

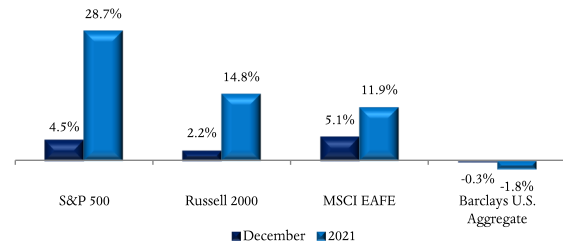


MARKETS

Global developed market equities ended 2021 on a high note, culminating in the third year in a row of strong returns. Performance drivers include robust earnings growth, low interest rates and accommodative monetary and fiscal policies. The emergence of the highly infectious Omicron variant of Covid-19 led to a spike in equity market volatility in the middle of last quarter, only to be reversed by the revelation that the mutation led to less severe disease. During the fourth quarter, the S&P 500 advanced +11.0% (+28.7% ytd). Small capitalization stocks, as measured by the Russell 2000 index, produced respectable gains (+2.1% in Q4; +14.8% ytd) but underperformed their larger counterparts. Overseas stocks also produced positive returns, led by Europe's Stoxx 600 index (+7.6% in Q4; +25.8% ytd). Elsewhere around the globe, advances were more moderate, as seen by the MSCI EAFE index's Q4 return of +2.7% (+11.9% ytd). In Asia, benchmarks were mixed in the final quarter of the year and generally subdued for the full year. China's Shanghai composite added +2.1% in Q4 (+7.0% ytd), while Japan's Nikkei 225 index declined -2.1% last quarter (+6.7% in 2021). The outlier in 2021 were emerging market equities, which declined -2.5%.

Fixed income performance during 2021 was uneven, as markets digested high inflation and reduced monetary stimulus from central banks. This backdrop led to weaker future growth expectations and a flattening of the US yield curve. Notably, higher short-term interest rates began pricing in a faster pace of Fed action. The Bloomberg Barclays US Aggregate index declined -0.3% during the fourth quarter, leading to a -1.8% total return for the full year. To the upside, in part due to their equity correlation, high yield bonds rallied in December, producing coupon-plus returns of +5.4% in 2021.

Energy prices were volatile in the fourth quarter, initial-



ly pulling back, then rallying +13.6% in December. All told, WTI crude oil finished 2021 at \$75.21/barrel, near its annual high, in what was a banner year (+55.0%). Not only did energy demand rise as economies reopened from pandemic closures, but supply was also curtailed. Total estimated investment in the US upstream oil and gas sector in 2021 declined to -23% below pre-Covid levels. In addition, potential discoveries fell to the lowest level in 75 years (half of 2020 levels).

GEOPOLITICS

In the ongoing battle against Covid-19, the highly contagious Omicron variant has emerged as the dominant strain, driving an accelerating global wave of new cases. While, Omicron seems to be evading vaccine immunity, it has been reported to cause milder symptoms, especially among the inoculated. Increased transmissibility has been ascribed to mutations in the spike protein that allow the virus to bind more strongly to receptors on the surface of our cells. The upshot is that while Omicron may not be the final variant, it will hopefully be the last variant of global concern.

Russia stepped up its military presence along the Ukrainian border, an action seen by some as progress towards President Vladimir Putin's grand design to recreate the Soviet Union. However, feigning an invasion may be pretense for a compromise to keep the Ukraine out of NATO, precluding use of its territory for Western military bases, and minimizing any military cooperation between Kyiv and western capitals.

UNITED STATES

The latest reading of the US Consumer Price Index (CPI) jumped 6.8% year-over-year, its highest level in nearly four decades, on back of broadly higher prices, led by energy (+33.3%), used cars (+31.4%) and food (+6.1%). The December unemployment rate registered 3.9%, down from the prior month's 4.2%. As a result of the rapidly tightening labor market and persistent inflationary pressures, the Federal Reserve has adopted a more hawkish stance, announcing plans to accelerate the tapering of asset purchases, which would bring the latest Quantitative Easing (QE) program to an end in March. Thereafter, the market consensus calls for three interest rate hikes in 2022. The cessation of asset purchases, in combination with higher rates, will amount to a significant curtailment of intermediate-term financial market liquidity.

In Washington, President Biden signed the Infrastructure Investment and Jobs Act, a long awaited \$1.2 trillion bipartisan infrastructure bill. The plan calls for \$550 billion of additional spending, 49% of which will be allocated to upgrading America's transportation sector, including ports, airports, railroads, roads, bridges and public transport, and 32% will be used to improve water and power infrastructure. The remainder will be spent on broadband (12%) and the environment (7%). Meanwhile, the ambitious Build Back Better spending bill, targeting \$1.7 trillion, hasn't mustered the necessary majority to pass the Senate. Nevertheless, 2022 US GDP growth is expected to reach an above-trend 4.0%.

EUROPE

In Europe, the unreliable flow of gas from Russia unveiled kinks in sovereign plans towards energy self-sufficiency via renewables. The associated disincentive to invest in fossil fuels, coupled with maintenance work on regional nuclear power plants, led to a sharp rise in gas and electricity prices across the continent, which partially retraced towards the end of the year. This commodity price shock and its inflationary effect

December 2021 Economic Statistics

	Dec-21	Dec-20	Dec-19
Federal Funds Target Rate	0 - 0.25%	0 - 0.25%	1.50-1.75%
Consumer Confidence Index	115.8	88.6	126.5
Manufacturing PMI Index	58.7%	60.7%	47.2%
Unemployment Rate	3.9%	6.7%	3.5%
JPY/USD	115.08	103.24	108.61
USD/EUR	1.1368	1.2213	1.1210
Gold/oz.	\$1,828.39	\$1,896.49	\$1,517.01
Oil (WTI)/bbl	\$75.21	\$48.52	\$61.06

served to dampen consumer sentiment.

The European Central Bank (ECB) confirmed that its pandemic emergency purchase program (PEPP) would end in March. Asset purchases will be reduced to €40 billion per month during the second quarter, €30 billion per month during the third quarter, and €20 billion per month until shortly before the first rate rise.

In the UK, CPI rose to 5.1% year-over-year, following similar global trends. The unemployment rate dropped to 4.2% on the back of a record high 1.2 million job openings. This is yet another indication of increasing labor market tightness that has the potential to result in an upward spiral of higher wages and prices. The Bank of England reacted by raising interest rates 0.15% to 0.25%, despite the uncertainty surrounding Covid-19 and its new variant.

ASIA

China's monetary policy stance continues to be counter to western nations. The local economy has not had the benefit of much fiscal stimulus during the pandemic, relying solely on the People's Bank of China (PBoC) to smooth financial conditions. The central bank must now deal with the rising level of leverage in the economy which continues to see defaults in the debt-laden property sector. Specifically, PBoC cut the reserve requirement ratio (RRR) by 50 basis points (bps). In addition, it lowered the re-lending rate by 25 bps to support agricultural and small enterprises, and has telegraphed more reductions to pare the burden of debts. In addition, the market expects fiscal stimulus to be reintro-

duced in 2022, especially to support the nation's zero covid policy. This suggests that longer-term structural reforms will have to be placed on the back-burner.

OUTLOOK

Given the rapid spread of the Omicron variant, near-term economic growth is likely to be challenged as seen by the loss of momentum in the services sector across the globe. Importantly, global manufacturing has counterbalanced this slowdown, despite supply constraints and rising input prices. Developed market manufacturing PMI's indicate a still healthy expansion in this sector of the economy, thanks to pent up consumer demand. This bodes well for corporate earnings, which are more closely linked to manufacturing than services.

In a much needed bit of good news regarding Covid-19, the latest strain appears to be milder in nature, which may transition it to becoming endemic. If such a scenario comes to pass, the latest mutation may be a blessing in disguise. Thus, financial markets have been willing to look through the near-term uncertainty towards the inevitable return to normalcy, which appears to be on the horizon.

Pandemic driven backlogs in demand and disruptions in supply chains, coupled with record monetary and fiscal stimulus, have led to a major inflationary impulse. Persistently higher and rising prices eventually forced the US Federal Reserve to taper its latest quantitative easing program at an accelerated pace. Overseas, three of the four major developed market central banks also indicated that they have greater concerns about inflation heading into 2022 than about the economic disruption that could be caused by the pandemic's latest wave. Further out, there is the threat of normalization of fiscal stimulus should politicians begin to question the merits of high levels of deficit spending. Nevertheless, private sector fundamentals look solid enough to carry US and global economies in the coming year. Strong performance of financial assets and real estate have pushed the ratio of US household liabilities-to-assets to its lowest level since 1973. This, along with still elevated savings, gives the consumer significant spending power, which they are likely to utilize over time.

Above trend GDP growth, corporate momentum and the prospect of further earnings advances, bode well for equities. In the current environment, we continue to think highly of globally-oriented large capitalization companies that oversee robust supply chains and command strong pricing power. Further, value oriented securities may attract increased investor attention in a rising interest rate environment, which should benefit our roster of active managers.

We foresee the reduction in monetary support from a hawkish Fed, along with persistent inflation, continuing to pressure fixed income markets over the coming quarters. Credit, particularly high yield, should benefit from strong corporate balance sheets and earnings growth, though investors should temper their return expectations given the low spreads versus the risk-free rate. With US CPI inflation at a four-decade high of 6.8%, and the 10-year US Treasury Note most recently trading near 1.7%, holders are earning a negative "real" yield of -5.1% (the lowest level since the 1940's), assuring a stream of annual losses in purchasing power. As such, we suggest the avoidance of long-dated fixed income in favor of shorter duration and floating rate securities.

With economies and corporate profits growing, amid strong demand and rising prices, equities still have room to advance. This is especially true given the relatively narrow stock market breadth. Thus, we believe that actively managed strategies have the propensity to outperform broad market averages in 2022. Our favored equity managers are also well equipped to navigate volatility stemming from the coming reduction in liquidity and higher interest rates. Further, we retain a positive view of hedged credit, as well as inflation protected investments such as real estate, energy exploration, and water infrastructure. For long-term investors seeking to capitalize on trends in technology we would propose select venture investments as well as our Nordic Technology and Innovation Fund

We wish you and your families a healthy, happy and prosperous 2022.

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Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.