January 14, 2022

Dear O'Brien Client,

As we look back at the year 2021, we were pleasantly surprised by the progress that occurred – even though it didn't always feel like we were moving forward in the moment. Over nine billion COVID vaccinations were administered globally. Sales of zero-emission vehicles surpassed sales of diesel vehicles for the first time in Europe. NASA's Perseverance rover was able to make oxygen on Mars. Juneteenth became a federal holiday. Tom Brady won a record seventh Super Bowl. And global stocks posted their third consecutive year of double-digit gains – the first time that has happened since the mid-2000s.

To be sure, 2021 brought human tragedy and on-going challenges as well. Over 3.5 million people lost their lives to COVID. Our daily interactions remained disrupted for a second year as Delta, and then Omicron, cases surged. Political division continued. But, taken together, the progresses outweighed the setbacks. We hope this trend continues so that we can meet again with you in person soon.

Market Performance

Markets rebounded strongly in 4Q to close out 2021. Stocks once again outperformed bonds, continuing the trend from the first half of the year. Within stocks, the U.S. once again outperformed the rest of the world. On the bond side, riskier markets, such as high yield, outperformed higher quality debt. All-in-all, 2021 made for a third consecutive year of solid market returns.

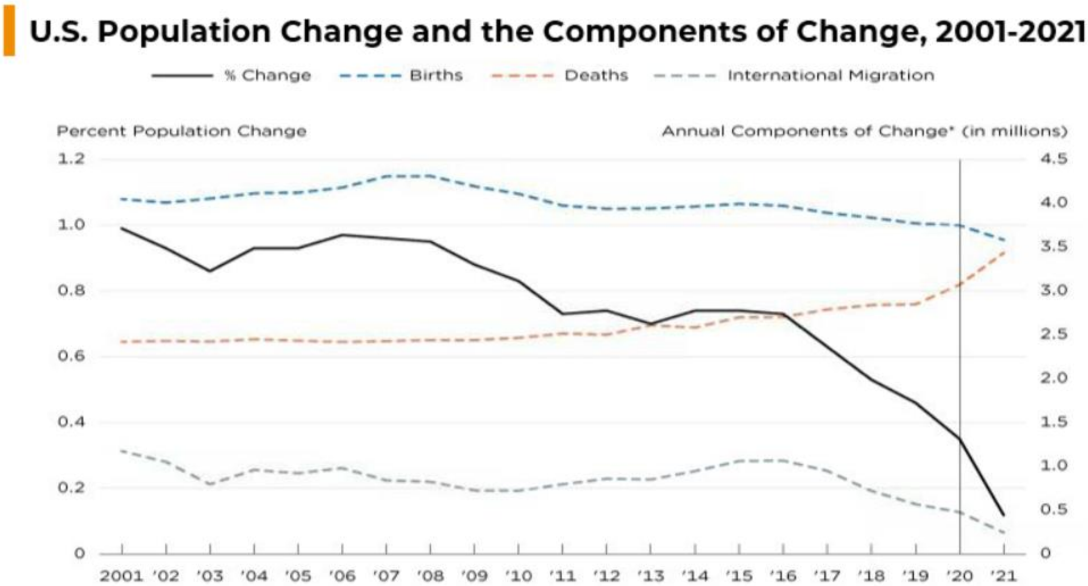
	4Q 2021	2021		4Q 2021	2021
Real Estate Stocks	16.2%	41.3%	Municipal Bonds	0.7%	1.5%
U.S. Large Cap Stocks	11.0%	28.7%	High Yield Bonds	0.6%	5.3%
Global Stocks	**6.7%**	**18.5%**	Investment Grade Bonds	0.2%	-1.1%
U.S. Mid Cap Stocks	6.4%	22.6%	Treasuries	0.2%	-2.3%
Gold	4.0%	-4.3%	**U.S. Aggregate Bond Index**	**0.0%**	**-1.5%**
Non-U.S. Developed Market Stocks	2.7%	11.3%	Mortgage-Backed Bonds	-0.4%	-1.0%
U.S. Small Cap Stocks	2.1%	14.8%	Emerging Market Stocks	-1.3%	-2.5%
Non-U.S. Stocks	1.8%	7.8%	Commodities	-1.6%	27.1%

Past performance is no guarantee of future results. You cannot invest in an index.
Source: Morningstar Direct, O'Brien Wealth Partners, as of 12/31/21.

Economic and Market Outlook

As we turn to the economic and market outlook, we begin by considering opportunities and risks over multiple time horizons. More often than not, when there is a difference of opinion about an economy or asset market that difference comes down to the time horizon under consideration.

Our secular views (think next decade) have not changed. Economic growth – on average – will likely be slower because population growth is slowing. 2021 was a good example of this dynamic. As the chart below shows, declining birth rates, rising mortality rates (which have been exacerbated by COVID), and a collapse in net immigration drove population growth down to its slowest pace since the nation's founding.

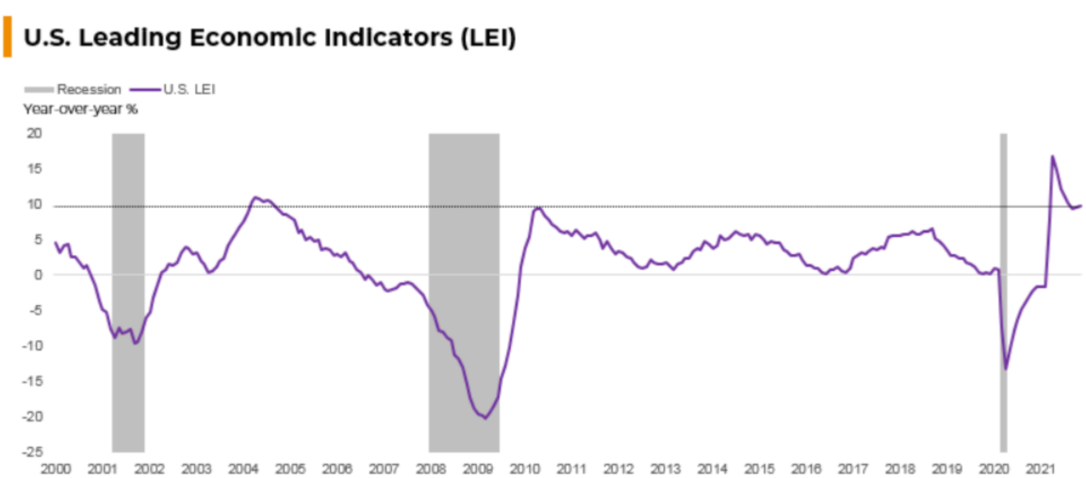


*Components of change include births, deaths, and net international migration. Note: Only data to the right of the line are from Vintage 2021. Source: U.S. Census Bureau, O'Brien Wealth Partners, as of 12/31/21.

When combined with relatively high asset valuations, the weaker economic outlook implies market returns may be more challenged than in previous decades. Our biggest concern is higher inflation, as the diversification benefits from owning stocks and bonds together tend to diminish when inflation is rising sustainably.

Cyclically, the transition of COVID from a pandemic to an endemic continues. Almost 60% of the world population has now received at least one dose of a COVID vaccine. An additional 4% of the world population has tested positive and survived. While Omicron cases are surging, COVID-related deaths have actually declined[1]. Progress is being made.

Domestically, economic momentum has been strong, but is likely to slow in 2022. As shown below, U.S. leading economic indicators – which are designed to estimate the pace of economic activity roughly six-to-nine months from now – have cooled from their breakneck pace, but are still solidly positive. This suggests the U.S. has economic tailwinds entering 2022 that should keep the odds of recession low despite tight labor markets and high inflation.



Shaded areas represent recessions as dated by the National Bureau of Economic Research (NBER). Source: The Conference Board, NBER, IHS Markit, O'Brien Wealth Partners, as of 11/30/21.

[1] Limited testing and challenges in the attribution of cause of death means the cases and deaths counts may not be accurate. Our World in Data, JPMorgan, O'Brien Wealth Partners, as of 12/31/21.

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While the economy is likely to keep expanding, it is worth noting – absent significant immigration reform – that labor market shortages are likely to persist. The U.S. working age population (people between the ages of 15 and 65) declined in 2021, with millions of people that were working pre-COVID remaining on the sidelines. While some of those people may return once COVID fades in importance, millions more have retired.

Tight labor markets, in turn, are likely to continue to drive higher wage growth. Leading wage growth data, such as the gap between wage gains for job leavers and job stayers is historically wide. Looking ahead to 2022, compensation plan surveys of employers suggest wage growth will remain strong, rising roughly 4% on average.

Manufacturing supply chain issues, which has been front-and-center in the news, are showing early signs of easing. The number of ships at anchor at the ports of Los Angeles and Long Beach was as high as 80 ships in October. Entering 2022, that number has fallen to 57. To be sure, that is still a significant backlog, but the trend is now moving in the right direction, which bodes well for continued economic expansion, as well as easing inflation pressures.

Fiscal policy will remain a headwind for U.S. growth as COVID stimulus packages continue to roll-off. Even if additional infrastructure stimulus is passed, it is unlikely to change this near-term headwind as much of the new stimulus being discussed would be spread out over the next decade. This reduction in spending will contribute to a slowdown in the overall pace of economic activity in 2022.

All of this bring us to our key theme for 2022: where is inflation headed and how will the Fed Reserve (Fed) react? Goods supply-chain disruptions, cash payouts from the government, and stay at home demand (e.g. delivery services) were all major drivers of the surge in inflation last year. We see those pressures easing this year.

But at the same time, we see wage pressures remaining elevated. And as progress against COVID continues, the economy should reopen further, bringing with it a surge in demand for services – such as travel and eating at restaurants. The rapid rise in house prices will also start to feed into government inflation data more meaningfully in 2022. These dynamics will likely offset some of those easing pressures. As a result, we anticipate a gradual easing in inflation over the course of the year, but ultimately that the pace of inflation remains above the Fed's 2% target.

Given this outlook, we expect the Fed to notably tighten monetary policy in 2022. Tapering of asset purchases will likely conclude in 1Q, followed by at least three rate hikes and the potential start of the shrinking of the Fed's balance sheet over the course of the year. That said, despite this policy shift, monetary policy overall will still be stimulative, as real (inflation-adjusted) borrowing costs remain significantly negative (see chart below).

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U.S. Real 10-Year Yields

Shaded areas represent recessions as dated by the National Bureau of Economic Research (NBER). Real: Inflation-adjusted. Source: Federal Reserve, NBER, Bureau of Labor Statistics, IHS Markit, O'Brien Wealth Partners, as of 11/30/21.

Internationally, while the U.S. economy led the way in 2021 we expect 2022 growth will be driven more evenly around the world as the pace of domestic activity moderates. In many developed markets fiscal policymakers continue to inject stimulus, while fiscal policy has become a headwind in the U.S. And while China's "Common Prosperity" agenda weighed down emerging market growth and returns last year, policymakers there are now starting to ease policy on the margin. Recent economic data in China have started to surpass subdued market expectations as a result.

These macro views lead us to the following investment outlook. Secularly, slower economic growth, high valuations, and policy/political risks are likely to persist and challenge average returns. Cyclically, less monetary stimulus likely reduces the magnitude of return potential in markets, but a solid economic backdrop keeps those returns, on average, positive.

One near-term market risk worth monitoring as 2022 progresses are election cycles. Brazil, India, France, Germany, Australia, and the U.S. – to name a few – have significant elections occurring in 2022. While the market impact from election cycles tends to be short-lived, volatility could pick up preceding them. This is particularly true in the U.S., where current polling data bode ill for the party in charge at the Federal level.

Portfolio Activity

Outside of the occasional tax loss harvest in the emerging market space where losses were meaningful, there were no major trades that took place during 4Q. While no one enjoys losing money, when those losses do occur we will recognize them – where appropriate – by selling the position to help offset taxable gains.

We remain constructive on the emerging market space and the fund where the losses occurred and therefore anticipate reversing that trade during the first quarter of the year.

We hope you are all taking care and staying healthy. If you have questions, or would like to talk, please reach out to your Advisor or any member of our investment team.

Your O'Brien Team

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