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Private Wealth Management
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A Wall of Worry!

A "three-peat" is what we got from the capital markets in 2021. It was the third consecutive year of double-digit gains for many indices; the equivalent of a triple play or a hat trick in sports, all while still in masks, dealing with remote school, and event and travel cancellations. The Dow Jones Industrial Average was up ~18%, the S&P500 up ~27 % and the NASDAQ ~22%. Commodities rallied and the dollar was strong. The bond market, however, was negative with the 10-year treasury down ~2%.

Lest we admire our financial largesse without discussing taxes… at the risk of being defensive, the capital gains for many portfolios are higher this year than they have been in many years. We had several years of unrealized appreciation that we realized in 2021. Portfolios had become overly concentrated in particular sectors and asset classes that have appreciated. Rebalancing is necessary to reduce risk and the potential for future underperformance. By delaying rebalances into 2021, we delayed the tax bill until 2022. Finally, the concern that capital gain taxes would rise in 2022 further influenced us to realign to respective asset allocation objectives.

As we turn our attention to the New Year and what we might expect from the capital markets, it is one of the most interesting and challenging forecasts we can remember. There is so much change in front of us! Wall Street's proverbial "Wall of Worry" is steep with rising interest rates and Central banks around the world removing stimulus, high inflation, tax law changes, Chinese policy changes and the country's slowing growth, continuing Covid disruptions and the on-going effect of supply chain and labor shortage dislocation. Uncertainty is a requirement for markets to rise. When there is unanimity and consensus, the market is about to change directions and make a fool of the crowd. This "Wall of Worry" just might be good news.

We do not portend to be smarter than the masses, but we do our homework and maintain our discipline with portfolio management. With that said, here we go for setting 2022 expectations…

We expect higher earnings for the S&P 500, with a range from $225-$235. We expect higher treasury yields with the 10-year trending to 2% and above. We expect oil to trade in the $80s-$90s per barrel. We look for US and global GDP to grow over 4% as well as inflation.[1]

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Important context to those numbers include the fact that the S&P 500 is trading at 20x the high-end of our range. This is a very optimistic starting point. If the 10-year treasury moves to 2% or higher, it will be the 2nd year in a row of negative returns for that bond market and would be only the second time that has happened since 1977.[2] For investors afraid of the heights in the stock market, the bond market does not offer the safety it has provided for the last forty years. We prefer cash to treasuries because flat is better than down, municipal bonds to cash because tax-free interest is better than no yield.

China's slowing growth, increasingly restrictive policies around business and aggressive overtures toward Taiwan make it the biggest wild card. The country's size and impact on the global economy mean it cannot be avoided or ignored. While China's positive growth is slowing, Europe's GDP growth is forecasted to accelerate faster than it has in over a decade.

As long term investors, we look for trends and direction rather than trades and momentum. The list of changes that will impact the economy over the next decade are plentiful. Inflation will be higher over the next decade than it has been the last decade, but will moderate as Covid ends (and it will end). Interest rates, too, will be trending higher in a way they have not meaningfully changed in over 40 years. Crypto currency and crypto technologies are maturing and becoming mainstream. That will arguably increase regulation and bring down prices. Net Zero Omission mandates will change corporate board room conversations and profit margins.

We may not have another year of double-digit gains in the equity markets, but an average 6-8% return would be pretty good. We plan for missteps by Central Bankers and the Federal Reserve. Volatility provides opportunity to capitalize on inefficiencies and uncertainties. Short term fears and disruptions allow disciplined investors to make money. We look into 2022 with a realistic expectation for profitability and a healthy dose of experience that tells us it will require change, discipline and vigilance!

We are grateful, as always, to serve your family. We are humbled by the responsibility of managing your finances and most importantly, your family's financial security!

Marcia C. Tillotson — **Managing Director-Investments**

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[1] 2022 Global Outlook, Black Rock Investment Institute. December 2021.

[2] 2022 Outlook, Wells Fargo Investment Institute. December 2021.

*Keeping in mind index returns are not fund returns. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results.

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