WestStar

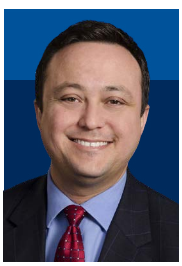
Wealth Watch

2021 Q4 Review & 2022 Q1 Outlook

The year 2021 capped a two year period of both tremendous strife and success; of sorrow and satisfaction; of prosperity and poverty. Society was compelled to contend with a pernicious pandemic, yet it thrived from the third consecutive year of double-digit stock market returns.

A Tale of Two Markets

The dichotomous state of the world in which we find ourselves as we enter the year 2022 brings to mind the immortal words of Charles Dickens in his classic novel, "A Tale of Two Cities." It may feel like "the best of times" from a capital markets perspective, yet from a public health perspective it may feel like "the worst of times." The "season of light" that is the economic recovery is only tempered by inflation's "season of darkness." What better words, then, to which one might refer than those of Dickens when contemplating current conditions? As such, it will be his words that will set the stage for our discussion regarding the pandemic, inflation, interest rates, and expectations for markets in the New Year.



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Your wealth, well managed.

What You Need To Know:

- December's "Santa Claus Rally" materialized and stocks had the third consecutive year of double-digit performance
- WestStar's tactical strategy was prescient and added value to client portfolios in 2021
- COVID witnessed a spike in transmission with Omicron but fatality rates did not increase
- Inflation is high but signs are showing relief may be on the horizon
- The Fed will hike rates in 2022 which may impact both stock and bond investors in different ways
- Maintain focus on your long-term strategy to achieve investment success

Asset Class Index Performance* 2021

STRONGEST

- US Large Cap Stocks 28.71%
- Real Estate 27.21%
- Commodities 27.11%
- US Small Cap Stocks 14.82%
- International Developed Market Stocks 11.26%
- High Yield Bonds 5.28%
- Alternative Investments 4.72%
- Money Market (Cash) 0.08%
- US Investment-Grade Bonds -1.54%
- International Emerging Market Stocks -2.54%
- International Bonds -7.05%

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Performance: *"It Was the Best of Times, It Was the Worst of Times"*

The S&P 500 ended the year as the single best performing category among the major ones we track as shown in the column to the left. Stock returns were primarily driven by the remarkable 65% earnings growth of S&P 500 companies. Furthermore, and as we anticipated in the last issue of the Wealth Watch, a late December rally more than made up for stock market weakness of September and November. Domestic equities outperformed International and Large Cap outperformed Small, but all equity categories save Emerging Markets enjoyed double digit returns. 2021 was nearly the "best of times" for stock investors as the S&P 500 notched 70 record highs-the second most on record following the 77 in 1995.

Bond investors, however, could characterize 2021 as the "worst-of-times", with most major bond categories posting negative returns amid rising interest rates. The lone positive bond category was High Yield. Bonds aside, nearly all other major categories were positive for the year.

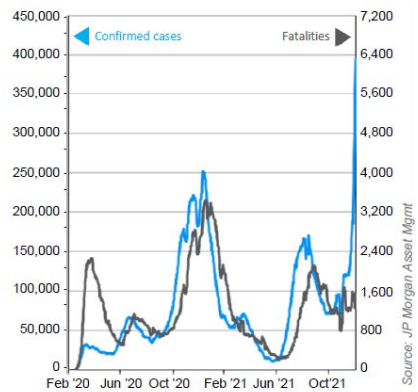
Tactical Strategy: *"It Was the Age of Wisdom..."*

One must excuse the tacit swagger of purposely excluding the second half of the Dickens quote, as WestStar's tactical investment strategy positioning was flawless in 2021. Over the course of the year, we maintained a "maximum-overweight" to stocks and a "maximum underweight" to bonds, thereby adding significant value to our client portfolios. In January of 2021 we increased our exposure to Real Assets and, as reflected in the column on the left, Real Estate and Commodities were the second and third best-performing categories. Even our bond strategies, which have maintained an overweight to High Yield and an underweight to Investment-Grade and International, outperformed. We do expect markets to be more volatile and the quest for returns to be more challenging in 2022, but will remain proactive in our tactical positioning as conditions warrant.

COVID: *"It Was the Spring of Hope, It Was the Winter of Despair"*

In the last edition of the Wealth Watch we noted that, at the time of its writing, over 80% of the American population had either been vaccinated against COVID, had the disease, or a combination of the two, which indicated that we had achieved or were quickly nearing herd immunity. This development was cause for hope that the summer spike in confirmed cases was the last. We included an important caveat in that assertion, however, in stipulating that such progress was contingent upon the absence of a new variant. Unfortunately, such a variant did materialize in the advent of Omicron. It was soon understood that the Omicron variant is by far more transmissible than its Delta counterpart, the spread of which is reflected in the chart at right. As can be seen, the winter surge in cases was gargantuan, causing cancelled travel, isolation related shutdowns, etc. One positive aspect gleaned from said chart is that fatalities have not increased. It remains to be seen whether the Omicron surge may recede by March and, barring some new variant, whether it will be the last.

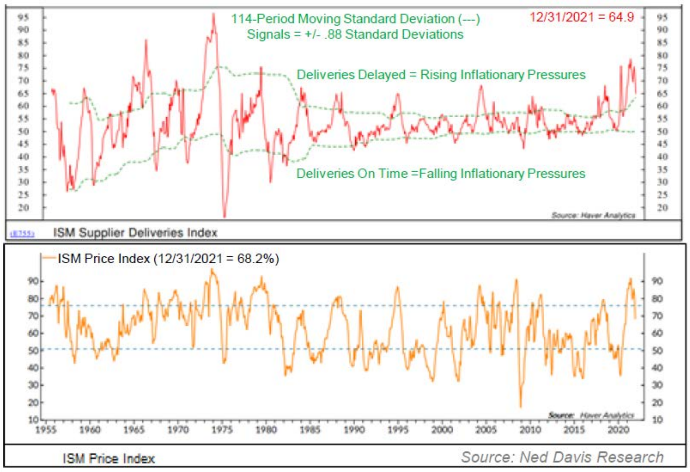
Change in confirmed cases & fatalities in the U.S. 7-Day Moving Average



*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Devel: MSCI EAFE Index; Int'l Emerg: MSCI Emerging Markets Index; Core Bond: Bloomberg Aggregate Index; Int'l Bond: Bloomberg Global Aggregate ex USD Index; High Yield: Bloomberg US Corporate High Yield Index; Cash: BofA Merrill Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodity: Bloomberg Commodity Index; Alternatives: Wilshire Liquid Alternatives Index

Inflation: *"It Was the Epoch of Belief, It Was the Epoch of Incredulity"*

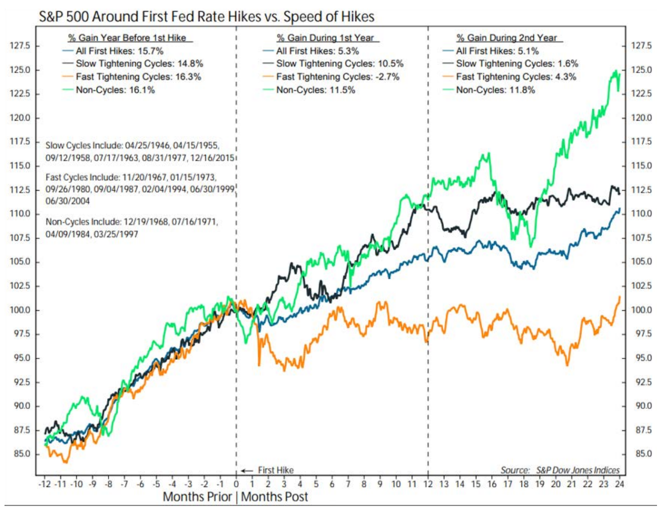
As stated previously, it was our view that inflation would reemerge in 2021 and we were certainly correct. The headline Consumer Price Index rose by a 40-year high of 7% year-over-year in December and the Fed's preferred inflation measure, Personal Consumption Expenditures, at 5.7% in November by far exceeded their 2% target. A popular refrain throughout 2021 was that inflation was "transitory," yet each month reports seemed to lack relief. So should we believe the "temporary" narrative or is high inflation here to stay?



A primary driver of inflation has been consumer demand shifting from services to goods at a time when manufacturers slowed production and/or shut down due to the pandemic. Meanwhile, shipping/delivery issues strained supply chains and a jump in energy prices exacerbated the supply vs. demand imbalance. The "transitory" characterization stems from the expectation that these issues will abate. While inflation remains high at present, the charts on the left indicate there has recently been some positive movement. The top chart shows delivery delays have improved slightly and the bottom one shows overall inflation pressures moderating. We have also seen energy prices moderate and the number of commodities in short supply decline. As such, it does appear that current inflation levels are temporary, though will remain higher than in recent years- likely in the 3% range in 2022.

Interest Rates: *"We Were All Going Direct to Heaven, We Were All Going Direct the Other Way"*

Ironically, the Omicron spike and the fiscal drag resulting from the expiration of economic stimulus policies may have alleviated inflationary pressures to a degree and tempered a "too hot" economy. That being said, the Fed is almost certain to hike rates this year and are seemingly targeting at least three. The good news is that analyzing the relationship between stock returns and interest rate movements indicates positive correlation until the 10 year Treasury yield reaches 3.6% - a long way from the current 1.8% (i.e. stocks can continue their ascent.) The bad news as shown on the chart at right is that the speed of Fed hikes has a negative effect, with a rapid tightening cycle being worst. Even worse, bond investors find themselves at the end of a double-edged rising rate sword: rising yields will help but if they stay below the inflation rate investors will have a negative real return. Furthermore, higher yields will help the interest income of new bond investors but existing ones will suffer capital losses.



Investment Strategy: *"We Had Everything Before Us, We Had Nothing Before Us"*

One can clearly see the dilemmas facing investors in 2022. While COVID may be spreading rapidly, the fatality rate has not increased. While inflation remains high, signs indicate it may have peaked and yet elevated levels relative to recent years may be expected. Interest rates are rising which will increase the income of bond investors but in the interim the value of their portfolios may be vulnerable. As it relates to stock investors, while rising rates are not necessarily a harbinger of stock market decline, an aggressive Fed may tip the scales toward weakness. One thing of which we can be reasonably certain is that the projected risk/return profile of various investments may be markedly different. We generally expect that the forward-looking returns of stocks and bonds over the next several years will be reduced relative to previous years and volatility will increase. While maintaining focus on one's long term objectives remains the most prudent course of action, we are reviewing our investment strategies given these expectations and will stand ready to make proactive adjustments as conditions warrant.

The team you can trust.

As true fiduciaries, our focus isn't on selling products to our clients. Instead, we focus on providing personalized service and real financial solutions.

Our team of wealth management professionals has the valuable depth of expertise you need to navigate life's events.

From retirement planning and investment management to trust services and estate settlement, we can help you devise the most effective plan to meet your financial goals.

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