MISSION FINANCIAL

Hot Topics of 2022: What To Expect This Year

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There is a lot of buzz and anticipation surrounding some big questions coming into this year: inflation, taxes, and market volatility to name a few. Here, we provide our insight into some of the hottest topics of 2022. While we cannot control any of these variables, we can provide facts and reason to help our clients maintain confidence through all market cycles. Though uncertainty is inevitable, our clients can depend on one thing remaining the same – we are dedicated to helping them achieve their most important financial goals.

ECONOMIC & MARKET OUTLOOK

Recession Risk

U.S. Recession Risk Indicators

↑ Expansion ● Caution ✕ Recession

		January 31, 2022
Consumer	Housing Permits	↑
	Job Sentiment	↑
	Jobless Claims	↑
	Retail Sales	↑
	Wage Growth	✕
Business Activity	Commodities	↑
	ISM New Orders	↑
	Profit Margins	↑
	Truck Shipments	↑
Financial	Credit Spreads	↑
	Money Supply	●
	Yield Curve	↑
	Overall Signal	↑

Data as of January 31, 2022
Source: ClearBridge Investments, BLS, Federal Reserve, Census Bureau, ISM, BEA, American Chemistry Council, American Trucking Association, Conference Board, and Bloomberg. The ClearBridge Recession Risk Dashboard was created in January 2016. References to the signals it would have sent in the years prior to January 2016 are based on how the underlying data was reflected in the component indicators at the time.

Today, we are in an economy that is starting 2022 in an overall expansionary state. While you'll notice many expansionary signs, you will also notice one negative indicator. We'll dive deeper into this in our section on *Inflation*, but it's important to know that higher cost of wages and labor eat into corporate profits. This is rather easily offset by raising output prices and transiting that increase to consumers. This is not ideal for inflation, but it does help corporations maintain profit margins, and that is one reason why we think the economy will grow this year.

Another factor working for economic growth is the reinvestment of profits back into private sector businesses. This growth spending from the private sector helps the economy grow, even if we experience some temporary setbacks and growing pains from tapering off government spending. We also believe that unemployment will continue to decrease. While we may not end the year in line with where we were pre-COVID, we estimate the addition of around 325-350k jobs on a monthly average through the year, which should help spur Gross Domestic Product (GDP) growth in the area of 3.0% for 2022.

Finally, we believe that as supply chain issues lessen, corporate profits remain strong, and innovation and technological advancements continue, the U.S. economy will experience strong economic growth in 2022, although it may be slower than 2021.

Outlook 2022

S&P:	5050
Dow Jones Industrial Average:	40,000
10-Year Treasury Note Yield:	2.0% – 2.5%
GDP:	3.0%
Inflation:	4.0%+
Payrolls:	325,000 -350,000 jobs/mo
Unemployment:	3.5% -4.0%
Corporate Profits:	10.0%

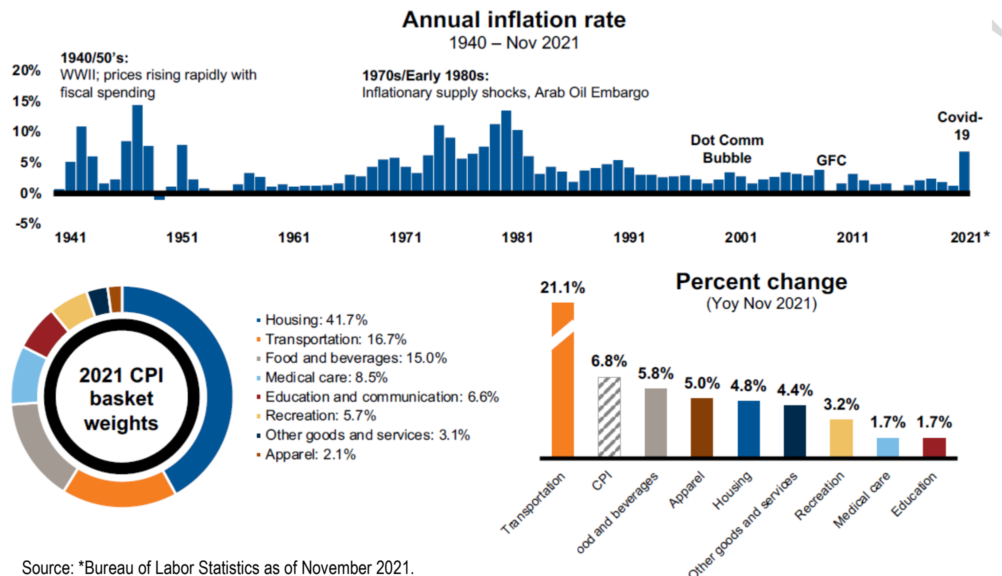
As for stock markets, we anticipate a strong year, albeit a year filled with some turbulence and volatility. From April of 2020 through August of last year, investors experienced very little downward pressure. Since August, we have seen more volatility as stock markets react to uncertainty surrounding the Omicron variant, talks of interest rate hikes, and geopolitical pressures regarding Russian-Ukrainian relations.

While it's easy to be swayed by media opinion or fall victim to fear-mongering, it's important to look at corporate profits, balance sheets, and earnings for long-term context. The truth is the market has overreacted to some news headlines, while earnings remain very strong in many high-quality corporations. It is normal to experience volatility, especially in a mid-term election year. However, investors with long-term mindsets and tolerance for movement in the markets would be wise to be invested and stay invested. Despite the slow start to the year, we anticipate another year of growth in U.S. markets and several other non-U.S. developed markets for 2022. We make it our mission to stay in tune with market activity, proactively monitor our clients' portfolios, and make adjustments accordingly.

INFLATION

Over the past 30 years, investors have faced many trials and tribulations, but inflation wasn't among them. Going into 2022, that narrative is changing. There are many questions surrounding how high inflation will get and how long it will last.

All of us are seeing prices of everyday goods and services rise faster than usual. The first question is: what's causing this rise in prices that we are all experiencing? This is tricky to answer, because there isn't a single culprit. Rather, it's a combination of many things working together to create high inflation. For starters, when trillions of dollars are printed and pumped into the economy by the government, it follows that the value of all new and existing dollars would weaken. To maintain the same buying power, companies must bring in more dollars, which causes them to increase their prices.



Further, we are seeing costs of labor and materials increase in price on the back end, which as a result, causes an increase in prices to us as consumers. When the cost of producing a good or service becomes more expensive, the easiest way to maintain profit margins for a company is to push that cost to their customers in the form of higher prices. While there are other variables at play causing heightened inflation, such as supply chain issues, these drivers help begin to explain why we saw year over year inflation of close to 7% in 2021 *(Russell Investments, 4th Quarter 2021 Review).*

The question of how long high inflation will affect us is a more difficult question to precisely predict. Some of this inflation is transitory – meaning temporary – while other parts are here to stay.

We ended 2021 with ***sticky inflation*** right around 2.6% annualized *(Capital Group, American Funds).* These are the price increases that ***tend to hang around for the long haul***. Think goods and services such as health care expenses, rent, and insurance. It's unlikely that those types of expenditures ever regress in price.

Flexible inflation is a different story. This type of inflation is defined by prices that fluctuate more often than every 4.3 months. We are seeing prices of goods and services that fall in the flexible inflation category rise at almost 14% annualized – levels that haven't been seen since the '70's. However, this type of inflation ***doesn't tend to exhibit staying power***. Examples of things that fall under this category would be food, cars, luxury items, and commodities. A great real-life example of this would be lumber. In the Spring of 2021, the price for lumber skyrocketed, only to come back down to levels that are much more palatable months later. As the supply chain issues are mitigated, we should see these prices come back down closer to normal levels over time.

It's important to remember the cycle of supply and demand in a capitalistic economy like the U.S. When demand is high and supply is low, prices tend to increase. However, entrepreneurs will see this as an opportunity and seize it – such as Intel opening new microchip plants in Ohio and Arizona. While this helps clear up short-term supply chain issues, the inevitable truth is that over time supply will outpace demand. This will result in flexible inflation tapering off, but could also produce other potential issues down the road. Ultimately, we believe we are near the worst levels of supply chain issues that we will experience. As it clears up, this should lead to inflation coming back down to lower (although higher than historic average) levels around 4%+ by the end of 2022. Beyond that, levels closer to 3-3.5% by the end of 2023 would be in line with our expectations. The sticky inflation components will drive inflation for 2022 and beyond, and that's what we are keeping our eyes on here. The best ways to fight inflation in your portfolio is to make sure you don't have too much cash and consider investing in a mix of companies with strong pricing power – meaning they have the ability to raise prices without losing their market share.

TAXES

A question on the minds of many Americans is "***Will my taxes be raised?***" Anymore, it's almost a question of ***when*** **rather than** ***if***. While we didn't see some of the tax hikes we thought were possible to start 2022, we believe hikes in the future are almost inevitable. To state our logic behind this theory as simply as possible, higher spending leads to either budget cuts or higher taxes, and our government isn't good at lowering their spending.

For 2021, the budget deficit was $2.77 trillion, second highest only to 2020 in the history of our nation *(Congressional Budget Office).* This means that future tax increases are likely. Although we aren't sure when exactly they will come, it is very possible we begin to see them starting next year. Likely scenarios for tax increases include a top rate back to their pre-Trump rates of 39.6%, a corporate rate from 21% to 28%, a top rate on capital gains and dividends of closer to 24% compared to the current 20%, and a lower exemption for estate tax *(First Trust Portfolios).* While the current administration may aim for more, these estimates are realistic middle grounds that would have a better chance of getting the needed votes to pass. It is important to note that tax hikes are not always easy to see. Sometimes the government can raise taxes simply by lowering the standard deduction or estate tax exemption, changing definitions of deductibility, or even failing to adjust brackets for inflation.

For now, these short-term solutions mostly effect higher income earners. Longer term, there may very well be a need to tap into the incomes of those making under $400k per year to help fund the deficit. For these reasons, investment vehicles such as HSA's, Roth IRA's/ Roth 401(k)'s, and tax-efficient investments can be important pieces to a financial plan while we are in a relatively more favorable tax environment. While things such as backdoor Roth IRA's may not be available forever, it is important to take advantage of the tools we have at our disposal now where they make sense.

U.S. DEBT

With all of the spending the U.S. Government realized through stimulus, relief packages, and other pandemic-related expenditures, it's easy to question the impact of the ever-rising and unprecedented debt obligation of the United States.

To combat this debt, it is important that the U.S. sees sustainable, *organic* growth of GDP. The Congressional Budget Office projects growth of 2.6% annually from 2021-2030 *(Congressional Budget Office)*. One positive is that over the past few months, we are seeing income growth come not from government transfer payments, but rather private sector wages and salary increases. These private sectors finished 2021 up an impressive 10% for 2021 after a 0.8% gain in December to round out the year *(First Trust Portfolios).* As Mission Financial Owner and Financial Advisor Janssen Longenecker mentioned in our Outlook 2022 & Beyond Webinar, ***the growth of the private sector will drive sustainable growth moving forward.***

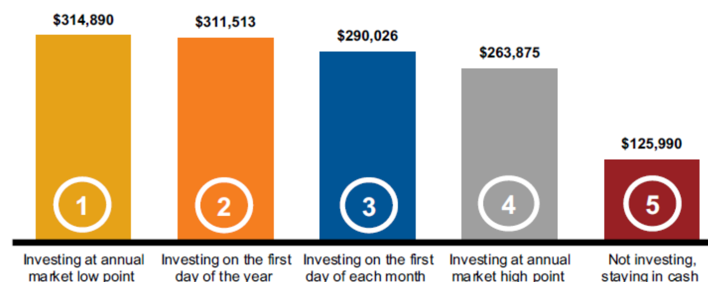
As discussed in our *Taxes* section, policy options to deal with the U.S. Debt problem include actions such as cutting spending and raising taxes. However, these actions may not be necessary at this moment. This is because the U.S. is not on the hook for the trillions of dollars we borrowed from ourselves – yet. This debt was borrowed at extremely low interest rates on 10-year debt notes. The interest is the obligation that the U.S. must pay over the next 8.5 years, which makes up a relatively small portion of the spending budget. For these reasons, we do not believe the more than $5 trillion spike in our country's debt will affect markets and the economy directly today *(Department of Treasury; Treasury Direct).* However, once the notes are due and it comes time to refinance these obligations in 2030, we will have a very close eye on interest rates and the balance sheet of the U.S. It is important to remember that despite the large debt amounts, the U.S. economy is one of the strongest in the world and demand is and will continue to be high for our nation's Treasury's and the guarantees that come with them.

2022 FINANCIAL RESOLUTIONS

#1 BE INVESTED AND STAY INVESTED.

Time in the market is much more vital than ***timing*** the market. The idea behind this statement is "control what you can control". It is impossible to know exactly when markets will rise and fall. That is completely out of our control as investors. However, we can control how much we invest and the amount of time we have it in the markets. Notice on the chart to the right that simply investing on the first day of the year for the past 10 years would have returned almost as much money as timing the market perfectly every single year. While one is virtually impossible, the other is controllable and has an almost equally impactful result.

Hypothetical ending wealth after investing $12,000 per year
Period ending December 31st, 2021



Cash in the title: M2: M2 is a measure of the money supply that includes cash, checking deposits and deposits that are easily converted to cash, such as bank accounts. As of Nov. 30, 2021

Russell Investments

Note that one year represents a 12-month period ending December 31st. Assumes an investment of $12,000 per year into a hypothetical S&P 500 Index portfolio with no withdrawals between Jan 1stst, 2012 and Dec 31st, 2021. Source: Russell Investments.
Cash return based on return of $12,000 invested each year in a hypothetical portfolio of 3-month Treasury bonds represented by the FTSE Treasury Bill 3-month Index without any withdrawals between Jan 31st, 2012 and Dec 31st, 2021. Source: Morningstar.
Indexes are unmanaged and cannot be invested in directly. Returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment. Hypothetical analysis provided for illustrative purposes only.

#2 FOCUS ON RATE OF SAVINGS RATHER THAN RATE OF RETURNS.

Many investors have seen their diversified investment plans trail in performance to indexes such as the S&P 500 the past several years. However, it is vital that we ***do not chase returns***. A diversified portfolio is the better solution in the long run. While many believe that the S&P 500 is well diversified in and of itself, the truth is that almost one-third of the performance of the index was driven by just five companies in 2021. This exposes investors to consolidation risk not only in the U.S. growth sector, but also in these individual companies as well. Although it seems like you're always losing with a diversified portfolio that contains international, small and mid-cap stock, and even fixed income where appropriate, that strategy helps balance loss in the bad times, and may lead to stronger long-term performance and mitigated risks.

A perfect market for "S&P Envy" during the last 20+ years — BlackRock

Years	S&P 500 Index	Diversified portfolio	
2000-2002*	-40.1%	-15.7%	"I lost money"
2003-2007	+82.9%	+87.1%	"Diversification worked"
2008	-37.0%	-26.6%	"I lost money"
2009-2019	+351.0%	+220.1%	"I didn't make as much"
Q1 2020†	-30.4%	-23.1%	"I lost money"
Q2 2020-2021‡	+119.0%	+66.6%	"I didn't make as much"
Total return	**+374.6%**	**+375.0%**	**"Diversification can work even when it feels like it's losing"**
Growth of $100,000	**$474,550**	**$474,970**	

Source: Morningstar as of 12/31/21. *Performance is from 9/30/00 to 12/31/02. †Performance is from 1/1/20 to 3/23/20. ‡Performance is from 3/24/20 to 12/31/21. Diversified Portfolio is represented by 25% S&P 500 Index, 19% Russell Mid Cap Index, 7% MSCI EAFE Index, 5% Russell 2000 Index, 4% FTSE Emerging Stock Index, 25% Bloomberg US Aggregate Bond Index, and 15% Bloomberg US Corporate High Yield Index. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You cannot invest directly in the index. Diversification does not guarantee a profit or protect against a loss in a declining market.

#3 TUNE OUT THE MEDIA.

The media doesn't get viewership by simply stating "everything will be ok." Rather, what drives their sales are egregious headlines and statements such as "America as we know it is coming to an end!" This fear-mongering has happened for many years, and it's been wrong every time. ***A bet against the U.S. economy has always been and continues to be a bad bet***. Don't let the media or fear deviate you from working towards your most important financial goals.

#4 LOOK THROUGH THE WINDSHIELD, NOT THE REAR-VIEW MIRROR.

While history gives us an idea of what has and hasn't worked, it also shows us that things rarely look the same from one year to the next. Just because one sector outperformed others for a period of time does not indicate that it will continue to do so. In fact, there are *several* sectors of the market that show increasingly attractive value and potential growth moving forward, creating even more demand for a diversified portfolio. ***Don't get distracted by the past***. Rather, use it as a guide to make informed decisions on what's to come.

#5 DEVELOP A PLAN YOU CAN HANG YOUR HAT ON.

Whether you are in the accumulation phase or distribution phase of the investment cycle, it is vital to ***have a comprehensive and well-rounded financial blueprint to fall back on.*** This plan should frequently be stress-tested against potential obstacles and evolve not only to economic changes, but also to changes in your most important financial goals. Your plan should be in line with your objectives, in tune with the economic outlook, and tracking progress towards success. It should also work towards tax-efficiency, diversity, and cohesiveness among all other financial aspects in your life.

Having a team of dedicated professionals to help through the turbulence is key to navigating the path towards accomplishing your goals and maintaining confidence in times of uncertainty. At Mission Financial, meeting these expectations is our passion. Please contact us and we would love to show just how we can add this value for you!

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