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Reflections on 2021 and a SWOT Analysis for 2022

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In 30-years' time, how will historians write about 2021? What words will they use to describe the last 365 days? While we don't know for certain, the word "tumultuous" will likely appear in some descriptions.

2021 began with the attack on the U.S. Capitol Building, which unfolded just six days into the new year. A new President was sworn into office later that month. Our 20-year involvement in Afghanistan ended. We saw the rise and tapering of the Covid-19 Delta variant, which gave way to the more virulent Omicron variant.[1] Inflation reached a 39-year high[2], and millions of Americans left their jobs as part of the "Great Resignation."[3] Most strikingly, the U.S. death toll from the pandemic reached more than 820,000 lives[4], bringing hardship to countless families. In the background, we collectively navigated disruptions in how we work, connect with loved ones, and enjoy the milestones that are part of life.

While it was certainly a tumultuous year, we also saw reasons — large and small — to be grateful: Nations mobilized to bring vaccines to hundreds of millions of people, powered by the rapid buildout and implementation of key infrastructure. This all followed the fastest vaccine development in history (at the end of 2020), which was nothing short of remarkable. We also saw new therapeutics that could treat symptoms of COVID-19 and reduce mortality rates.[5] In our day-to-day lives, we collectively got better at living life during a pandemic, which helped many people reconnect in ways that were not possible during 2020.

We are grateful for the health care workers and first responders who have been battling on the front lines of the pandemic for nearly two years to keep us safe. We are also grateful to our clients, our team members, and our community for their continued partnership as we collectively navigate an unprecedented time in our lives.

As we begin this new year, we want to take a moment to assess 2021 from the perspective of the capital markets and share some thoughts for the year ahead. To help organize this thinking, what follows is a

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[1] NBC, *Omicron variant accounts for 73 percent of new Covid cases in U.S.* (Link)

[2] The Wall Street Journal, *U.S. Inflation Hit a 39-Year High in November* (Link)

[3] The Wall Street Journal, *Who's Quitting Their Jobs? New Data Show Some Workers Are More Likely Than Others* (Link)

[4] New York Times, *Coronavirus In The U.S.: Latest Map & Case Count*. (Link)

[5] Reuters, *Gilead's remdesivir reduces COVID-19 mortality risk – data* (Link)

"SWOT" analysis of the Strengths and Weaknesses of the capital markets in 2021, and potential Opportunities and Threats that we will be monitoring as we begin 2022.

Strengths (2021)

Capital Markets
The capital markets were certainly a source of strength in 2021, with U.S. markets leading much of the world higher. The S&P 500 posted a 26.89% gain during 2021[6], while the Russell 2000 finished the year up 13.70%.[7] Looking globally, the MSCI ACWI (excluding the U.S.) finished the year up 7.68%.[8]

Much of this performance in the U.S. was driven by a combination of fiscal stimulus, accommodative policies from the Federal Reserve, and improving underlying economic data. In 2022, although the Biden administration will work hard with Congress to pass some modified version of the Build Back Better legislation, its outcome is far from certain. Accordingly, we expect less fiscal stimulus/support in the new year. Additionally, we expect the Federal Reserve to continue to normalize monetary policy and reduce the level of accommodation and liquidity currently in the system.

When prices within the capital markets are more fully valued, these markets can be more price-sensitive to external stimuli (such as the Omicron variant or tapering from the Fed). We remain cautiously optimistic about the pace and trajectory of the U.S. economy as we begin the new year, however, we do feel that investors would be wise to temper their investment return expectations of the capital markets in the near term.

The U.S. Economy
In the last year, the U.S. economy continued to recover from the worst of the pandemic in 2020. In 2021, the unemployment rate steadily declined, moving from 6.3% in January to 4.2% in November.[9] In terms of production, U.S. GDP is now well above pre-pandemic levels, reported at $23.2 trillion in Q3 of 2021 compared to 21.7 trillion in Q4 of 2019[10].

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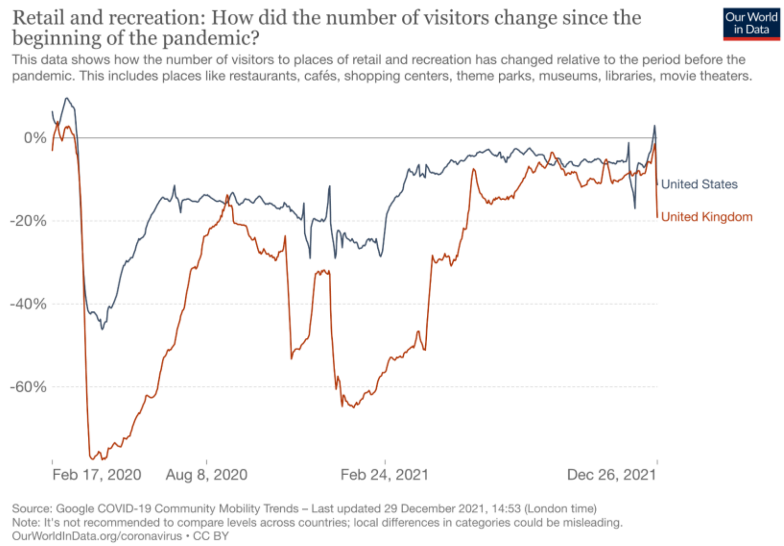
[6] Morningstar, *S&P 500 PR (Link)*
[7] Morningstar, *Russell 2000 PR USD (Link)*
[8] Morningstar, *iShares MSCI ACWI ex US ETF ACWX (Link)*
[9] Trading Economics, *United States Unemployment Rate*. *(Link)*
[10] U.S. Bureau of Economic Analysis, *Gross Domestic Product (Link)*

These macro trends are a positive sign as it relates to the pace of recovery, and mobility data is confirming that we are slowly returning to "life as usual." The chart to the right shows visitations to retail and recreational outlets since the beginning of the pandemic in the U.S. and the United Kingdom. As you can see, after two long years, we see visitations slowly returning to pre-pandemic levels.[11]



Weaknesses (2021)

COVID-19 Variants

In 2021, COVID-19's Delta variant threatened to slow down the economic recovery earlier in the year, and fears surrounding the ultra-transmissible Omicron variant have so far proven well-founded; on December 31, the United States saw more new cases (446,567) than at any point in the pandemic, exceeding the previous high of 229,977 in January 2021.[12]

We have already seen an impact on air travel as airlines struggle with the number of pilots and flight attendants who have tested positive with the virus,[13] and other economic sectors will most certainly be impacted by this new variant. One notable example is cruise lines, particularly since the CDC has issued a recommendation to the public to stand clear of these trips for now.[14] However, despite high transmission rates, Omicron appears to be less severe than previous variants.[15] We will be monitoring COVID-19 and its variants closely as we begin the new year, and we expect COVID-19 to remain the key storyline through 2022.

Inflation Concerns

Abnormally high inflation was a key concern throughout 2021, as the annual inflation rate in the United States rose to 6.8% in November 2021 — the highest it's been since June 1982.[16] The concern with

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11 Our World In Data, *COVID Mobility Trends*: *United States*. (*Link*)

12 New York Times, *Coronavirus In The U.S.: Latest Map & Case Count*. (*Link*)

13 Wall Street Journal, *Thousands of Additional Flights Canceled as Winter Storm, Omicron Surge Hurt Airlines* (*Link*)

14 Reuters, *Avoid cruise travel as Omicron cases surge, says U.S. CDC* (*Link*)

15 The Economist, Omicron: *Omicron causes a less severe illness than earlier variants* (*Link*)

16 Trading Economics, *United States Inflation Rate–2021 Data*. (*Link*)

inflation is not only its potential impact on economic growth and consumer buying power, but what measures the Fed may take in response to inflationary pressures.

The cause of inflation will dictate whether Fed policy changes are the appropriate prescription or not. If, for example, the Fed raises interest rates with the desire to curb inflation, this approach may be appropriate for dampening inflationary pressures brought on by excess demand. Whereas if the inflation is being caused by the persistence of supply chain issues, then we could see elevated consumer prices *and* higher interest rates (rather than rising rates working to decrease inflation and consumer prices). Like COVID-19, inflation and the Fed's course of action will be a key theme our team will be monitoring in the weeks and months ahead.

Labor Market Challenges

The labor market will play a major role in our continued economic recovery, particularly the labor force participation rate. For this reason, the Great Resignation has been a cause for concern, especially after November 2021, with employees quitting their jobs at the highest rate ever recorded.[17] The economic recovery has continued despite these inefficiencies in the labor market. However, labor shortages could provide a headwind for continued economic growth, and at the end of November there were 10.6 million job openings left unfilled.[18]

Will wages need to be raised further in order to entice people to fill those jobs? Will this, in turn, unleash additional inflationary pressure on the economy? If so, would this force the hand of the Fed, and encourage them to raise rates further? Like the other weaknesses from 2021 mentioned above, we will be monitoring the labor market closely as part of our ongoing economic analysis.

Opportunities (2022)

Tax Planning

With the Build Back Better act looking unlikely to pass in its current form, high earners may have caught a break on some of the tax increases that will be needed to fund an expanded federal budget. However, this reprieve may be short-lived — many of the exemptions in the current tax code (such as the estate tax exemptions) have a sunset provision in 2025, at which point they will expire without legislative intervention.

So, while it is not a traditional "opportunity," we do feel that tax planning should be prioritized in 2022 as a means to mitigate the potential impacts of a changing tax code. To that end, we will be holding a webinar in early February to discuss the current tax landscape, and certain strategies which exist that may prove to be useful to high earners.

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17 The Wall Street Journal, *Workers Quit Jobs at a Record Level in November (Link)*

18 The Wall Street Journal, *Workers Quit Jobs at a Record Level in November (Link)*

Strategic Planning
Capital markets saw a volatile end to 2021, and we expect a degree of volatility to continue. Accordingly, we recommend that investors pay close attention to the level of liquidity within their portfolio. On the asset allocation side of the equation, it may be a good time to review your current allocation and make sure the asset mix is consistent with your tolerance for risk and time horizon. Those who have concentrated exposure in individual securities and sectors would do well to consider strategies to reduce these potential vulnerabilities. Additionally, depending on one's circumstances, the introduction of other asset classes, including "alternative investments," may be appropriate. These alternatives include, but are not limited to: private equity, private credit, private real estate, and infrastructure. Depending on which alternative asset class we are referring to, each has the potential to provide either return enhancement and/or risk mitigation. The reason for this is that many of these alternatives have lower correlations with the direction of public capital markets, making them a potentially valuable addition to a diversified portfolio. Should you wish to learn more about alternative investments please reach out to your Wealth Advisor to discuss the objectives, risks, and costs associated these investment opportunities.

As always, defining a strategic plan of action and sticking to that plan presents the greatest opportunity for long-term success. For our private clients, there is never a substitute for a thoughtful financial plan that serves as the North Star for your wealth management strategy. Likewise, for our institutional clients, there is no substitute for a thoughtful assessment of your organization's objectives and a plan to achieve those objectives.

Threats (2022)

As touched on previously in this journal entry, Federal Reserve policy, inflation, and COVID-19 are all potential "threats" that we will be monitoring as we enter 2022. In addition to these items, we view political instability and U.S. population growth as two longer-term themes which should be monitored.

U.S. Population Growth
For the year ending July 2021, the U.S. population grew by 0.1% — the lowest rate on record. And while this annual figure is unusually low, it's part of a longer-term slowdown in the U.S. birth rate that has been observed since the 2007-2009 recession.[19] Birth rates matter for capital markets since population growth is a key driver of economic growth over the long run.

Last September, we hosted a webinar with David Bridges, who spent 25 years in the CIA's Clandestine Service. In this webinar, David shared with us that just 4% of the world's population growth during the next few decades is expected to originate from the U.S., Canada, Europe, and Japan. This larger trend is part of the reason why we believe that a diversified portfolio should include exposure to countries and continents where population growth is expected to be higher in the coming decades.

Political Instability

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[19] The Wall Street Journal, *Covid-19 Pandemic Drives U.S. Population Growth to Record Low* (*Link*)

Finally, the potential for political instability — both at home and abroad — cannot be overlooked as we head into 2022. As we've covered in previous journals, political tensions between the U.S. and China remain a potential threat to economic growth in both countries. Will we see a selective economic de-coupling occur between nations? One potential impact of a de-coupling could be a further exacerbation of the supply chain disruptions that we experienced in 2021.

Looking domestically, Americans will go to the polls on November 8, 2022 for the midterm elections. As always, we expect market volatility and uncertainty to creep in as we approach election day. While we anticipate that there will likely be opportunities and risks relating to the upcoming election cycle, we do not anticipate that the 2022 midterms will provide cause for clients to deviate from a longer-term, strategic plan of action.

Conclusion

Regardless of what the new year brings, your team at GYL is ready to guide your wealth each step of the way. If you have any questions about the information covered in this journal or how it may impact your comprehensive strategy, we invite you to connect with your Wealth Advisor.

From all of us at GYL, we wish you a happy and healthy start to the new year.

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