Outlook 2022

2021 RECAP

U.S. stock markets recorded a third straight year of growth in 2021, with major indexes posting double-digit gains as the V-shaped recovery continued, as investors looked towards economic data improving, unemployment levels declining, and the profit cycle climbing back to pre-pandemic levels. In a year marked by severe economic hardships, the market's current optimism may be perplexing.[1] Nonetheless, even in the face of increasing costs and supply chain delays, 2021 witnessed excellent business profits, buoyed by exuberant consumer spending. Surprisingly, the U.S. consumer has a healthier balance sheet than prior to the pandemic, with spending up nearly 25% and the best debt-service ratio in nearly 50 years. We feel this sets up for continued strong growth heading into 2022 and beyond.

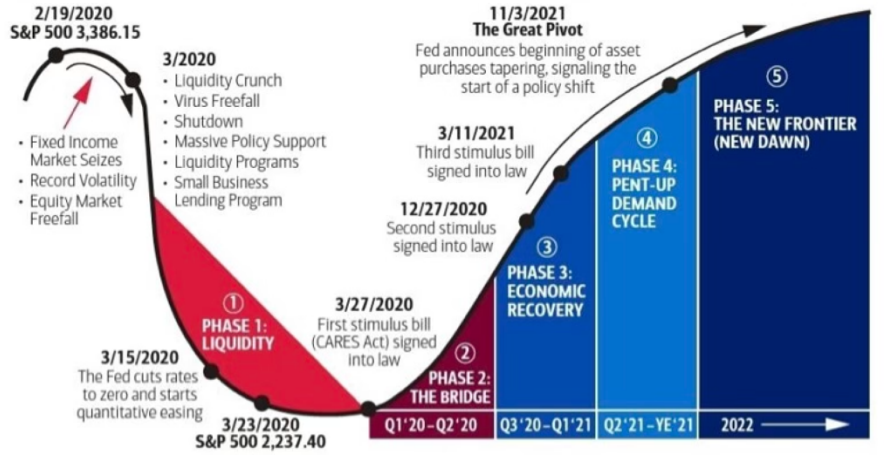
The conclusion to 2021 on Wall Street contrasted strongly with the distress felt by millions of Americans dealing with the highly transmissible Omicron variant. As the pandemic approaches its third year, the country faces some economic concerns, with inflation nearing 40-year highs and supply chain constraints remaining present.[2] A shortage of workers recently has forced temporary closures for many businesses and has been a cause for concern amongst consumers. We view inflation as the top economic challenge in 2022, with supply chain disruptions likely to abate towards the second half of the year.

As the United States grapples with Omicron, which is likely to peak sometime this month, there is a sense going forward it will begin to be viewed as an endemic and treated like a seasonal flu. While there is some uncertainty with COVID-19 remaining, we can confidently say that the economy is in better shape this year than it was during the onset of the virus in the spring of 2020. Policymakers at the Federal Reserve are confident enough to announce intentions to raise interest rates and conclude the Fed's bond purchasing program, focusing their attention on surging inflation, as job openings are now at records highs. The market had a knee-jerk reaction to this announcement in December, with markets briskly, but briefly selling off. Investors can expect the Fed to remain one of the dominant forces influencing the market's trajectory in 2022, with multiple rate hikes likely. Our estimate is that 3 rates hikes will occur, with a possibility for a fourth.[3]

GOING FORWARD

Wall Street analysts have been attempting to figure out what to expect in 2022 for the U.S., and their predictions are somewhat wide-ranging. Forecasts for 2022 boil down to projecting the pandemic's sustained impact, especially given the late 2021 rise in cases and the uncertainty presented by the new variant. Also, investors will also be looking at Washington for possible tax reforms and additional spending bills. Despite recent standstills, this could potentially impact corporate profits and inflation projections. Most firms are expecting high single to low double digit returns for the S&P, which is a view we also share, with periods of volatility likely.[4] We expect to see market upside on continued robust earnings growth as the labor market recovery continues, consumers remain flush with cash, supply chain issues ease, and inventory cycle accelerates off historic lows. As always, we view volatility as an opportunity to take advantage of market weakness and make tactical allocations that align with our client's goals-based plan. Over the long-run, we expect equity markets to be revalued upward as multiples expand and rates stay near historic lows.

Exhibit 1: The Journey from the Great Separation to *The Great New Dawn.*

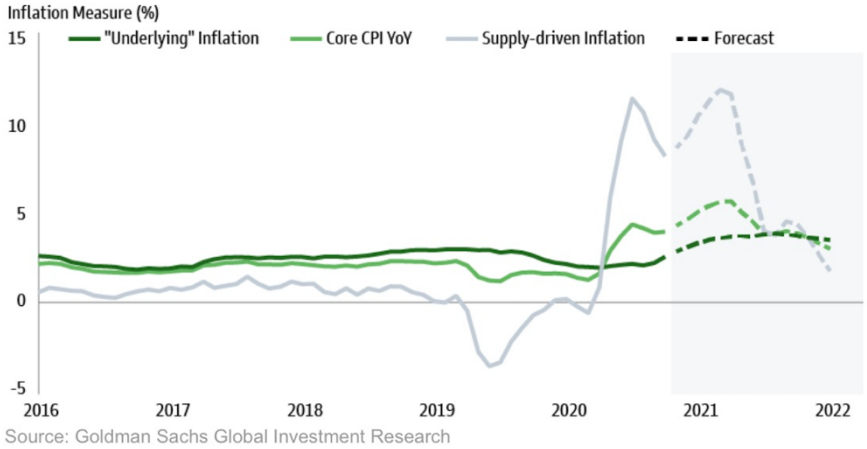


We expect emerging market GDP growth will drop to 4.6 percent next year, down from 6% in 2021, but it will still be higher than the 2015-19 trend. Moderating developed market growth and changes in the Chinese economy, as well as the departure of domestic fiscal and monetary policy support, will be the key drags.[5]

PORTFOLIO ALLOCATION

Heading into 2022, we remain believers that equities will continue to outperform fixed income, quality matters, and the U.S. should be favored over the rest of the world. We view Financials, Real Estate, and Healthcare as dominant themes in 2022, with Technology continuing to be a secular trend that remains an attractive growth opportunity for our clients. The banking sector will see improved margins, as interest rates increase and the yield curve steepens, as the Fed finally looks to take action this year to control persistent inflation. In the few trading days of

2022, we've seen the yield on the 10-year move significantly higher in anticipation of Fed policy adjustments. In 2021 Financials gained 34%.[6] With rates hike to take place in the coming months, we believe Financials will continue to outperform the S&P 500 this year. Healthcare underperformed relatively speaking during the worst of COVID-19, as a significant amount of elective care was paused. We view valuation at these levels highly attractive, especially when focusing on long-term prospects, as well as expenses relating to pandemic care subsiding due to improved case counts going forward. With interest rates still near historic lows, thriving e-commerce and pent-up demand for single and multi-family housing remaining, we view real estate and the REIT sector as another area of outperformance in 2022. Despite fears of inflation affecting future cash flows of high-valued technology firms, we remain optimistic as the economy continues to evolve digitally and balance sheets of Mega Cap Tech safe havens remain our favorites.



SUMMARY

As we come into a post-pandemic world, we are expecting society to adapt to variants and reopenings to continue. For larger macroeconomic trends, we expect to see higher energy costs leading to greater expansion, development, and adoption of green technologies in the years ahead. Our firm's ESG strategy focuses specifically on this theme. Shortage of labor will persist for some time, but we also expect the cyclical rotation trend to continue as the Fed pivots more aggressively amid rising inflation. Nevertheless, we still expect to witness above average GDP and equities benefiting from strong corporate profits across the board. Active rebalancing and tactical adjustments will continue to play a critical role in maintaining a successful portfolio for our clients in year that will see interest rate hikes for the first time since late 2018. Alternatives will also continue to have a place in a diversified portfolio. Historically, equities perform well in a rising interest rate environment and our asset management team anticipates this trend to continue in 2022. As a result, we feel there is adequate opportunity to generate excess returns (alpha) for the year.

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Sources

[1] https://www.washingtonpost.com/business/2021/12/31/stocks-markets-2021-omicron-pandemic/

2 https://www.washingtonpost.com/business/2021/12/31/stocks-markets-2021-omicron-pandemic/

[3] https://www.forbes.com/advisor/investing/2022-stock-market-outlook/

[4] https://www.jpmorgan.com/insights/research/market-outlook-2022

[5] https://www.blackrock.com/us/individual/insights/blackrock-investment-institute/outlook

6 https://www.gsam.com/content/gsam/us/en/advisors/market-insights/market-strategy/global-market-monitor/2022/market_monitor_010722.html

Exhibit 1: https://olui2.fs.ml.com/Publish/Content/application/pdf/GWMOL/ISO_ExecSum_12-21_BofA.pdf