NORTH STAR
Resource Group

MARKET UPDATE

QUARTER 4, 2021

"A man never steps in the same river twice, for it's not the same river and he's not the same man." This is an old quote from the Greek philosopher Heraclitus and what Dr David Kelly of JPMorgan used to open discussions for their yearly market outlook. This is one of the earliest theories that nothing is permanent, except for change. This is very fitting to wrap up the markets for 2021 and look forward into 2022. Not only is the United States stock and bond markets in a state of flux, so too is the rest of the modern-day world as we continue to emerge from Covid.

The markets continued their epic run in 2021 as the vaccine allowed the economy to further emerge from the covid lows of 2020. The S&P 500 was up for the year, 28.7% for US Large cap stock, up almost 15% for small caps in the Russell 2000, even the international MSCI EAFE index was up over 11%[1]. The emergence of a new highly contagious strain of Covid, the Omicron variant, in December did cause the markets to panic and pullback, as they digested the extent of the new strain while awaiting confirmation of the vaccine's effectiveness.

The stock markets continued to see rotation from growth towards value in addition to boosting the case for active over passive management. The effects of inflation concerns, Fed policy and employment with wage growth are the main drivers for this market shift. For the quarter, Technology, Material and Consumer Staples were up 16.7%, 15.2% and 13.3% respectfully, leading the sector returns[1]. This is also leading to increases in cyclical and defensive portions of the equity markets. For the year, Energy sector, up 54.6%, Financials, up 35% and Technology, up 34.5%, lead with performance[1]. The sector laggards for the year were Utilities, Consumer Staples, and surprisingly, Industrials[1]. While we are noticing the rotation to those value or cyclical portions of the economy, you cannot abandon growth, especially Technology. The key to the growth companies is owning those companies with sustainable growth and manageable Price to Earnings ratios, P/E, hence, the current market bias for actively managed funds and managers.

Speaking of PE ratios, the forward P/E ratios continue to be elevated at 21.18 times for the S&P500. This is over 1 SD, standard deviation, from the 25yr average of 16.83 times[2]. The CAPE, Cyclically Adjusted Price to Earnings, or Shiller's P/E, is currently 40.9 times compared to the 25 year average of 27.86, which is over 2 standard deviations[2]. These metrics are historically pretty expensive, although not anywhere near 1999 levels. This could be a concern, questions around earnings growth will come into play with the potential for higher inflation and subsequent rise of interest rates from central banks around the world. Continued growth is expected into the first 2 quarters of 2022 with the potential for economic and earnings growth to slow, from current pace - not stop, in last two quarters of 2022.

Continued headwinds for the equity and fixed income markets continues to revolve around Inflation concerns, monetary policy, supply chains and employment, in addition to new Covid variants and their effect on potential economic shutdowns. Inflation came in at 4.7% for the fourth quarter, over 3.5% from the previous year[2], which is well above Fed target of 2% inflation. This increase in inflation has seen the US Fed change their tune, dropping the word "transitory" from it's vocabulary, and laying the groundwork for monetary policy changes. The labor shortage continues to affect corporations and supply chains, along with the "great resignation". This will cause employers to increase wages to attract and retain employees. Increased wages, or wage growth, is inflationary and will affect corporate bottom lines at a time when growth could slow because of higher interest rates. *Continued on next page>>*

Ironically, this does come as an economic benefit; worker productivity usually increases as corporations engage in becoming more efficient using technology. Normally, the months of January and February are the slowest months for retail which may allow supply chains to catch up to demand. Of course, geo-political concerns will always continue to weigh on markets, but usually with minimal effects.

On the fixed income side, the 10-year Treasury yield ended the year at 1.52% after a fourth quarter rally in the Treasury markets. Yields peaked for the year at 1.78% at end of first quarter[2]. A bond market rally is the buying of bonds, pushing prices up and yields lower. This late year rally was in contrast to the message the Federal Reserve and inflation were indicating about the economy. During the fourth quarter, the US Federal Reserve Bank has indicated it will began tapering and looking to increase interest rates in 2022 as they found themselves behind the inflation 8 Ball. Consensus among economists is that the Fed will increase the Fed Funds Rate, the key bank rate, 3 times in 2022. The aggressive tapering of bond buying will end in March of 2022 with the expectation that Fed will begin to raise rates, 25bps each time, once in June, once in Sept and for a final time in December. These are all expectations, as actual markets, growth rates and inflation could dictate otherwise. Even with the late year bond rally, we saw the Barclay's US Aggregate Bond down 1.54% for the year[1].

Monetary policy from central banks around the world are appearing to be following a similar strategy with interest rates and inflationary policies. The US dollar strengthened in Q4 but is expected to weaken in 2022 as the new US Fed Reserve policies are implemented. A weakened dollar could provide opportunities in the international equity markets, particularly developed markets; they still look very cheap historically compared to US equities. The MSCI ACWIxUS current P/E ratio is 14.3 times, which is a 32.7% discount to the US S&P500, almost 3 standard deviations below the average![2]

Taking the long-term view at North Star Investment Resource Center, we continue to believe diversified portfolios and disciplined investment strategies can continue to provide the best opportunities for those investors seeking growth.

We welcome investment discussions, should you have any questions or concerns; or if there is a change in your investment time horizon or financial circumstances, please feel free to contact us at your convenience.

Written by North Star Investment Resource Center

(Average Annual Returns chart on next page)

AVERAGE ANNUAL RETURNS FOR PERIODS ENDING 12/31/2021						
INDEX	**4TH Q**	**YTD**	**1 YR**	**3 YRS**	**5 YRS**	**10 YRS**
S&P 500	11.03%	28.71%	28.71%	26.07%	18.47%	16.55%
Russell 2000	2.14%	14.82%	14.82%	20.02%	12.02%	13.23%
MSCI EAFE (U.S. dollars)	2.69%	11.26%	11.26%	13.54%	9.55%	8.03%
Barclays US Aggregate Bond	0.01%	-1.54%	-1.54%	4.79%	3.57%	2.90%
BENCHMARK COMPOSITES	**4TH Q**	**YTD**	**1 YR**	**3 YRS**	**5 YRS**	**10 YRS**
Aggressive Growth	6.34%	20.39%	20.39%	21.50%	14.75%	13.65%
Growth	5.01%	15.66%	15.66%	18.28%	12.64%	11.57%
Conservative Growth	4.09%	11.60%	11.60%	15.14%	10.69%	9.53%
Income and Growth	2.74%	7.03%	7.03%	11.64%	8.34%	7.29%
Income	1.78%	3.31%	3.31%	8.64%	6.32%	5.37%
USD VS LCL	**4TH Q**	**YTD**	**1 YR**	**3 YRS**	**5 YRS**	**10 YRS**
MSCI EAFE NR USD	2.69%	11.26%	11.26%	13.54%	9.55%	8.03%
MSCI EAFE NR LCL	3.91%	18.70%	18.70%	13.35%	8.36%	10.09%

Source: Morningstar

The Benchmark Composite returns are a weighted average of index data comprised in the following manner. Aggressive Growth is 45% S&P 500, 25% Russell 2000 and 30% MSCI EAFE. Growth is 35% S&P 500, 20% Russell 2000, 25% MSCI EAFE and 20% Barclays US Aggregate Bond. Conservative Growth is 30% S&P 500, 10% Russell 2000, 20% MSCI EAFE and 40% Barclays US Aggregate Bond. Income and Growth is 20% S&P 500, 5% Russell 2000, 15% MSCI EAFE and 60% Barclays US Aggregate Bond. Income is 15% S&P 500, 5% MSCI EAFE and 80% Barclays US Aggregate Bond.

Sources of Information:
[1] Morningstar Direct
[2] JPMorgan – Guides to the Market Q4 2021

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any funds or stocks in particular, nor should it be construed as a recommendation to purchase or sell a security. Investments will fluctuate and when redeemed may be worth more or less than when originally invested.

Investments that focus in one sector may involve a greater degree of risk and volatility than an investment with greater diversification.

S&P 500 - The S&P 500 Index is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S. Please note an investor cannot invest directly in an index.

Russell 2000 - Russell 2000 Index is an equity index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. Please note an investor cannot invest directly in an index.

MSCI EAFE - The MSCI EAFE Index is the Morgan Stanley Capital International Index and is designed to measure the total return of the developed stock markets of Europe, Australia and the Far East. Investment risks associated with international investing, in addition to other risks, include currency fluctuations, political and economic instability and differences in accounting standards when investing in foreign markets. Please note an investor cannot invest directly in an index.

Barclays US Agg Bond - The Barclays U.S. Aggregate Bond Index is a broad-based bond index comprised of government, corporate, mortgage and asset-backed issues, rated investment grade or higher, and having at least one year to maturity. Please note an investor cannot invest directly in an index.

MSCI ACWIxUS - The MSCI ACWI ex US Index is a market capitalization weighted index was designed to provide a broad measure of equity-market performance throughout the world. It is comprised of stocks from 22 of 23 developed countries (excluding the US) and 25 emerging markets. Please note an investor cannot invest directly in an index.

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