MARKET INSIGHTS

from Ziegler Capital Management

Monthly Market Commentary: January 2022

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The S&P 500 returned 4.48% in December and has returned 28.71% for the calendar year ending December 31, 2021. Small cap stocks, as measured by the Russell 2000, returned 2.23% in December and 14.82% in 2021. Large Cap Value outperformed Growth in December with the Russell 1000 Value returning 6.31% and the Russell 1000 Growth returning 2.66%. For the year, Growth outperformed Value with a return of 28.27% versus 25.16%. In December, the Russell 2000 Value returned 4.06% and the Russell 2000 Growth returned 0.77%, and Small Cap Value led Small Cap Growth considerably for the year with a return of 28.24% for Small Cap Value versus Small Cap Growth at 3.17%.

Financial news headlines continue to be led by the Federal Reserve's revised inflation commentary and taper comments, as well as supply chain disruptions that are trickling down and are having a broader effect on U.S. companies and their consumers. COVID cases and hospitalizations have recently spiked, although we have not yet seen a corresponding spike in deaths, and the number of people who have received at least one dose of a COVID-19 vaccine continues to increase. According to the Centers for Disease Control (CDC), 71.1% of the United States population over 12 years old is fully vaccinated against COVID-19, with 83.5% of the population having received at least one dose as of December 30th. In recent weeks, COVID-19 cases and hospitalizations have increased with many areas of the country experiencing substantial or high levels of transmission. The Delta and Omicron variants are currently the most prevalent sources of infection with reports that the Omicron variant has less severe symptoms but a high degree of transmissibility.

Returns by Sector

	S&P 500		Russell 2000	
Sector	YTD	Dec. 2021	YTD	Dec. 2021
Communication Services	21.57	2.53	14.70	-2.77
Consumer Discretionary	24.43	-0.25	26.09	0.10
Consumer Staples	18.63	10.29	20.79	7.86
Energy	54.64	3.08	71.66	-0.33
Financials	35.04	3.33	28.28	3.82
Health Care	26.13	8.98	-16.69	0.31
Industrials	21.12	5.33	23.72	1.65
Information Technology	34.53	3.38	15.84	1.54
Materials	27.28	7.57	25.34	4.55
Real Estate	46.19	10.23	28.34	7.98
Utilities	17.67	9.64	11.02	7.63
TOTAL RETURN	28.71%	4.48%	14.82%	2.23%

Source: Bloomberg

ABOUT ZCM MARKET INSIGHTS

A series that provides a glimpse of our internal thought process through current topics affecting our clients and colleagues.

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The $1.0 trillion infrastructure package that focuses on bridges, roads, railways, and broadband internet was signed into law by President Biden on November 15th. Funding will go out over a five-year period and puts $550 billion of new funds into transportation, broadband and utilities. This includes $110 billion in roads, bridges, and other major projects. The American Families Plan remains in limbo with reports it will be called for a vote in early 2022. In more recent negotiations, several of President Biden's campaign promises have been abandoned such as providing free community college and clean electricity standards. Programs such as the expanded Child Tax Credit and expanded Medicaid that were initially going to be permanent will instead expire in a year or two. To pay for his plans, President Biden's proposals include raising the top income tax and capital gains rates, increasing corporate taxes, and expanding the Internal Revenue Service's collections.

Gross Domestic Product (GDP) increased at an annual rate of 2.3% (revised from 2.1% from the first estimate) according to the second estimate released by the Bureau of Economic Analysis (BEA). There were upward revisions to Personal Consumption Expenditures (PCE), and private inventory investment. They were partly offset by a downward revision to exports. Imports, which are a subtraction in the calculation of GDP, were revised down.

The increase in private inventory investment reflected increases in wholesale trade (led by nondurable goods industries) and in retail trade (led by motor vehicles and parts dealers). The increase in PCE reflected an increase in services that was partly offset by a decrease in goods. Within services, increases were widespread with the largest contributions coming from "other" services (international travel), transportation services, and health care. The decrease in goods primarily reflected a decrease in spending on motor vehicles and parts. The increase in nonresidential fixed investment reflected an increase in intellectual property products (led by software and research and development) that was partly offset by decreases in structures and equipment.

The decrease in residential fixed investment primarily reflected decreases in improvements and in new single-family structures. The decrease in federal government spending primarily reflected a decrease in nondefense spending on intermediate goods and services after the processing and administrating the Paycheck Protection Program by banks on behalf of the federal government ended in the second quarter. The decrease in exports reflected decreases in both goods and services. The increase in imports primarily reflected an increase in services (led by travel and transport).

According to the U.S. Bureau of Labor Statistics, the unemployment rate fell to 4.2% in November from 4.6% in October. The number of unemployed fell to 6.8 million people in November from 7.4 million in October. In November, notable job gains occurred in professional and business services, transportation and warehousing, construction, and manufacturing. Employment in retail trade declined over the month. Both measures continue to fall and are significantly lower than their April 2020 highs but remain above their February 2020 pre-pandemic levels of 3.5% and 5.7 million people. The labor force participation rate of 61.8% in November increased from 61.6% in October. It has remained in a narrow range of 61.4% and 61.8% since June 2020 with November's reading the highest rate in that period.

The U.S. savings rate was 6.9% in November, decreasing from a revised downward 7.1% in October. The long-term average savings rate is approximately 9% after its stunning peak of 32.2% in April 2020. Personal income increased $90.4 billion (0.4%), reflecting increases in compensation of employees and government social benefits. Within compensation, the increase reflected increases in both private and government wages and benefits. Government social benefits increased in November primarily reflecting an increase in the Provider Relief Fund, a fund responsible for handling the costs of COVID-19 care.

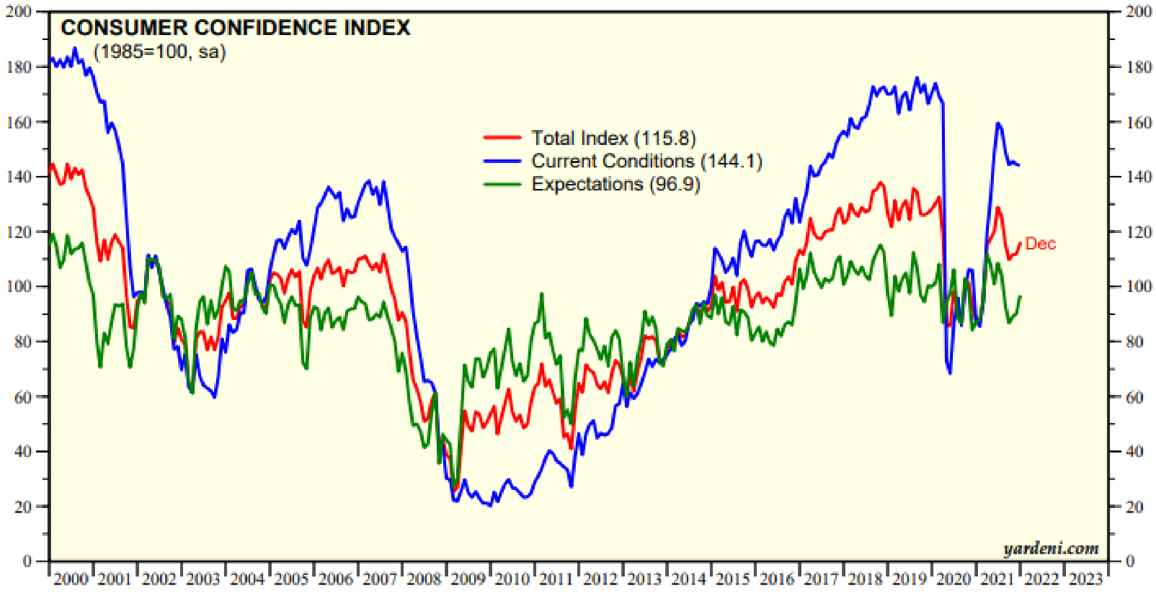
The Federal Reserve set the stage in December for a series of interest rate increases beginning in the spring of 2022, completing a major policy pivot that showed much greater concern about the potential for inflation to stay elevated. The mid-December "dot plot" projected at least three 0.25% rate increases in 2022 versus September projections when many voting members projected that rate increases would not be warranted until 2023. In early November, the Fed agreed to reduce their $120 billion a month bond purchases by $15 billion a month, paring back to $90 billion in December. At their mid-December meeting, the Fed said they would further accelerate the wind-down by reducing purchases by $30 billion a month. As a result, they will purchase $60 billion in Treasury and mortgage securities in January, putting the program on track to end by March.

Fed Chair Jerome Powell told the House Financial Services Committee on December 1st that most economists regard the current price spikes, which have sent inflation readings to their highest pace in 30 years, as largely a response to the supply and demand disruptions brought on by the pandemic. He added that the Federal Reserve cannot be sure that price increases will slow in the second half of next year as previously stated. These statements contradict his frequently expressed views that these imbalances should fade as the pandemic eases, which should reduce inflation. Powell stated "The point is, we can't act as if we're sure of that. We're not at all sure of that. Inflation has been more persistent and higher than we've expected." In economic projections released in mid-December, the Fed projected core inflation to reach 4.4% at the end of 2021 before declining to 2.7% in 2022. Those figures are up from projections in September 2021 that inflation would slow from 3.7% to 2.3% at the end of 2022.

Consumer Confidence increased in December to 115.8, up from an upward revised 111.9 in November. Consumer Confidence recently reached a peak of 128.9 in June. According to a statement from the Conference Board, "Consumer confidence improved further in December, following a very modest gain in November. The Present Situation Index dipped slightly but remains very high, suggesting the economy has maintained its momentum in the final month of 2021. Expectations about short-term growth prospects improved, setting the stage for continued growth in early 2022. The proportion of consumers planning to purchase homes, automobiles, major appliances, and vacations over the next six months all increased. Meanwhile, concerns about inflation declined after hitting a 13-year high last month as did concerns about COVID-19, despite reports of continued price increases and the emergence of the Omicron variant. Looking ahead to 2022, both confidence and consumer spending will continue to face headwinds from rising prices and an expected winter surge of the pandemic." The Present Situation Index (based on consumers' assessment of current business and labor market conditions) fell slightly to 144.1 in December from a revised 144.4 in November. The

Expectations Index (based on consumers' short-term outlook for income, business, and labor market conditions) rose to 96.9 in December from a revised 90.2 in November. According to information from the BEA, the consumer is responsible for approximately 70% of the U.S. economy.

Consumer Confidence



Source: The Conference Board.

The Bloomberg U.S. Aggregate Bond Index returned -0.26% in December and returned -1.54% in 2021, on the heels of a 7.51% return in 2020. The 10-Year U.S. Treasury ended December at 1.51% after ending November at 1.45% and beginning the year at 0.92%. While it remains lower than the 2020 beginning reading of 1.92%, it has increased dramatically since hitting an all-time low of 0.54% in July 2020. The 2-Year U.S. Treasury and 10-Year Treasury spread began the year with a spread of 80 basis points (2-year: 0.12% and 10-year: 0.92%). As of December 31st, the spread is 78 basis points with the 2-Year increasing in yield 61 bps (0.73%) and the 10-Year increasing 59 basis points (1.51%). Option Adjusted Spreads (as represented by the Bloomberg Corporate Index) ended December at 92 basis points, 4 basis points tighter than December 2020. Spreads peaked in 2020 at 373 basis points on March 23, 2021, concurrent with the equity market lows.

West Texas Intermediate (WTI) finished December at $75.21 a barrel, increasing 13.6% from November's closing price of $66.18 a barrel. WTI increased 58.9% in 2021 after beginning the year at $48.40 per barrel. WTI is significantly higher than April 2020's close at $18.84 per barrel during the Saudi/Russia price war.

The Volatility Index (VIX) ended December at 17.22, falling nearly 37% from the November month end reading of 27.19. The VIX had spiked on November 26th and 30th as concerns over the Omicron strain of COVID-19 and Fed Chairman Powell's comments that inflation was no longer to be considered transitory rattled the markets. The VIX peaked in 2021 at 37.51 during the volatility from the well-publicized trading activity in fundamentally questionable retail companies. For calendar year 2021, the VIX fell over 24%. It remains considerably lower than the March 16, 2020, peak of 82.69 and is now lower than the long-term average of approximately 20.

We actively monitor the capital markets and are prepared to respond accordingly. As we have stated in the past, we continue to advise our clients to adhere to their long-term plans and objectives.

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