ECONOMIC AND MARKET COMMENTARY

4th Quarter 2021

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AN AFFILIATE OF b1BANK

OUR MISSION

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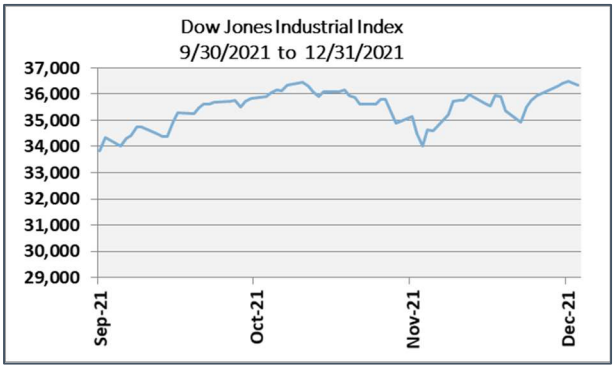
I. FOURTH-QUARTER 2021 EQUITY MARKET RECAP

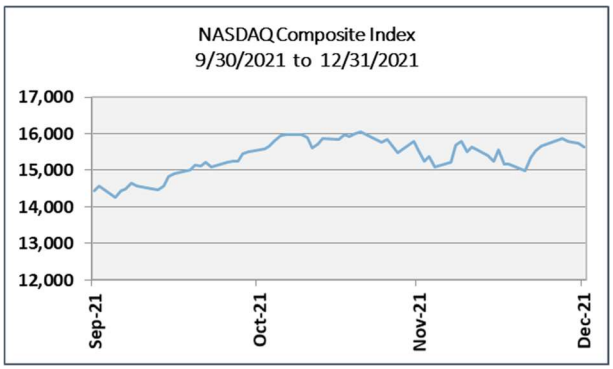
The major U.S. stock indices were all positive for the fourth quarter, with the tech-heavy NASDAQ edging out the S&P 500, while the Dow Jones Industrial Average lagged both. Emerging-market equities declined on concerns surrounding China's regulatory tightening and slowing growth. Year to date, U.S. stock performance remained strong, while bond returns were lackluster.

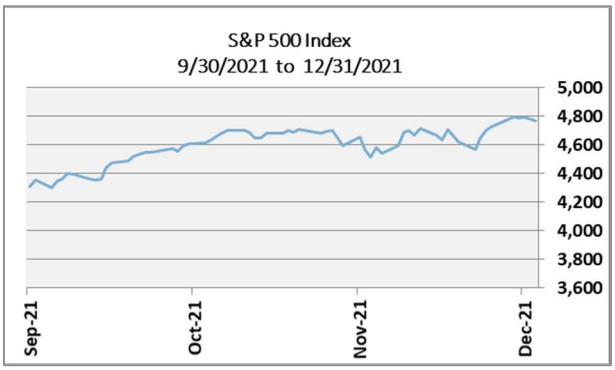
Concerns surrounding the economic impact from the Omicron variant and the Federal Reserve's more aggressive QE tapering and rate hike schedule weighed on smaller-cap companies in particular, as investors sought relative safety in large-cap tech amid the rising possibility of slowing economic growth in 2022.

Looking forward, volatility is expected as the Federal Reserve continues to unveil plans to curb inflation; in addition, the pandemic remains a key driver in market volatility as new data on variants and vaccination requirements are released. Despite volatility from Fed tapering and ongoing pandemic concerns, another solid corporate earnings season could continue to drive equity markets.

One of the biggest takeaways from another unpredictable year in the markets is the importance of diversification and following a well-constructed long-term investment plan that helps mitigate virtually any market surprise.







*Registration of an Investment Adviser does not imply any certain level of skill or training.

II. FOURTH-QUARTER 2021 BOND MARKET RECAP

The U.S. Treasury yield curve flattened during the quarter, with shorter-dated bond yields spiking during the second half of the quarter as the Federal Reserve echoed a more hawkish tone. The 10-year benchmark ended unchanged after experiencing some relatively high swings during the period. See chart and graph below.

	9/30/21	Low	High	12/31/21
2-Year Treasury	0.28%	0.27%	0.76%	0.73%
5-Year Treasury	0.98%	0.93%	1.34%	1.26%
10-Year Treasury	1.52%	1.35%	1.68%	1.52%

With the U.S. one of the few developed countries having positive rates across the entire curve, the global reach for yield could keep a lid on how high U.S. interest rates can climb in 2022. A flat-to-inverted Treasury yield curve could be in the cards for 2022, as the Federal Reserve raises its overnight rate and begins reducing its balance sheet.

Government bonds outperformed corporate bonds for the quarter. In the U.S. market, investment-grade debt experienced modestly positive returns, while high yield was the standout performer, beating all other fixed income asset classes both in Q4 and for 2021.

In November, President Biden signed the Infrastructure Investment and Jobs Act, a long awaited $1.2 trillion bipartisan infrastructure bill. The bill includes $550 billion of additional spending, 49% of which will be allocated to upgrading America's transportation sector, including ports, airports, railroads, roads, bridges and public transport, and 32% will be used to improve water and power infrastructure. The remaining will be spent on broadband and the environment.

III. THE WORLD 2022

Predicting market returns in 2022 will be as difficult as ever and much of it hinges on how well the US Federal Reserve and other major central banks (the European Central Bank, the Peoples Bank of China, the Bank of Japan and the Bank of England, etc.) navigate reductions in monetary support programs and a tightening of economic policy. While central bankers expect and actually desire for a low level of annual inflation (e.g., 2%), things begin to get sticky for the bankers when prices jump at materially higher levels than their targets and then show a stubbornness at staying elevated long after it was predicted they would moderate.

We have heard for well over a year from Fed Chairman Jerome Powell that current inflation is only "transitory" – brought on as a result of temporary product supply and demand imbalances (the COVID-19 side-effect). Now, the Fed is showing some nervousness that 7% year-over-year inflation is more serious (and more protracted) than they originally projected. As noted above, the Fed has recently begun more hawkish rhetoric with additional hikes suggested in the short-term interest rates and a quicker pace at ending monetary support (Fed open market purchases of U.S. Treasuries and mortgages).

The effect on the economy is similar to replacing the punch bowl with a pile of salt. If the transition is subtle then the party winds down orderly, but if the swap occurs too rapidly the party can end abruptly and someone gets hurt (e.g., the economy and financial markets).

The underlying strength of the current economy is fairly strong as evidenced by a tight labor market and a frenzy for goods and services. Assuming the Fed can navigate a mild landing and ease into tighter monetary policy, the economy will just keep humming along. A smooth landing will be good for equity markets and will keep longer-term interest rates still low by historical standards. However, inflation reports will be key and the markets' interpretation as to the Fed's plan of action. If we experience stubborn, elevated inflation deep into the year markets will react to the downside.

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The source of the information in this commentary is SSW, Wall Street Journal, Capital Economics and Bloomberg.