Retirement Market RECAP Q4 2021

HANYS Benefit Services

A robust close to a strong year for U.S. equities

As the second year of the pandemic came to a close, the looming threat of COVID-19 continued to drive volatility across global markets. Despite the dual economic headwinds of the omicron variant and inflationary pressure, U.S. markets saw a strong fourth quarter to end a headline-centric, but robust 2021.

The S&P 500 saw an 11.03% gain in the fourth quarter, with a total return of 28.71% in 2021, its third straight year of double-digit gains. The final weeks of December saw the S&P 500 reaching its 70th record high close and a brief moment above the 4800 price level. Within the S&P 500, almost all sectors saw robust gains, with 10 out of 11 seeing positive performance. Real estate was the top performer in Q4 (+17.5%) to close out a remarkable 2021 (+46.0%) performance, primarily due to markets pricing in sticky inflation. Real estate has historically been seen as a strong performer in past cycles of inflation. Information technology also performed well in Q4 (+16.7%). Energy was the best overall performer in 2021 (+54.4%), but lagged (+8.0%) in Q4. Communications was the sole non-black sector, ending flat for the quarter (0.0%), but still saw positive performance for the year (+21.5%).

Within U.S. markets, large capitalization equities outperformed smaller capitalization stocks. Non-U.S. markets continued their 2021 trend of underperformance compared to their U.S. counterparts in Q4 with the S&P 500 outperforming the MSCI EAFE by 8.64% and the MSCI Emerging Markets Index by 12.39%.

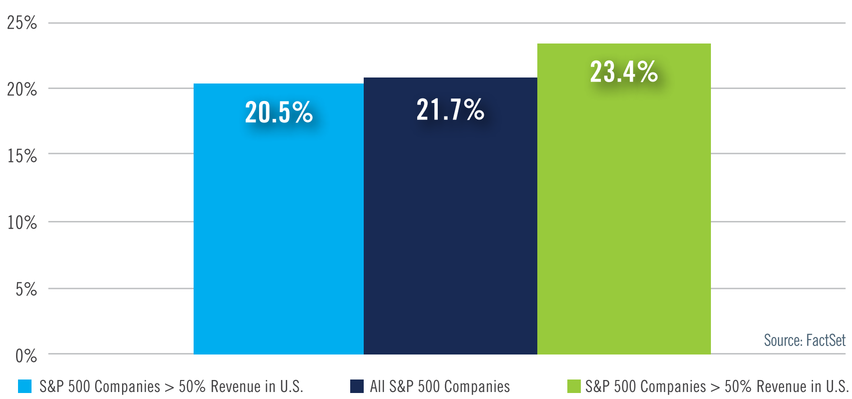
The bustling economic environment of 2021 combined with a backlog of possible deals provided a fertile environment for merger and acquisition activity, with an estimated $5 trillion in activity throughout the year, the largest on record. Initial public offerings, however, fared poorly in Q4, with two-thirds of IPOs trading below their opening price according to *The Wall Street Journal**, in a historic year of volume for traditional IPOs.

Earnings and estimates by companies were less favorable in Q4 than previously seen, mainly due to inflationary pressures, supply chain concerns and reopening discouragement brought on by the delta variant. Despite this, expected earnings are still above estimates. While final data will not be available until the coming months when all S&P 500 companies report Q4 earnings, according to FactSet, earnings growth for the S&P 500 components is estimated to be 21.7% (see chart). This estimate outpaces initial Q4 expectations of 20.9% provided in September 2021. If these estimates prove correct, this would provide a substantial 45.1% growth rate year over year for 2021.

However, economic expectations for 2022 have proven to be less favorable than 2021, fueling a potential threat of lower economic growth coupled with higher equity valuations and inflation. According to a poll of 45 strategists conducted by *Reuters***, before the prevalence of the omicron variant, the median expected S&P 500 close at the end of 2022 was 4910.

Emerging markets' equities faced a difficult 2021 overall against a stronger U.S. dollar index (+6.4%), and plagued by longstanding COVID-19 fears and

S&P 500 Earnings Growth: Q4 2021



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* wsj.com/articles/ipos-had-a-record-2021-now-they-are-selling-off-like-crazy-11640773806
** reuters.com/markets/europe/wall-street-strategists-see-more-gains-2022-2021-12-01

concerns within China. Most notably, the Chinese real estate development sector faced a considerable headwind in 2021. Evergrande Group, the largest real estate developer in China, faced a continual default crisis for most of the second half of the year. The size and numerous industries in which Evergrande operates created fears of a contagion effect within Chinese markets, pulling the broader MSCI EM Index down. However, the Evergrande crisis has had minimal effect on U.S. markets.

Fixed income as an asset class struggled in the second half of 2021 relative to equities. October saw consumer inflation rise above 6% for the first time in more than 30 years. Federal Reserve meetings throughout the third and fourth quarters showed a more hawkish tilt toward monetary policy than the first term of Chair Jerome Powell's tenure; a tilt leading to the possibility of faster rate hikes in 2022.

In December, the Federal Reserve signaled its intention to speed up tapering of its quantitative easing program, with purchase scaling being doubled to $30 billion. This may lead to a projected conclusion of the program in early 2022 rather than mid-2022 as initially planned. Fears of slowing economic growth and concerns of faster rate hikes in 2022 led to a flatter U.S. yield curve. Broadly speaking, the Bloomberg US Aggregate saw a relatively flat quarter (+.01%). With inflation proving to be more sticky than transitory, fixed income markets have rewarded inflation-protected securities, as the Bloomberg US Treasury TIPS Index saw a gain of 2.36% for Q4 and a return just shy of 6% in 2021 (+5.96%). Riskier bond investors were also rewarded as spreads tightened with the Bloomberg High Yield Corp Index seeing a small gain (+.71%), while shorter term US Treasury indices struggled in the fourth quarter.

Alternative assets see record year

- Physical commodities saw a remarkable year in total returns from large rallies as supply chain woes affected the global logistics system. 2021 led to significant returns in non-traditional assets. Coffee led commodities with a gain of 76.30%, cotton followed closely with 44.14%, while both corn and sugar saw 2021 returns above 20% (22.57% and 21.89%, respectively).
- Cryptocurrency saw a historic year, gaining roughly $1.5 trillion in market value at its peak in November. Bitcoin, the most well-known digital coin, saw a gain of 59.8% in 2021, reaching a record high near $69,000 in November. However, Bitcoin's trademark choppiness was on display in Q4, with a steep December selloff of 19%. Newer and lesser known crypto assets, such as Ethereum, saw even larger gains (+398.3%) in 2021.
- Gold has historically been seen as an inflation hedge and a store of value but did not share the rallies that other alternatives shared. Despite a strong Q4 (+4.1%), fueled by high inflationary expectations and omicron-induced volatility, gold underperformed in 2021 (-3.5%). This calls into question gold's place as an inflation hedge, as investors fled to other more speculative stores of value in cryptocurrencies.

As investors look forward to 2022, there appears to be more uncertainty compared to the vaccine optimism felt just a year ago. As the omicron variant's effect on global markets becomes more apparent, investors who have ridden previous waves have been rewarded with seemingly irrepressible markets. However, this may be tested in early 2022 as central banks attempt to combat inflationary pressures and as economies continue to develop a sense of normalization in a world of supply chain constraints.

EQUITY INDICES	3 MO	1 YR	3 YR	5 YR	FIXED INCOME AND RETIREMENT INDICES	3 MO	1 YR	3 YR	5 YR
S&P 500 TR USD	11.03%	28.71%	26.07%	18.47%	ICE BofA 3M US Trsy Note TR USD	0.01%	0.08%	1.03%	1.17%
Russell 3000 TR USD (Broad Market)	9.28%	25.66%	25.79	17.97	ICE BofA 1-3YR US Trsy TR USD	-0.53%	-0.55%	2.02%	1.61%
Russell 1000 TR USD (Large Cap)	9.78%	26.45%	26.41%	18.43%	BBgBarclays Long Term US Trsy TR USD	3.08%	-4.65%	8.82%	6.54%
Russell Midcap TR USD	6.44%	22.58%	23.29%	15.10	BBgBarclays US Aggregate Bond TR USD	0.01%	-1.54%	4.79%	3.57%
Russell 2000 TR USD (Small Cap)	2.14%	14.82%	20.02%	12.02%	BBgBarclays US Treasury US TIPS TR USD	2.36%	5.96%	8.44%	5.34%
MSCI EAFE NR USD (Int'l Equity)	2.69	11.26	13.54	9.55%	BBgBarclays High Yield Corp TR USD	0.71%	5.28%	8.83%	6.30%
MSCI Emerging Markets NR USD (E.M. Equity)	-1.31%	-2.54%	10.94%	9.87%	BBgBarclays Global Aggregate TR USD (Global Bond)	-0.67%	-4.71%	3.59%	3.36%

ICE BofAML – Intercontinental Exchange Bank of America Merrill Lynch; BBgBarc – Bloomberg Barclays; S&P 500 – Standard & Poors; MSCI – Morgan Stanley Capital International
Sources: Morningstar as of Dec. 31, 2021

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