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Financial Market Commentary: 4th Quarter 2021 (October through December)

As the Economy Booms, Inflation Rings Loud

Markets have been unrelenting and explosive, driven by an impressive economic boom created by massive monetary and fiscal stimulus from around the world. It took all year but finally the words "transitory inflation" were dropped from the U.S. Federal Reserve's lexicon as it was based on the false assumption that the Fed would not let things get out of control.

Fortunately, the Fed did finally act – well, kind of – with the commencement of tapering in December. While this might carry the connotation of subtracting monetary stimulus, i.e. to stop spending and repay debt, this couldn't be further from the truth. Tapering means the Fed will still be spending – a.k.a., adding to its $9 trillion balance sheet – through March 2022, albeit at a gradually reducing rate. Thus, the Federal Reserve is still very, very accommodative.

Under such monetary policy conditions and still-high fiscal spending, anticipate inflation to sport a 7% - handle through the first few months of 2022 and corporate income taxes to rise. Meanwhile, geopolitical risks are also likely to escalate, led by the dynamic duo of Russia and China. What could possibly go wrong?

The Federal Reserve – as both solution and problem – is walking a tight rope, and it is very important for it not to waiver. Markets are expecting a steady Fed hand and the Fed must deliver on tapering and rate increases, or the consequences could be devastating. This may seem counterintuitive, that the market would want a "tightening" posture from the Fed. The reason is the fear of inflation, not in goods but in the market, which is creating identifiable imbalances, raising risks of a far more severe correction if not reined in. Therefore, the primary variable for forecast is based on a strong, unwavering Fed that gradually reins in inflation.

Equity Markets 2021 Review

Equity markets had a stellar year in 2021, especially in the U.S.:

- Global REITs were the number-one asset class in 2021 with a 32.4% return
- The S&P 500® reached 70 closing highs on its way to a 28.7% annual return. Its smaller brethren were close behind, as the S&P 400 MidCap's gained 24.8% and the S&P 600 SmallCap's returned 26.82%, both for the year
- International performance was mixed; the MSCI EAFE index was up 11%, but the MSCI Emerging Markets index logged a -2.2% performance, with large losses in the China component, which accounts for almost a third of the benchmark's weight
- All S&P 500 sectors posted gains in 2021, led by Energy – up 55% after its 34% loss in 2020 – followed by Real Estate, Financials and Technology, all up 46%, 35%, and 34%, respectively

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- Fixed Income was led by High Yield bonds' 5.3% gain, while Global Bonds were the worst, producing a -4.7% return. The surprise comeback was long U.S. Treasuries, which nonetheless logged a -4.4% return for the year despite a strong showing in December
- The Dow Jones Commodity Index (DJCI) surged 30.8%, and the S&P GSCI rose 40.35%, led by GSCI Energy's 60.7% gain, and despite a surprising loss by GSCI Precious Metals of -5.1%
- The S&P 500/CBOE Volatility index – or the VIX® – ended the year at 17.7% or -24.3% for the year, which is indicative of a positive market and risk-on sentiment

The Consumer is "The Gamechanger" and Continues to Deliver the Goods and Services

Pun intended since GDP's personal consumption is made up of goods and services, but there is far more. For example:

- The consumer is 68.5% of U.S. GDP, or $15.9 trillion of the overall $23.2 trillion economy
- U.S. wealth hit an all-time high of $145 trillion in 2021
- Retail sales for November 2021 hit a record high of $639.8 billion, or nearly $100 billion more per month than pre-pandemic November 2019, which was $546.5 billion
- Jobs are plentiful, as the unemployment rate is expected to drop to 3.2% from the 4.2% at year-end
- Housing is going gangbusters as prices gain 19.1% year-over-year on the latest Case-Shiller report
- Housing starts in November rose 11.8% to a 1.68 million clip versus a 15-year high of 1.72 million in March, leaving an 8.3% year-over-year gain

A consumer backdrop of this magnitude is a counterbalance to almost any risk… except for "closing the economy".

Conclusion

The cat is out of the bag and its name is Inflation. It's up to the Fed to address tapering. There is a chance that the Fed gets serious and tightens with several rate increases. Risks are the unforeseeable, such as a cyber-attack on our electric grid, or worse. The good news is that we enter 2022 with low unemployment, still high GDP, a veritable manufacturing boom, and a relentless consumer. Welcome to 2022, and remember that "Fundamentals Drive Markets".

Sources: Morningstar, VOYA

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Disclosure: Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. Diversification does not assure a profit or protect against loss in declining markets. All indices are unmanaged and investors cannot invest directly into an index. The Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue-chip stocks. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Free Index is a market capitalization-weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin. It excludes closed markets and those shares in otherwise free markets that are not purchasable by foreigners. The Barclays Capital Aggregate Bond Index is an unmanaged market value-weighted index representing securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade fixed-rate bond market, with index components for a combination of the Barclays Capital government and corporate securities, mortgage-backed pass-through securities, and asset-backed securities. The Barclays Capital U.S. Corporate High Yield Index covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moodys, Fitch, and S&P is Ba1/BB+/BB+ or below.

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Equity Performance

Equity Index	Style	YTD Return As of 12/31/2021	1 Year Return As of 12/31/2021	3 Year Return As of 12/31/2021	5 Year Return As of 12/31/2021	10 Year Return As of 12/31/2021
Russell 1000 TR	U.S. Large Cap Stocks	26.45%	26.45%	26.18%	18.41%	16.53%
Russell MidCap TR	U.S. Mid Cap Stocks	22.58%	22.58%	23.26%	15.09%	14.89%
Russell 2000 TR	U.S. Small Cap Stocks	14.82%	14.82%	20.00%	12.01%	13.22%
MSCI EAFE NR	Foreign Develop Stocks	11.26%	11.26%	13.53%	9.54%	8.02%
MSCI EM NR	Foreign Emerging Stocks	-2.54%	-2.54%	10.93%	9.87%	5.48%
DJ US Real Estate TR	Real Estate	38.99%	38.99%	19.26%	12.33%	11.70%
Bloomberg Commodity TR	Commodities	27.11%	27.11%	9.86%	3.66%	-2.85%

Fixed Income Performance

Fixed Income Index	Style	YTD Return As of 12/31/2021	1 Year Return As of 12/31/2021	3 Year Return As of 12/31/2021	5 Year Return As of 12/31/2021	10 Year Return As of 12/31/2021
Bloomberg US Aggregate Bond TR	U.S. Core Bonds	-1.54%	-1.54%	4.79%	3.57%	2.90%
Bloomberg US Corporate High Yield Bond TR	U.S. High Yield Bonds	5.28%	5.28%	8.83%	6.29%	6.82%
Bloomberg Global Aggregate Bond TR	Foreign Developed Bonds	-4.71%	-4.71%	3.59%	3.36%	1.77%
JPM EMBI Global TR	Foreign Emerging Bonds	-1.51%	-1.51%	6.06%	4.46%	4.95%
FTSE Treasury Bill 3-Month	Cash	0.05%	0.05%	0.95%	1.11%	0.60%

Source: Morningstar®