INVESTMENT STRATEGY UPDATE

MARKET REPORT
QUARTER 1 • 2022

ASCENTIAL WEALTH ADVISORS

STRONG FINISH FOR US STOCKS

After vaccines offered an optimistic start to 2021, equity markets around the globe battled concerns surrounding the ongoing COVID-19 pandemic, supply chain problems, and inflation for most of the year. Despite these headwinds, US stock posted strong returns, outpacing foreign equities and continuing a streak of outperformance. Posting double digit gains, the S&P 500 closed 2021 slightly less expensive than it started the year on a valuation basis, with corporate earnings rising even more than stock prices.

Within the US, the dominance of growth stocks moderated, with growth and value stocks delivering similar gains. Worries about persistent inflation weighed more heavily on growth companies. Inflation in the US rose to a level not seen in almost 40 years, with the Consumer Price Index up 6.7% in 2021. In spite of this, the US economy and companies appear healthy with unemployment falling, plentiful job openings and wages rising, along with higher corporate revenues and profit margins. This is due in large part to the sizable fiscal and monetary stimulus the US employed over the past 18 months, which is expected to be less generous in the year ahead.

Outside of the US, gains were lower and less consistent, and developed equity markets significantly outperformed emerging markets. The MSCI Emerging Markets Index was down -2.5% for the year, with challenges in countries such as China and Brazil weighing heavily on performance. There were a multitude of underlying factors causing the disparity, however, at the close of the year, foreign equities were significantly undervalued relative to US stocks, and in many ways potentially poised for recovery.

The bond market ended 2021 in negative territory, and most bond yields remained below inflation. Bond investors have been weighing expectations for higher inflation and interest rates, against the economic risks posed by the ongoing pandemic.

Index	*2021 (through 12/31)*
S&P 500	+28.7
DJIA	+21
EAFE (Int'l)	+11.3
BC Ttl Bond	-1.5

Dow Jones Relative Risk Benchmarks

Conservative	-.2
Moderate	+9.4
Aggressive	+18.6

The 10-year US Treasury yield experienced a fairly volatile 2021, beginning at 0.9% and rising as high as 1.75% in March 2021, before closing the year at 1.5%. The Federal Reserve, along with most global central banks, began to shift its policy toward less monetary support and is now expected to raise interest rates in 2022, putting more pressure on bonds in the upcoming year.

WHAT NEXT?

Here are a few things we are keeping an eye on that could impact financial markets in 2022.

PANDEMIC CURVEBALL- Making predictions about the COVID-19 pandemic seems foolish after the past couple of years. As this is being written, the Omicron variant is rapidly sweeping across the globe. While we don't foresee a return to lockdowns such as in the spring of 2020, the pandemic will likely still impact the economy and markets on its way to becoming an endemic disease.

LESS STIMULUS- The "Build Back Better" legislation got stuck in Congress in 2021, and the outlook is not promising, with gridlock likely to persist in a mid-term election year. Without the passage of further legislation, economic stimulus will be much lower in 2022, which could dampen consumer spending and slow growth.

HAWKISH FEDERAL RESERVE- The Fed has already started pulling back on its monetary support, and indicated that it will raise interest rates in 2022. The Fed will attempt to strike a balance between slowing the economy enough to keep inflation in check but not so much that it will cause a recession.

CONTINUED ON REVERSE SIDE ▸

SUPPLY CHAIN NORMALIZATION- We expect a game of catch-up in the supply chain, to clear the backlog of goods stuck in shipping limbo, replenish stock at retailers, and refill inventories in warehouses. Businesses should benefit all along the supply chain as the system returns to normal, however, there could be delays if the pandemic continues to impact trading partners, particularly in emerging markets such as China.

STRONG LABOR MARKET- At the end of 2021 there were 11 million job openings in the US and far less unemployed workers. Unemployment at 4.2% was well below its 50-year average of 6.3%, and wage growth at almost 6% well above its 50-year average of 4%. The US is experiencing a labor crunch, with the working population declining. Expect to see more dislocation in the job market as workers look to take advantage of their bargaining power, and a continuation of wage increases as employers compete for talent.

OUR VIEW

FIXED INCOME — Bond returns could struggle in the year ahead, with yields today generally below inflation (a negative "real return"), coupled with the potential for rising interest rates to erode bond prices. On the other hand, when equity markets fall, bonds can offer stability in portfolios and are a critical component of a risk managed strategy. We continue to recommend slightly lower traditional fixed income exposure and a combination of bonds and alternative strategies to help manage both equity and interest rate risks.

US EQUITIES — Returns on US stocks have been supported by high earnings growth, with earnings for S&P 500 companies up 34.5% in 2021. This momentum is anticipated to slow somewhat in 2022, with less economic stimulus fueling the fire, but still projected to remain above historical averages as supply chains normalize and pent-up demand is satisfied. While some stocks look expensive, reasonably valued stocks exist and there continues to be opportunities in US equities. We favor more selectivity and active management in this environment and a fairly equal balance of growth & value stocks. Growth companies can't be ignored in a world focused on innovation. However, value stocks are cheaper, tend to be more cyclical, and should have more resilience against inflation.

INTERNATIONAL EQUITIES — Foreign stocks look attractive for multiple reasons. The price/earnings valuation for the MSCI All Country World ex-US index is currently -33% lower than the S&P 500, plus the dividend yield on the foreign index is 1.6% higher. (JP Morgan, Dec 31, 2021) Earnings growth outside of the US is projected to be strong, and a weakening US Dollar has the potential to provide an added tailwind. Over the long run, valuations matter, and we see recovery opportunity in foreign stocks and favor a slightly higher allocation. Due to the uneven nature of foreign economies, particularly in a pandemic, we generally prefer active management in both developed and emerging markets.

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