Portfolio Manager Commentary

December 31, 2021

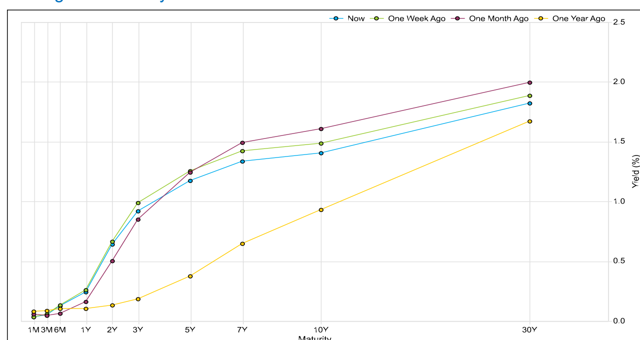
Economic Outlook

The last week of 2021 was very light on economic releases. Initial jobless claims came in below 200,000 for the week ending December 25 signaling continued strength in the labor markets and the Chicago Purchasing Managers Index was 63.8 which is very strong. Anything above a 50 for this index signals expansion in the sector. This week will be busy with economic news with Friday's labor report for the month of December being the highlight.

Fixed Income

Negative annual returns in U.S. Treasuries are rare, and when it does happen the next year is almost a certainty to be a positive return for investors. But some on Wall Street see that relationship possibly ending in 2022. The Bloomberg U.S. Treasury Index returned a negative 2.5% for 2021, its first yearly loss since 2013. In records dating back to 1974, this index has never fallen two years in a row. With yields so low by historical standards and the Federal Reserve poised to raise short-term rates sooner than later to battle inflation, some are bracing for more losses over the coming 12 months. "A repeat of 2021 is a reasonable expectation for Treasury market returns in 2022," said Jean Boivin, head of the BlackRock Investment Institute, the asset manager's in-house think tank. "If inflation eases slowly from where it is at the moment, there is the risk for more downside performance in Treasuries." The prospect of rate hikes in 2022 has naturally pushed up policy-sensitive short-dated yields. In contrast, both the ten-year and thirty-year bond yields remain below their peaks from 2021, which has led to a flattening of the yield curve and uncertainty of whether the economy can thrive if the Fed tightens rates.

Change in Treasury Yield



Current Generic Bonds Yields

Treasuries		Agencies		Corporates		Municipals	
3 mo.	0.03%	3 mo	0.11%	3 mo	0.35%	3 mo	0.27%
6 mo	0.18%	6 mo	0.17%	6 mo	0.39%	6 mo	0.28%
1 yr	0.37%	1 yr	0.34%	1 yr	0.47%	1 yr	0.30%
2 yr	0.73%	2 yr	0.72%	2 yr	0.83%	2 yr	0.37%
5 yr	1.26%	5 yr	1.14%	5 yr	1.51%	5 yr	0.75%
10 yr	1.51%	10 yr	1.62%	10 yr	2.13%	10 yr	1.18%
30 yr	1.90%	30 yr		30 yr	2.82%	30 yr	1.72%

Equity

U.S. Equity finished the week lower as the S&P 500 notched a -1.96% loss. The believed explanation for the pullback involves the Fed continuing its hawkish pivot with an accelerated taper, in which a median estimation of three rate hikes was given for 2022, the removal of the transitory reference to inflation, and comments from Fed Chair Powell that suggested the maximum employment goal may be reached sooner than expected (FactSet).

Consumer Staples (+1.36%), Health Care (+2.48%), and Utilities (+1.24%) were the sole sectors to finish positive for the week as the overall equity market fell. Growth (-2.93%) was hit harder for the week compared to Value (-0.53%), though Growth is still outperforming on a year-to-date basis by ~700 basis points.

Index Returns	Last Week	YTD
Dow Jones Industrials	-1.65%	17.52%
S&P 500 (LCap)	-1.96%	24.53%
S&P 400 (MCap)	-1.86%	18.27%
Russell 2000 (SCap)	-1.71%	10.08%
NASDAQ Composite	-2.95%	17.70%
MSCI EAFE (Int'l)	-1.35%	8.42%
iShares Real Estate	1.05%	32.64%

Source: FactSet Research Systems

Asset Allocation

Current Sentiment

Cash	Favorable
Short FI	Neutral
Intermediate FI	Neutral
Inflation-Adjusted FI	Neutral
High Yield FI	Unfavorable
International FI	Unfavorable
Equity Income	Neutral
Large Cap Equity	Favorable
Mid Cap Equity	Neutral
Small Cap Equity	Unfavorable
International Equity	Unfavorable
Emerging Markets Equity	Unfavorable
Real Estate	Neutral
Commodities	Unfavorable

Summary below - Current stance on most asset classes:

Cash - Overweighting due to market volatility and uncertainty from Covid-19.

Short Term Bonds - Relative to Intermediate Bonds, the reduced duration is preferable given the oversold long-end of the curve.

Intermediate Term Bonds - The current trading range of intermediate bonds warrants a neutral position with limited upside potential. Some opportunities still remain in certain sectors.

Inflation-Adjusted Bonds - Low inflation expected in near-term providing zero real return.

High Yield Bonds - Spreads are rising given the market turbulence and exposure to unnecessary credit risk when compared to Treasuries would not be advised.

International Bonds - Foreign bonds offer good diversification qualities and higher yield opportunities, however, risks have been elevated recently and investment should be made cautiously.

Equity Income - High quality and higher-dividend-paying companies remain attractive for long-term investors given their favorable risk-adjusted profile and current yield curves.

Large Cap Stocks - A favorable weighting is recommended. Growth continues to be a more favorable style and should continue to be overweighed versus Value.

Mid Cap Stocks - Mid cap exposure remains neutral - more attractive than small caps but not as attractive as large caps.

Small Cap Stocks - In broad market corrections, small cap stocks will suffer most with increased volatility. Underweight until a clearer picture of recovery ensues.

International Stocks - Given most foreign investment is in developed markets and European countries, until sovereign debt concerns are alleviated, an underweight is recommended.

Emerging Market Stocks - Stronger balance sheets, less debt, and better growth potential make emerging markets more fundamentally attractive than developed countries longer-term. However, trade uncertainty and dollar strength provide a headwind for EM in the near term.

Real Estate - Pricing has begun to stabilize and long-term valuations appear attractive. Real Estate should continue to be a strong alternative to other asset classes.

Commodities - Global demand should support higher prices if the global recovery remains on track. Volatility will be higher, and commodities will be susceptible to short-term

Sources of statistical information are Bloomberg and Ned Davis Research.
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