



Fourth Quarter 2021 Recap & First Quarter 2022 Outlook

Stock Market Themes Carry into Fourth Quarter

The fourth quarter was a mixture of all the investment themes that defined 2021. Consumer demand remained strong, inflation pressures intensified, the labor market remained tight, a new Covid-19 variant started spreading, and the Federal Reserve took another big step toward raising interest rates. Despite 2021's many extraordinary headlines, the S&P 500 traded higher during the quarter and finished the year with a +28.6% total return. This quarterly letter provides an update on current investment themes as markets exit 2021 and look ahead to 2022.

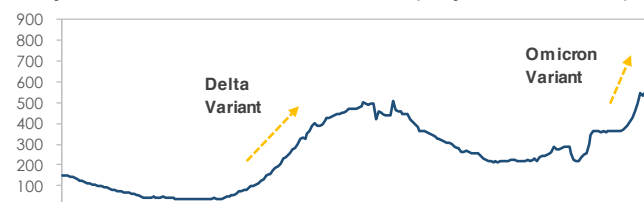
Omicron Variant Emerges in Late November

The latest Covid variant (Omicron) emerged in South Africa the last week of November. Health officials were initially concerned by Omicron's high number of mutations, and a review of the early data reveals why. Figure 1 measures Omicron's impact using three metrics: new confirmed Covid cases (top); Omicron's share as a percentage of total covid cases (middle); and new weekly hospital admissions (bottom). The top chart shows the number of U.S. Covid cases is significantly above the Delta variant's summer peak. The middle chart shows Omicron is becoming a bigger share of confirmed U.S. cases and rapidly replacing Delta as the dominant variant. While the top two charts indicate Omicron is highly transmissible and spreading rapidly, U.S. hospitalization data suggests Omicron may be less severe than prior variants. The bottom chart shows the number of new weekly Covid hospital admissions is still below Delta's summer peak despite surging Covid case counts.

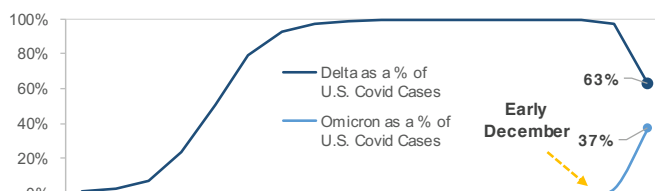
Omicron's emergence is yet another sign of the pandemic's continued grip on society. In the weeks since Omicron emerged, public officials have reimposed varying degrees of testing requirements, travel restrictions, and mask mandates to contain its spread. Real-time data shows economic activity was affected during December, but Omicron's initial impact appears more limited than prior Covid flare-ups. TSA reported screening more than 2 million flyers per day in the week leading up to Christmas, only slightly below 2019 levels. Likewise, OpenTable reservations declined during December but were still within ~10% of December 2019 levels. Omicron's emergence may signal a new stage of

the pandemic whereby Covid flare-ups remain an unfortunate part of daily life, but their impact becomes more limited over time as businesses and consumers adapt to living with the virus.

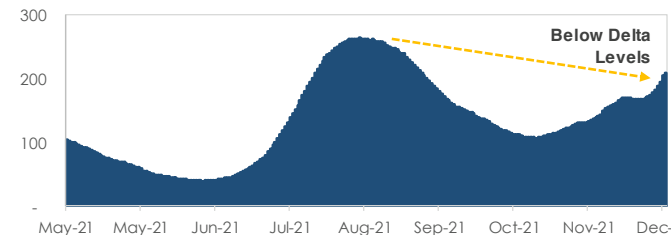
FIGURE 1
Daily New Confirmed Covid-19 Cases (May 2021 - Present)



Omicron % of Total U.S. Covid-19 Cases (May 2021 - Present)



New Weekly Covid Hospitalizations (May 2021 - Present)



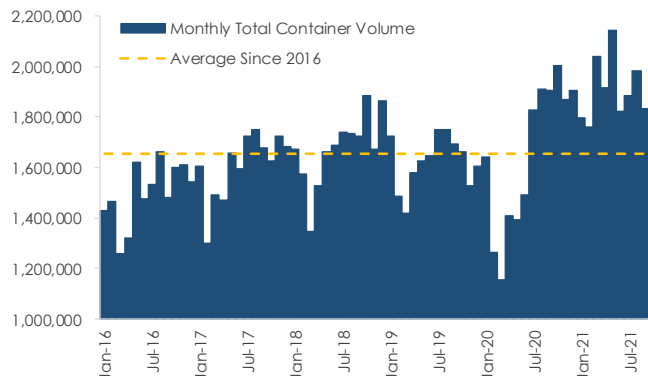
Source: MarketDesk, OurWorldInData.org. Data as of 12/28/2021.

Consumer Demand Remains Incredibly Strong

The U.S. consumer, which accounts for ~70% of annual U.S. economic activity, continues to be a bright spot. Consumer demand remains particularly strong across goods categories, such as furniture, appliances, and electronics, while the pandemic is causing individuals to spend less on services. The robust consumer demand is evident in global shipping data as a wave of imports reaches U.S. shores. Figure 2 tracks the total number of shipping containers, both empty and full, passing through three California ports: Los Angeles, Long Beach, and Oakland. The chart shows monthly container traffic plunged during the early stages of the pandemic as the global economy locked down. However, container traffic rebounded quickly and remained above-average during each of the past 17 months. Soaring container throughput

is a contributing factor to current supply chain issues. Port operations simply cannot keep up with the volume surge, which is causing containers to pile up on docks.

FIGURE 2
Monthly Shipping Container Traffic



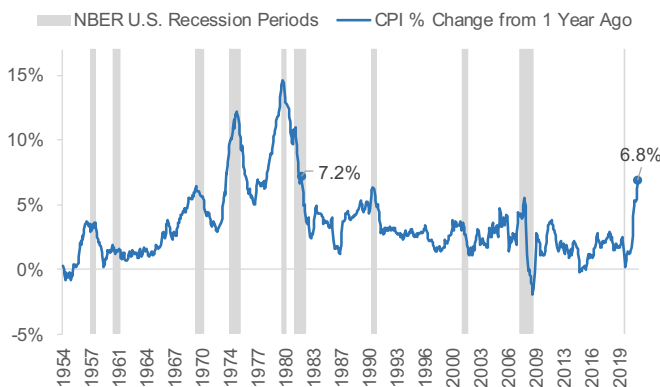
Source: MarketDesk, Ports of Los Angeles, Long Beach, and Oakland

As ports and supply chains work to get caught up, attention is shifting toward future demand. There are questions about how much demand the pandemic pulled forward and uncertainty about how long consumer demand can remain strong. After all, one would think consumers only need so many televisions, appliances, bikes, furniture, etc., before demand declines.

Inflation Accelerated at the Fastest Pace Since 1982

After easing slightly during the third quarter, inflation resumed its climb higher during the fourth quarter. Inflation, as measured by the Consumer Price Index (CPI), rose 6.8% year-over-year during November, which was the fastest pace since 1982. The price increases were broad, with food, new and used vehicles, housing, and energy prices all rising over the past 12 months.

FIGURE 3
Inflation (CPI) Rose at Fastest Pace Since 1982



Source: MarketDesk, Bureau of Labor Statistics

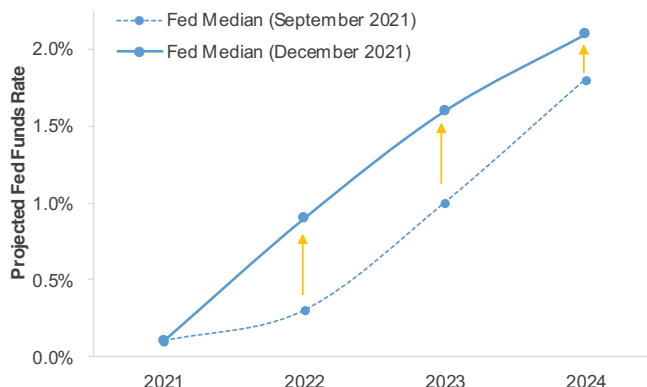
Economists attribute the inflation pressures to the previously mentioned strong consumer demand running

up against tighter inventories brought on by the combination of a tight labor market and volatile supply chains. Rising inflation poses a threat to demand because it erodes consumers' purchasing power. Investors and economists will be watching consumer demand closely during 2022 for any sign of a drop-off.

Federal Reserve Signals More Aggressive Interest Rate Hikes to Combat Persistent Inflation Pressure

There is a continued debate over how long inflation pressures will last. Throughout most of 2021, the Federal Reserve viewed price pressures as a temporary factor brought on by the pandemic. However, November's high inflation report caused the Federal Reserve to make an abrupt pivot during the fourth quarter. Members of the Federal Reserve's monetary policy committee became more concerned about the long-term threat posed by persistent inflation pressures. The result was a significant change in the Fed's forward guidance. Figure 4 compares the Federal Reserve's projected interest rate path at the December 2021 meeting against the September 2021 meeting. It shows the Fed's projected path rose sharply at the December meeting, which indicates members now believe the central bank will need to raise interest rates more quickly and aggressively to combat inflation in 2022.

FIGURE 4
Federal Reserve Median Projected Fed Funds Rates



Source: MarketDesk, Federal Reserve

Equity Markets End 2021 With Positive Q4 Returns

U.S. equity markets traded higher during the fourth quarter despite the many crosscurrents. The S&P 500 Index generated a +11.1% total return, easily outpacing the Russell 2000 Index's +2.0% total return. Fourth quarter performance pushed year-to-date gains for the major U.S. stock market indices firmly into positive territory. The S&P 500 Index returned +28.6% including dividends during 2021, while the Russell 2000 Index returned +14.5% during 2021 after rallying during the final months of 2020. The Nasdaq 100 Index, which is

viewed as a proxy for technology stocks, produced a +27.3% total return as the pandemic continued to accelerate technology adoption.

S&P 500 sectors performance trends were mixed during Q4 2021. Real Estate and Technology were the top two performing sectors, returning +17.5% and +16.7%, respectively. Cyclical sectors tended to be relative underperformers due to Omicron's late November emergence. Financials returned +4.5%, while Energy and Industrials returned +7.9% and +8.5%, respectively.

Fourth quarter performance trends across international equity markets were a continuation of the year-to-date trend with developed and emerging market stock indices both underperforming U.S. stocks. The MSCI EAFE Index of developed market stocks generated a +2.8% total return, while the MSCI Emerging Market Index produced a -1.6% total return. International underperformance is wider when you look at total 2021 returns. The MSCI EAFE Index produced a +11.4% 2021 total return, while the MSCI Emerging Market Index lost -3.6%. Throughout most of 2021, international stocks were weighed down by a relatively stronger U.S. economic recovery and U.S. dollar strength.

Credit Market Volatility Rises During Fourth Quarter

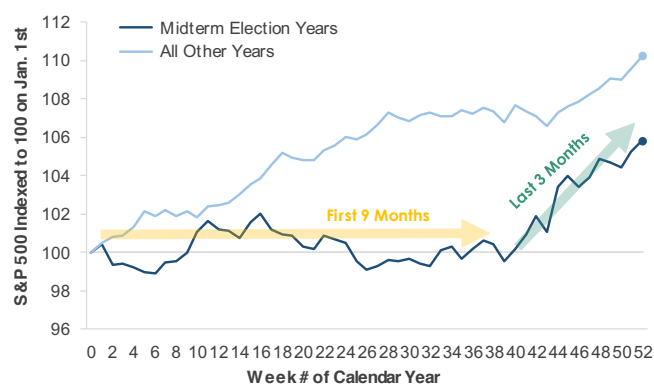
The credit market experienced increased volatility during the fourth quarter. Interest rates rose and declined as markets continued to digest Federal Reserve policy updates, persistent inflation pressures, and Omicron. One of the more notable credit market developments during the quarter was the flattening Treasury yield curve. Short maturity yields, which are more sensitive to monetary policy, rose as markets prepared for the Federal Reserve to raise interest rates during 2022. In contrast, long maturity yields, which are more sensitive to the economic environment and outlook, were flat to slightly lower. Credit markets are historically viewed as the canary in the coal mine, so the fact that the yield curve flattened suggests investors are growing more anxious about the future with inflation rising, Omicron spreading, a tight labor market, and congested supply chains.

Bond returns were limited during the fourth quarter. Investment grade bonds generated a +0.4% total return, slightly underperforming high yield bonds' +0.8% total return. For all of 2021, investment grade bonds and high yield bonds produced total returns of -1.9% and +3.7%, respectively. 2022 may be a tough year for credit markets. As a reminder, bond prices trade lower as interest rates rise, which means bonds could lose principal as the Federal Reserve raises interest rates.

A Quick Note on Midterm Election Years

Figure 5 compares the S&P 500's price return path during midterm election years against all other years for the period from 1950 to today. The S&P 500 historically trades higher during the average non-midterm year. However, during the average non-midterm year, it historically trades sideways for the first nine months and then trades higher into year-end after election results are finalized. This does not necessarily mean the S&P 500 will repeat history exactly, but it does indicate markets dislike uncertainty, such as elections. It will be important to separate the political emotion from investing next year and not get caught up in the moment as the two political parties battle for control of Washington D.C.

FIGURE 5
S&P 500 Return Path - Midterm Years vs All Other Years Since 1950



Source: MarketDesk. Based on average annual price returns since 1950.

2022 Outlook – Looking Ahead

As we look toward 2022, the calendar is filling up with several market-moving events. Among the 2022 calendar events — the third year of the current bull market, the Fed's first interest rate increase since 2018 (expected Summer 2022), U.S. midterm elections (November 2022), and a forecasted slowdown in economic growth.

Since the depths of the Covid-19 pandemic in March 2020, the U.S. government has supported businesses and individuals via stimulus checks, unemployment benefits, pausing student loan repayments, and low interest rates. 2022 is likely to be the year the training wheels come off as the U.S. economy shifts from government support to private sector support. While this transition could lead to increased market volatility and lumpy economic data, it is important to keep the big picture in mind. Data indicates the U.S. economy is growing, the consumer is strong, and the recovery is progressing. In our view, it's hard to ask for much more.

As 2021 comes to an end and 2022 starts, our team wishes you and your family a happy new year!

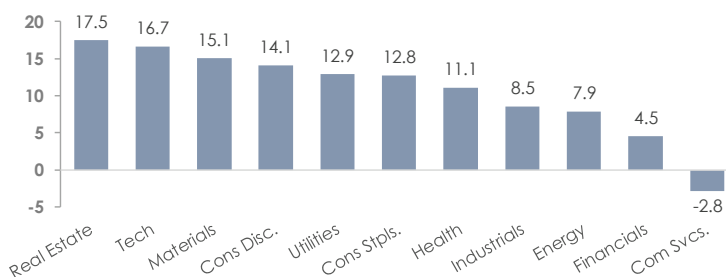
THIS QUARTER IN NUMBERS

FIGURE 6
U.S. Style Returns (4Q 2021 in %)

	Value	Blend	Growth
Large	7.8	11.1	11.7
Mid	8.5	6.5	2.9
Small	4.2	2.0	-0.1

Data Reflects Most Recently Available As of 12/31/2021

FIGURE 7
U.S. Sector Returns (4Q 2021 in %)



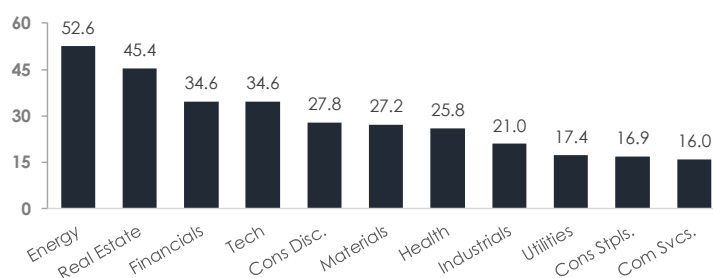
Data Reflects Most Recently Available As of 12/31/2021

FIGURE 8
U.S. Style Returns (2021 in %)

	Value	Blend	Growth
Large	24.8	28.6	27.4
Mid	28.0	22.4	12.6
Small	27.9	14.5	2.5

Data Reflects Most Recently Available As of 12/31/2021

FIGURE 9
U.S. Sector Returns (2021 in %)



Data Reflects Most Recently Available As of 12/31/2021

FIGURE 10
Market Data Center

Stocks	Level	1 month	3 months	YTD	1 year	3 years
S&P 500	4,766	4.6%	11.1%	28.6%	28.6%	96.9%
Dow Jones	36,338	5.5%	7.8%	20.7%	20.7%	63.3%
Russell 2000	5,580	2.3%	2.0%	14.5%	14.5%	70.8%
Russell 1000 Growth	2,033	2.0%	11.7%	27.4%	27.4%	137.1%
Russell 1000 Value	1,022	6.3%	7.8%	24.8%	24.8%	59.2%
M SCI EAFE	1,362	4.4%	2.8%	11.4%	11.4%	44.6%
M SCI EM	70,053	1.5%	-1.6%	-3.6%	-3.6%	32.7%
NASDAQ	15,645	1.1%	11.3%	27.3%	27.3%	161.2%

	Dividend Yield	NTM P/E	P/B
	1.20%	21.1x	4.9x
	1.58%	19.0x	5.0x
	0.94%	23.4x	2.5x
	0.50%	30.9x	14.0x
	1.62%	15.8x	2.7x
	3.33%	15.3x	1.9x
	1.99%	12.4x	1.8x
	0.43%	28.8x	9.0x

Fixed Income	Yield	1 month	3 months	YTD	1 year	3 years
U.S. Aggregate	1.77%	-0.4%	-0.1%	-1.8%	-1.8%	14.3%
U.S. Corporates	2.30%	0.0%	0.4%	-1.9%	-1.9%	27.1%
Municipals (10 yr)	1.81%	0.0%	0.7%	1.0%	1.0%	13.4%
High Yield	4.02%	2.3%	0.8%	3.7%	3.7%	22.3%

Commodities	Level	1 month	YTD
Oil (WTI)	75.21	13.6%	23.2%
Gasoline	2.23	10.8%	32.6%
Natural Gas	3.56	-22.1%	62.5%
Propane	1.04	1.5%	109.4%
Ethanol	2.46	-28.7%	92.5%
Gold	1,829	2.9%	20.1%
Silver	23.35	2.4%	30.3%
Copper	4.46	4.1%	59.4%
Steel	1,435	-10.9%	143.6%
Corn	5.93	4.5%	53.0%
Soybeans	13.42	10.7%	42.6%

Key Rates	12/31/2021	11/30/2021	9/30/2021	6/30/2021	12/31/2020	12/31/2018
2 yr Treasury	0.73%	0.52%	0.29%	0.25%	0.12%	2.50%
10 yr Treasury	1.51%	1.44%	1.53%	1.45%	0.92%	2.68%
30 yr Treasury	1.90%	1.78%	2.09%	2.06%	1.65%	3.01%
30 yr Fixed Mortgage	3.24%	3.23%	3.18%	3.13%	2.87%	4.51%
Prime Rate	3.25%	3.25%	3.25%	3.25%	3.25%	5.50%

Data Reflects Most Recently Available As of 12/31/2021

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