2022 Market Update

March 16, 2022

Given the unprecedented events in Ukraine, we felt it was appropriate to update you on our market outlook for 2022. We have hosted several webinars and distributed various reports from Raymond James. Please check out our website under the Resources/Market & Economic Commentaries tab at: www.greenwealthmgt.com.

The war is horrific on every level. Putin has (thus far) resisted all reason, painting himself into a corner with no obvious off-ramp. Without a settlement, Putin seems intent on destroying Ukraine's economy and military capabilities, making an association with the EU or NATO more difficult. There is some hope that China or Israel could broker a deal, but there is no guarantee they will be successful.

On the positive side, the market sell-off is providing long-term investors with what we believe is an attractive entry point for US Stocks with a favorable risk/reward bias.

Our pre-war Investment Themes and Risks for 2022 are shown below, and that outlook has not changed:

Investment Themes

1) Transition from Pandemic to Endemic – Zero tolerance COVID policies and mask mandates are beginning to fade
    a. Vaccine effectiveness and availability improves
    b. Better treatments are available
    c. Less severe disease from Omicron than previous variants
2) Corporate earnings growth remains above long-term trend.
3) Fed Pivot – A long-standing adage is "Don't fight the Fed." After years of extremely accommodative monetary policy (tailwinds), the winds are shifting as the Fed will begin raising the Discount Rate to fight inflation.
4) Return to 'normal' levels of market volatility

Risks

1) Fed Policy Error: Raising rates faster than the market expects or more than the market expects, or so much it tips the US economy into recession.
2) Geopolitics with Russia, Ukraine and China
3) New COVID variants that are vaccine resistant

Clearly, geopolitical risks with Russia have already been realized. We expect this to shave earnings growth to some extent. The counterweight is that the Fed may be more cautious about raising rates.

Fed "Tightening":

Today (as expected) the Fed raised the target Discount Rate by ¼ point, and implied additional ¼ point hikes could happen at each of the 6 remaining. At this point, we believe the Fed will err on the side of conservatism, telegraphing policy moves to the market well in advance and working carefully to avoid a recession. Historically, Fed rate hikes have usually resulted in an initial decline for stocks, followed by higher prices one year later. But this Fed is being more transparent than any time in history, making surprises that shock the markets less likely. Bond investors have never seen such low real returns (actual

Treasury yield minus inflation), and we expect bond holders will dictate higher yields relative to inflation.

Energy: The war in Ukraine has caused the markets to move from 'Risk-On' to 'Risk-Off.' Oil prices are near a 14 year high. Historically, oil prices can be notoriously volatile during periods of disruption. Prior to the invasion, our outlook was for higher oil prices ($100 per barrel for WTI Crude). We do not expect any relief until the shooting stops. Higher energy prices will be a headwind to US economic growth and corporate earnings growth. Higher gasoline prices at the pump are like a tax on consumer spending. In spite of this, we believe the risk/reward for equities remains favorable.

Inflation: Sanctions against Russia will only add more friction to supply-chain issues. Historically speaking, wars are inflationary. All of this means the Fed will be faced with even greater challenges to contain inflationary pressures without causing a recession. For this reason, we carefully monitor more than one dozen leading indicators on the economy to give us some early warning signs.

Volatility: In 2022, we expected to see a return to normal market volatility (again… before the war). Historically, stocks will have 2-3 pullbacks for 5% or more in every calendar year. Currently, we view these as an opportunity to add to equity positions.

High Levels of Cash Reserves: 2020 - 2021 saw $5.1 trillion in stimulus dollars that won't be there in 2022. But record savings should provide an ongoing stimulus to the US economy. Consumer leverage is at a 40-year low and corporate balance sheets have never been stronger. It is estimated there is ~$2 trillion in cash on the sidelines. For these reasons, we remain positive on the US economy.

2022 Mid-Term Elections: The Democratic Blue Wave is on thin ice. History suggests the incumbent party typically loses seats in the US House of Representatives during mid-term elections. We believe Democrats will focus on:

- Improving economic conditions
- Launching the policy programs passed in 2021
- shoring up voter sentiment for members in competitive races.

This would mean few major policy shifts in 2022 (particularly the closer we get to the elections). From a policy perspective, this would be good for stocks.

Earnings Growth: Cyclical stocks should benefit from above trend earnings growth. Target price for the S&P 500 Index is now ~4,725 (versus our original forecast of 5,023). The longer sanctions/war last, the great the impact this will have on the economy and corporate earnings.

Small Cap: Small company stocks are more economically sensitive. They should do well in an early cycle recovery. We recommend overweighting from normal levels. We added to Small Cap Value in 2021. Small Cap Growth is actually trading at record lows relative to historic valuation levels, and may be poised for an even bigger rebound in 2022.

Summary Outlook: We believe the US economy (GPD) may grow ~3.5% annually without Fed policy support. Spending will continue to shift from Consumer Goods towards Services as economy reopens (post-Omicron). We expect rates to continue to rise across the yield curve. It is important that you maintain adequate cash flow reserves and appropriate asset allocation. If you have excess cash, we view this sell-off as an opportunity to add to stocks. Please reach out to us to discuss your specific situation.

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