

Fourth Quarter 2021



Figure 1 – S&P 500



Figure 2 – U.S. 10-Year Treasury Yield

Market Recap

Stocks resumed their climb in the fourth quarter, with the large cap S&P 500 gaining 11.0%, finishing the year +28.7% (**Figure 1 – S&P 500**). Growth (+13.4%) outperformed value (+8.3%) by a substantial margin, as growth expectations for the economy moderated. Other U.S. indices also posted strong returns in the quarter. The S&P Mid Cap 400 index rose 8.3%, and the Russell 2000 Small Cap index added 2.1%. International indices continued to lag the U.S, with foreign developed countries +2.7% and emerging markets -1.3%. Developing economies have struggled with the pandemic. In addition, after years of business-friendly policies, China has moved to a more authoritarian stance, greatly increasing regulatory oversight and government interference.

Corporate earnings continued their growth in the third quarter, increasing 41.5% after a very robust 95% jump in the second quarter, according to research service Zacks. Those quarters had easy comparisons, following the deep trough of mid-2020. Earnings for the recently completed fourth quarter are expected to rise 19.3% on +11.4% higher revenues. However, forecasts have moderated, decreasing -1% since the mid-October high. The energy sector has been a standout, with earnings revised higher by +26.3%. Cost concerns have hit forecasts for consumer companies, following disappointing reports from Amazon and Apple last quarter. Supply chain issues coupled with higher labor expenses have weighed on many stocks. These problems did not derail the stock market last quarter but remain a concern in 2022. Earnings in 2022 are expected to grow 8.7% in 2022, a sharp decline from this year's expected +45.2%. This is a tricky time for investors because stocks have risen so much on this year's rapid growth. Companies who miss expectations this quarter, or guide to lower future earnings, will see their stocks suffer.

Economic Perspective

Growth slowed in the third quarter to +2.3%, following the second quarter's blistering +6.7% expansion. Services and government spending rose, offsetting declines in manufacturing and retail sales. Businesses replenished inventories that were depleted by strong second quarter spending. Purchasing manager surveys reported reduced activity as the quarter progressed, but still indicated solid growth. Orders for durable goods rose late in the quarter more than expected, a sign of continued consumer strength.

Some industry observers have suggested recently that supply chain issues may be waning, but lead times for new orders appear to be at cycle highs. In addition, in what feels like a repeating refrain, the Omicron variant of the Covid virus has spread rapidly in the U.S. and abroad, overwhelming hospitals and disrupting the economy. An estimated 5 million workers called in sick in the first week of the year, forcing economists to reduce their growth forecasts for the current quarter. While our economy has proven resilient to prior Covid waves, it is too early to determine the full impact of Omicron, which has been much more contagious than earlier variants.

The employment picture continued to improve gradually in the fourth quarter. The economy added jobs every month, but at a much slower pace than anticipated in November and December. The unemployment rate dropped to 3.9%, an indication of full employment, but the total number employed has still not reached pre-Covid levels. In November, the

Job Openings and Labor Turnover Survey (JOLTS) reported 10.6 million job openings, close to August’s high, while more than 4.5 million workers quit, an all-time high. Covid burnout appears to be a factor, as restaurants and health care experienced the most turnover. In addition, the large number of openings has given workers confidence to seek new opportunities and higher compensation. Work force management will continue to be an issue for businesses, and wage increases will add to inflation pressures throughout the economy.

The 10-year Treasury rate barely moved in the fourth quarter (**Figure 2 - U.S. 10-Year Treasury Yield**), and some bond returns were flat to slightly positive, after losing ground most of the year. However, 2022 began with a sharp increase in interest rates as investors, fearing continued inflation, sold bonds and added to cyclical stock positions. The Federal Reserve has signaled that they may begin raising short-term interest rates as early as March. In addition, they will likely reduce their bond holdings, which may also push interest rates higher. While bond positions may still be appropriate for risk-averse investors, a repeat of last year’s modest losses is a possibility. Higher yielding fixed income, including preferred stock, may offer better total return potential.



Fig. 3 – Brent Crude Oil Futures



Fig. 4 – Energy Select SPDR Sector Fund

Looking Ahead

After 3 years of strong U.S. returns, many investors are questioning how much higher stocks can go. With the Federal Reserve poised to raise interest rates, stocks may be set for a substantial correction, larger than any pullback in 2021. However, the economy appears to be on solid footing. Consumer debt service (**Figure 3 – Household Debt Service Payments as a Percent of Disposable Income**) remains historically low, and the national savings rate (**Figure 4 – Personal Savings Rate**) continues to run at the higher end of the past twenty years’ range. This should support growth in our economy, which remains consumer driven. It’s important to remember that, as investors, we don’t get to choose when the market rises or falls. But if we stay invested, time is generally our friend, allowing our portfolios to recover from losses and enjoy compounded returns.

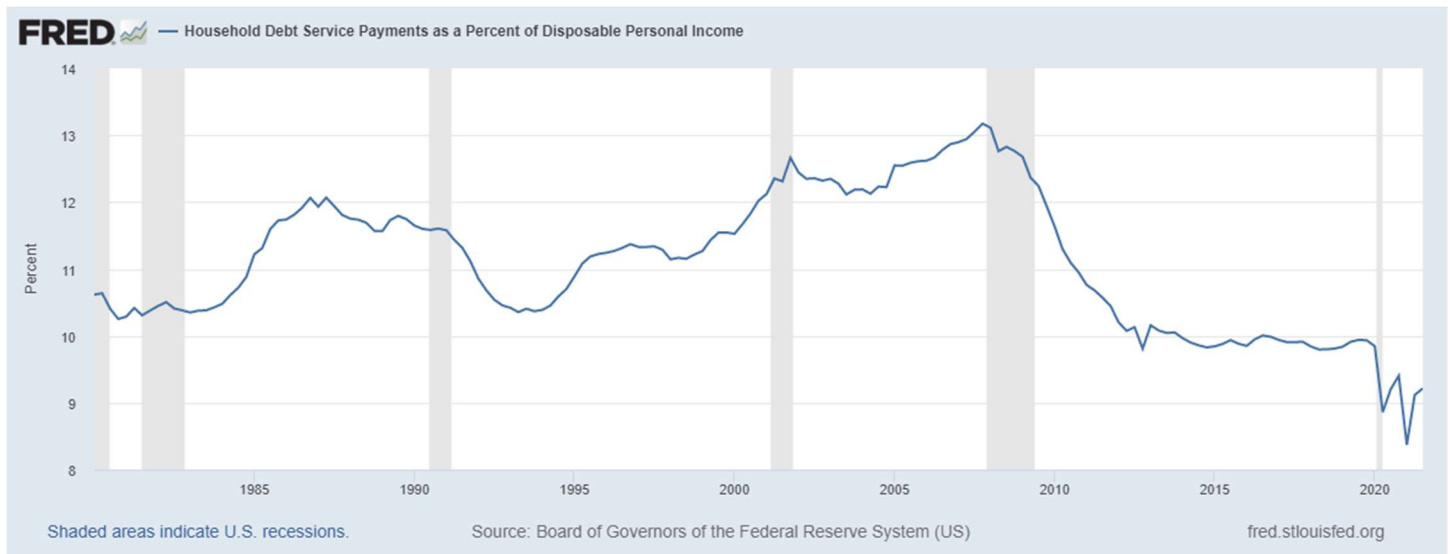


Figure 3 – Household Debt Service Payments as a Percent of Disposable Income

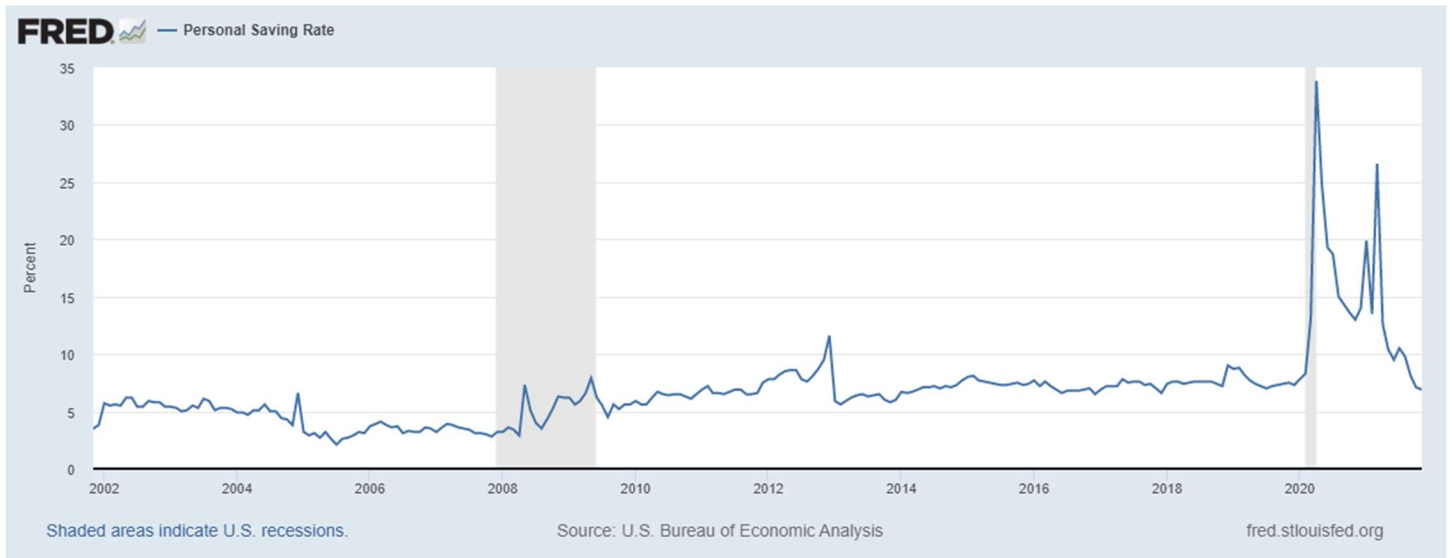


Figure 4 – Personal Savings Rate

December 2021 marked ten years since I founded Bernard Wealth Management. We've grown substantially in that time, and I am grateful for the trust that you have placed in us. The past two years have been challenging and sometimes tragic for everyone and have tested investors' patience and fortitude. I'm proud of the care that our team has given our clients during this trying time. I have always felt that we should put our clients first and respond quickly and effectively to their needs and concerns, while maintaining a long-term perspective on their investments. I know that Deanna, Andy and Barb share this perspective. As we add to our team, we'll always look for professionals with these core values.

We expect to be in our Royal Oak office by the end of the month. We hope that the new year finds you well and look forward to seeing you soon.

Best regards,

Kenneth M. Bernard, CFA