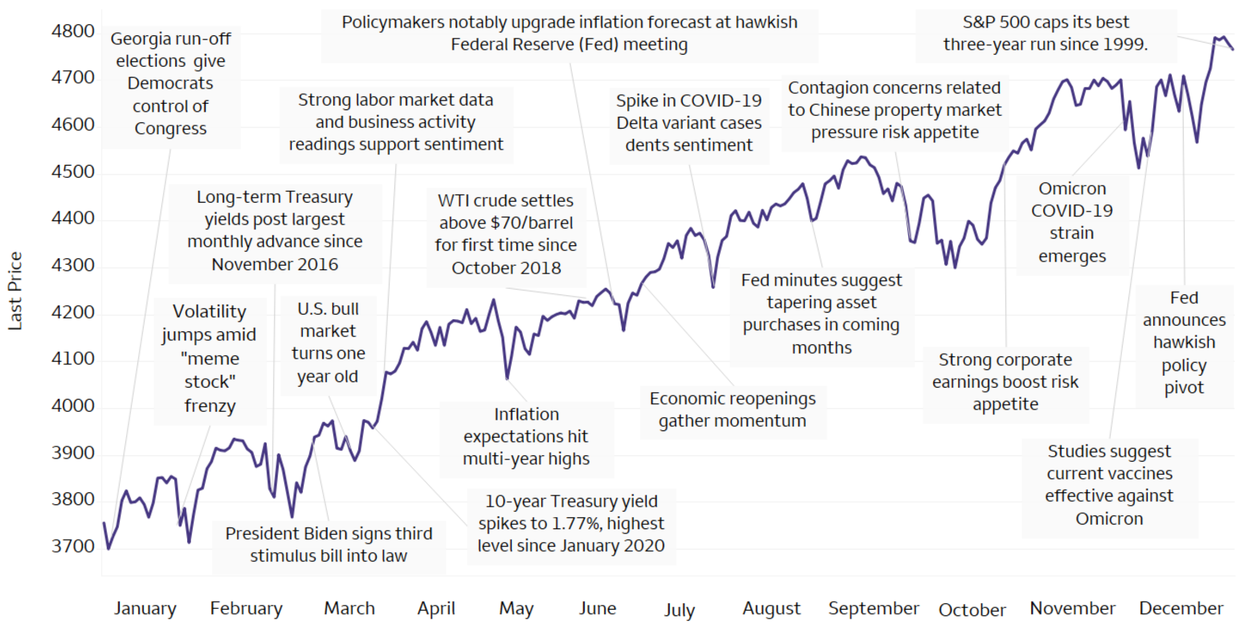
# 2021 Annual Market Commentary

2021 was another unprecedented year for the financial markets. Following the outsized volatility of 2020, risk assets continued to climb in the second year of the COVID-19 pandemic, supported by historic corporate earnings growth and robust economic activity. The year was not without uncertainty, however, as a confluence of concerns arose in tandem with the upbeat equity performance. The emergence of the retail investor helped buoy U.S. equities, but also gave rise to the controversial meme stock craze. Robust consumer demand remained a bastion of support for the economy, but also contributed to supply chain bottlenecks as prices for everything from commodities and food to automobiles climbed at the fastest pace in decades. These inflationary concerns rattled bond markets in 2021 and inspired central banks around the globe to adopt a less accommodative policy stance as the year progressed. Despite the wall of worries, U.S. stocks outpaced their global counterparts by the widest margin in two decades, with the S&P 500 climbing 26.9% to cap its best three-year run (+72%) since 1999.

## S&P 500 performance 2021

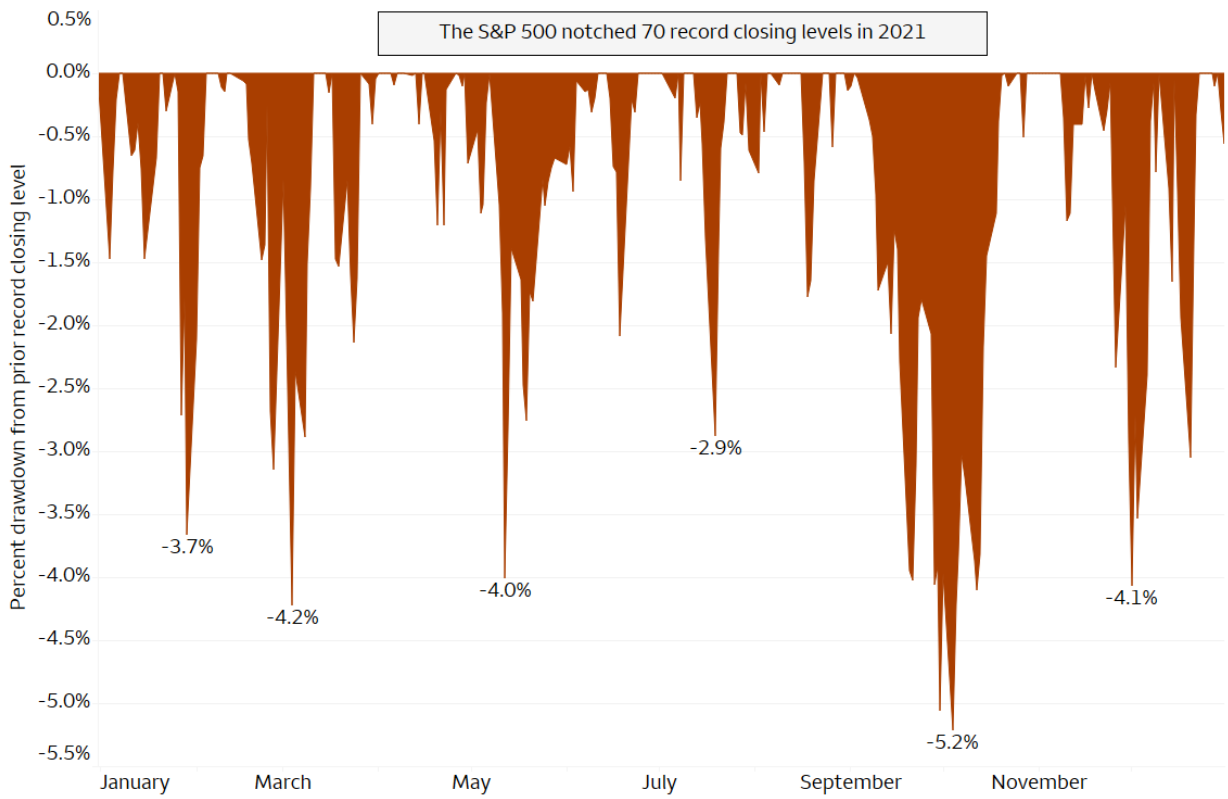



Source: Bloomberg *As of December 31, 2021, 4:00 p.m. ET. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

The relentless march higher for stocks in 2021 stood in sharp contrast to the prior year's rollercoaster ride. In 2020, investors observed the longest bull market on record give way to the fastest (and then shortest) bear market in history. A *V-shaped* recovery powered by extraordinary fiscal and monetary stimulus ensued as the S&P 500 added $14 trillion in value in the final nine months of the year, capping what ended up being a 16% annual gain for the S&P 500. As the calendar turned, investors were monitoring the aftermath of a contentious 2020 U.S. presidential election, as well as emerging optimism that newly deployed COVID-19 vaccines would help return the world and the global economy "back to normal."

The vaccine optimism, as well as prospects for additional fiscal stimulus from the (newly Democrat-led) Federal government, inspired a strong start to the year for stocks tied to the economic reopening. Attention quickly shifted from the seismic political and economic shifts, however, as a new trend influenced by the COVID-19 pandemic stole the spotlight. Buoyed by massive stimulus and the emergence of commission-free trading, the influence of individual investors came to the forefront in early 2021. Online message boards and social media helped propel a number of *meme stocks* to outsized gains in the first quarter, headlined by a 2,500% January jump in shares of recently embattled GameStop Corp. The waxing and waning fortunes of the video game company and several other small-cap stocks dominated the financial press during the start of 2021, though related headlines seemed to dissipate as the year went on. Still, the influence of individual investors remained a major story, with retail inflows in 2021 surpassing the prior 25 years combined.

## *Buy-the-dip* pattern persists in 2021



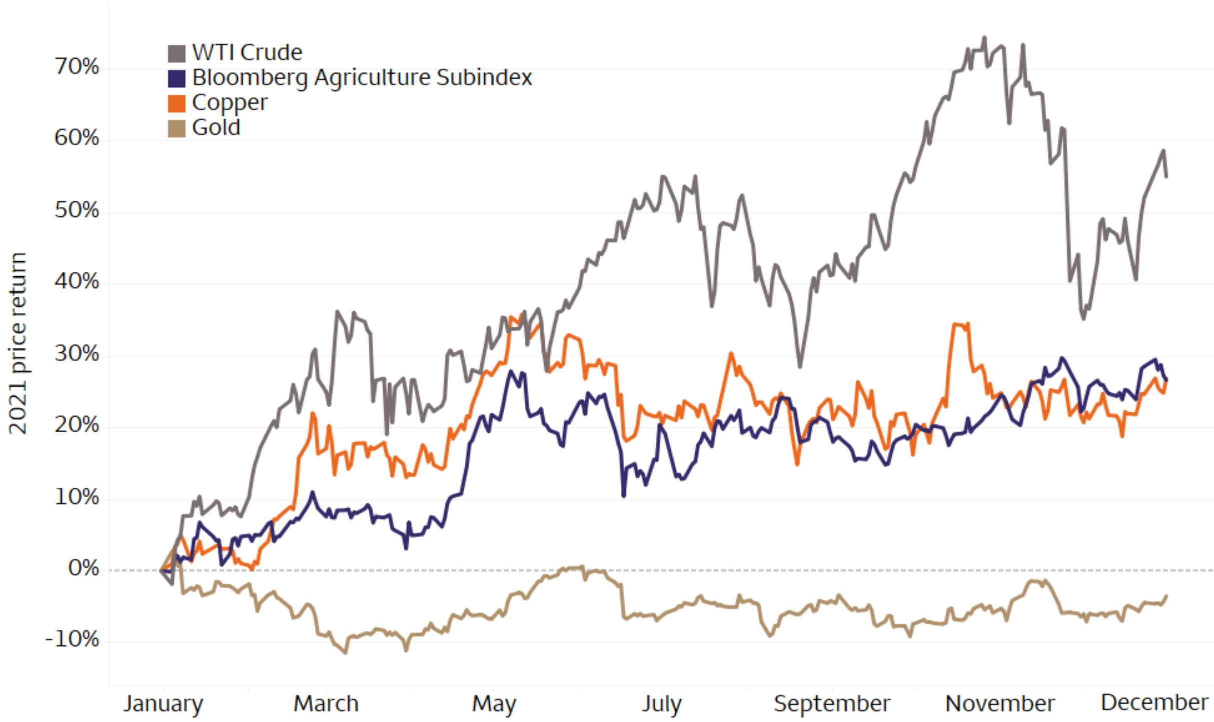

Source: Bloomberg *As of December 31, 2021, 4:00 p.m. ET. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

While the *meme stock* craze led to outsized volatility that tripped up broader equity benchmarks in January, the increasing influence of retail traders also provided a bastion of support for the major averages in times of weakness. The January volatility, like most periods of weakness in 2021, proved to be short lived. In the ensuing months, every pullback or period of market turbulence was met with a strong *buy-the-dip* response from investors. In fact, the S&P 500 avoided falling even 5% below a recent all-time high for nearly a year (from October 2020 through September 2021). Following a slight January pullback, equities embarked on a steady upward climb that was supported by accomodative fiscal and monetary policy, along with a rapidly improving U.S. economy as pandemic-era lockdowns and restrictions were loosened. This gave way to the *reflation trade*, characterized by rising bond yields and surging commodity prices, as gauges of business activity and retail sales powered to multi-year highs. Stocks tied to the reopening, such as Energy, Financials, and Industrials, outperformed in the first half of 2021, with the Russell 1000 Value Index outpacing its growth counterpart by the widest gap in more than a decade.

As the economic recovery accelerated, corporate earnings—which rebounded faster than anticipated from the pandemic in late 2020—began expanding at a historic pace. In the first quarter, a record 87% of S&P 500 companies topped analyst earnings expectations as profits grew at an annualized clip of more than 50%. By the second quarter, corporate earnings had nearly doubled from the same period in 2020, surpassing even the most optimistic

Wall Street projections. As profits continued to increase, a rotation began to unfold in U.S. stocks. The rally in value stocks, which had firmly outperformed since November 2020, began to run out of steam as spring turned into summer, with the Russell 1000 Growth Index leading the next leg of the equity ascent. A period of historic outperformance for the Russell 2000 Index of small-cap stocks also faltered, as the next portion of the relentless rally in U.S. stocks was led by growth-oriented large-caps.

## Most commodities surge in 2021



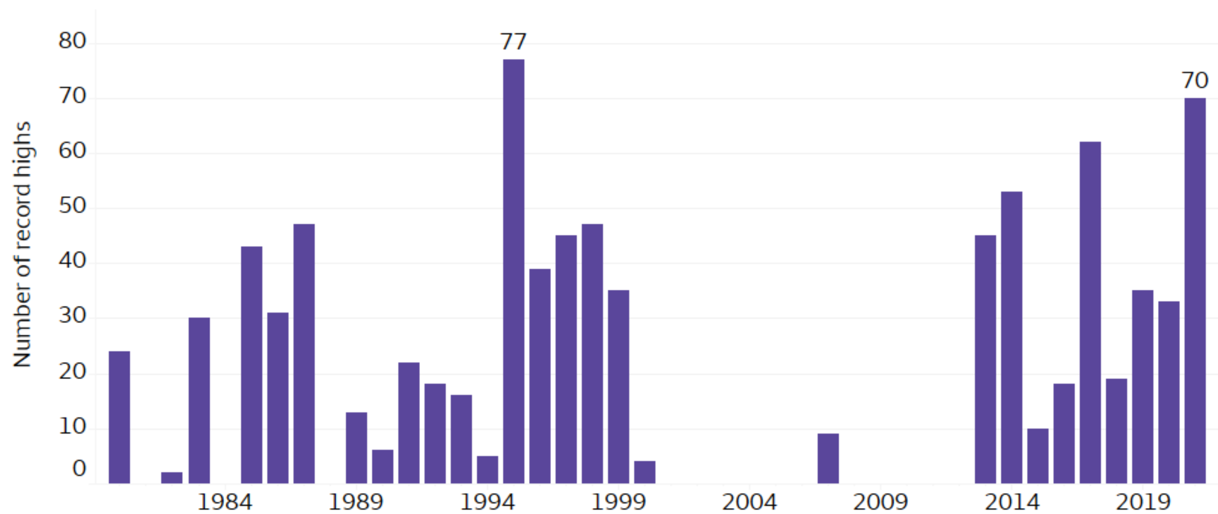

Source: Bloomberg *As of December 31, 2021, 4:00 p.m. ET. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Another meaningful trend to emerge in mid-2021 was the focus on a series of interconnected concerns that had developed in the midst of the torrid economic recovery from the COVID-19 pandemic. Pent-up demand and massive stimulus had contributed to record consumer spending, at a time when many companies were still trying to ramp up production following the chaos caused by the pandemic. Stretched supply chains and low inventories combined with the robust consumer demand to stir meaningful inflation in the United States for the first time since the 2008 Financial Crisis. This was no more evident than in the commodities complex, as the Bloomberg Commodity Index climbed to its highest level in a decade in May amid surging food, industrial metal, and oil prices. By June, the Consumer Price Index (CPI) had increased to the highest level since the onset of the 2008 Financial Crisis, while the term *inflation* was mentioned on corporate earnings calls three times as often as it had been the prior year.

Despite the growing concerns about supply chain bottlenecks and building price pressures, the Federal Reserve (Fed) continued to maintain its stance that inflation would prove “transitory.” After small hiccups in May and June, equities continued their steady ascent throughout the summer, with the S&P 500 advancing for seven straight months through August, even in spite of a new coronavirus variant, termed *Delta*. But as summer turned into fall, concerns about elevated price pressures continued to mount. By the Fed’s September meeting, market participants were expecting the central bank to begin scaling back its pandemic-era bond purchases by the end of 2021, reducing a key source of liquidity from financial markets. The Fed also began to alter its posture on the inflation issue, with policymakers gradually changing their characterization of rising prices from “transitory” to “persistant.” Political issues were also front of mind for investors, including a looming debt ceiling deadline and gridlock in Congress surrounding additional fiscal stimulus. In fact, the Build Back Better bill proposed by the Biden Administration, which had started as a multi-trillion dollar initiative spanning a number of areas of focus, continued to be scaled back as moderate democrats questioned the need for such comprehensive stimulus, given a growing economy and ongoing inflation worries. Amid these concerns, the S&P 500 finally ended its monthly winning streak in September, while also experiencing its first 5% pullback in nearly a year.

Once again, the sell-off would prove fleeting. As third-quarter earnings reports began to roll in, investors took solace in the continued upward trajectory of corporate profit growth, and the march higher in U.S. equities resumed in October. The S&P 500 was back to all-time highs at the end of the month, and by early November, the index had reached its 66th record high of 2021, the most in any year since 1995. The so-called "everything rally" paused after Thanksgiving, however, as another new coronavirus variant—deemed *Omicron*—stirred fears of tripping up the economic momentum experienced throughout 2021. A period of increased volatility followed after Thanksgiving, and the S&P 500 notched its third monthly loss of 2021 in November. A couple weeks later, the Fed's final meeting of 2021 was construed by many market participants to be *hawkish,* as Fed Chair Jerome Powell suggested the central bank would scale back monetary support at a faster pace in an effort to tame rising prices. Furthermore, the Fed's *dot plot* indicated committee members forecasted multiple rate hikes in 2022. Despite these lingering concerns, a *Santa Claus rally* ensued in late December, leaving U.S. stocks in record territory once again. Remarkably, Bespoke Investment Group highlighted that the S&P 500 ended a session in positive territory a remarkable 63% of the time in 2021, with the benchmark's three-year total return surpassing 100% for the first time since March 2000.

## S&P 500 posts most record closing levels since 1995




| | 2019 | 2020 | 2021 |
|---|---|---|---|
| **Number of 1% moves in either direction** | 37 | 109 | 55 |
| **Average daily move (absolute value)** | 0.57% | 1.35% | 0.63% |
| **Average CBOE Volatility Index** | 15.4 | 29.3 | 19.7 |

Source: Bespoke, Bloomberg *As of December 31, 2021, 4:00 p.m. ET. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

In fact, the S&P 500 closed 2021 26.9% higher, capping its strongest three-year rally since 1999 (+72%). Meanwhile, the Nasdaq Composite climbed 21.4%, underperforming the broader benchmark for the first time since 2016 as demand for tech-related shares somewhat eased amid economic reopenings. The prospect of tighter monetary policy was also cited as a headwind to growth stocks, as the valuations of these companies are largely derived from future cash flows, which would need to be discounted at a higher interest rate. Still, the tech-heavy index has advanced in nine of the last 10 years. The blue-chip Dow notched its third straight annual gain, rising 18.7%, while the small-cap Russell 2000 logged a more modest 13.7% increase. Globally, equities enjoyed generally strong returns in 2021, with the MSCI All-Country World Index capping a 16.8% jump. Across the pond, the STOXX Europe 600 Index saw its second-best year since 2009, though Asian stock benchmarks lagged, largely due to COVID-19 flare-ups in the region inciting economic slowdowns. Hong Kong's Hang Seng Index weathered its largest annual loss since 2011, pressured by tightening regulatory measures from China and a debt-burdened property market. A gauge of emerging market stocks also declined in 2021, partly dragged down by a strengthening U.S. dollar (+6%). In the metals complex, COMEX gold (futures traded on the Commodity Exchange) weathered its worst year since 2015, down 3.4% to $1,830.20/ounce. However, a measure of industrial metals saw its strongest annual performance since 2009.

## Asset class and select index performance 2021 by period

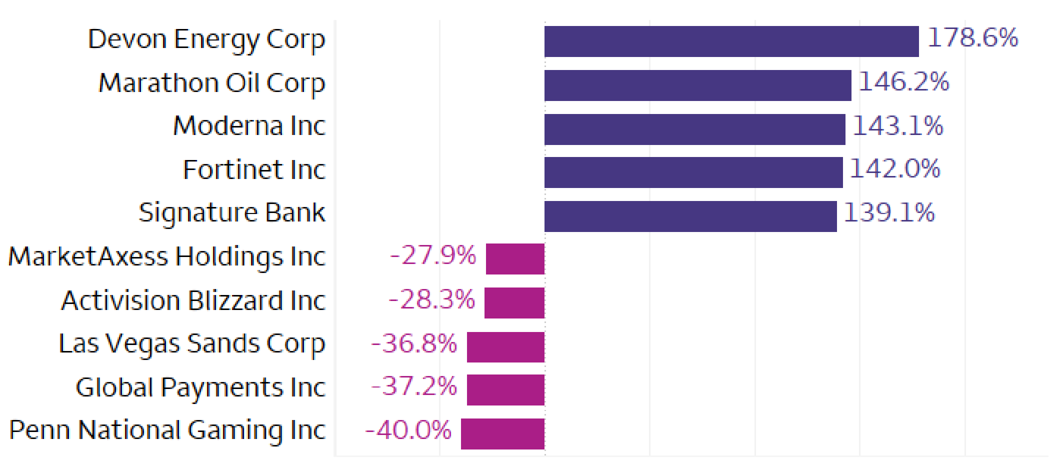
| | Jan. 1 - June 30 | July 1 - Dec. 31 | Full Year 2021 |
|---|---|---|---|
| S&P 500 | 14.4% | 10.9% | 26.9% |
| Dow Jones Industrial Average | 12.7% | 5.3% | 18.7% |
| Nasdaq Composite | 12.5% | 7.9% | 21.4% |
| Russell 2000 | 17.0% | -2.8% | 13.7% |
| Russell 1000 Growth | 12.6% | 12.5% | 26.7% |
| Russell 1000 Value | 15.9% | 5.9% | 22.7% |
| MSCI Emerging Market | 6.5% | -10.4% | -4.6% |
| MSCI EAFE | 7.3% | 1.4% | 8.8% |
| Euro STOXX 600 | 13.5% | 7.7% | 22.2% |
| China's Shanghai Composite | 3.4% | 1.4% | 4.8% |
| Japan's Nikkei 225 | 4.9% | 0.0% | 4.9% |
| Bloomberg US Agg Bond | -1.6% | 0.1% | -1.5% |
| Bloomberg US Treasury Inflation-Linked Bond | 1.7% | 4.2% | 6.0% |
| WTI Crude | 51.4% | 2.4% | 55.0% |
| COMEX Gold | -7.1% | 2.9% | -4.5% |

Source: Bloomberg *As of December 31, 2021, 4:00 p.m. ET. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Arguably the S&P 500 sector hardest hit by pandemic shutdowns in 2020, Energy shares made a sharp comeback in 2021. So much so that the group soared to a historic 47.7% annual advance — as pandemic lockdowns ended and travel demand rebounded. (In fact, the last time any S&P 500 sector climbed as much on an annual basis was in 2012, when the Information Technology group surged roughly 60%.) The combination of pent-up fuel demand and suppressed output from the Organization of the Petroleum Exporting Countries (OPEC) and its allies sparked a global energy supply crunch that powered West Texas Intermediate (WTI) crude over 55% higher for the year (to $75.51/barrel), which constituted the biggest annual increase since 2009. Companies involved in oil and gas exploration and production benefitted the most from the rise in oil prices, with Devon Energy Corp. and Marathon Oil Corp. the two top-performing S&P 500 stocks in 2021. Still, the Energy group carries one of the smallest weightings in the broad index, and so the S&P 500's overall ascent still depended largely on mega-cap companies, many of which are housed in the Information Technology, Consumer Discretionary, and Communication Services sectors.

In fact, over $2 trillion in market value was created by just three companies in 2021: Apple Inc., Microsoft Corp., and Google parent Alphabet Inc. Furthermore, roughly half of the S&P 500's advance during the final eight months of the year came from these stocks, along with Tesla Inc. and chipmaker NVIDIA Corp. Alphabet Inc. firmly outpaced its big tech peers, with its Class A shares popping 65.3% during the year—its strongest showing since 2009 as consumers remained dependent upon Google's digital services throughout the pandemic. Microsoft Corp. recorded a double-digit gain (in percentage terms) for the ninth consecutive year as demand for its cloud computing and enterprise software steadily grew. Apple Inc. came within striking distance of being the first company to reach $3 trillion in market cap—an exclusive milestone that would value the Tech titan above Germany's entire stock market.

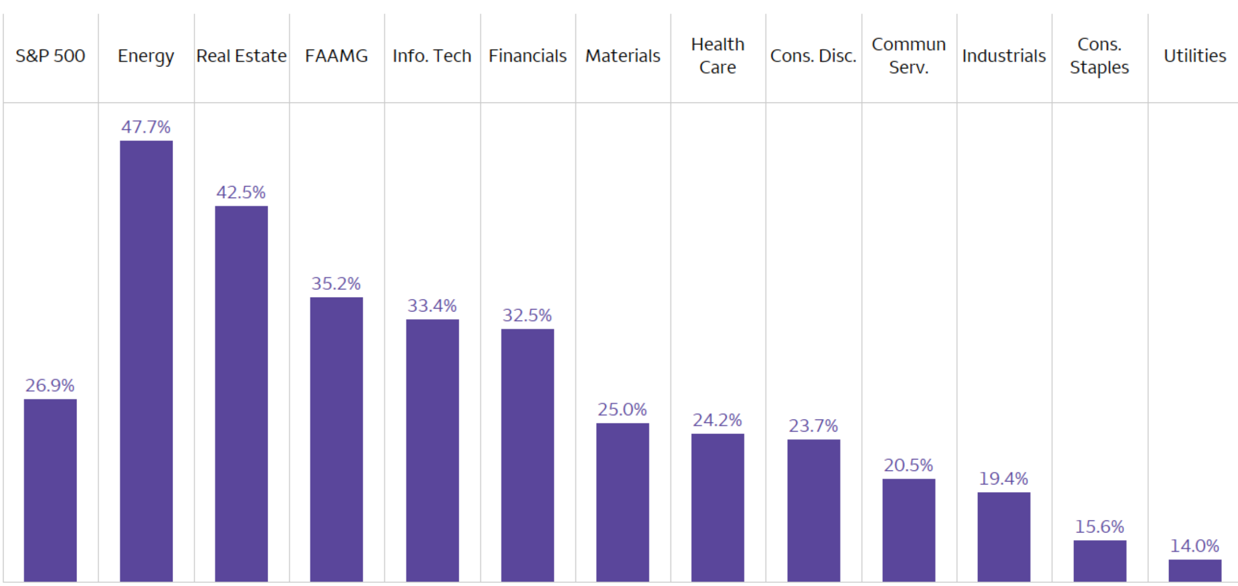
## Best and worst performing S&P 500 stocks of 2021




Source: Bloomberg *As of December 31, 2021, 4:00 p.m. ET

**Amazon.com Inc.** lagged in the FAAMG complex, adding a meager 2.4% as it grappled with higher labor costs and supply chain snarls. Still, shares of the e-commerce giant have enjoyed a seven-year winning streak, rising almost 1,000% over that timespan. Facebook garnered attention after changing its corporate name to Meta Platforms Inc. to reflect future growth outside social media and into the broader virtual world. Meanwhile, Tesla Inc. rocketed over 50% as the electric vehicle maker managed to boost production by about 80% during the year, meaningfully above the 1% increase from automakers overall, according to data from research firm IHS Markit. While a global shortage in semiconductors and supply chain disruptions afflicted the broader industry, Tesla Inc.'s in-house focus on software engineering contributed in no small part to the company's success in 2021.

## S&P 500 sector performance with FAAMG*

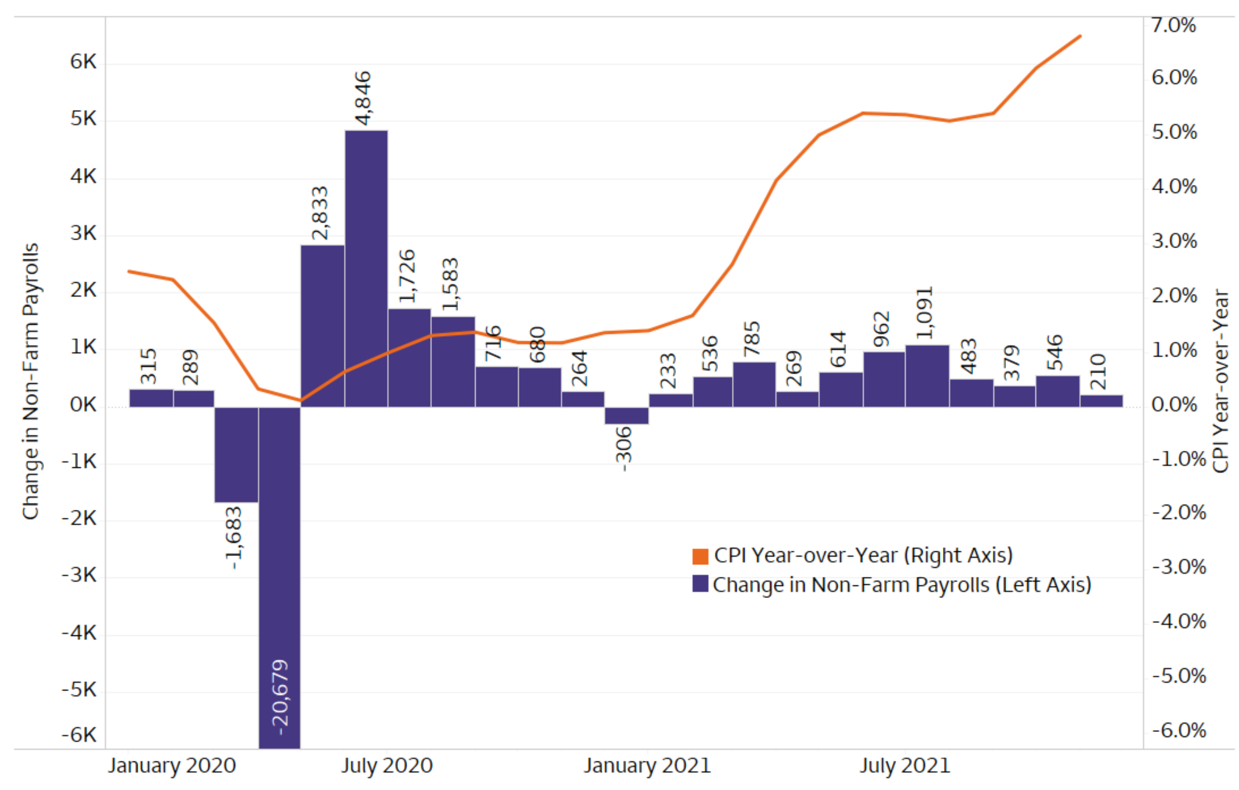



Source: Bloomberg *As of December 31, 2021, 4:00 p.m. ET *FAAMG represented by an equal weight portfolio of Meta Platforms (formerly known as Facebook), Amazon, Apple, Microsoft and Alphabet. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Also in the corporate arena, M&A (mergers & acquisitions) activity soared to a record during the year as borrowing costs remained historically low and companies responded to changing industry trends. Globally, M&A volumes climbed 64% in 2021 to a total of $5.8 trillion, well above the prior record of $4.55 trillion realized in 2007, according to data from Dealogic. M&A activity in the U.S. accounted for almost 50% of global volumes. Among the most notable deals, AT&T Inc. and Discovery Inc. decided to combine their media assets into a new, publicly traded company, while Block Inc. (formerly Square Inc.) acquired buy-now-pay-later firm Afterpay Ltd., and Oracle Corp.

bought medical records company Cerner Corp. Meanwhile, the popularity of SPAC (special purpose acquisition companies) listings drove an unprecedented number of new IPOs (initial public offerings) on U.S. exchanges in 2021.

## Fed keeps tab on a recovering labor market and a rising price pressures




Source: Bloomberg *As of December 10, 2021, 8:30 a.m. ET

A major factor underpinning this year's "everything rally" was the continuation of monetary stimulus from global central banks. In order to stem the economic fallout from the pandemic, the U.S. Federal Reserve (Fed) had cut its benchmark lending rate to zero in March 2020 and pledged practically unlimited market support in the form of asset purchases and other liquidity measures. This carried into 2021 as officials vowed to keep monetary policy loose to encourage a complete economic recovery. In fact, the Fed kept its eye on two key factors—job growth and price pressures—that coincided with its dual mandate of maximum employment and a 2% average inflation target.

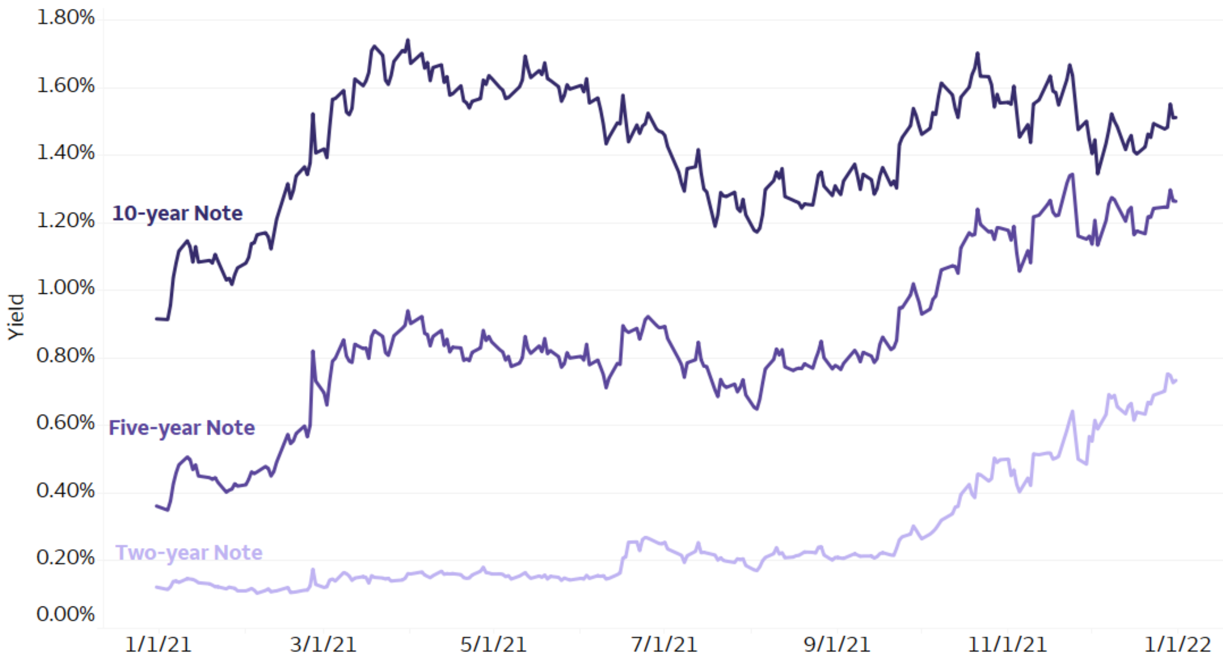
The Labor Department's monthly non-farm payrolls report showed steady job growth throughout 2021, while the unemployment rate dropped to a post-pandemic low of 4.2% by year-end, pointing to an ongoing recovery. Although the U.S. economy still remained roughly 5 million jobs shy of its pre-pandemic at the end of 2021, the shortfall was chalked up to a number of shifting dynamics, including sizeable pandemic savings, lingering COVID-19 concerns and related childcare issues, along with an increase in retirees. The overall tightness of the labor market was evident in job openings hitting a historic high, while the quit rate also reached a record. Additionally, weekly readings on initial jobless claims fell back to levels associated with a healthy labor market, actually falling to troughs not seen in 52 years.

Meanwhile, as economic reopenings gathered momentum, pent-up demand for goods and services caused unexpected supply chain bottlenecks across industries. The result was a spike in inflation readings that Fed Chair Jerome Powell and fellow policymakers characterized as "transitory" for the better part of the year. By May, a bond market measure of inflationary expectations over the next five years jumped to a level not seen since the onset of the 2008 Financial Crisis. Perhaps most widely cited was a clear upward trend in the Consumer Price Index (CPI), which serves as a proxy for real-time inflation since it is comprised of a weighted average of goods and services commonly purchased by households. By the end of 2021, CPI had climbed an eye-popping 6.8% on an annual basis, marking the fastest pace since 1982.

As price pressures showed no signs of abating and the labor market continued to recover, the Fed eased into the idea of dialing back pandemic-era monetary stimulus by the second half of the year. Policy meetings subsequently became more hawkish. In the fall, Federal Open Market Committee (FOMC) members clearly signaled plans to begin tapering, or reducing, asset purchases by year-end. Then, on the final day of November, Fed Chair Jerome Powell finally admitted it was time to retire the word "transitory" from inflation descriptions. During their December meeting, Fed officials announced plans to expedite their tapering timeline in order to combat inflation that was proving more persistent than originally forecasted. The move set the stage for an end to the Fed's bond-buying program in March 2022, opening the door for monetary policy tightening in the form of interest rate hikes.

## Treasury yield curve flattens with short-term rates jumping




Source: Bloomberg *As of December 31, 2021, 4:00 p.m. ET

As the bond market priced in the increasing likelihood of Fed rate increases, the yields on shorter-dated Treasuries (such as two- and five-year maturities) reached pandemic-era highs. However, longer-dated yields failed to break out of a narrow trading range in 2021 as a number of factors kept rates generally depressed. Lingering pandemic uncertainty, lower economic growth expectations, and other technical variables, such as strong foreign demand, all supported U.S. government securities. After starting 2021 at 0.91%, the yield on the benchmark 10-year note hit a peak of 1.77% in March before settling at 1.51% by year-end. This dynamic left the overall U.S. Treasury yield curve near its flattest since March 2020. As yields climbed overall, the Bloomberg U.S. Treasury Index experienced its first annual loss since 2013 as positive coupons were insufficient to offset a negative price return.

# Companies Mentioned

| Ticker | Price | Ticker | Price | Ticker | Price |
|---|---|---|---|---|---|
| GME | $148.39 | DVN | $44.05 | MRO | $16.42 |
| AAPL | $177.57 | MSFT | $336.32 | GOOGL | $2897.04 |
| GOOG | $2893.59 | TSLA | $1056.78 | NVDA | $294.11 |
| AMZN | $3334.34 | FB | $336.35 | T | $24.60 |
| DISCA | $23.54 | DISCK | $22.90 | SQ | $161.51 |
| AFTPY | $59.90 | ORCL | $87.21 | CERN | $92.87 |
| FTNT | $359.40 | SBNY | $323.47 | PENN | $51.85 |
| GPN | $135.18 | LVS | $37.64 | ATVI | $66.53 |
| MKTX | $411.27 | MRNA | $253.98 | | |

Source: Bloomberg as of December 31, 2021 4:00 p.m. ET

**Definitions**

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market.

Dow Jones Industrial Average is an unweighted index of 30 "blue-chip" industrial U.S. stocks.

NASDAQ Composite Index measures the market value of all domestic and foreign common stocks, representing a wide array of more than 5,000 companies, listed on the NASDAQ Stock Market.

Nikkei-225 Stock Average is a price-weighted average of 225 top-rated Japanese companies listed in the First Section of the Tokyo Stock Exchange.

Shanghai Stock Exchange Composite Index is a capitalization-weighted index. The index tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange.

Hang Seng Index is a free-float capitalization-weighted index of a selection of companies from the Stock Exchange of Hong Kong. The components of the index are divided into four sub-indices: Commerce and Industry, Finance, Utilities, and Properties. The index was developed with a base level of 100.

STOXX Europe 600 Index is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 17 countries of the European region.

Bloomberg US Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury. Treasury bills are excluded by the maturity constraint, but are part of a separate Short Treasury Index. STRIPS are excluded from the index because their inclusion would result in double-counting.

Bloomberg US Treasury Inflation-Linked Bond Index measures the performance of the US Treasury Inflation Protected Securities (TIPS) market.

Bloomberg U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

The MSCI ACWI Index is a free-float weighted equity index. It was developed with a base value of 100 as of December 31 1987. MXWD includes both emerging and developed world markets.

MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

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Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. The real-time value is calculated with a base value of 135.00 as of December 31, 1986.

The Bloomberg Commodity Index (BCOM) is calculated on an excess return basis and reflects commodity futures price movements. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production and weight-caps are applied at the commodity, sector and group level for diversification. Roll period typically occurs from 6th-10th business day based on the roll schedule.

Bloomberg Agriculture Subindex (formerly known as Dow Jones-UBS Agriculture Subindex) is a commodity group subindex of the Bloomberg Commodity Index. It is composed of futures contracts on coffee, corn, cotton, soybeans, soybean oil, soybean meal, sugar and wheat. It reflects the return of underlying commodity futures price movements only and is quoted in USD.

Chicago Board Options Exchange (CBOE) Volatility Index (VIX) is a financial benchmark designed to be an up-to-the-minute market estimate of the expected volatility of the S&P 500® Index, and is calculated by using the midpoint of real-time S&P 500 Index (SPX) option bid/ask quotes.

**General Disclosures**

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