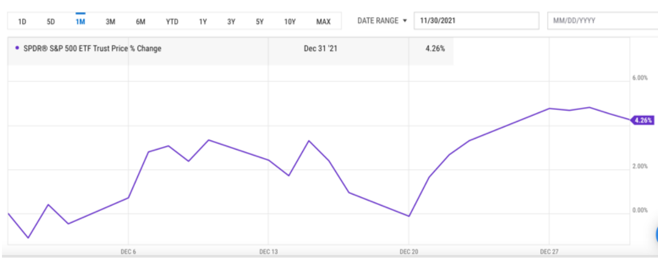
January 4, 2022

Overview

Major equity markets performed spectacularly in December. The S&P's 500 rose **4.48%** on a total return basis. Internationally, The EPAC BMI index of developed economies rose **4.78%.** The MSCI EM index of emerging markets rose only **1.88%,** reflecting the likely greater impact on developing economies of the Omicron variant**.**

Domestically, the Nasdaq Composite suffered comparatively with a meager **.74%** gain while the Russell 2000 (small caps) did better with a **2.23%** performance.

The month of December was eventful and only in the waning days of the year did equities register most of their gains, as illustrated In the chart below:



After many ups and downs from December 1 to December 20, the S&P's 500 finally surged forward with a 4% plus performance in what market watchers call a "Santa" rally.

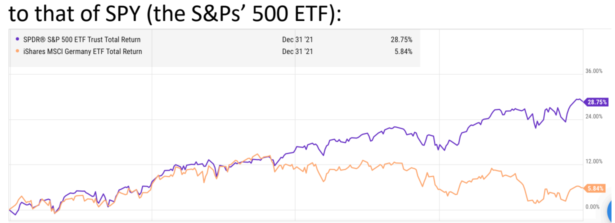
Elsewhere in investor-land, the USD dropped a bit against most major currencies (-.28%) and helped non-US developed markets sustain the rally. US fixed income markets drifted down a bit amid more real concerns of a rise in interest rates in 2022. The long US bond lost **1.42%** while shorter-term notes remained flat or lost **.25%.** The high-yield sector managed to register a good performance at **1.87%,** carried forward by the same risk-on mood that pushed equities upward.

Last month, the performance of our clients' portfolios hovered between **1.73%** and **3.06%.** Over the same period, a portfolio consisting of 50% ACWI (All Country World Index) and 50% AGG (US Bond Aggregate) rose **1.77%**. Clients' portfolios were up from **7.77%** to **13.75%,** in 2021, net of fees. Our benchmark stands at **8.45%** over the same period. The equity allocation in our clients' portfolios ranges currently from 40% to 70%, depending on risk profiles.

Market developments

As illustrated in the prior chart, the first part of December was mixed. Markets were choppy reflecting contradictory economic data. In the early part of the month, the unemployment number for November came in softer than expected. So did retail sales data. However, inflation came in high, at 6.8%, pointing to a still solid consumer-driven demand. From December 15-17, the Federal Reserve met and concluded their get-together with a relatively hawkish statement confirming their decision to accelerate the removal of measures taken to support the bond market (known in market parlance as "tapering") when Covid first emerged in March 2020. The end of the Fed's taper is currently anticipated for March 2022, at which point the Fed could raise the Fed fund rate, the reference interest rate for the US economy. It took the market about two days to digest this relatively hawkish statement and to like it. After all, the Fed was showing its resolve to fight inflation at a time when the economy is booming with a US consumer ready to spend; and that is a good thing. The Santa rally ensued.

The stellar performance of US equity markets in 2021, with the S&P's 500 registering a **28%** advance for example, is to be contrasted with that of other developed markets. The performance of the EPAC BMI in 2021 was, in comparison, a paltry **7.32%.** The performance of the German equity markets (in USD terms) is a good proxy for that of non-US (developed) markets overall. It is shown in the chart below in comparison to that of SPY (the S&Ps' 500 ETF):



The German equity market started losing ground in the Summer, presumably as the Delta variant of the Coronavirus was spreading across the globe and investors felt that the US was better equipped to deal with it (?). At that time the USD accelerated its 2021 rise against major currencies, to end the year with a 6.38% gain against a basket of currencies, explaining in part the wide divergence in performance. Going forward, an annual performance gap of this magnitude would be hard to comprehend. I would not be surprised to see a much better relative performance for non-US developed equity markets in 2022. A catch-up is likely in 2022. It may have started in December.

Tilts and Allocations

Our portfolios performed well in December, on an absolute and relative basis. DLR, our tech whare-housing Reit was up more than 6%. So were Air Liquide (AIQUF) and EWQ (our French equity ETF), both performing north of 6% each. AIQUF has a lot more to offer in the coming months as I expect the USD to stabilize and European markets to recoup some of their lost ground vs. US markets.

In December I started taking a small position in Goodyear Tire and Rubber Co. (GT). This is an equity that has been on the rebound since November 2020, the time I started taking a closer look at it. With a CEO looking to make his mark, a series of very positive quarterly reviews from a reputable research house (Value Line) and momentum behind it, I decided to invest, selling KMI to make room for it. We invested for most clients at around $20/share. GT has the potential of reaching the low $30's within 18 months. Should that happen, we would exit then.

There was a lot of excitement in Crypto-land in December with Bitcoin dropping 26% in the space of six weeks. The chart below illustrates this spectacular drop since the end of November:

For those clients that have expressed an interest in gaining exposure to this asset, I either started or added to our positions, taking advantage of the price weakness.

Conclusion

2021 was yet another good year for US equities. A spectacular performance of this sort is unlikely to continue.

For those investors old enough to have experienced (as investors) the end of the 90's, the past three high-performance years are reminiscent of the late 90's, when 25% annual gains were almost the norm and caused Alan Greenspan, the then Fed chairman, to refer to the markets as "exuberant". What followed was not particularly pretty: Three years of negative market performances. Over that span of time, the Nasdaq lost more than 70% of its value. It took it 15 years (your read well) to return to its former high-water mark.

Today, conditions are different but what is not is the unsustainability of high double digit market performances. Prudence is particularly warranted in term of allocation to equities going forward.

Thank you for your continued trust.

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