The Fairlead Quarterly

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Fairlead
Financial Advisors, LLC

www.fairlead-fa.com 415-381-6890

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Quarterly Overview

After a relatively flat third quarter, the "Christmas Rally" did not disappoint as stocks finished strong in December capping a strong fourth quarter. The S&P 500 (SPDR S&P 500 ETF) finished December up 4.63%, the quarter up 11.07%, and the year up 28.75%. An incredible one-year return, particularly in the midst of a pandemic. More incredible, is the performance over the past 3 years - though a look at the past 4 years is more instructive. In 2018 the Fed was finally beginning to raise interest rates after a decade of stimulative policies and a historically low Fed Funds rate to stave off disaster in the wake of the 2008 financial meltdown. In 2018 the S&P ETF lost -4.65% during a tightening cycle that entered the fourth quarter of 2018 with overtures of more rate hikes to come. But in December of 2018 the Fed abruptly reversed course and began easing again causing the S&P to gain 31.22% in 2019. Then the Coronavirus hit in the first quarter of 2020, and after a brief, steep sell-off in March, the market rallied (primarily rewarding tech investors) due to another round of unprecedented stimulus - bond buying, enhanced unemployment benefits, enhanced employer benefits, rates at 0% - and the S&P ended the year up 18.22%. The 3-year annualized return for the S&P ETF is 25.93%, but now we find ourselves facing the highest level of inflation in 40 years and a Fed that is forced to raise rates to cool things down.

The Russell 1000 ETF (Large Cap Stocks) ended the quarter up 9.63%, with the Russell 1000 Growth ETF up 11.66%, and the Russell 1000 Value up 7.77%. The performance gap between Growth and Value narrowed significantly during 2021 with Growth posting a 27.43% gain and Value a 24.95% gain. Contrast that with 2020 when Growth was up 38.25% and Value up a mere 2.63%.

As for smaller capitalization stocks, the Russell Midcap Index, gained 6.46% up 22.44% for the year. Value outperformed Growth 28.10% to 12.60% for the year a complete flip-flop from 2020. Similarly, the Russell 2000 Small Cap ETF was up 14.54% for the year with Value outperforming Growth 27.96% to 2.54%.

The reality is 2021 witnessed a pretty significant rotation from the tech/growth sector into the more reasonable valuations found in the old economy/value sector. While the smaller cap returns reflect this rotation pretty obviously, the rotation was present in the large cap segment, as well, with many big tech names easily in correction (down -10%) territory.

MSCI EAFE (Developed Overseas Markets) was up 2.84% for the quarter and 11.46% for the year, and Foreign Emerging Markets (MSCI Emerging Markets), were down -1.57% for the quarter and -3.62% for the year.

The Vanguard US Bond ETF was down -0.04% for the quarter, and down -1.86% for the year. Goldman Sachs U.S. High Yield Corporate Bond ETF (Junk- lower quality bonds) was up 0.63% for the quarter and 3.21% for the year.

The Vanguard Real Estate Investment Trust ETF was up 15.03%, for the quarter and 40.52% for the year. Utilities Select Sector SPDR staged a 4th quarter rally, up 12.93% and up 17.69% for the year. The Alerian MLP ETF (Energy - Master Limited Partnership) was only up 0.38% for the quarter but was up 39.03% for the year.

The Backdrop

Oil & Commodities: Average crude oil prices (WTI Crude) ended last quarter at $75.33 up only 0.15% for the quarter but up 58.69% from the beginning of the year.

The Invesco Deutsche Bank Commodity ETF) was up 2.97% for the quarter, and up 41.63% for the year. Gold (SPDR Gold ETF) was up 4.10% but down -4.15% for the year.

The Fed, The Treasury and Global Central Bankers: With growing concern over inflation and low unemployment (wage inflation) the Fed has further accelerated the "taper" of its bond buying program planning to end it by March rather than June. They have also projected three rate increases next year, those typically occurring in quarter point increments. Some members of the board have indicated that a fourth increase is possible.

Elsewhere, the Bank of England actually raised its benchmark index from 0% to 0.25%, the first major central bank to raise rates since the beginning of the pandemic. In a departure from the pack the European Central Bank (ECB) elected to extend its bond buying while withdrawing other sources of stimulus from the economy.

The big question is, "What impact will the removal of stimulus and interest rate increases have on the financial markets and the economy, and will it be effective in reducing inflation?"

Trade, Tax & Fiscal Policy: In November President Biden signed into law a $1 trillion infrastructure bill to improve roads, bridges, upgrade the electrical grid and expand the availability of broadband internet access. This bill had passed both the House and the Senate with an unusual level of bipartisan support. A more controversial bill for an additional $1.85 trillion, the Build Back Better Act, passed the House by only 7 votes and will only pass the Senate if every democrat votes in favor with the Vice President as the tie-breaker.

At the center of the Build Back America Act is a series of changes to the Federal Tax Code, focused on the notion that wealthy Americans and profitable corporations should pay more toward improvements in healthcare, education, climate, child care and immigration programs.

U.S. and Overseas Economic Activity:

Europe: In the third quarter of 2021 (most current data) the Euro Area GDP was up by 3.7% after a record breaking 14.4% in the prior quarter, which was a rebound from 5 straight quarters of contraction. Inflation in the Euro Area- was at 5% year over year in December. Consumer confidence hit its lowest levels in 9 months, reflecting a decline in household expectations about the general economic situation and their intentions to make major purchases. By contrast Industrial Sentiment hit a record high. The unemployment rate was 7.2% down slightly from 7.3%

U.S.: Third Quarter GDP increased by 2.3% (most current data, Third Estimate) a significant decline from the 6.7% posted in the second quarter. The trade deficit has been steadily increasing over the past two year with the three-year moving average climbing from under $45 billion in November of 2019 to over $75 billion in November of 2021.

China: China's economy also slowed in the third quarter, growing at 4.9% compared to a year ago versus the 7.9% growth rate in the second quarter. An IMF forecast has China's growth rate slowing to 5.6% in 2022, down from an expected 8.0% in 2021.

Inflation: The Consumer Price Index for All Urban Consumers (CPI-U) increased, 0.5% in December, and over the last 12 months the all items index increased 7.0% - the largest increase since June of 1982. The all items less food and energy index increased at 5.5% - the largest 12 month change since February of 1991. The food index increased 6.5% and the energy index increased 29.3% over the past year.

Unemployment: In December the US unemployment rate fell to 3.9% as the economy added 199,000 jobs in December. The number of people not in the work force who want a job is unchanged at 5.7 million which is a decrease of 1.6 million from a year ago but still 717,000 higher than February 2020.

Housing: Case/Shiller data (published with a two month lag - October 2021) for the National Home Price NSA Index reported a 19.1% annual gain, down from a record 19.7% in July. The 10 City Composite was up 17.1% and the 20 City Composite was up 18.4% year over year. Phoenix, Tampa and Miami lead the way with increases of 32.3%, 28.1% and 25.7% respectively.

"In October 2021 US home prices moved substantially higher but at a decelerating rate…October's gains were below September's and September's were below August's." (S&P Dow Jones Press Release)

Going Forward

Looking back 2021 was another year of astonishing performance in the equities markets with large cap growth stocks continuing to show their dominance. Looking forward the picture becomes somewhat murkier. We ended the year with a rate of inflation we haven't seen in almost 40 years (back when money market funds paid double digits, not the few hundredths of a percent they pay now); we have a tight labor market showing wage inflation which will be passed on to consumers; a Fed trying to get ahead of inflation by raising rates and withdrawing monetary stimulus; and a political regime hoping to raise corporate tax rates. On the bright side most current economic data points are positive. But 12 out of 12 times if unemployment increases during a Fed tightening cycle the economy has gone into recession. Short term it's hard to time the market, and long term the market is the place to be, even in an inflationary environment, but that doesn't mean the ride will be smooth.

As always I am available to discuss the markets, the economy, your portfolio and your concerns.

JOHN VREELAND

SUMMARY OF INDEX ETF RETURNS

Global Markets Year to Date					
INDEX-INVESTABLE ETF	4th Quarter 2021	Calendar Year 2021	Calendar Year 2020	Calendar Year 2019	INDEX DESCRIPTION
iShares Russell 1000 (IWB)	9.73%	26.32%	20.77%	31.06%	*US Large-cap Stocks*
iShares Russell 1000 - Growth (IWF)	11.66%	27.43%	38.25%	36.08%	
iShares Russell 1000 - Value (IWD)	7.77%	24.95%	2.73%	26.13%	
SPDR Dow Jones Industrials - (DIA)	7.85%	20.84%	9.61%	25.01%	
SPDR S&P 500 - (SPY)	11.07%	28.75%	18.22%	31.22%	
Fidelity NASDAQ Composite (ONEQ)	8.60%	22.11%	44.89%	37.15%	
Invesco NASDAQ 100 (QQQ)	11.29	27.42%	48.62%	38.96	
iShares Russell Mid-Cap (IWR)	6.46%	22.44%	16.92%	30.23%	*US Mid-cap Stocks*
iShares Russell Mid-Cap - Growth (IWP)	2.91%	12.60%	35.24%	35.04%	
iShares Russell Mid-Cap - Value (IWS)	8.53%	28.10%	4.80%	26.74%	
iShares Russell 2000 (IWM)	2.00%	14.54%	20.03%	25.39%	*US Small-cap Stocks*
Russell 2000 - Growth (IWO)	-0.09%	2.54%	34.68%	28.48%	
Russell 2000 - Value (IWN)	4.21%	27.96%	4.66%	22.01%	
iShares MSCI EAFE (EFA)	2.84%	11.46%	7.59%	22.03%	*Developed Overseas (US$)*
iShares MSCI ACWI World ex USA (ACWX)	2.00%	7.68%	10.29%	21.03%	*World ex USA (US$)*
iShares MSCI Emerging Markets (EEM)	-1.57%	-3.62%	17.03%	18.20%	*Emerging Mkts (US$)*
Consumer Price Index - US (CPI-U)*	2.2%	7.0%	2.1%	1.91%	*Measure of Inflation*
Goldman Sachs Hi Yld Corp Bond (GHYB)	0.63%	3.21%	6.38%	14.55%	*High Yield (Junk) Bonds*
Vanguard US Bond (BND)	-0.04%	-1.86%	7.71%	8.84%	*General US Bond Index*
Vanguard Real Estate (VNQ)	15.03%	40.52%	-4.68%	28.87%	*Real Estate Investment Trusts*
Utilities Select Sector SPDR (XLU)	12.93%	17.69%	0.57%	25.92%	*Utility Index*
Alerian MLP Index (AMLP)	0.38%	39.03%	-32.19%	5.80%	*Energy Master Ltd Prtnshps*
Invesco Deutsche Bank Commodity (DBC)	2.97%	41.36%	-7.84%	11.84%	*Basket-Commodities Futures*
Vanguard Materials (VAW)	14.14%	27.41%	19.40%	23.53%	*Materials Companies*
SPDR Gold Shares (GLD)	4.10%	-4.15%	24.81%	17.86%	
iShares Silver Trust (SLV)	4.82%	-12.45%	47.30%	14.88%	

*Inflation for the quarter is All Items Seasonally Adjusted and non-annualized. Yearly figures are All Items Unadjusted over the previous 12 mos. (August 2021) and is not an investable index product