HANGING ON

My birthday is December 26. Kind of a strange day for a birthday. One year, my brother gave me one shoe on Christmas and the second shoe on my birthday.

It was also unique because I always anticipated someone famous would die on my birthday. My mom was a nurse who always marveled at how the hospital would empty out right before Christmas, only to refill quickly once the holiday had passed. If sick folks could possibly be home for Christmas, they would be. No one wanted to spend the holiday in the hospital. For the folks who were dying, there was this strange sense of hanging on and doing anything to get one more Christmas with their families.

Of course, once the holiday passed, reality resumed. The hospitals filled up again and sadly people resumed expiring. Jack Benny died on my birthday. Harry Truman died on my birthday. This year it was Desmond Tutu.

For Sacramento, this was a rough holiday season, losing two legends who had called this city home. Joan Didion was acclaimed and beloved in the literary world. Wayne Thiebaud got to see his paintings sell for millions of dollars, a rarity for a living artist. Both were probably more acclaimed in New York and Los Angeles than they were in their hometown, but they are on the short list of the most famous Sacramentans ever. Rest in peace.

For the economy, it's the same sense of hanging on. Another wave of COVID-19. Another round of closures and trepidation about activity in a public setting. But most economists and public health officials seem to be looking past this current wave, believing our pandemic is on the cusp of becoming endemic. Another concern to investors is the Fed and how quickly they will move this year to raise interest rates and tighten monetary conditions. Still, we need to keep in mind that the normalization of interest rates is a good thing. If we view the economy as the patient, then this patient is about to come off the ventilator and breathe on his or her own for the first time in two years, without the assistance of interest rates at zero.

As always, we appreciate your trust in us as we seek to navigate this year of transition. To quote another great Northern Californian whom we lost last month, "Don't worry about the horse being blind, just load the wagon!." (John Madden)

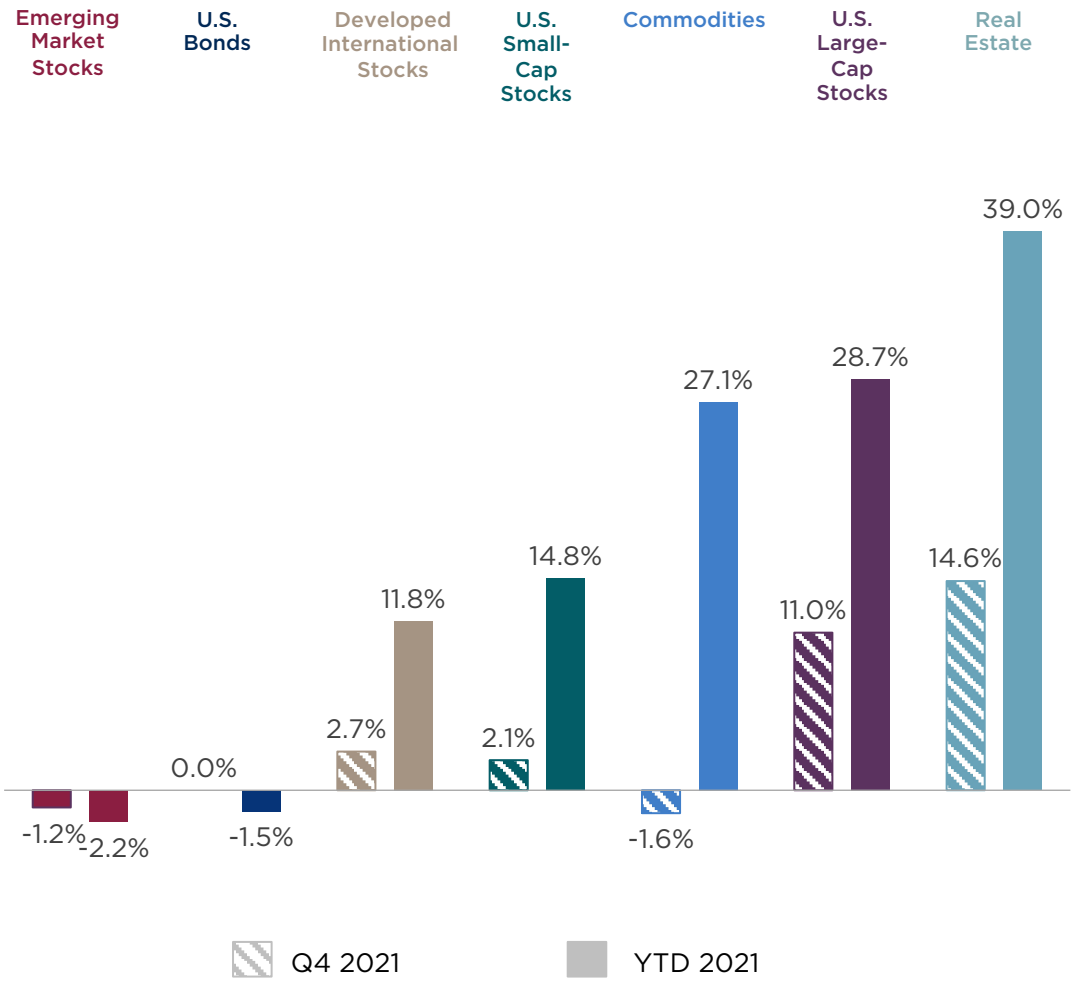
All of us at CAPTRUST wish you and yours a healthy and prosperous 2022!

Kelly Brothers, CFP®, MBA
Principal, Financial Advisor

CHOPPY QUARTER CAPS STELLAR YEAR FOR U.S. STOCKS

Despite bouts of volatility fueled by virus and policy uncertainty, supply chain woes, and inflation worries, most asset classes posted solid returns in 2021, led by economically sensitive sectors that benefitted from reopening trends. Emerging markets stocks were roiled by China policy and growth concerns, and core bonds moved sideways as bond yields ticked modestly higher.

- U.S. large-cap stocks delivered solid returns for the quarter and finished 2021 with a gain of nearly 29% for a third consecutive year of outsized returns. Small-cap stocks lagged their large-cap peers but still posted double-digit returns.
- International developed market stocks also posted healthy returns for the year, even as China risks cast a dark cloud over emerging markets.
- Fueled by a rebound in oil prices, commodities advanced by more than 27% for the year despite a fourth-quarter pullback amid rapid spread of the omicron variant.
- Public real estate added to gains in the fourth quarter despite continued virus concerns, following steady advances over the course of the year.
- Core bonds treaded water in the fourth quarter (and the full year), as bond yields shrugged off inflation concerns with only a modest uptick.



Asset class returns are represented by the following indexes: Bloomberg Barclays U.S. Aggregate Bond Index (U.S. bonds), S&P 500 Index (U.S. large-cap stocks), Russell 2000® (U.S. small-cap stocks), MSCI EAFE Index (international developed market stocks), MSCI Emerging Market Index (emerging market stocks), Dow Jones U.S. Real Estate Index (real estate), and Bloomberg Commodity Index (commodities).

DIGGING DEEPER: STOCKS AND BONDS

Equities

	Q4 2021	YTD 2021	Last 12 Months
U.S. Stocks	11.0%	28.7%	28.7%
• Q4 Best Sector: Real Estate	17.5%	46.1%	46.1%
• Q4 Worst Sector: Communication Service	0.0%	21.6%	21.6%
International Stocks	2.7%	11.8%	11.8%
Emerging Market Stocks	-1.2%	-2.2%	-2.2%

Fixed Income

	12.31.2021	09.30.21	12.30.20
1-Year U.S. Treasury Yield	0.39%	0.09%	0.10%
10-Year U.S. Treasury Yield	1.52%	1.52%	0.93%

	QTD 2021	YTD 2021	Last 12 Months
10-Year U.S. Treasury Total Return	0.67%	-3.60%	-3.60%

Equities – Relative Performance by Market Capitalization and Style

Q4 2021				YTD 2021				Last 12 Months			
	Value	Blend	Growth		Value	Blend	Growth		Value	Blend	Growth
Large	7.8%	11.0%	11.6%	Large	25.2%	28.7%	27.6%	Large	25.2%	28.7%	27.6%
Mid	8.5%	6.4%	2.8%	Mid	28.3%	22.6%	12.7%	Mid	28.3%	22.6%	12.7%
Small	4.4%	2.1%	0.0%	Small	28.3%	14.8%	2.8%	Small	28.3%	14.8%	2.8%

Sources: Bloomberg, U.S. Treasury. Asset class returns are represented by the following indexes: S&P 500 Index (U.S. stocks), MSCI EAFE Index (international developed market stocks), and MSCI Emerging Markets Index (emerging market stocks). Relative performance by market capitalization and style is based upon the Russell US Style Indexes except for large-cap blend, which is based upon the S&P 500 Index.

ECONOMIC OUTLOOK

Markets in 2021 were propelled by a strong but bumpy reacceleration of economic activity. Although fundamentals remain in place for continued, albeit moderating, growth, investors continue to weigh a range of risks that will shape the markets' next phase.

HEADWINDS

Variants Raise Specter of Winter Surge

- New virus variants continue to rattle markets. Omicron represents an uncertain threat given reports of high transmissibility. However, given its milder symptoms, this could also mark the beginning of COVID-19's transition from pandemic to endemic.

As Inflation Fears Mount...

- The November Consumer Price Index (CPI) reached a 40-year high level of 6.8%. Although skewed by outliers in categories such as energy and transportation, robust demand, supply constraints, and rising wages and housing costs suggest more persistent inflationary pressures may be ahead.

...Central Bank Hawks Kettle

- The Federal Reserve has joined other global central banks in emphasizing inflation risks in statements on future policy. In December, it doubled the pace of tapering its asset purchases, paving the way for rate hikes in 2022.
- The pace of tightening will be driven by how sticky inflation is relative to virus threats and labor conditions. This raises the risks of policy error if the Fed acts too soon—or waits too long.

TAILWINDS

Buying Power

- The consumer is the engine of the global economy, and U.S. household balance sheets are uncommonly strong following several years of asset price gains, lower costs, and stimulus checks. The result is trillions of dollars in excess savings that will buoy demand into 2022.

Strong Fundamentals

- Corporate profit margins exploded in 2021 as pandemic-driven cost-containment measures met a surge of pent-up demand, resulting in an estimated 45% pop in S&P 500 earnings—far in excess of the 5% average growth seen over the past decade.
- Even as earnings growth returns to earth and input costs rise, easing supply chains and an extended inventory restocking cycle bode well for continued above-trend earnings growth.

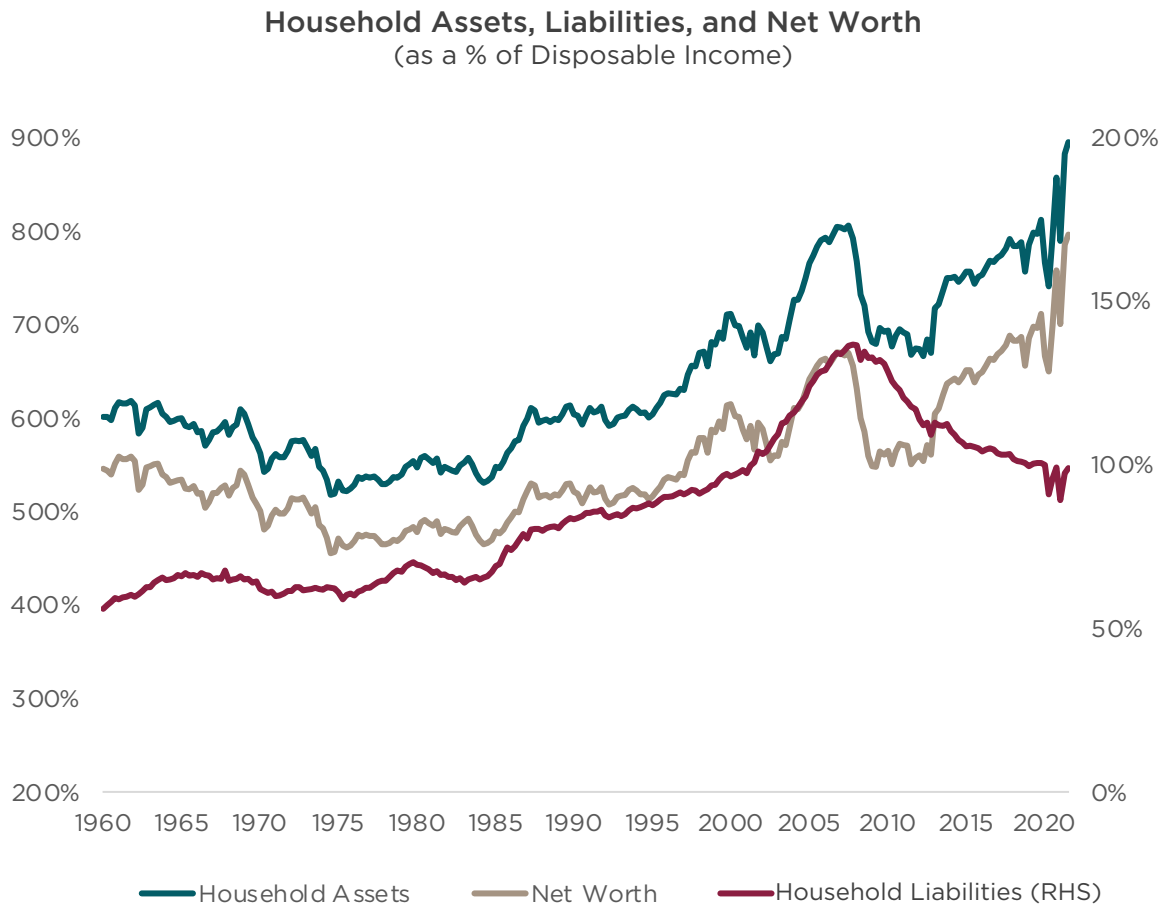
Tight Labor Markets Push Wages Higher

- Rising wages will help fill the gap left by the winding down of government stimulus, particularly as inflation pressure falls. A combination of higher pay, pandemic progress, and fewer childcare constraints could entice workers sidelined by the pandemic back to the workplace.

Following a third year of outsized equity returns, investors should not be complacent. Although fundamentals remain strong, the global economy now faces a risky transition as exceptional stimulus fades into a tighter policy environment even as virus risks remain.

HOUSEHOLD WEALTH SURGE SUSTAINS GROWTH

Despite the personal and economic trauma caused by the COVID-19 pandemic, U.S. household wealth swelled by nearly $30 trillion since the end of 2019 through the combination of massive fiscal support and stimulus programs and surging asset prices. Although the direct impacts of fiscal stimulus are now fading, solid wage growth will provide further support to household balance sheets in 2022 and beyond.



Sources: U.S. Federal Reserve, U.S. Bureau of Economic Analysis, Federal Reserve Bank of St. Louis

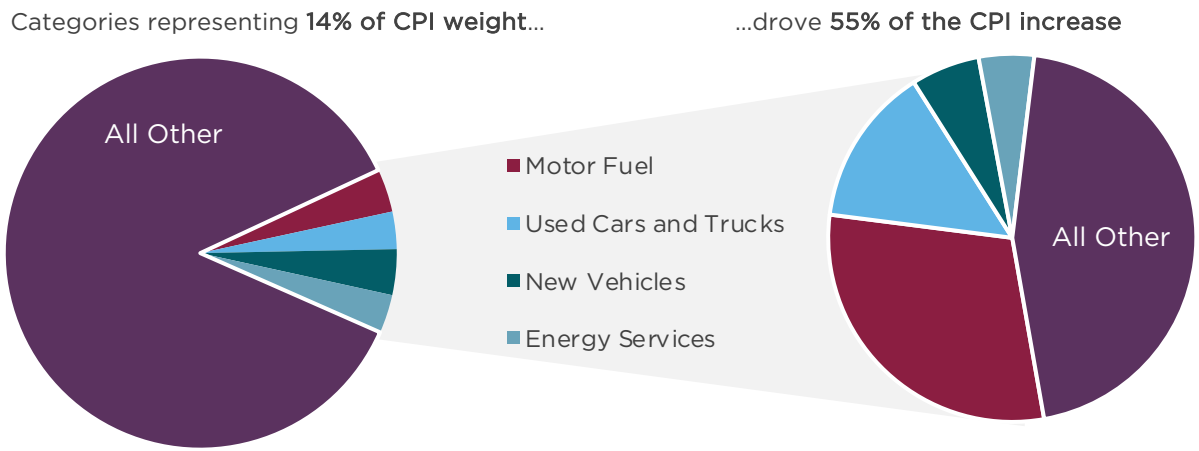
OBSERVATIONS

- Consumer balance sheets have never been stronger. Household wealth surged over the past two years, propelled by financial and real estate asset prices and elevated savings rates.
- Importantly, wealth gains have been spread across income bands, given the significant impact of stimulus checks, extended unemployment benefits, and rising wages.
- Although the post-pandemic surge in pent-up demand for goods may be behind us, higher levels of U.S. household wealth and income will continue to provide significant support to the economy.
- Shrinking loan balances represent another reservoir of future spending power as households have steadily de-levered following the global financial crisis.

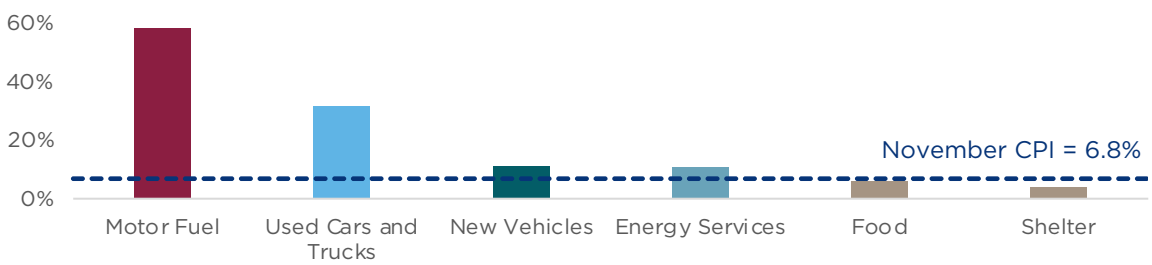
INFLATION: LOOKING PAST THE HEADLINES

The Consumer Price Index (CPI) posted a shocking 6.8% year-over-year change in November, the highest reading since 1982, quickly prompting a pivot by the Federal Reserve as it begins to tighten policy. However, a closer look at the latest CPI reading reveals that price pressures remain uneven, largely isolated within categories most disrupted by the pandemic.

November CPI by Category



Consumer Price Index - November 2021
Year-over-Year Change (in %)



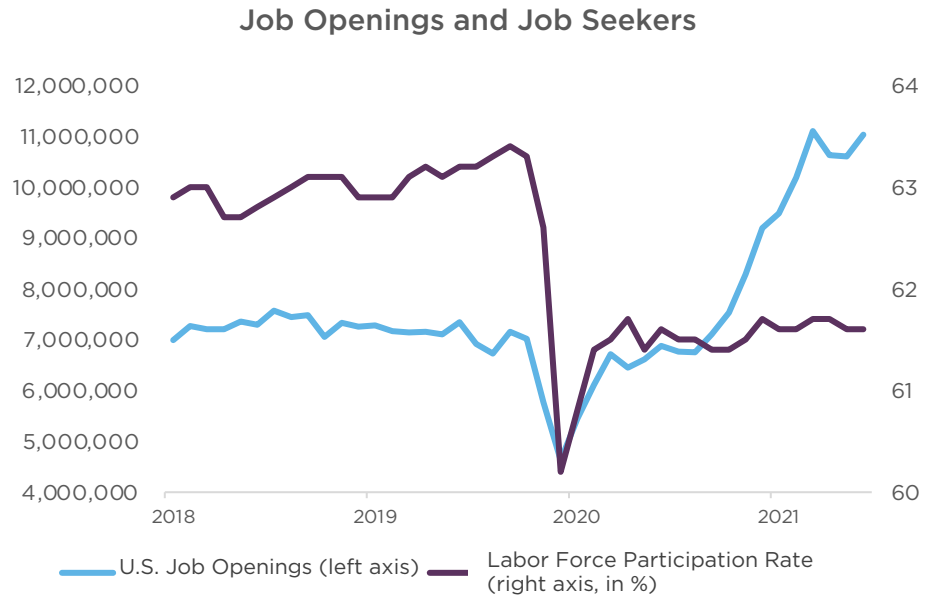
Sources: U.S. Bureau of Labor Statistics, Bloomberg, CAPTRUST Research

OBSERVATIONS

- A subset of categories tightly linked to the economic reopening—such as fuel and energy—along with categories most affected by supply chain problems (such as autos) has driven most of the inflation pressure this year.
- Despite alarming levels of headline inflation, market-based measures remain more sanguine. Treasury yields have barely budged, and the 10-year breakeven rate—the average level of inflation expected by investors over the next decade—remains well below 3%.
- A key aspect of whether inflation is temporary or a stickier, 1970s-style problem is how it alters consumer behaviors. So far, consumers appear unfazed.
- A recent survey suggests consumers expect inflation to settle at 3% over the next five years, even given the historical tendency of such surveys to overestimate inflation's future path.

TIGHT LABOR MARKET DRIVES WAGES HIGHER

In 2021, economic challenges were largely driven by supply constraints. Soaring demand for goods and stressed supply chains have contributed to delays, bottlenecks, and rising prices. The same forces are now at work within labor markets as the economy continues to add jobs—but not the workers to fill them. The result is rapidly rising wages, particularly for lower-wage service sector jobs.



OBSERVATIONS

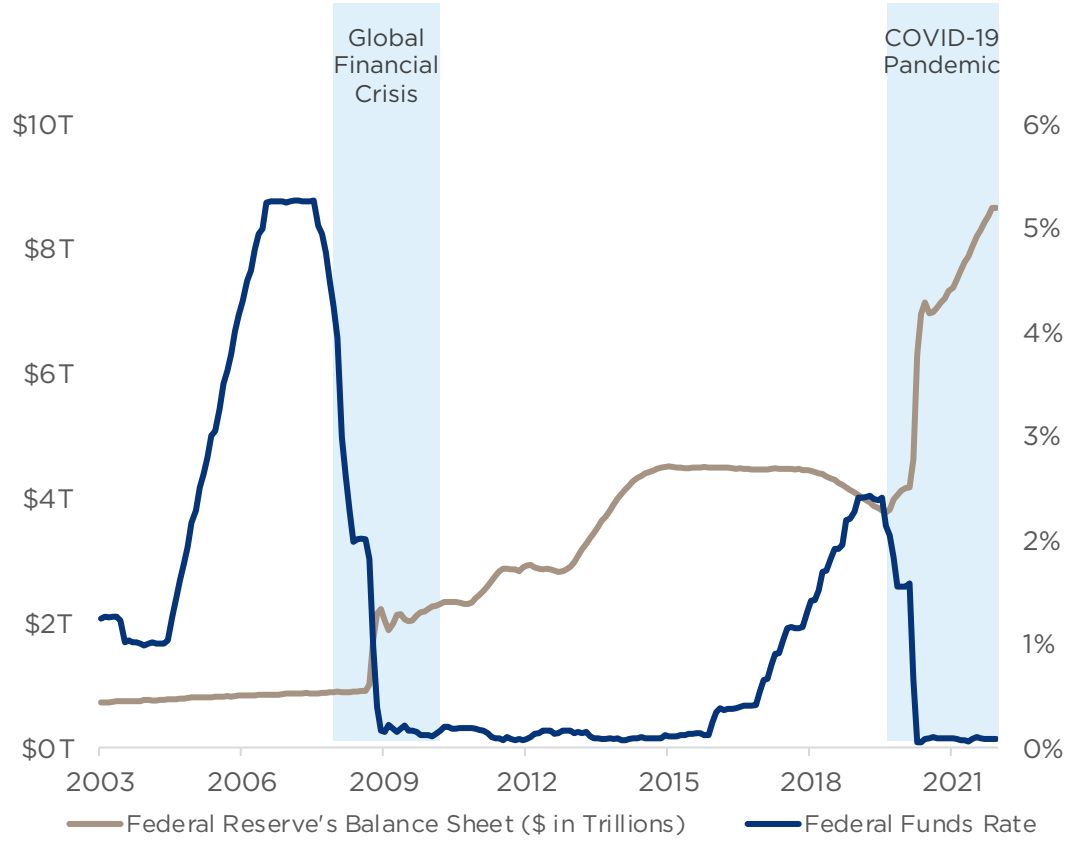
- As U.S. gross domestic product returned to pre-pandemic levels, job creation has been strong, resulting in more than 10 million open positions. However, total employment continues well below its pre-pandemic peak as labor force participation remains stubbornly low.
- Reasons for this shortfall are many and complex, including accelerated retirements made possible by strong investment returns, health fears, and childcare concerns, not to mention elevated personal savings, stimulus checks, and enhanced unemployment benefits.
- Many workers will eventually be compelled to return to work. But if they don't return soon enough, an already-tight labor market could get even tighter, adding to inflation concerns and threatening corporate profit margins under pressure from rising input costs.

Sources: Bloomberg, Bureau of Labor Statistics, Federal Reserve Bank of Atlanta

TALKING ABOUT TAPERING AND TIGHTENING

In December, the U.S. Federal Reserve abruptly shifted its tone from one of patience while the labor market fully recovers to heightened wariness of inflation pressures. Given the outsized influence of monetary policy on asset prices and growth conditions, investors are wise to pay close attention to the Fed's comments and actions. Shifting gears on policy priorities also creates heighted risk of a policy error, if the Fed either tightens too soon and too fast or waits too long.

Federal Reserve Balance Sheet and Fed Funds Rate



Sources: St. Louis Federal Reserve Bank; CAPTRUST Research

OBSERVATIONS

- To accomplish its dual mandate of maintaining maximum employment and price stability, the Fed relies on two primary tools: changes to the fed funds rate and the size and composition of its balance sheet.
- Less traditional tools, such as credit and liquidity facilities, are also available in times of stress.
- After slashing its discount rate to zero at the onset of the COVID-19 crisis, the Fed returned to its crisis playbook and began gobbling up Treasury and mortgage bonds at a $120 billion per month clip to lower financing costs, loosen financial conditions, and spur demand.
- Now, with the economy expanding at a faster-than-expected rate and inflation fears rising, the Fed announced a swifter conclusion to this program. Its planned $30 billion/month taper is a much faster pace than following the global financial crisis and paves the way for rate hikes next year if inflation concerns persist.

ASSET CLASS RETURNS

Period Ending 12.31.21 | Q4 21

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Fixed Income 5.24%	International Equities 42.14%	Real Estate 28.48%	Real Estate 8.69%	Real Estate 17.77%	Small-Cap Stocks 38.82%	Real Estate 30.38%	Strategic Opportunities 2.86%	Small-Cap Stocks 21.31%	International Equities 27.77%	Cash 1.87%	Large-Cap Stocks 31.43%	Large-Cap Stocks 20.96%	Real Estate 38.99%
Cash 1.51%	Mid-Cap Stocks 40.48%	Small-Cap Stocks 26.85%	Fixed Income 7.84%	International Equities 17.39%	Mid-Cap Stocks 34.76%	Large-Cap Stocks 13.24%	Real Estate 2.14%	Mid-Cap Stocks 13.80%	Large-Cap Stocks 21.69%	Fixed Income 0.01%	Mid-Cap Stocks 30.54%	Small-Cap Stocks 19.96%	Large-Cap Stocks 26.45%
Strategic Opportunities -13.09%	Real Estate 28.61%	Mid-Cap Stocks 25.48%	Large-Cap Stocks 1.50%	Mid-Cap Stocks 17.28%	Large-Cap Stocks 33.11%	Mid-Cap Stocks 13.22%	Large-Cap Stocks 0.92%	Large-Cap Stocks 12.05%	Mid-Cap Stocks 18.52%	Strategic Opportunities -0.49%	Real Estate 28.92%	Mid-Cap Stocks 17.10%	Mid-Cap Stocks 22.58%
Small-Cap Stocks -33.79%	Large-Cap Stocks 28.43%	Large-Cap Stocks 16.10%	Cash 0.10%	Large-Cap Stocks 16.42%	International Equities 15.78%	Fixed Income 5.97%	Fixed Income 0.55%	Real Estate 7.56%	Small-Cap Stocks 14.65%	Real Estate -4.03%	Small-Cap Stocks 25.52%	International Equities 11.13%	Small-Cap Stocks 14.82%
Large-Cap Stocks -37.60%	Small-Cap Stocks 27.17%	International Equities 11.60%	Mid-Cap Stocks -1.55%	Small-Cap Stocks 16.35%	Strategic Opportunities 3.58%	Small-Cap Stocks 4.89%	Cash 0.05%	International Equities 5.01%	Real Estate 9.84%	Large-Cap Stocks -4.78%	International Equities 22.13%	Fixed Income 7.51%	International Equities 8.29%
Real Estate -37.97%	Fixed Income 5.93%	Fixed Income 6.54%	Strategic Opportunities -3.71%	Fixed Income 4.22%	Real Estate 2.47%	Strategic Opportunities 0.79%	Mid-Cap Stocks -2.44%	Fixed Income 2.65%	Fixed Income 3.54%	Mid-Cap Stocks -9.06%	Fixed Income 8.72%	Strategic Opportunities 2.72%	Strategic Opportunities 2.10%
Mid-Cap Stocks -41.46%	Cash 0.21%	Cash 0.13%	Small-Cap Stocks -4.18%	Strategic Opportunities 0.88%	Cash 0.07%	Cash 0.03%	Small-Cap Stocks -4.41%	Cash 0.33%	Strategic Opportunities 3.40%	Small-Cap Stocks -11.01%	Strategic Opportunities 4.37%	Cash 0.67%	Cash 0.05%
International Equities -45.25%	Strategic Opportunities -3.58%	Strategic Opportunities -0.12%	International Equities -13.33%	Cash 0.11%	Fixed Income -2.02%	International Equities -3.44%	International Equities -5.25%	Strategic Opportunities 0.31%	Cash 0.86%	International Equities -13.78%	Cash 2.28%	Real Estate -5.29%	Fixed Income -1.54%

Source: Markov Processes, Inc., Bloomberg, Mobius

- Small-Cap Stocks (Russell 2000 Index)
- Mid-Cap Stocks (Russell Mid-Cap Index)
- Large-Cap Stocks (Russell 1000 Index)
- Real Estate (Dow Jones U.S. Real Estate Index)
- Strategic Opportunities (HFRX Absolute Return Index)
- Cash (Merrill Lynch 3-Month Treasury Bill)
- International Equities (ACWI Ex-U.S. Index)
- Fixed Income (Bloomberg Barclays U.S. Aggregate Bond Index)

2022 TAX FACTS

Federal Tax Brackets — Married Filing Jointly		
Taxable Income	Tax Rate	Effective Tax Rate at Bracket Max
$0 – $20,550	10%	10.0%
$20,551 – $83,550	12%	11.5%
$83,551 – $178,150	22%	17.1%
$178,151 – $340,100	24%	20.4%
$340,101 – $431,900	32%	22.8%
$431,901 – $647,850	35%	26.6%
$647,851 and Over	37%	28.3% (at $750,000)

Federal Tax Brackets — Single Filer		
Taxable Income	Tax Rate	Effective Tax Rate at Bracket Max
$0 – $10,275	10%	10.0%
$10,276 – $41,775	12%	11.5%
$41,776 – $89,075	22%	17.1%
$89,076 – $170,050	24%	20.4%
$170,051 – $215,950	32%	22.8%
$215,951 – $539,900	35%	30.1%
$539,901 and Over	37%	32.1% (at $750,000)

Standard Deduction Amounts	
Single	$12,950
Married	$25,900

Net Investment Income Tax (NIIT)	
3.8% NIIT applies to the lesser of net investment income or the amount by which modified adjusted gross income (AGI) exceeds the threshold limits below	
Modified AGI Threshold Amount — Single	$200,000
Modified AGI Threshold Amount — Married	$250,000

Additional Medicare Tax	
0.9% tax on earned income that exceeds the threshold limits below	
Modified AGI Threshold Amount — Single	$200,000
Modified AGI Threshold Amount — Married	$250,000

Sources: Internal Revenue Service; Social Security Administration

Estate and Trust Tax Brackets		
Taxable Income	Tax Rate	Effective Tax Rate at Bracket Max
$0 – $2,750	10%	10.0%
$2,751 – $9,850	24%	20.1%
$9,851 – $13,450	35%	24.1%
$13,451 and Over	37%	33.5% (at $50,000)

Required Minimum Distributions (% of Year-End Account Balance)					
Age	%	Age	%	Age	%
72	3.7%	82	5.4%	92	9.3%
73	3.8%	83	5.7%	93	9.9%
74	3.9%	84	6.0%	94	10.5%
75	4.1%	85	6.3%	95	11.2%
76	4.2%	86	6.6%	96	11.9%
77	4.4%	87	6.9%	97	12.8%
78	4.6%	88	7.3%	98	13.7%
79	4.7%	89	7.8%	99	14.7%
80	5.0%	90	8.2%		
81	5.2%	91	8.7%		

2022 TAX FACTS

Retirement Account Contribution Limits	
401(k), 403(b), and 457 Plan Employee Deferral (Pre-Tax & Roth)	$20,500
Catch-Up—Age 50 or Older	$6,500
Defined Contribution Maximum	$61,000
Traditional or Roth IRA	$6,000
Catch-Up—Age 50 or Older	$1,000
SEP IRA (25% Limit on Compensation)	$61,000
SIMPLE IRA	$14,000
Catch-Up—Age 50 or Older	$3,000
Covered Compensation Limit 401(a)	$305,000

Phaseouts for IRA Deductibility and Roth Eligibility	
IRA—Single	$68,000 – $78,000
IRA—Married Filing Jointly	$109,000 – $129,000
IRA with non-Participant Spouse	$204,000 – $214,000
Roth—Single	$129,000 – $144,000
Roth—Married Filing Jointly	$204,000 – $214,000

Long-Term Capital Gains and Qualified Dividend Tax Rates		
Tax Rate	Single	Married Filing Jointly
0%	Up to $41,675	Up to $83,350
15%	$41,676 – $459,750	$83,351 – $517,200
20%	$459,751 and Over	$517,201 and Over

Social Security	
Full Retirement Age (FRA) in 2022	66 and 4 months (born in 1956)
Maximum Monthly Benefit at FRA	$3,345
Portion of FRA Benefit Paid at Age 62 / 70 (Born in 1960)	70% / 124%
Earning Limit Before Benefits Are Reduced—Years Prior to FRA (Lose $1 for Every $2 of Earnings)	$19,560
Earning Limit Before Benefits Are Reduced—Year of FRA Up to Retirement Month (Lose $1 for Every $3 of Earnings)	$51,960
Earning Limit Before Benefits Are Reduced—FRA or Later	No Limit
Modified AGI Limit Before Benefits Are Taxable (Single)	$25,000 – $34,000 (50% Taxable) $34,000+ (85% Taxable)
Modified AGI Limit Before Benefits Are Taxable (Married Filing Jointly)	$32,000 – $44,000 (50% Taxable) $44,000+ (85% Taxable)

Medical Expense Account Contribution Limits	
Flex Spending Account (FSA)	$2,850
Health Savings Account (HSA)	$3,650—Single $7,300—Family

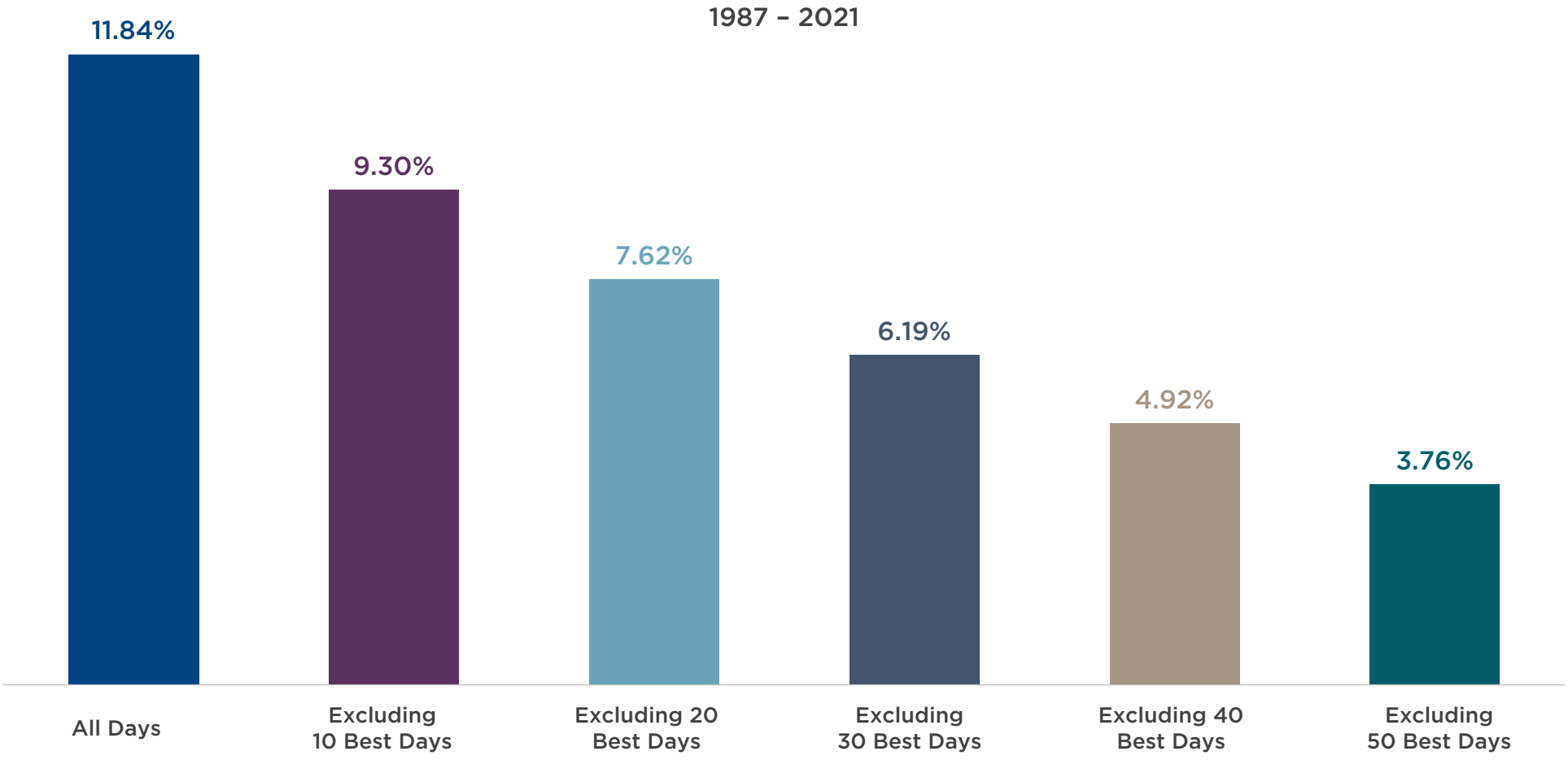
Estate and Gift Tax Exemption	
Estate Tax Exempt Amount	Individuals – $12.06 million Married – $24.12 million
Gift Tax Annual Exclusion Amount	$16,000

529 Plan Contributions	
Annual Gift–Tax-Free Limit	$16,000
One-Year Front Loading*	Up to $80,000
*Gifts can't be made for the next 4 years	

Sources: Internal Revenue Service; Social Security Administration

TIME IN THE MARKET, NOT TIMING THE MARKET

The annualized price return of the S&P 500 Index from 1.1.1987 through 12.31.2021 was 11.84%. The chart below illustrates the reduction in annualized total return that would have resulted for an investor who missed the stock market's best-performing days. We believe investors should maintain a well-diversified portfolio, even during periods of market stress, and avoid timing the market.



Sources: Data as of 12.31.21. Morningstar, CAPTRUST Research. S&P 500 Index returns are based on price index only and don't include dividends.

ANOTHER YEAR IS IN THE BOOKS

Around the globe, developed economies saw their stock markets rally in 2021, boosted by massive government stimulus measures and pent-up consumer demand. Over the course of the year, global equity returns were tempered at times by worries about rising inflation, proposed legislation, higher interest rates, and the spread of COVID-19 variants. On the fixed income front, bond investors struggled in the face of a rising 10-year Treasury yield, which began 2021 at 0.93 percent and ended the year at 1.52 percent. After the first week of 2022, the 10-year Treasury yield continued to surge to 1.76 percent. Not a good omen for bond investors for 2022.

Looking ahead we need to be mindful of the risks inherent in the change of a policy regime, from a stimulative stance to a more restrictive posture. Global economic growth is slowing, especially in China (be mindful that slowing is not contracting; it's growing less rapidly), and central bankers have started the process of reducing monetary stimulus measures, which will be a headwind. Valuations domestically are elevated across the board, from stocks to bonds to real estate. That doesn't mean things are overvalued, but not many things in the U.S. look cheap today.

Against this challenging backdrop, we remain cautiously optimistic. The following are some of the reasons why we maintain that view.

Inflation

One thing that seems to be on the top of everyone's mind today is inflation. It's unsettling from an investor's perspective because inflation can erode a company's future profits, which is the biggest driver to valuing an asset. But many companies have pricing power and can protect their profit margins by passing on cost increases to their customers. While we're not ready to believe we are heading into a period of sustained inflation, we do believe rising costs will linger well into this year, fueled by labor shortages and broken supply chains. But eventually consumer prices will stabilize, and inflation will subside to more moderate levels. It's just going to take longer than the Fed officials are projecting. There is no question the discussion around inflation is going to create additional volatility in financial markets in the first half of 2022.

Someone once told me, "Inflation is like chewing gum. It's sticky and flexible, and you definitely don't want to step in it." Well, for the last 30 years it hasn't been much of an issue to worry about. But that changed this past summer with some consumer goods skyrocketing in price. Sticky inflation tends to have longer staying power; that would include things like wages (once you give someone a pay raise, it's hard to take it back), rent, insurance, and medical expenses. Flexible inflation affects things like food, energy, and cars, whose prices have risen much faster in recent months, but many believe those increases will subside as supply chain issues get resolved. The real concern or risk is the sticky components. The thing to watch for is not whether the newly elevated prices subside from where they have jumped up to, but whether those prices go up at more muted rates from this point forward. We will not really know the answer to that question until later in the year when we can compare the year-over-year numbers.

Midterm Election

This could be one of the more consequential midterm elections in our lifetimes. While it's still 10 months away—and that's a lifetime in politics—history suggests we might see a backlash against the party in power, resulting in the change of control of the House and possibly the Senate as well.

ANOTHER YEAR IS IN THE BOOKS (continued)

This possibility is not lost on Democrats. So, expect their more progressive goals to be tempered by the political reality of the party's slender majority in each house. Still, political uncertainty has often had noticeable short-term effects on markets. Over the last 90 years equity returns on average have been lower, and volatility has been higher in the first half of midterm election years. Bottom line, midterm elections—and politics as a whole—generate a lot of noise. Prudent investors would be wise to look past the short-term highs and lows and maintain a long-term focus.

China

There is no way to sugarcoat it: Risks to investing in China have risen. Heavy government intervention in the country's internet-related sectors, an everchanging regulatory environment, a slowing economy, and tightening credit in their real estate sector have investors rightfully on edge. To put it into perspective, the International Monetary Fund (IMF) is projecting the Chinese economy will grow by 5.6 percent in 2022, but we think that number is too optimistic. Nonetheless, China's economy should expand at a rate the U.S. would be happy to achieve. Some investors even question whether China is investable. Clearly, certain companies and industries will face heightened uncertainty in the near term. We still believe there are plenty of attractive investment opportunities in China. But in our minds, investing in an index fund to get exposure to China is clearly not the answer.

Euro Land

The IMF is projecting that the major economies in the European Union will grow in the 4 percent to 5 percent range this year as the Eurozone enjoys a delayed, but now strong COVID-19 rebound, similar to what the U.S. experienced last year. From a valuation perspective the MSCI EAFE index is trading for 15.2 times this year's projected earnings, while in the U.S. the S&P 500 index is trading for 21 times this year's projected earnings. Another simple metric is the MSCI EAFE has a dividend yield of 2.51 percent while the S&P 500 Index has a dividend yield of only 1.22 percent. We view these markets as attractive over the intermediate term.

You will have probably noticed that we have been actively rebalancing your accounts, trimming some winners, and reinvesting all of the cash distributed at year-end in the form of capital gains distributions from the various mutual funds. There has been no major surgery, but we have incorporated some new positions mainly in small- and mid-cap value.

As we move into 2022, we are expecting more muted returns from domestic equities and increased volatility in the first half of the year. Despite some challenges and headwinds, we believe corporate profitability will continue to rise at a reasonable rate to counteract those obstacles. While we expect China's equity markets to struggle in the near term, we believe the balance of the emerging market universe will do well in 2022, as should be the case for a majority of other developed markets.

As always, we are thankful for the trust and confidence that you have placed in us. It is a responsibility we take very seriously! Wishing you and yours a very happy and prosperous New Year!

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