Investment Tally & Perspective

MAJOR ASSET CLASS RETURNS	4th Qtr. 2021	1-Year	3-Year	5-Year
Equities				
S&P 500	11.0%	28.7%	26.1%	18.5%
MSCI EAFE	2.7%	11.3%	13.5%	9.5%
MSCI Emerging Markets	-1.3%	-2.5%	10.9%	9.9%
Fixed Income				
Barclays Capital US Aggregate	0.0%	-1.5%	4.8%	3.6%
Barclays Capital US Corp. Inv. Grade	0.2%	-1.0%	7.6%	5.3%
Barclays Capital Emerging Market	-0.5%	-1.7%	5.8%	4.6%
Other Assets				
MSCI US Reit Index	16.3%	43.1%	18.5%	10.8%
S&P GSCI	1.5%	40.4%	8.0%	2.8%
ICE WTI Crude Oil	0.2%	55.0%	18.3%	7.0%
Comex Gold	4.1%	-3.5%	12.7%	9.1%

Source: Capital IQ — All returns greater than one year are annualized

Market Activity - The U.S. stock market, as measured by the S&P 500, returned 11.0% in the fourth quarter and 28.7% for the full year. The market has had a remarkable run, gaining in 12 of the past 13 years, and returning 587% since year-end 2008. International equities lagged the U.S. for the quarter and the year. Fixed income markets had a difficult 2021, though Lincoln Capital clients tended to have a better experience. Municipal bonds also outperformed taxable bonds. Holding down bond returns was the rise in interest rates. The 10-year U.S. Treasury started the year under 1.0% and finished just above 1.5%. While the adjustment period is painful on a mark to market basis, higher interest rates are a positive for long-term fixed income investors.

Economic Activity – While the world is currently experiencing a coronavirus driven slump, the U.S. and other developed economies are poised to grow solidly in 2022. While case counts are up dramatically, hospitalizations have yet to reclaim past peaks which is significant as hospitalizations are the most important metric for lockdown policies. Without significant hospital strain, the economic impact will remain limited. Also encouraging is that South Africa, the epicenter of the new variant, is already seeing cases drop substantially, suggesting our wave will also be brief. As we get further into January, a clearer picture will emerge.

Beyond the first quarter, the outlook is strong with the biggest uncertainties surrounding inflation and employment. For the latter, unemployment claims, open positions, and the level of quits all suggest a very tight labor market. Participation (the percent of the population working, or actively looking for work) is beginning to show improvement, which is encouraging, however, we are unlikely to regain all the jobs lost from February 2020 due to demographics and early retirements. This will bode well for those able and willing to work,

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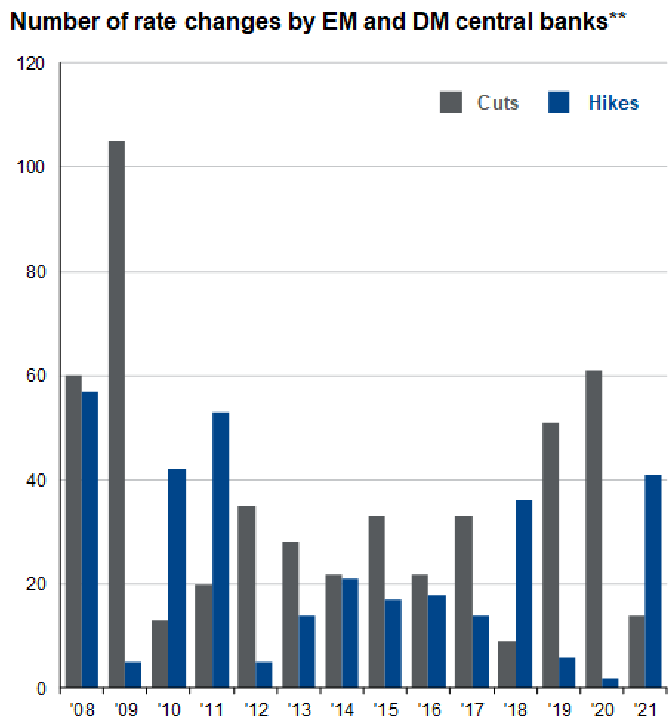
yet increasing wages impacts business profit margins without an increase in prices or productivity. Compensation is a factor in inflation rates which is another key uncertainty for 2022. While we expect inflation pressures to moderate as the year progresses, inflation is likely to be higher than pre pandemic for some time, particularly in the service economy.

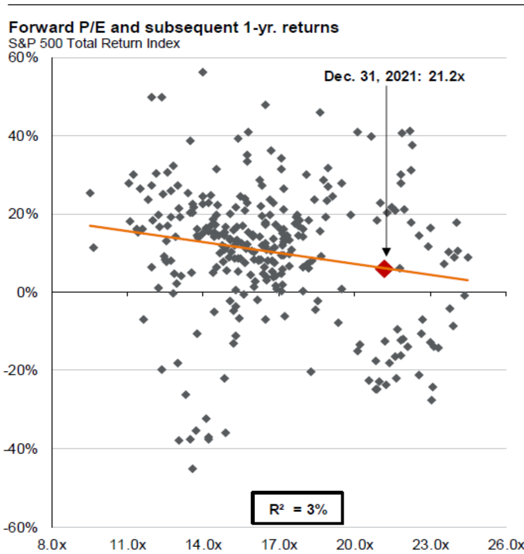


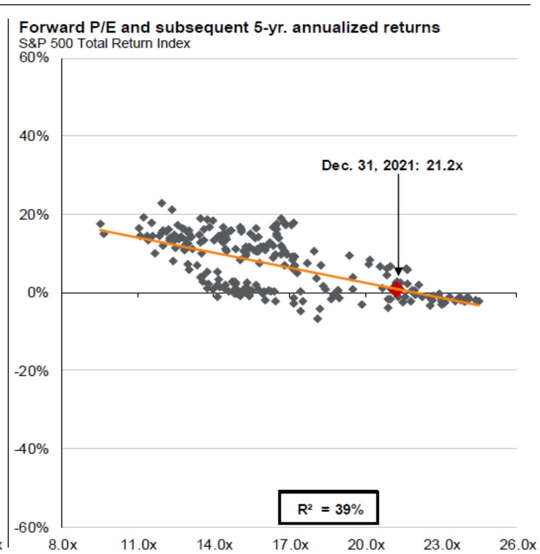
Source: J.P. Morgan

Monetary Policy – The direction of monetary policy changed substantially in the fourth quarter. While the ECB and BOJ did not make notable changes, our Federal Reserve, the Bank of England, and other developed central banks began the process of removing accommodation. The graph to the right displays the shift in policy.

Behind this change in stance has been rising concerns surrounding inflation and the view that we are closer to full employment than evident by total payroll figures. In October, the market was pricing in near 100% certainty that the fed funds rate would be between 0.0% and 0.25% after the March FOMC meeting. Now the market is expecting a 70% probability of one hike, and even a 6% chance of two hikes in March! The period of maximum accommodation is clearly over. As recently explained by the Bank Credit Analyst, since 1961, equity returns are more responsive to the level of the fed funds rate, than the direction. Given the policy rate will continue to be accommodative for some time, they posit it is too soon to fret over hikes.

Valuation and Sentiment - Equity returns are driven by dividend yields, earnings growth, and P/E multiples. Today's dividend yield is 1.3%, while 2022 earnings per share is expected to grow 8%. As we have described in past communications, the period post pandemic has been unique, in that earnings were revised higher throughout the quarter, and companies posted results much better than expected. This dynamic now appears to be over. For equity investors, this means the change in the P/E multiple is the most likely determinant of 2022 equity returns. At 21.2x 2022 EPS, valuations are above their historical averages, and higher volatility and lower returns are to be expected in the new year. However, as seen to the right, starting valuation levels are a poor predictor of subsequent 1-year returns, but a better gauge of subsequent 5-year returns.





Source: J.P. Morgan

Investment Outlook and Strategy

Of all the factors that impact the investment outlook, currently the most prominent are the virus, the economy, and the Fed. The following provides a summary of our related views.

COVID 19 – What's Next - Pandemic, Epidemic, or Endemic?

- Pandemic - According to the World Health Organization (WHO), a Pandemic is when a disease's growth is exponential, spanning multiple countries or regions.
- Epidemic - The Centers for Disease Control and Prevention (CDC) describes Epidemic as an unexpected increase in the number of disease cases in a specific geographical area, whether it is contagious or not.
- Endemic - A disease outbreak that is consistently present but limited to a particular region which makes the disease more predictable.

We view the recent increase in virus cases as part of a peaking process which will decline as spring arrives. Importantly, the technology and knowledge gained in the past two years has provided new treatments and vaccinations, with more on the way, which mitigate spreading and soften the virus impact. As has been seen with each successive wave, the world's ability to cope with the virus continues to improve.

The Fed, the Economy, and the Financial Markets

The recent increases in inflation have been primarily caused by virus disruption of supply chains and labor shortages. Though the Fed must address these issues and take actions to suppress inflation, they do not want to induce a recession. Recall that when the pandemic surfaced two years ago, economic activity had upward momentum and the unemployment rate was at record low levels, not unlike the present. With consumers and businesses having healthy balance sheets and pent-up demand, GDP and corporate profits remain primed for growth. Inflation pressures will lessen as supply chain issues are resolved, and it is likely that some who left the workforce in recent periods will, once again, become employed.

Investment Strategy

We are very bullish on the exponential rate of growth under-way globally due to technological changes such as artificial intelligence, 3D Printing, and the decoding of DNA. Though we expect developing technology to continue increasing productivity and creating new industries in all global sectors, we expect financial markets to be more volatile as assets are repriced to higher interest rates. Bond prices will be pressured lower as the Fed pivots from being a buyer of bonds to potentially a seller of bonds, and all assets will gradually reprice as interest rates move towards historic norms. In the past 19 years, during which the Fed was quite accommodative, common stocks (S&P 500) on a calendar year basis have only experienced two negative years with the last three years providing positive double-digit returns (26% annualized).

Our view for 2022, and perhaps 2023, is that odds favor stock returns exceeding those from cash and bonds, yet the path ahead will not be smooth and marked with periodic declines. Though bullish on the years ahead, we advise tempering near-term return expectations. As Fed policies and actions likely change from being accommodative to neutral to potentially restrictive in coming months and years, well-managed companies will adapt to continual change, such as inflation and interest rates rising, and provide attractive returns to patient investors.

Notable Financial and Retirement Planning Changes in 2022

2021 will not be fondly remembered by everyone due to the ongoing pandemic, yet, for most, it was an improvement from the government enforced lockdowns of 2020. Effective with the beginning of 2022, there are numerous tax and regulatory changes worth noting, and we highlight changes made to retirement plan contributions, Social Security benefits, and Medicare below.

For those eligible to contribute to a workplace retirement plan such as a 401(k) or 403(b), the maximum contribution limit has been raised by $1,000, to a total of $20,500 in employee contributions. The catch-up contribution for those over age 50 remains at $6,500. While an additional $1,000 per year may not seem like much, at an annual return of 7% it would grow to $188,632 for those who start in their mid-twenties and retire at full retirement age (67). While not everyone can maximize their contributions, it is important to save what you can, as money saved in these plans may reduce current year taxable income and allow for tax-deferred growth.

Along with higher retirement plan contribution limits, another change to reduce taxable income is the standard deduction for 2021 and 2022. In 2021, the standard deduction for a married couple increased by $300 to $25,100 ($12,550 for single filers) and in 2022, this rises to $25,900 for a married couple filing jointly ($12,950 for single filers). While this is beneficial for those taking the standard deduction, the 2021 tax break that allowed Americans to write off cash donations to charity (up to $600 per married couple) was temporary and now it is gone. Going forward, as it was before 2021, to receive a tax deduction for donations to charity you will need to itemize.

Social Security benefits are rising by 5.9% in 2022, the largest increase since 1982. This also applies to disability and Supplemental Support Income (SSI). While those who receive increased benefits may welcome them, for many this COLA (Cost-of-Living Adjustment) will not result in more money in their pockets as higher inflation rates in the U.S. may offset any gains. Also due to inflation- the standard Medicare Part B premium costs will be rising by $21.60 a month, the largest in the health insurance program's history. Medicare Part B covers doctor visits, outpatient services such as lab tests and screening. Other changes will be addressed as we collaborate individually with clients on their financial, retirement, and income planning.

As always, if you have any questions about the upcoming changes, or need assistance in any manner, please know we are available at your convenience.