December 2021

FIDUCIARY PULSE

4th Quarter 2021: U.S. Economy Confronts a New COVID-19 Variant Amid Continuing Inflation and Supply Chain Bottlenecks

By Clark Kendall

The Quarter In Brief

The stock market kicked off the fourth quarter with a powerful rally in October and added to those gains into November until investors were blindsided by news of the emergence of a new COVID-19 variant, Omicron, and testimony by Fed Chair Jerome Powell that escalating inflation and an improving labor market warranted consideration of an acceleration of its bond purchase tapering plans.

Markets, as a rule, do not like surprises and uncertainty and the combination of a new variant and a suddenly more hawkish Fed sent stocks into a skid that largely erased the November's accumulated gains. Market reaction to the Omicron news was exacerbated by when the news hit--on Black Friday, a day that typically provides less liquidity since many investors and traders are on holiday.

Investors soon learned the contours of what a more hawkish monetary policy would look like. In its mid-December meeting, the Federal Open Market Committee (FOMC) announced plans to speed up its bond purchase tapering schedule and signaled that, once tapering is concluded in March 2022, up to three rate hikes may follow.

Markets settled down into the final weeks of the quarter as early indications suggested that Omicron's health impact was less severe than the Delta variant. Relieved that its economic consequences may be less than initially feared, reinvigorated investors jumped back into the market, pushing stocks higher into the end of December and capping a strong year of

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performance.

Corporate profits for the third quarter were solid. Eighty-two percent of the companies comprising the Standard & Poor's 500 Index reported earnings above Wall Street analysts' expectations, posting an average earnings growth rate of 39.8% in the third quarter. This earnings momentum is anticipated for the fourth quarter, with an earnings growth forecast of 20.9%, which, if realized, will mark a historical high watermark in corporate profits.

The U.S. Economy

After a Delta variant-induced slowdown in the third quarter, signs are pointing to a strong economic rebound in the fourth quarter and solid growth into 2022. Though the official economic growth rate for the fourth quarter won't be reported until January's Gross Domestic Product (GDP) report, according to the Federal Reserve Bank of Atlanta, which tracks economic data in real time, their model is indicating a 7.2% annualized real rate of Q4 GDP growth.

This economic rebound overcame several headwinds, including accelerating inflation, supply chain bottlenecks, a labor shortage, and a pending pivot toward monetary normalization.

The labor market evidenced considerable recovery as initial jobless claims fell steadily, while the unemployment rate shrank to 4.2% in November, even as some 600,000 Americans entered the labor market and the labor participation rate rose to pre-pandemic levels.

The nation's manufacturing sector gathered momentum in the fourth quarter. The Institute for Supply Management (ISM) Manufacturing Index rose in November for the eighteenth straight month, with the trend pointing toward a faster acceleration in that growth.

Looking ahead, one survey of economists conducted by the Federal Reserve Bank of Philadelphia shows a median forecast of 3.9% in GDP growth in 2022, with stronger growth in the first half of the year and a moderating expansion in the final two quarters.

Especially noteworthy is the American consumer, the primary driver of economic growth. Americans have stockpiled $2.3 trillion of excess savings (i.e., savings above pre-pandemic levels), providing a strong underpinning to fuel future economic activity.

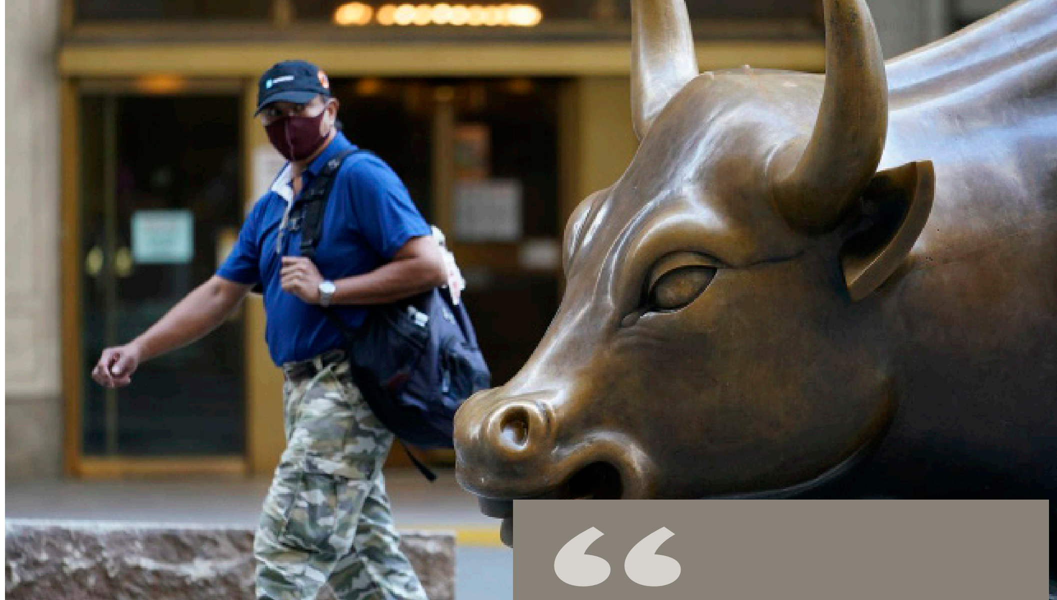
While the economic outlook appears positive, headwinds exist.

The economic impact of Omicron is difficult to estimate. For now, it appears unlikely to lead to widespread lockdowns, but it may pose the potential to prune economic growth at the margins.

Perhaps the most concerning potential financial risk is inflation, which has persisted at an elevated rate for longer than the Fed expected. November's Consumer Price Index (CPI) provided little comfort, as prices jumped at a rate not seen in nearly forty years, rising 6.8% year-over-year. It was the sixth consecutive month that inflation exceeded 5%.

Shaky consumer confidence is another possible risk. Though consumers may be flush with excess savings, spending requires consumers to be confident about their personal situations and the economy. In the University of Michigan's November consumer sentiment survey, Americans expressed less optimism than at any time since the credit crisis years, largely due to rising inflation and perceived government inaction to address it.

While additional risks may present further challenges, the overall expectation, nevertheless, is for continued economic expansion in the near- to intermediate-term.



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Global Economic Health

The economic outlook in European Union (EU) countries remains encouraging despite the rise in Delta and Omicron variant infections and instances of some countries, e.g., Austria and Germany, instituting fresh economic restrictions. Maintaining this economic growth momentum has been primarily a result of continued progress in the region's vaccination efforts. As a consequence, the EU economy is projected to grow by 5.0% for the full year 2021 and by 4.3% in 2022. Domestic demand and an improving labor market are expected to drive this economic improvement, but inflation, ongoing supply chain bottlenecks, and the Omicron variant are the main risk factors that could upend this otherwise strong forecast.

The Bank of England is less sanguine about the prospects for the United Kingdom's economic growth going forward. While GDP growth in 2021 is expected to be a very healthy 7.0%,

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MARKET INDEX	12/31 Close	Q4 % CHANGE	Y-T-D % CHANGE
DJIA	36,338	7.37%	18.73%
NASDAQ	15,645	8.28%	21.39%
S&P 500	4,766	10.65%	26.89%
BOND YIELD	**12/31 RATE**	**1 MO AGO**	**1 YR AGO**
10 YR TREASURY	1.51%	1.44%	0.92%

Sources: Wall Street Journal, December 31, 2021, Treasury.gov (Bond Yield)

The market indexes discussed are unmanaged and generally considered representative of their respective markets. Individuals cannot directly invest in unmanaged indexes. Past performance does not guarantee future results. U.S. Treasury Notes are guaranteed by the federal government as to the timely payment of principal and interest. However, if you sell a Treasury Note prior to maturity, it may be worth more or less than the original price paid

the estimated growth rate for the fourth quarter was shaved due to supply chain disruptions. For 2022, the U.K.'s central bank is forecasting a 5.0% expansion in GDP. Similar to other countries, continuing supply chain problems, inflation, and the spread of COVID-19 represent risks to the U.K. economy in the months ahead.

Economic growth in China slowed considerably in the latter part of 2021. In fact, GDP growth in the third quarter (+4.9%) was the slowest growth rate in a year, and materially lower than the second quarter growth rate of 7.9%. Economic growth is expected to further decelerate in the fourth quarter and remain weak into the first half of 2022. There are a variety of factors that are weighing on China's economy, including its zero-COVID policy, power shortages, massive debts held by property developers, and the drag of government regulation on private sector businesses.

The Bank of Japan shaved its forecast for economic growth in 2021 from 3.8% to 3.4%, but raised its estimate for GDP expansion in 2022 to 2.9%, up from 2.7%, citing the effects of COVID-19 infections and the expectation that the Japanese economy would rebound as the COVID-19 overhang wanes.

The MSCI-EAFE Index, which tracks developed overseas markets, rose 2.40% in Q4, while emerging markets, as measured by the MSCI-EM (Emerging Markets) Index, fell 1.68%.

Looking Back, Looking Forward

Investors enjoyed robust stock market returns in 2021. It was a performance that had less to do with P/E ratio (Price-to-Earnings) expansion – the market P/E actually came off its high – and more a result of strong earnings growth.

One overlooked feature of the stock market's 2021 performance was the successive waves of rotational corrections. From the view of major indices, stocks enjoyed a steady rise throughout the year without a correction (i.e., a decline of 10%-20%), suggesting a generally stable, even placid, stock market.

However, beneath this smooth ascent were periods of volatility for specific industry groups. For example, as of November 26, while the year-to-date return on the S&P 500 was 22%, 92% of its constituent stocks experienced at least a 10% decline from their YTD highs, with an average drawdown of 18%. Similarly, the technology-heavy NASDAQ Composite, which was up by 20%, saw 89% of stocks with a drawdown of at least 10% and an average retreat from YTD highs of 40%.

In other words, while the major market indices did not experience a correction, most stocks comprising these indices suffered corrections at some time during the year.

It is unrealistic to expect a repeat of the 2021's outsized gains, but the consensus of Wall Street analysts is one of modest price gains in 2022 amid continued economic growth and low, though rising, interest rates.

While the market may be affected by multiple "known unknowns," e.g., geopolitical flare-ups, trade frictions, or inflation, there are several key ones worth highlighting.

The Federal Reserve began to pivot toward monetary normalization, announcing in December an acceleration of bond tapering and the possibility of up to three interest rate hikes. Markets expected this, so this may already be priced in. However, if the Fed finds itself behind the inflation curve and needs to increase the number of rate hikes or accelerate their pace, it may unsettle investors.

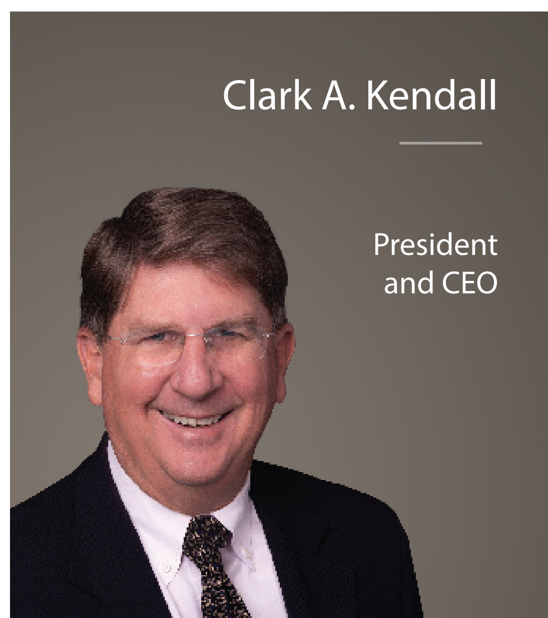
Corporate earnings growth is anticipated to moderate in 2022. This is to be expected considering the rate of economic expansion will likely slow and its comparative period, 2021, established such a high bar.

That said, 4Q 2021 earnings (reported in 1Q 2022) is forecast to grow by 20.9%, which, if that materializes, means 2021 full-year earnings growth will be 45.0%.

For 2022 Wall Street analysts are projecting an 8.8% jump in corporate profits. This is a substantial come-down, but it represents healthy growth from a high watermark. Should companies exceed these expectations, it may help support higher valuations.

Another important market influence may be a slowdown in China's economy. A deceleration in the growth of the world's second largest economy may translate into lower consumption of imported consumer goods or production of manufactured goods, representing a potential risk to the global economy.

Possible rate hikes, higher inflation, and moderating economic growth may sound like a recipe for a tepid stock market, but history tells us that stocks are more likely to rise in a rising interest rate environment and during periods of moderate economic deceleration. While past performance is not a guarantee of future returns, it suggests that markets may advance under less-than-optimal circumstances.



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Eight Money Moves to Jumpstart Your Financial Health in 2022

By Katelyn Murray

For many, the new year is a time of renewal and reinvention, which makes it the perfect time to optimize your personal finances for 2022 and beyond. What financial, business, or life priorities do you need to address in the new year? Here are some ideas on how to get started:

Review your financial plan.

This is a great time to review your financial plan to ensure that it is still reflective of your personal goals. A financial plan is a living document, and as such, it should be revisited and adjusted regularly. Having a plan in place will make it easier for you to track your progress throughout the year and will help you set specific short- and long-term goals and develop clear strategies on how to achieve those goals. Don't have a financial plan yet? The team at Kendall Capital can help with that!

Create a spending plan.

Notice I used the term "spending plan" there—not "budget." Budgets often feel restrictive, complicated, and rigid. For this reason, most people don't enjoy the process of "budgeting." In fact, they dread it, which is why most folks struggle with sticking to that process. Here's what you can do instead: create a spending plan to use as a roadmap for how you'll spend your money, focusing on paying yourself first (i.e., treating contributions to your savings goals and retirement accounts like any other household bill). Once you've worked out how much of your income you'll use to "pay yourself" and how much to direct to non-discretionary expenses like housing and utilities, you can feel empowered to freely spend the rest on whatever you like! This less restrictive approach to mindfully putting your money to work for you is quite effective at helping people spend mindfully without overly restricting.

Double check your contribution to your retirement plan at work.

Periodically, the IRS increases the maximum allowable annual contribution to employer retirement plans, so New Year's is a great time to double check that you're making the most of your plan. For 2022, the 401(k)-contribution limit has been increased to $20,500 (the catch-up contribution for those over 50 remains the same for this year, at $6,500).

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Did you forget to fund your IRA or HSA last year?

Don't panic—there's still time! You have until April 15, 2022 to make a "prior year" contribution to a Traditional IRA, Roth IRA, or Health Savings Account (HSA) for 2021. You can stash away up to $6,000 in an IRA for 2021 ($7,000 for those over 50). The 2021 HSA contribution

limit is $3,600 for single coverage or $7,200 for family coverage (plus an extra $1,000 if you're over 55). If you've already fully funded these accounts for last year, consider going ahead and checking this year's contribution off the list.

Spend down your FSA.

If your employer offers a grace period to use up Flexible Spending Account (FSA) funds from the 2021 plan year, that grace period expires on March 15th. Check out the list of eligible medical expenses at: https://fsastore.com/fsa-eligibility-list.aspx

Check on your credit report.

You can get a free copy of your credit report from www.annualcreditreport.com. You can also regularly monitor new activity and alerts on your credit through Credit Karma. They also provide helpful tips for building credit, but they're funded by affiliate links for credit card companies, so be wary!

Review your insurance policies to make sure you aren't over- or under-insured.

Review all your policies—homeowner's, auto, disability, life, and long-term care insurance. Are the limits adequate? Should the deductibles be raised? Is there a less expensive policy with similar coverage? Are you taking advantage of all the discounts offered to you by your insurance providers? Websites such as www.insurance.com and www.policygenius.com provide quotes from several insurers so you can compare and find the best coverage for the best price.

Hire a fee-only fiduciary advisor.

In our increasingly complex world, if you are struggling with questions regarding your current or future financial situation, you are not alone. Having a trustworthy professional in your corner to help guide you as you navigate financial decisions can help you reduce stress, build confidence, and feel empowered to spend your money on the things that truly enrich your life.

At Kendall Capital, we help Middle-Class Millionaires® put their money to work for them instead of the other way around. Give us a call today and let us help you make 2022 the beginning of an even brighter future for you and yours.

Katelyn Murray
CFP®

Financial Planner/ Relationship Manager

Social Security: Take or Delay?

By Carol Petrov

Most American workers who have at least 10 years of work history will be able to start taking Social Security benefits as soon as they reach age 62. But should they?

Some years back, there was considerable debate about whether a person was better off receiving the monthly checks early and investing them in the markets or waiting until full retirement age (currently age 67)—or, alternatively, waiting until age 70 and receiving even higher benefits.

Today, that debate has largely gone away.

At Kendall Capital, we typically recommend waiting, if you can, at least until full retirement age and, even better, holding off until age 70.

Why?

The problem with most of those older calculations was that they were assuming that the U.S. investment markets would follow historical long-term averages—which, as I think most of us have seen—is not guaranteed. What IS guaranteed is that the Social Security benefits will rise with each and every year that a qualified recipient waits to start taking them. For persons born after 1943 (that is, pretty much everybody who is qualified to take Social Security benefits), the "delayed retirement credit" is a whopping 8% a year. Yes, that means that each year you wait means that the monthly check will be 8% higher than it would have been before. You will not get that kind of guarantee from the investment markets.

The Social Security Administration offers a calculator on its website which shows the percentage of your normal retirement age benefits you would receive depending on what age you start taking your monthly checks. For a person born in September of 1960 who decides to turn on the Social Security benefits at age 62, the benefits represent 70.42% of the checks that same person would have received if he or she had started taking benefits at age 67. By waiting until age 70, the same person would receive 124% of the so-called "primary insurance amount."

But there's more to the story than simply larger checks.

Social Security is the only guaranteed source of retirement income that is protected against inflation, which means offering protected purchasing power. Those larger checks become proportionately larger depending on the inflation rate. That is not the case with annuity checks and most pension accounts—where the amount received will be less valuable with each passing year.

Of course, there are always questions about Social Security's solvency.

The Social Security Trust Fund has been projected to run out of money in 2033, which wouldn't mean a total loss of benefits, since working taxpayers would still be paying into the system. In a worst-case scenario, those payment amounts would cover 78% of today's projected benefits. But it seems unlikely that Congress would fail to shore up a system that currently delivers benefits to 69.1 million voters. In fact, the Social Security Enhancement and Protection Act was recently reintroduced in the U.S. House of Representatives; among the provisions is a 5% increase in monthly benefits for all beneficiaries who have been retired for 20 years and bolstering the Trust Fund by phasing out the Social Security payroll tax cap, which currently applies only to wages up to $142,800. In addition, the payroll tax rate would gradually rise from the current 6.2% to 6.5%.

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Vice President and Senior Relationship Manager

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QCDs to the Rescue

By Brian Mattox

When the 2017 Tax Cuts and Jobs Act raised the standard deduction for taxpayers to $24,000 for couples ($12,000 for singles), and lowered individual tax rates, an unintended consequence was to reduce the tax benefits of making charitable donations. Fewer taxpayers were itemizing, which means their donations didn't count as deductions. Itemizing taxpayers—including people who intentionally raised their level of giving in order to cross the standard deduction threshold—found that the lower brackets reduced their tax benefits.

The Urban-Brookings Tax Policy Center has estimated that the law reduced the marginal tax benefit of giving to charity by more than 30 percent and raised the after-tax cost of donating by about 7 percent.

Some Middle-Class Millionaires, however, are able to avoid these limitations.

How? As most of us know, people age 72 and older who have individual retirement accounts (IRAs) are required to take required minimum distributions (RMDs) out of the account—and those percentages increase with age. If they're charitably inclined, and otherwise frustrated by the new tax rules, they can take their distribution in the form of a qualified charitable distribution (QCD). The distribution would be a direct transfer to the charitable organization of their choice, up to a limit of $100,000.

How does that benefit them?

If the QCD is made directly to the charity, it is not counted as income for federal tax purposes—and therefore reduces the income that the taxpayer has to include on the 1040 form. In effect, the QCD gives back the full charitable deduction that was otherwise lost to the tax reform writers.

Due to a quirk in the law, IRA owners as young as age 70 1/2 can make QCDs, even though they aren't required to take RMDs until age 72. Why would someone take a distribution before he or she has to? Once again, for someone who is charitably inclined, the QCD brings back the full charitable deduction. And some taxpayers might want to reduce the size of their IRA before they have to start taking distributions, in order to lower their future income to fit into lower tax brackets.

If a taxpayer and spouse each have IRAs, each can make their own qualified charitable donations. And the option is not limited to IRA owners. IRA beneficiaries—that is, people who have inherited IRAs, and have to take out the money within 10 years, can also make QCDs if they choose.

Finally, taxpayers who make the full $100,000 donation direct to a charity can also make further donations out of their IRA. But in those cases, only the first $100,000 will come out without any tax consequences. The remaining amount will be treated as a taxable distribution, which would then qualify for a normal charitable deduction if the taxpayer itemizes deductions.

We encourage you to reach out to your advisor here at Kendall Capital if you have questions on QCDs or other tax concerns.

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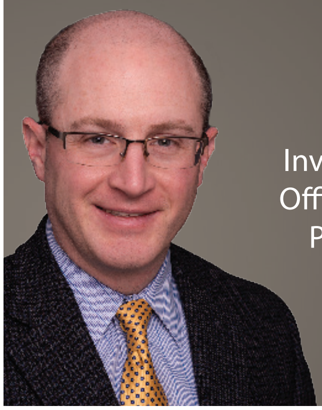
Brian Mattox
CAIA

Chief Investment Officer, Vice Preisdent



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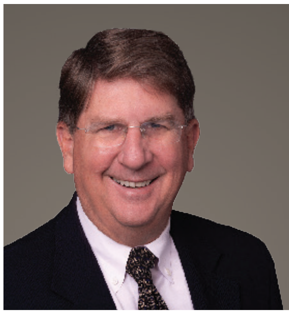
THE KENDALL CAPITAL TEAM



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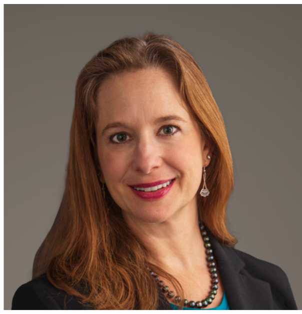

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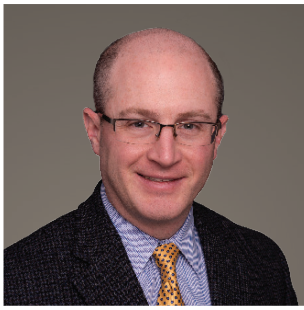

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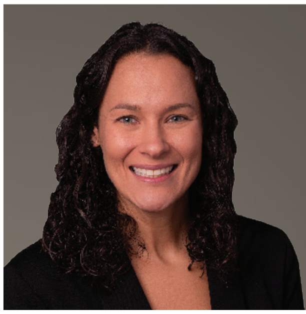

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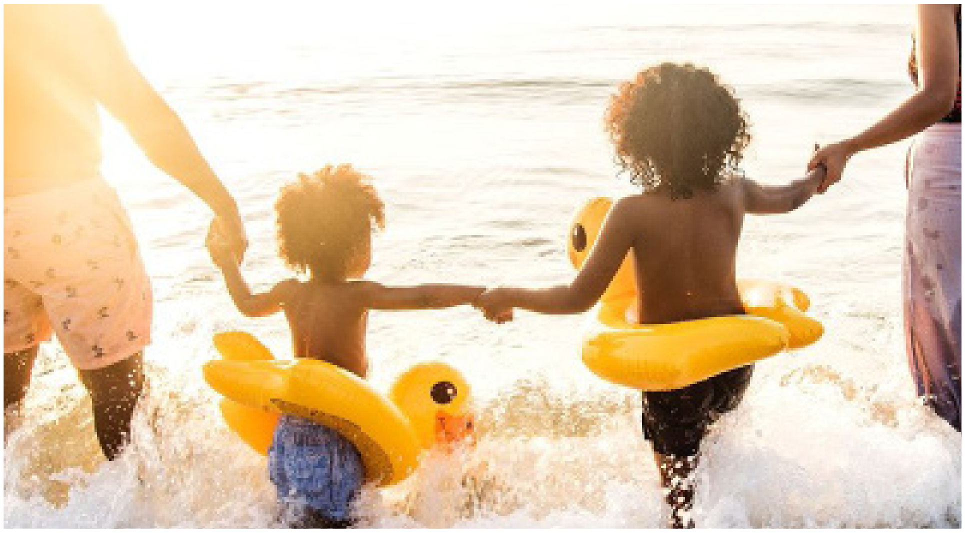

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