Performance Dashboard as of December 31, 2021 Source: DFA Returns Web							
Index:	**MSCI ACWI**	**S&P 500**	**Russell 2000**	**MSCI EAFE**	**MSCI EM**	**Barclays Glbl. Agg. (Hedged)**	**Gold**
Q4 2021:	+6.19%	+11.03%	+2.14%	+2.74%	-1.24%	+.07%	+4.11%
2021 Yearend:	+18.71%	+28.71%	+14.82%	+11.78%	-2.22%	-1.40%	-3.64%

2021 Market Rundown:

2021 marked the third consecutive year of double-digit gains for the global stock market, which finished near a record. However, performance was uneven, with noticeable disparity across geographies and market caps. Large-cap U.S. equity prices (S&P 500) rose by +28.71%. According to Goldman Sachs, earnings growth for the index surged even higher, increasing +47%. As a result, valuations (Price/Earnings) are more attractive today than at the beginning of the year. U.S. small-caps (Russell 2000) trailed their large-cap counterparts but added +14.82%. International developed equities (MSCI EAFE) increased by +11.78%, but emerging market stocks (MSCI EM) finished the year in the red, declining by -2.22%. Chinese equities, which comprise 34% of the MSCI EM Index, were the primary reason for the fall after plunging -35.26% from February 2021 peak levels by yearend. The performance dispersion between the U.S., foreign, and emerging stock markets in 2021 was the greatest in 25 years, but it's a continuation of a longer-term trend. Over the last ten years, the S&P 500 Index is up +16.55% per annum, while the MSCI EAFE and MSCI EM indices have gained only +8.53% and +5.87% per year, respectively. Zooming out, one can see that this performance gap between the U.S. and foreign stock markets tends to alternate over 10 to 15-year cycles. For example, the S&P 500 returned only +1.41% per annum in the decade prior, while the MSCI EAFE and MSCI EM indices rose by +3.94% and +16.23% per annum.

As gauged by the Barclays Global Agg Index (hedged), the bond market had its second calendar year loss in the last three decades, shedding -1.44%. The only other negative year for the index was 1994's -4.71% decline. The 2021 loss was primarily due to an uptick in interest rates (bond prices move inversely to interest rates). On the plus side, bond default rates were the lowest in ten years.

2022: Looking Ahead

Coming into 2021, investors had a lot to be bullish about: The Covid vaccine rollout was underway. Globally, governments implemented fiscal and monetary stimulus to spur economic growth. Plenty of pent-up consumer demand was ready to be unleashed. This cocktail led to strong global economic growth and a spike in inflation. According to the most recent U.S. Bureau of Labor report, YOY inflation is up +7.0%, the most significant increase since the period ending June 1982.

Tight labor market conditions increased the cost of labor, exacerbating inflationary forces. First-time unemployment claims are at the lowest level in 52 years, and the most recent JOLTS report showed a record 4.5 million people quit their jobs in November (over 3% of the total workforce).

By: M. Euston MS, CFP©

The U.S. Federal Reserve projects a 3.55% unemployment rate by 2022, below pre-pandemic levels. While the unemployment rate is improving, labor force participation remains anemic. People are just not coming back into the workforce, so these tight labor market dynamics aren't likely to change anytime soon.

At first blush, this situation might seem like a win for workers, and in some ways, it is. Since the pandemic began, the American workforce has gained significant bargaining power, leading to rising wages and benefits. On the other hand, inflation has offset these gains, leaving many with no increase in purchasing power. The U.S. Federal Reserve has a dual mandate from Congress to promote maximum employment and stable prices. With inflation running hot and the economy near full employment, the Fed has signaled it will tighten monetary policy, and interest rates could rise as soon as this March. Additional lockdowns to combat new Covid variants could alter this course. While this is possible, we do not think it is likely. Despite the Delta and Omicron variants last year, the downtrend in global lockdown conditions continued.

Global lockdown conditions have steadily declined despite new Covid variants. Source: GSAM

Elevated inflation and monetary tightening will be headwinds for financial markets this year, but there are reasons for optimism as well:

1. We anticipate global GDP growth in the +4.5-5% range, well above pre-pandemic levels.
2. Inflation will likely remain elevated, but we expect the rate of increase to wane.
3. A significant "wealth effect" will make the ongoing recovery resilient.

Consumers have benefitted meaningfully from rising asset prices, and their balance sheets are in great shape. In the two years since the pandemic hit the U.S. in Q1 2020, household net worth levels have jumped by +31.81%.

The Impact of Rising Rates:

Our last quarterly newsletter focused on the implications rising rates have on investment portfolios. Since most questions we are fielding today still revolve around this topic, I thought it would be worth reiterating our thoughts here. The bottom line for Heirloom clients is that we feel portfolios are well-positioned for a rising interest rate environment.

The impact of rising rates on equity and real estate investments depends on the speed of change and the level of rates. Regarding speed, a rapid change in rates, either up or down, has historically been a headwind for asset prices. The level of rates is an essential factor in how investors discern the present value of assets via "discounted cash flow" or "DCF" analysis. According to the time value of money principle, money in hand today is more valuable than the same amount in the future. To account for this, investors apply a "discount rate" comprised of the risk-free rate of interest (influenced by the Federal Reserve) and a risk premium to future cash flows to arrive at a present value estimate. In other words, what would one be willing to pay today for those future

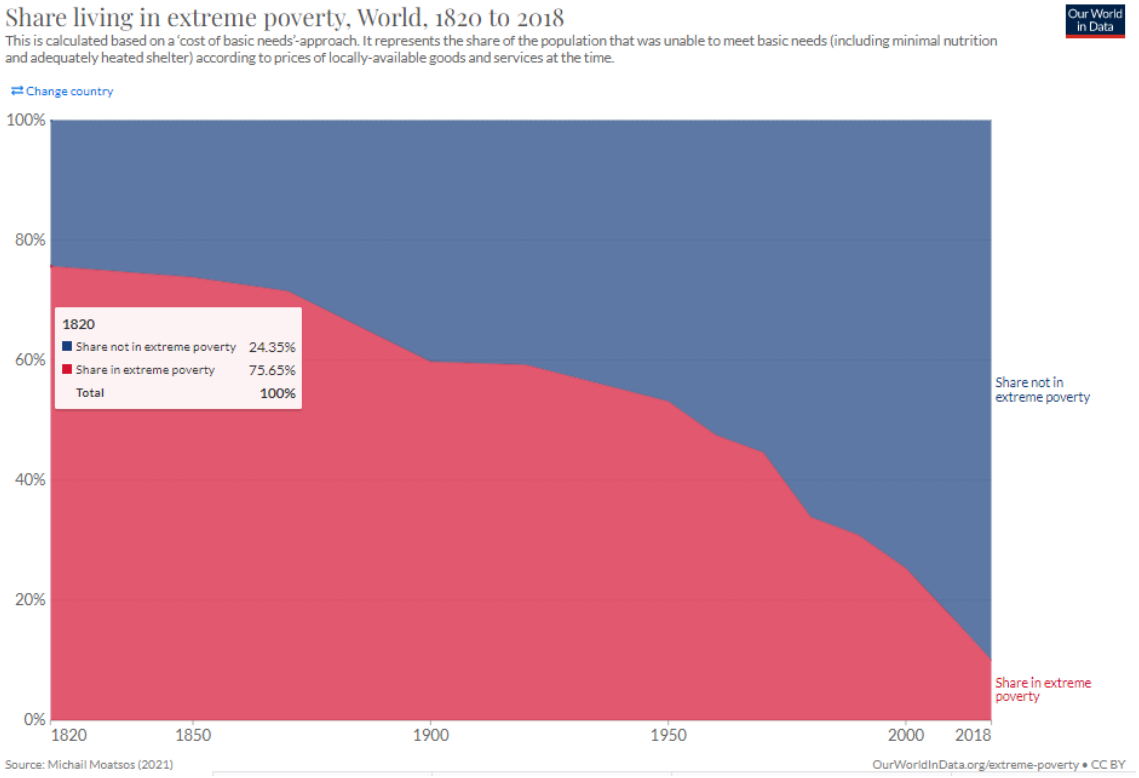
cash flows? The higher the discount rate becomes, the less an investor would pay today for each dollar of future cash flows (and vice versa). Our base case scenario is for interest rates to remain near historically low levels, and we expect the Federal Reserve to do its best to avoid a rapid change. As such, we expect interest rate conditions will remain favorable for stocks and real estate investments in the coming years.

For bonds, the short-term relationship with interest rates is relatively easy to understand; bond prices move inversely to interest rates. Thus, an increase would be a near-term headwind for bond prices. However, rising rates can be a long-term positive for bond investors, especially those using them for retirement income. Analysis done by PIMCO has shown a strong relationship between the starting yield of an investor's bond portfolio and their subsequent ten-year returns. The only time investors have earned higher returns vs. their starting yield has been in a gradually rising interest rate environment – a time we may be entering now.

Looking on the Bright Side:

Bad news permeates the media making many believe things have never been worse. There is always room for improvement, but I don't think there has ever been a better time to be alive than now. Here's one example to support this viewpoint in the first quarterly newsletter installment of "Looking on the Bright Side":

Did you know the percentage of people around the globe living in extreme poverty has declined from 75.65% to 10.01% over the last 200 years? 10.1% is still too high, but things are getting better!



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