

## December 2021 Monthly Commentary/ 4th Quarter Letter

Jan. 3, 2022

### Stock Market & Portfolio Performance

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**Fourth Quarter 2021:** U.S. stocks rose broadly for the fourth quarter and full year led by large-cap stocks. International stocks rose more moderately for the quarter and year. Bonds were flat for the quarter and fell modestly for the year in response to rising interest rates.

	4th Qtr	FY 2021	Description:
Without Dividends:			
S&P 500	10.6%	26.9%	500 Largest Public U.S. Companies
Russell 2000	1.9%	13.7%	2000 of the smallest U.S. stocks
MSCI EAFE	2.4%	8.8%	international stock index
U.S. Aggr Bond	0.0%	-1.5%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	6.9%	16.2%	non-very conservative MAM portfolios
MAM Consv	3.3%	8.6%	portfolios with 45%+ bond allocation

*The returns showed above are unaudited. Past performance is not indicative of future results. Returns for McCarthy Asset Management Portfolios (“MAM Portfolios”) are net of management fees and transaction costs, and reflect the reinvestment of dividends. Results represent a composite of clients using a similar investment strategy, individual results will vary.*

*Returns for the indices are provided solely as a general indication of current market conditions. MAM Portfolios are not invested in a style substantially similar to any index. Indices do not reflect the deduction of management fees or transaction costs or the reinvestment of dividends. Performance for the indices would be lower if these costs were reflected.*

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## Economic & Investment Outlook for 2022

**U.S. Economy:** After experiencing its worst year since the Great Depression, the U.S. economy bounced back in 2021 with one of the best years of growth in nearly 40 years. For all of 2021, GDP growth is estimated to be 5%. A combination of aggressive actions by Congress authorizing record fiscal stimulus, a healthy consumer, an accommodative Federal Reserve, vaccinations given to many Americans, and the reopening of businesses all contributed to the strong year of growth.

While growth is expected to slow from 2021's rapid pace, the economy is still expected to perform well for 2022. Economists currently project GDP growth of around 4%. This can be attributed to household wealth gains, pent-up consumer demand, a gradual improvement in supply chain challenges, and a potential boom in business capital expenditures.

Risks to strong economic growth for 2022 include higher inflation, a shift toward monetary tightening by the Fed, and new coronavirus variants (with Omicron being the latest).

**Inflation Outlook:** Inflation rose to 6.8% in November, a 39-year high. Prices that are surging include gasoline, groceries, new and used vehicles, hotels, airline fares and more. As discussed in our November 2021 Monthly Commentary, the recent spike in inflation is due to persistent supply shortages and strong consumer demand. Unless pandemic conditions deteriorate significantly, improving global supply chains and factory reopenings should ease the upward pressure on prices in 2022. By the end of 2022, the inflation rate could fall to around 3.0%.

A longer-term risk will be if inflation starts to permeate into wages, which in turn, could drive expectations regarding rising inflation. If so, inflation may not be as transitory as currently thought. If the Federal Reserve starts to feel that the sharp rise in inflation is not just a temporary occurrence, it is likely to start raising short-term interest rates. After its December 15<sup>th</sup> meeting, most Fed officials indicated they expect to increase short-term interest rates three times during 2022. This was a significant shift from just three months prior when half of Fed officials thought rate increases wouldn't be warranted until 2023.

**Outlook for Global Economy and International Equities:** Despite headwinds from the pandemic, the global economic recovery still appears to be on track with projected 2022 GDP growth of around 5%. While the current COVID resurgence in Europe and the emergence of the highly mutated Omicron variant are reminders that the pandemic is still with us, the net economic effect of past waves, such as the spread of the delta variant, has been to postpone activity, not prevent it.

**MAM Stock Market Outlook:** One year ago, we said we were cautiously optimistic in our outlook for equities due to strong economic growth and sharply rising corporate earnings. It turns out 2021 was a banner year for the stock market. We are again cautiously optimistic for equities for 2022 as solid economic and earnings growth should help stocks deliver additional gains. Stock market returns, though, could be constrained by relatively high stock prices. In addition, the development of new COVID variants remains a risk.

**MAM Bond Market Outlook:** Similar to our 2021 outlook, our 2022 bond outlook is not promising. Bond prices move inversely to the direction of interest rates. The rate on the 10-year Treasury bond rose from 0.9% at the start of 2021 to 1.5% at the close of 2021. As a result, most bond prices fell moderately for 2021, as indicated by the loss of 1.5% in the Lehman Aggregate Bond Index for the year. For 2022, we expect the yield on the 10-year Treasury to continue to climb, reaching perhaps 2.0% by year-end due to strong economic growth and persistent inflation.

As with 2021, rising interest rates will negatively impact bond prices. As such, while bonds will continue to play an important role in protecting portfolios on the downside, we are using bond funds with a shorter duration and avoiding longer-term bonds.



## Build Back Better Act Failed— Back in 2022?

Build Back Better!

As discussed in our November 2021 Monthly Commentary, the House of Representatives passed the \$2 trillion Build Back Better (BBB) Act on November 19<sup>th</sup>. It then went to the Senate where all 50 Democratic Senators would have needed to vote in favor of it for passage. Changes were expected to appease resistance from Democratic Senator Joe Manchin. After discussions between President Biden and Senator Manchin, Manchin announced on December 19<sup>th</sup> that he could not support the package in its present form. This effectively killed the bill for now. The new plan, according to Senate Majority Leader Chuck Schumer, is that Democrats will move forward early next year with a discussion and then vote on the package. At this point, it's not clear what a revised BBB Act will look like, and whether the Senate can get it passed in 2022.

## Real Estate Prices to Level Off?

Today's hot nationwide housing market is one of the peculiar outcrops of the pandemic. Housing supply was already low before COVID, but it was further hampered as lockdowns took place. Furthermore, a combination of low mortgage rates, economic stimulus and changes in buying patterns as people work remotely, has been pushing real estate prices higher all over the world. Home prices nationwide grew by 17.2% in June 2021 compared with June 2020—a record increase, according to the latest CoreLogic report.



The surge in prices have slowed a bit from earlier this year, according to the National Association of Realtors (NAR) quarterly home price report. The median home price was up 16% to \$363,700 in the third quarter from a year ago, a slower clip than the 22.9% jump in the second quarter. "Home prices are continuing to move upward, but the rate at which they ascended slowed in the third quarter," said Lawrence Yun, NAR's chief economist. "I expect more homes to hit the market as early as next year, and that additional inventory, combined with higher mortgage rates, should markedly reduce the speed of price increases," Yun said.

Robert Shiller, the professor of finance at Yale University, who predicted the 2008-2009 housing collapse, recently said that he expects housing prices to level off over the next two years. Shiller helped establish a futures market for housing. He said that quotes on it are flat, meaning that no increases are expected over the next couple of years. This prediction does not necessarily apply to strong housing markets like the San Francisco Bay Area, which are also influenced by the stock market performance of local technology and biotech companies.

## IRS Raises 401(k) Limits for 2022



Workers will be able to funnel more money into their 401(k) plans in 2022 thanks to contribution increases that were announced by the IRS last month. Employees will be able to contribute up to \$20,500 to their 401(k) account in 2022, up from \$19,500 for 2021. The maximum for workers 50 and older for 2022 will be \$27,000, up from \$26,000 for 2021. Meanwhile, the IRS did not increase the amount workers can contribute to their individual retirement accounts. The maximum contribution for regular and Roth IRAs will remain at \$6,000 for those under age 50, and \$7,000 for those 50 and older.

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## Our Services

McCarthy Asset Management, Inc. (MAM) is an independent, privately owned Registered Investment Advisor firm. We provide clients with the peace of mind that comes from knowing professionals are managing their financial affairs. The services we offer include:

### Investment Management Services:

- MAM creates and manages customized investment portfolios based on each client's investment objectives, timeframe and risk tolerance.

### Financial Planning Services:

- The Net Worth Analysis (NWA) tracks the accumulation of Invested Assets for pre-retirees and the retention of Invested Assets for retirees. Updated annually.
- "Retirement Analysis" a comprehensive analysis of your retirement goals, which produces easy-to-read, interactive working plan, stored in the cloud. Updated as needed for life events.
- Social Security Planning is an analysis of the best strategy for when and how to start claiming Social Security benefits.

Tax Services: Clients have the option of utilizing the income tax services provided through the firm Stephen P. McCarthy, CPA. These services are offered at an hourly rate and may include:

- Tax Return Preparation
- Income Tax Projections
- Tax Minimization Ideas
- Tax Authority Representation

Other Services: MAM has retained outside experts, whose services are available at no cost to our clients:

- Long Term Care Planning– Allen Hamm of Superior LTC Planning Services, Inc.
- Medicare Advisory Program (MAP) - Eileen Hamm

## Reminders/Updates

- 1) **Estimated Tax Payments:** 4th Quarter 2021 Federal & State are due January 18, 2022.
- 2) **ADV Part II:** You were provided a copy of our ADV Part II when you became a MAM client. As a Registered Investment Advisor, we file this this document annually with the Securities and Exchange Commission. Along with other items, it contains information regarding our fees, experience and educational backgrounds. Each year, the SEC requires us to offer clients the opportunity to receive a copy of our most recent ADV Part II. Please let us know if you would like to receive a copy.



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