ADVISER
INVESTMENTS

Adviser Outlook

JANUARY 2022

QUICK TAKES

- ✔ U.S. stocks, led by a handful of big tech companies, notched a record-breaking year
- ✔ High inflation is forcing the Federal Reserve to act sooner rather than later to raise interest rates
- ✔ Economic fundamentals (including employment, earnings and consumer spending) support further growth in 2022
- ✔ Expect more bumps in the market compared to last year; diversification will smooth the ride

If someone told you that the U.S. stock market would close the year near its all-time high (after hitting 75 new peaks over the prior 12 months), suffer declines off those highs of no more than 5% at any given point—all during a pandemic—and that it would feel like a disappointment to most investors, well, you'd probably want a good explanation. That's what happened in 2021; the reason, in a word, is "breadth."

Breadth is not a meditation technique. It's a measure of how many stocks are contributing to the overall return trends in a market or index. Last year, breadth was narrow, and a significant portion of the S&P 500's gains could be attributed to just seven mega-sized stocks: Alphabet/Google, Amazon, Apple, Meta/Facebook, Microsoft, Nvidia and Tesla. It was an excellent absolute year for stock market investors, but diversified portfolios that held bonds, foreign stocks, out-of-favor sectors and small- or mid-cap shares lagged on a relative basis.

What does this mean for 2022? First off, we think that 2021 was an outlier in much the same way that 1999 and 2000 were outliers with wild swings in sentiment favoring and then discarding technology stocks of all sizes and shapes. That isn't to say that 2022 will bring a bursting of the technology sector, but it does mean that we believe putting all your eggs in the tech basket will be a tempting mistake.

It should come as no surprise that we remain firm believers in a diversified, risk-aware investment approach. When we widen our view beyond just a single 12-month period and consider the markets' long-term lessons, we see great value in having a variety of asset classes and risk buffers in our portfolios working in harmony with well-vetted, up-to-date financial plans, particularly as we prepare for increased volatility in the months ahead.

After an almost total economic shutdown in 2020, it was a banner year for corporate earnings, economic growth and job creation in 2021. Now, inflation is running hotter than it has in the last 40 years. If that isn't enough, we're in an ongoing fight to end the COVID-19 pandemic, supply chain kinks persist, the path to infrastructure spending legislation is fraught and the Federal Reserve has signaled it will be shifting swiftly to tighter monetary policy (meaning higher interest rates). Trade relations with China are tense and could worsen, and China's self-inflicted market wounds aren't helping

QUARTER REVIEW

- ✔ The S&P 500 surged in Q4 to close with a 28.7% gain for the year; foreign stocks lagged over both periods
- ✔ Every U.S. market sector except communication services posted a positive return in the fourth quarter, led by real estate and technology
- ✔ The bond market was flat over the final three months of the year and declined 1.5% in 2021

matters. Any of these factors alone could contribute to a market pullback and the first few trading days of 2022 showed just that. We believe it's best to be prepared. And the best way to be prepared is to stay diversified.

Fortunately, the stock market rests on a strong foundation. Signs point to continued economic growth (albeit at a slower pace), workers and consumers are confident in their prospects and, from a medical standpoint, we're hopeful that a silver lining of the omicron surge is that it transforms the coronavirus into a more manageable endemic akin to the seasonal flu. From a market standpoint, the solutions developed by businesses facing new challenges enabled companies to cope, persevere and thrive over the latter course of the pandemic—the latest object lesson in American ingenuity and resilience.

Fourth Quarter Review

After marginally positive returns in the third quarter, U.S. stocks finished the year strong, with the S&P 500 returning 11.0%, the MSCI U.S. Broad Market index up 9.3% and the Dow Jones Industrial Average gaining 7.9% in Q4. All three indexes returned more than 20% in 2021.

Stocks Finish 2021 Strong

INDEX	Q4	2021
S&P 500	11.0%	28.7%
MSCI U.S. Broad Market	9.3%	26.1%
Dow Jones Industrial Average	7.9%	20.9%
MSCI EAFE	2.7%	11.3%
Bloomberg U.S. Aggregate Bond Index	0.0%	-1.5%
MSCI Emerging Markets	-1.3%	-2.5%

Note: Ranked by Q4 returns. Performance numbers are total returns, reflecting reinvested dividends through 12/31/21. Source: Morningstar.

Turning to sectors, real estate investment trusts (REITs) gained 16.3% in the final three months of the year, followed by technology stocks (14.3%) and shares of materials producers (14.2%). For the year, the energy sector continued to benefit from higher oil prices and the lifting of pandemic restrictions, gaining 55.9% while REITs were up 43.1%.

PERSONAL FINANCE FOCUS

The Case for Trusts

Wills and trusts both have advantages, but trusts often have the edge with estate planners—in large part because they avoid the probate process, which can be long, drawn out and public. These are a few reasons why trusts are a popular financial planning tool:

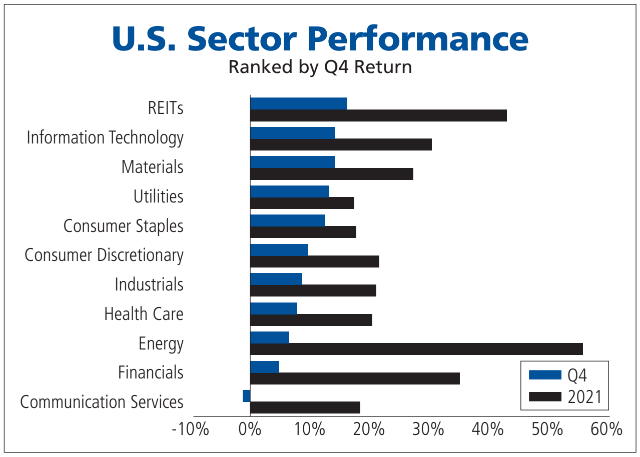
- **Faster resolution.** Assets placed in a trust are generally safe from creditors and can be disposed of (i.e., sold) by the trustee in short order. By contrast, under probate it can take months or years for debts to be paid and heirs to be notified before beneficiaries receive assets they've inherited. And documents filed in the probate process usually become part of court records, opening up your bequests to public scrutiny.
- **Greater control.** Trusts make it easier to ensure the money you pass on is used as you wish. While a will bequeaths funds to a named individual or institution, beneficiaries can generally spend them how they please. With a trust, the grantor can establish a series of instructions that restrict what the inheritance may be used for.
- **Greater flexibility.** Many types of trusts allow the grantor to access the assets during their lifetime. This makes it easier to adjust your estate plan as needed. If a grantor becomes ill, for example, it's easier to create provisions within the trust that assign funds to cover debt and expenses during the grantor's disability.
- **Less complexity.** If you have real estate or other assets in multiple states, or if your heirs live in different locations, a revocable trust may help you reduce complexity by avoiding the need to establish a probate case in each separate jurisdiction.

There are many types of trusts. Be sure to consult an estate attorney to learn more about your options—and if you need help understanding what's best in your situation, reach out to your wealth management team. We're happy to help.

For more on trusts, listen to our podcast (adviserinvestments.com/trust-podcast/) or read our blog post (adviserinvestments.com/trust-strategies/).

OUR OUTLOOK

- ✔ It's not going to be 2020 or 2021 all over again—earnings, GDP and inflation trends will change the dynamic
- ✔ Diversification has taken a gut punch, but it's not down for the count
- ✔ We're here to help you review your investment strategy and update your financial plans



Source: Morningstar.

Communication services was the only sector to decline in the fourth quarter, falling 1.2%. Financials lagged the broad index over the three months due to concerns about Fed policy shifts, while energy stocks cooled along with oil prices. That said, every U.S. stock market sector finished the year with a gain.

The benchmark MSCI EAFE index, a measure of developed foreign stocks, gained 2.7% in Q4 and 11.3% in 2021—nice returns for equities under any flag. But at less than half the return of the S&P 500, this was the fourth consecutive calendar year U.S. stocks outperformed their overseas brethren. Emerging markets stocks had even tougher sledding, falling 1.3% in the fourth quarter and 2.5% over the 12 months—Chinese stocks' 20%-plus decline was the story there.

The bond market was flat in Q4 and generated a loss of 1.5% in 2021. Bond yields trended higher to start the year, as the economy continued to reopen, then drifted lower over the summer due to concerns surrounding the delta variant's impact on the economy. As inflation fears ramped up in the fall, bond prices fell and yields rose once again. In all, the yield on the 10-year Treasury rose from 0.93% at the end of 2020 to 1.52% at the close of 2021. (Read Adviser Investments' full *Bond Outlook* from Chris Keith, our own "bond guy," here: **adviserinvestments.com/bonds-22q1/**.)

Our Outlook

You may have heard the joke that 2022 is pronounced *2020 II*. It makes for clever (if shudder-inducing) wordplay, but we're not in for a repeat of 2020—or 2021, for that matter.

Economic and earnings growth will slow in 2022. But slower growth is still growth. Economic output is at a record high, unemployment has fallen from 6.7% to 3.9% in just one year, surveys show business activity is at or near its highest levels in decades and consumers have cash in the bank. These are all good signs, but the comparisons with 2021's abnormally high growth rates are about to get harder, which could lead to negative headlines and knee-jerk market volatility.

Consider that corporate earnings were about 50% higher year-over-year in the third quarter (we won't have Q4 numbers for a few weeks). That pace is simply not sustainable, but deceleration in this case does not

COMPANY NEWS

The Jonathan St. Clair 'Adviser Way' Award

ANYONE WHO PARTNERED with Jonathan St. Clair during his more than 20 years at Adviser Investments knows firsthand of his steadfast commitment to clients and colleagues. After his sudden passing in 2017, we created an annual honor for employees who embody Jonathan's resolute work ethic and generosity of spirit. This year's recipient is Laura Sweeney, Adviser Investments' head of talent acquisition and career development. Laura's oversight of the firm's mentor program and devotion to professional development for everyone under her stead throughout her 15-year tenure here have been critical to the firm's growth and our ability to always provide 1% more for our valued clients. Thank you to Laura for setting a superlative example of *The Adviser Way*.

indicate weakness. We saw jaw-dropping growth in 2021 because profits were so hard-hit during the pandemic. Earnings are still expected to grow around 10% in the year ahead, building off of a higher base following last year's bounce. That's the good news.

Inflation is possibly the biggest bugbear for market watchers and investors today. Consumer prices have risen 6.8% over the year through November and the Fed's preferred inflation measure was running only slightly cooler, at 5.7%. Much of the increase in prices can be explained by supply chain kinks—which are being straightened out—but higher prices are impacting consumers even as federal fiscal stimulus is being phased out (extended child tax credits, rent controls, etc.).

We still see the current inflation surge as a temporary phenomenon—but we're watching the data closely to be sure this is so. Oil prices are falling. Ports are clearing up thanks to increased productivity and support from an administration whose political fortunes depend in part on slowing price gains. As the pandemic becomes endemic, consumers should turn from stockpiling goods to spending more on services. And as we often say, the cure for high prices is… high prices. Additionally, the Fed has accelerated its inflation-fighting timeline. It won't happen overnight, but we expect that the clamor will have quieted substantially in a year's time.

To bring things full circle: We think the trend of narrower market breadth will revert to the mean of broader market participation. Not every stock or asset class can always be a winner (something that traders of cryptocurrencies, meme stocks and non-fungible tokens would be wise to keep in mind). Over time, diversification has been one of the best tools for long-term investors to simultaneously control risk and participate in market gains. In any given year, it's an easy prediction that stocks will hold greater growth potential than bonds, and that appears to be the case in 2022, even as stock prices are currently at or near highs. But given today's low yields, bonds' value will be the income they generate and the ballast they provide to stock market volatility rather than their muted potential to grow investment capital.

You should be hearing from your wealth management team soon, if you haven't already. The beginning of a new year is a great time to reassess your financial plan, review your investment strategy and take stock of where you are in relation to your goals. As always, we are here to help you in any way we can.

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