Vertex Planning Partners LLC

Quarterly Market Review

Q4

Fourth Quarter 2021

Economy

Monetary Policy

What's Happening:

With the uptick in inflation, Fed policy has shifted away from the ultra-accommodative stance it has held since the beginning of the pandemic. Federal Reserve Chair Jerome Powell has indicated the plans to begin unwinding their QE program, as well as opening the door to rate hikes beginning in 2022[1].

What does this mean?

With the Fed no longer identifying inflation as "transitory", they are looking for ways to withdrawal excess liquidity from the markets. This will come in the form of tapering of the monthly bond purchases and potential rate hikes in the coming quarters[2]. We have already seen some impacts, with mortgage rates rising along with longer dated treasury yields.

Fiscal Policy

What's Happening:

Washington has hit a wall with the Build Back Better Act, a $1.9 trillion spending plan focused on social spending, health care and climate change. Needing full cooperation from Democrats, the concerns over the tax and spend legislation during rising inflation were enough for Joe Manchin (D) of West Virginia to split from party voting lines[3].

What does this mean?

The size and speed of the economic recovery was enhanced by the large amount of one time transfer payments from the US Government in 2020 and '21. With Washington heading towards gridlock, GDP expansion will be less dependent on fiscal spending and more reliant upon more traditional drivers such as productivity and workforce participation.

Economy

Geopolitics

What's Happening:

China policy, both domestically and internationally, has impacted markets due to punitive actions against publicly traded technology and domestic for-profit education companies [4]. With particular concerns within the real estate markets, China has taken a substantial hit to their economic growth outlook.

What does this mean?

China always had a tenuous relationship with capitalism in the 21st century. After almost a decade at the head of the Chinese Communist Party, Xi Jinping has been actively consolidating power over the past year with the takeover of Hong Kong, crackdowns of private corporations and government officials, and most recently with the termination of tech IPOs and other for-profit ventures. The questions investors have is how far is the CCP willing to go, as China struggles with continued virus outbreaks, increasing food and energy inflation, and a world that is waking up to Chinese ambitions to overtake US influence overseas.

GDP

What's Happening:

GDP growth in Q3 2021 slowed to 2.3% after rising 6.7% in the second quarter [5], with estimates for Q4 back up to 6.8% [6].

What does this mean?

Despite a second year dealing with the global pandemic caused by COVID-19 and subsequent disruptions, the US economy has shown resiliency in historically high GDP growth numbers.

Markets

Equity

US Equity markets finished the year strong, with the S&P 500 posting double digit returns (11.03%) in Q4 to wind up plus 28.71%. European and Japanese markets posted positive returns for the year (8.29%), but after a strong start Emerging Markets (-2.22%) ended negative for the year due to Chinese market disruptions and difficulties for emerging economies dealing with the pandemic [7].

Fixed Income

Inflation expectations and rising rates at the beginning of the year, and the subsequent selloff in bonds, had a profound impact bond total returns for 2021 [7]. Combined with the current Consumer Price Index (CPI) level[8], most fixed income outside of Treasury Inflation Protected Securities (TIPS) and High Yield had both negative total and real (inflation adjusted) returns.

Current Strategy

Reasons To Be Optimistic

The amount of fiscal stimulus from 2020 and 2021, unprecedented in scale and scope, is still working through the global economy. Although the economy has been impacted by Delta and Omicron flare-ups, supply chain disruptions, and high levels of inflation, many of these impasses can be seen as transitory as the pandemic's impact on economic activity fades in the future. If interest rates remain in check, risk asset prices remain at moderate valuations relative to treasury yields.

Reasons To Be Cautious

The Federal Reserve has begun reversing their policies which have greatly benefited the capital markets, and it is possible we have reached the upward limits to fiscal spending in Washington. Markets thrive on liquidity, so although markets are awash with money, rising inflation can lead to swift reversals in policy in the future.

Strategy for 2022

We remain nimble in our strategy, and look for opportunities to rebalance our portfolios by selling outperforming assets classes and sectors and purchasing lagers. Primary this will entail shifting to "value" sectors like financials and energy that can benefit from inflation or rising rates, along with allocating to international holdings. On the asset class level, we previously paired back our exposure to fixed rate bonds, adding to inflation protected treasury bonds and adjustable rate fixed income. We continue to focus on adding to our commodity exposure. In 2022 we favor tax managed strategies for taxable accounts to take advantage of increased market volatility and to help offset potential higher capital gains rates.

Source

1) https://www.cnbc.com/2021/12/01/what-fed-chair-powells-hawkish-turn-means-for-the-market-economy.html

2) https://www.marketwatch.com/story/fed-accelerates-taper-of-bond-purchases-eyes-three-interest-rate-hikes-in-2022-11639595645

3) https://www.cnn.com/2021/12/19/politics/joe-manchin-build-back-better/index.html

4) https://www.reuters.com/world/china/china-crackdown-wipes-hundreds-billions-off-top-companies-values-2021-09-13/

5) https://www.bea.gov/news/2021/gross-domestic-product-third-estimate-gdp-industry-and-corporate-profits-revised-3rd

6) https://www.atlantafed.org/cqer/research/gdpnow

7)

	2021 TR	Q4	Q3	Q2	Q1
S&P 500 Total Return	28.71%	11.03%	0.58%	8.55%	6.18%
MSCI ACWI Ex USA Total Return	8.29%	1.88%	-2.88%	5.64%	3.60%
MSCI Emerging Markets Total Return	-2.22%	-1.24%	-7.97%	5.12%	2.34%
Bloomberg Municipal Bond	1.52%	0.72%	-0.27%	1.42%	-0.35%
Bloomberg US Aggregate	-1.54%	0.01%	0.05%	1.83%	-3.37%
Bloomberg Commodity Index Total Return	27.11%	-1.56%	6.59%	13.30%	6.92%

8) https://www.bls.gov/news.release/pdf/cpi.pdf