Advisor Group
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Q4 2021

# MARKET VIEW QUARTERLY

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Coming out of 2020, expectations were high that 2021 would be an exceptional year as we finally made it through to the other side of the Pandemic, and the "Great Reopening" would spur economic growth and markets alike. While we did witness economic growth well above trend, both the Delta and Omicron variants threatened to stall the recovery and ultimately tempered expectations for a full return to normal. Growth has rebounded in the United States with GDP up 4.9% on a quarter-over-quarter basis in the third quarter, following an exceptional second quarter reading of 12.2%.[1] The labor market has also made a remarkable recovery from the pandemic era lows, as the U-3 unemployment rate has come back from 14.7% in April of 2020 to 4.2% in November of 2021. Though the unemployment rate has come down, there is still considerable slack in the labor market as the labor force is still down about 2.4 million participants compared to pre-pandemic levels. Supply chain issues coupled with unprecedented levels of fiscal and monetary stimulus led inflation to dominate headlines during the year, as the Consumer Price Index (CPI) increased 6.8% year-over-year as of November, the fastest rate since June of 1982. Due to the persistence of price increases, the Federal Reserve made a hawkish pivot in their last meeting of 2021 by increasing the rate of tapering of their bond purchases, as well as signaling a greater likelihood of multiple rate increases in the coming year. While we expect moderation in economic growth in the months ahead, we believe the recovery will remain strong in the coming quarters as we return to normal and the impact of Coronavirus fades.

## DOMESTIC EQUITIES

Since the beginning of the year, stocks have remained in a steady and mostly uninterrupted uptrend, with only one 5% pullback (versus a historical average of three per year, according to FactSet). As a result, the S&P 500 Index returned 28.71% in 2021.[2] This marks only the 10th time that the S&P 500 has generated three straight years of positive double-digit returns in the last 90 years. The main factors driving stocks higher in 2021 were sustainable profit margins and strong corporate earnings. The (year-over-year) earnings growth rate for 2021 is projected to come in at 45.1%. If 45.1% is the actual growth rate for the year, it will mark the highest annual earnings growth rate reported by the index since FactSet began tracking this metric in 2008. The current record is 39.6%, which occurred in 2010. Investors seemed to take comfort in the consistency of earnings growth and were thus able to look through stubbornly high inflation, labor shortages, supply chain issues and new COVID-19 variants. Following the vaccine rollout, optimism around the economic reopening drove sizable gains in economically sensitive investments, including value stocks and small-cap stocks. However, these early gains were not enough to change market leadership. As a result, the outperformance of asset classes and sectors that benefit from the reopening reversed around May, about when the 10-year yield peaked, and technology and growth stocks regained control. For the year, the Russell 1000 Growth Index led the way, returning 27.60%. Large cap value stocks narrowed the gap, but still ultimately trailed growth with the Russell 1000 Value Index returning 25.16%. The Russell Mid-Cap Index returned 22.58% and the Russell 2000 Index returned 14.82%.[2] Overall, we expect stocks to continue to grind higher in 2022. The strength of the US consumer gives us optimism about the prospects for equities moving forward, as shown in the most recent Conference Board Consumer Confidence Index® reading, as the index rose to 115.8 in December, the highest reading since July. Moreover,

consumer concerns about inflation declined after reaching a 13-year high last month, along with concerns about COVID-19. This report points to positive signs for the economy next year as consumer demand is a vital driver of the economy.

## INTERNATIONAL EQUITIES

International developed equities and emerging market (EM) equities returned 11.26% and -2.54% for the fourth quarter, respectively, both lagging the S&P 500. International and EM stocks got off to a hot start in 2021,[2] however, successive COVID-19 waves and new virus variants interrupted the recovery and pushed further back any chance for synchronized global growth. Similarly, the financial impact of China's Evergrande debt fiasco, a broad China Tech crackdown, and the potential for higher interest rates (emerging markets debt is frequently issued in US dollars) weighed on EM investments. However, moving forward we could see strong performance from the international space. Potentially the biggest driver of incremental economic activity these days appears to be COVID-19 and its variants. According to data from the New York Times, 62% of Americans are now fully vaccinated; However, those rates are higher in most international developed economies, including Spain at 80%, Japan at 78%, France at 73%, and the UK at 71%.[3] If it appears COVID-19 is being dealt with effectively and cases are moderating, we believe economic activity will reflect such progress. Furthermore, we believe that another tailwind for the space could be the rotation into value-oriented stocks as the developed international equity market (mainly Europe and Japan) is much more value-focused than the U.S. market, based on the MSCI EAFE Index and the S&P 500 Index.

## FIXED INCOME

Following a strong 2020, fixed income faced a difficult path to continue to appreciate in 2021. The fixed income market, as measured by the Bloomberg US Aggregate Bond Index, returned -1.54% for the year.[2] Coming off of all-time lows in 2020, long-term interest rates quickly reverted to pre-pandemic levels in the first quarter and have remained range bound since, as market participants re-evaluated the path of the Federal Reserve and the staying power of inflationary pressures. The 10-year U.S. Treasury yield sits at 1.51% at year end, up 0.60% from the beginning of the year. As short-term rates remain anchored by the Federal Reserve, the yield curve began to steepen as the difference between long and short-term rates increased to 0.78%.[1] During their most recent meeting, the Federal Reserve made a hawkish pivot, announcing an increase from tapering $15 billion in bond purchases per month to $30 billion beginning in January, and the dot plots signaled the potential for three rate increases in 2022. Despite the headwinds that duration posed to fixed income, lower credit quality bonds benefitted from a risk on environment as the Bloomberg US Corporate High Yield Index increased 4.25% on the year.[2] Over the next year, we project the path for short-term rates to increase as the Federal Reserve embarks on a tightening cycle. However, we believe long-term rates may have an upward bound of around 2% as price-insensitive buyers counteract the impact of rate hikes and higher inflation on the longer end of the yield curve. Thus, we believe fixed income securities will continue to benefit portfolios from a diversification perspective but may offer low returns moving forward.

## ALTERNATIVES

Alternative assets have continued their climb from the third quarter into the fourth as investors weigh the effects of higher inflation expectations. WTI Crude prices reached new highs, however it was a volatile quarter due to the emergence of new COVID variants, which potentially impacted future demand. WTI crude oil prices started the quarter at $73.59 a barrel before falling as low as $62.26, before recovering and ending the quarter at $75.21 a barrel. For the year oil prices have risen tremendously, beginning the year at $47.32 before ending at $75.21, an increase of 58.94%.[1] Demand for oil has had a negative relationship with the arrival of new variants and increasing caseloads. Hedge fund-like alternatives moved higher on the year, up 2.30%, as measured by the Morningstar Diversified Alternative index, ending the year in positive territory, up 9.82%.[2]


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# REAL ESTATE

With interest rates anchored near zero, home buyers have been eager to take advantage of low mortgage rates. However, as home prices continue to rise, more and more buyers are being pushed out of the market and are moving towards renting. According to the St. Louis Fed, the median price for a new home sold reached a record of $404,700, which marked the sixth quarter in a row of sale price increases.[4] Over the past year, single-family starts are down -0.8% while multi-unit starts are up +37.1%. In addition, compared to last year, permits for single-family units are down -4.5% while permits for multi-family homes are up +12.6%. These vast differences are evidence of how difficult it has become for many to afford a home, and that developers are shifting their resources and sights towards the multi-family sector in reaction to rising rents as more people move back into cities.

# CONCLUSION

The last year was one of transition, coming from the depths of the Coronavirus to slowly restoring some level of normalcy. While we expected a great reopening, the pandemic continued to linger on and disrupt a full return to normal. As we close out the year, we acknowledge that 2021 did not play out exactly as we had hoped or expected, but the global economy and markets remained resilient. We expect a moderation in economic growth in 2022 but we believe we are through the worst of the pandemic and its impact on the economy. As the recovery continues, we don't expect data to be as strong as it has been, but there are still tremendous levels of pent-up consumer demand that should allow the United States to continue on its path to a robust recovery.

***Economic Definitions***

**GDP:** Gross domestic product (GDP) measures the final market value of all goods and services produced within a country. It is the most frequently used indicator of economic activity. The GDP by expenditure approach measures total final expenditures (at purchasers' prices), including exports less imports. This concept is adjusted for inflation.

**Unemployment Rate**: The unemployment rate tracks the number of unemployed persons as a percentage of the labor force (the total number of employed plus unemployed). These figures generally come from a household labor force survey.

**CPI (headline and core):** Consumer prices (CPI) are a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.

**Housing Starts:** Housing (or building) starts track the number of new housing units (or buildings) that have been started during the reference period.

**Building Permits:** This concept tracks the number of permits that have been issued for new construction, additions to pre-existing structures or major renovations. These statistics are based on the number of construction permits approved

**Conference Board Consumer Confidence Index:** The Consumer Confidence Survey® reflects prevailing business conditions and likely developments for the months ahead. This monthly report details consumer attitude, buying intentions, vacation plans and consumer expectation for inflation, stock prices and interest rates. Data are data available by age, income, region and top 8 states.

**West Texas Intermediate (WTI):** West Texas Intermediate (WTI) crude oil is a specific grade of crude oil and one of the main three benchmarks in oil pricing, along with Brent and Dubai Crude. WTI is known as a light sweet oil because it contains around 0.34% sulfur, making it "sweet," and has a low density (specific gravity), making it "light."

**The Federal Reserve System:** The central bank of the United States. It performs several general functions to promote the effective operation of the U.S. economy and, more generally, the public interest.

### *Index Definitions*

**S&P 500:** The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

**Russell 1000 Value:** Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.

**Russell 1000 Growth:** Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.

**Russell Mid-Cap:** Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

**Russell 2000:** The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. The real-time value is calculated with a base value of 135.00 as of December 31, 1986. The end-of-day value is calculated with a base value of 100.00 as of December 29, 1978.

**MSCI EAFE:** The MSCI EAFE Index is a free-float weighted equity index. The index was developed with a base value of 100 as of December 31, 1969. The MSCI EAFE region covers DM countries in Europe, Australasia, Israel, and the Far East.

**MSCI EM:** The MSCI EM (Emerging Markets) Index is a free-float weighted equity index that captures large and mid-cap representation across Emerging Markets (EM) countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

**Bloomberg Barclays US Agg Bond:** The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

**Bloomberg Barclays High Yield Corp:** The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded.

**Morningstar® Diversified Alternative Index:** The Morningstar® Diversified Alternatives Index is designed to provide diversified exposure to alternative asset classes in order to attempt to enhance risk-adjusted portfolio returns when combined with a range of traditional investments. The index consists of a diversified set of ProShares alternative exchange traded funds that employ alternative and nontraditional strategies such as long/short, market neutral, managed futures, hedge fund replication, private equity, infrastructure, or inflation-related investments.

## *Disclosures*

Index performance does not reflect the deduction of any fees and expenses, and if deducted, performance would be reduced. Indexes are unmanaged and investors are not able to invest directly into any index. Past performance cannot guarantee future results.

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[1] Bloomberg as of 12.31.2021
[2] Morningstar as of 12.31.2021
[3] https://www.nytimes.com/interactive/2021/world/covid-vaccinations-tracker.html
[4] Median Sales Price of Houses Sold for the United States (MSPUS) | FRED | St. Louis Fed (stlouisfed.org)