices can present challenges for the economy in 2022 and prompt the Fed to accelerate the raising of interest rates.

Q2: The price of electricity from solar and wind has fallen by what % in the last decade, respectively?

A: 20% & 10%

B. 30% & 25%

C. 60% & 40%

D. 90% & 70%

### **What's next for the markets?**

We expect increased market volatility and relatively muted returns in 2022. We believe the uncertainties surrounding global economic growth – inflation, supply chain disruption, and a virus that sadly is still around – will continue to shake the markets. Valuations remain a risk after a year like 2021, when the S&P 500 rose more than 28%. Still, despite our lower return expectations, we believe 2022 presents opportunities across asset classes and careful selection is key.

**U.S. Equity** – Above average returns have driven expectations for future returns lower. With broader and deeper global vaccination rates, we expect increased mobility which should provide opportunities in sectors still recovering from the pandemic lows. We'll keep investments in companies with strong fundamentals that we believe are undervalued to provide growth and keep up with inflation.

**Foreign Equity** – Improving fundamentals have positioned international stocks for higher future returns in the long term, especially within the developed markets. They also play a key role in managing the risk in your portfolio by providing additional diversification within the equity portion of the portfolio. International markets, besides having more attractive valuations and long-term return prospects, represent a significant portion of the global equity market capitalization and shouldn't be ignored.

**Fixed Income** – This asset class is essential in reducing the risk of your portfolio and providing income and stability. While the rising-interest-rate environment we're heading towards will be challenging for bond prices (they move in opposite directions), their fundamental role in the portfolio has not changed. We will continue to invest in high-quality bond funds with shorter maturities that should hold up well in a rising-rate environment.

**Alternatives** – As the performance of these investments is not driven by the factors that typically affect stocks and bonds, they provide additional diversification and downside protection, reducing risk within the portfolios. We continue to hold these investments and will opportunistically add to these positions during the year.

**Q3: In the past decade, how many months has it taken on average for the S&P 500 to recover from a 5-10% pullback?**

A: 3 months

B: 6 months

C: 12 months

D: 24 months

## What Does It All Mean for Your Portfolio?

We recognize that it's been exciting to watch the markets set new records and portfolios appreciate as much as they have over the last few years. It's also been fascinating (and admittedly confusing at times) reading about meme stocks, non-fungible tokens (NFTs), and crypto currencies. And the buzz and enthusiasm can be contagious – you may have wondered about, or even ventured into some of these areas yourself. That said, booms are followed by busts and it's uncertain which of these new assets will end up being worth keeping.

Which brings us back to our focused and disciplined approach to managing your money – we avoid emotional biases by sticking to a plan. We will remain disciplined and strategic in managing your portfolio for the long term based on your individual goals and risk tolerance. We continue to employ time-tested principles for successful long-term investing that better positions your portfolio for the next unexpected event.

As we analyze economic and market conditions, we continually search the investment landscape for opportunities that will grow and protect your portfolio. Different asset classes come in and out of favor based on the constantly changing market conditions – so remember:

- You have equities to help your portfolio grow and keep up with rising inflation.
- You have bonds that provide downside protection when the equity markets don't do so well.
- Systematic rebalancing your portfolio takes advantage of market volatility and ensures you're closely aligned with your long-term strategic target.
- As appropriate (based on each client's specific situation), we'll keep sufficient cash to ensure your specific needs are met.

In staying disciplined and focused on these fundamental principles we will continue to grow and protect your portfolio for years to come.

If you have any questions about our outlook or your specific situation, please let us know.

A: Know the correct answers to the quiz questions? Email us your responses to test your knowledge!