Colorado Capital
MANAGEMENT

QUARTERLY MARKET UPDATE / JANUARY 2022

Economic Outlook

Overview

The U.S. economy has continued to grow and add jobs at a strong pace, making steady progress towards the Federal Reserve's goal of maximum employment. Consumer and business confidence are both high and the stock market has flourished. But supply constraints—both bottlenecks and labor shortages—have had a larger and more persistent effect on the economy than anticipated. Due to the collision between those supply constraints and strong demand, inflation pressures have become more widespread and may last longer into 2022 than first thought. The economic recovery should continue but the risks that supply constraints may limit job gains and economic output growth have increased, and inflation could complicate the Federal Reserve's management of monetary policy in 2022.

At this point, it is still too early to know the full extent to which the Omicron variant will change the public health scenario and weigh on economic activity. The Covid virus has been less devastating economically with each ensuing wave, but the next few months will be telling.

CCM Key Economic Indicators

Indicator	12.31.21	9.30.21	12.31.20
U.S, Economy			
Quarterly GDP Growth	Est. 6.5 %	2.3%	4.5%
Unemployment Rate	3.9%	4.7%	6.7%
U.S. CPI (Core)	5.5%	4.0%	1.6%
Interest Rates			
Fed Funds Rate	0.1%	0.1%	0.1%
10-Year Treasury Rate	1.47%	1.37%	0.93%
Currency & Commodities			
Crude Oil (WTI)	$ 75.33	$ 75.22	$ 48.35
Gold Price	$ 1,820	$ 1,731	$ 1,891
Trade Weighted Dollar Index	115.8	113.8	111.9
Confidence			
Consumer Confidence Index	115.8	109.3	88.6
ISM Purchasing Managers Index	58.7	61.1	60.7
Stock Prices			
Dow Jones Industrial Average	36,338	33,844	30,606
S&P 500 Forward P/E ratio	21.2	20.3	22.3

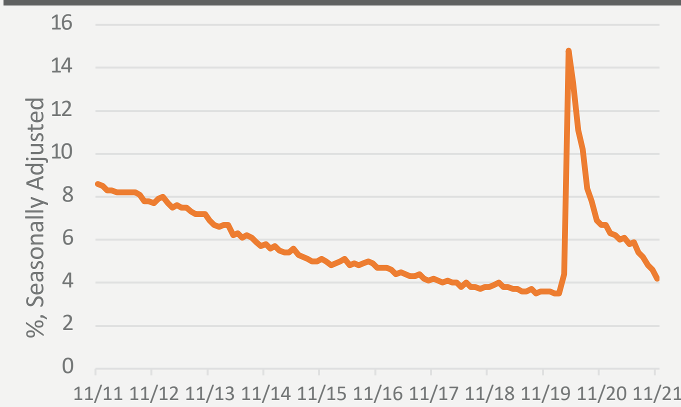
GDP

In the third quarter of 2021 the Delta variant and supply chain problems threw the economy off its strong growth track. Growth appears to have rebounded during the fourth quarter as we continued to learn how to manage and adapt to the disease and ever-improving treatments reduced the likelihood of death and hospitalization. Preliminary estimates of annualized US GDP growth for both the fourth quarter and the full year are in the 6% range. If realized, that would mark the fastest yearly GDP growth since 1984. Looking forward, real GDP growth will likely downshift to about 4.5% in 2022, which is still very strong.

Employment

Conditions in the job market are as tight or tighter than they were pre-COVID, even though the unemployment rate is more than a percentage point higher. There has been ample data showing labor demand is strong. Job openings have remained at a record level. New businesses are starting up at a much higher pace than they did from 2017 to 2019. People are leaving jobs at a record rate, confident that they can find new ones. The improvement expected in managing COVID should drive demand higher but also provide a boost to labor supply as those who have been on the sidelines return to a job market that keeps improving.

Unemployment Rate

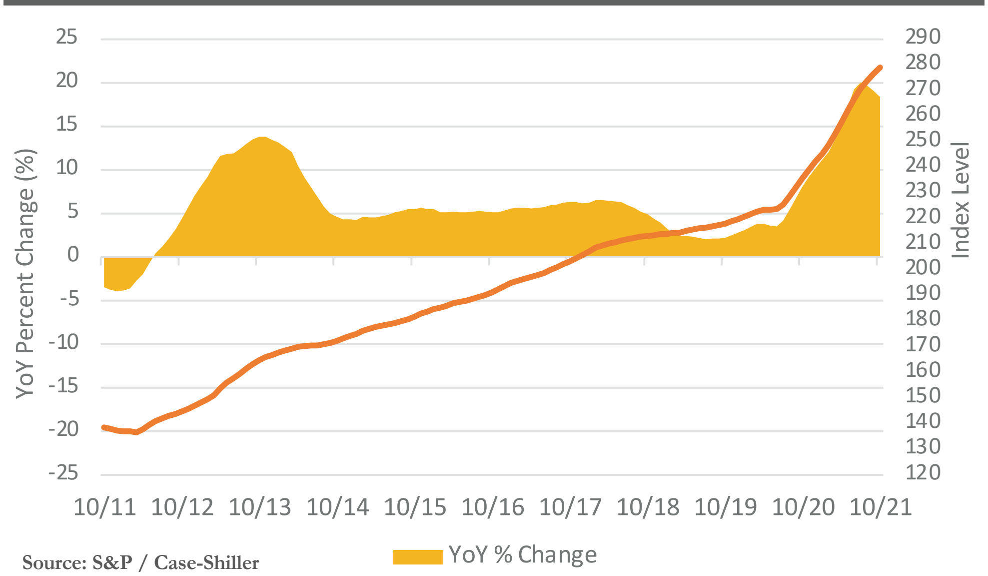


Source: U.S. Board of Governors of the Federal Reserve

Inflation

Inflation has escalated substantially this year and may get worse before it gets better. These pressures are related to both supply constraints and strong demand. Wages have continued to grow quickly and on a more sustained basis than they have in more than 20 years. Despite this, inflation in 2021 wiped out any real wage increase for the average worker. Upward price pressures have become widespread across industries. There has been a notable increase in the prices of energy, food, goods, and services, as well as the cost of buying and owning a home.

S&P Case-Shiller 20-City Home Price Index



Source: S&P / Case-Shiller

The last few months saw energy join the list of supply-side impediments impacting the global economy. An energy supply crunch in China and Europe sent natural gas and coal prices skyrocketing, with follow-on effects to North American natural gas and world oil prices. The jump in oil and gas prices has contributed to consumer price indexes hitting multi-decade highs. The overall CPI index, including food and energy, rose 7% in the last year.

Interest Rates

The Omicron variant has circled the globe, closed borders, and sparked new restrictions on economic activity. Yet central banks, instead of loosening monetary policy to prop up their economies as they did at the start of the pandemic, have moved to unwind stimulus, and raise interest rates. They are concerned that growing inflationary pressures, together with signs of an ever-tighter labor market could lead to a wage-price spiral.

As a result, the Fed plans to implement a major policy pivot, ending their bond buying program in March and beginning a series of interest rate increases in the second quarter. Fed rate hikes will not restore clogged supply chains, but they could prevent long-run inflation expectations from becoming unmoored.

Government Spending

Pandemic support programs have expired, and attention has turned to infrastructure and social spending proposals. President Biden recently signed the Infrastructure Investment and Jobs Act into law. The legislation authorizes about $1 trillion in spending, of which $550 billion is "new" spending above previously authorized levels, over the next 10 years on "hard" infrastructure.

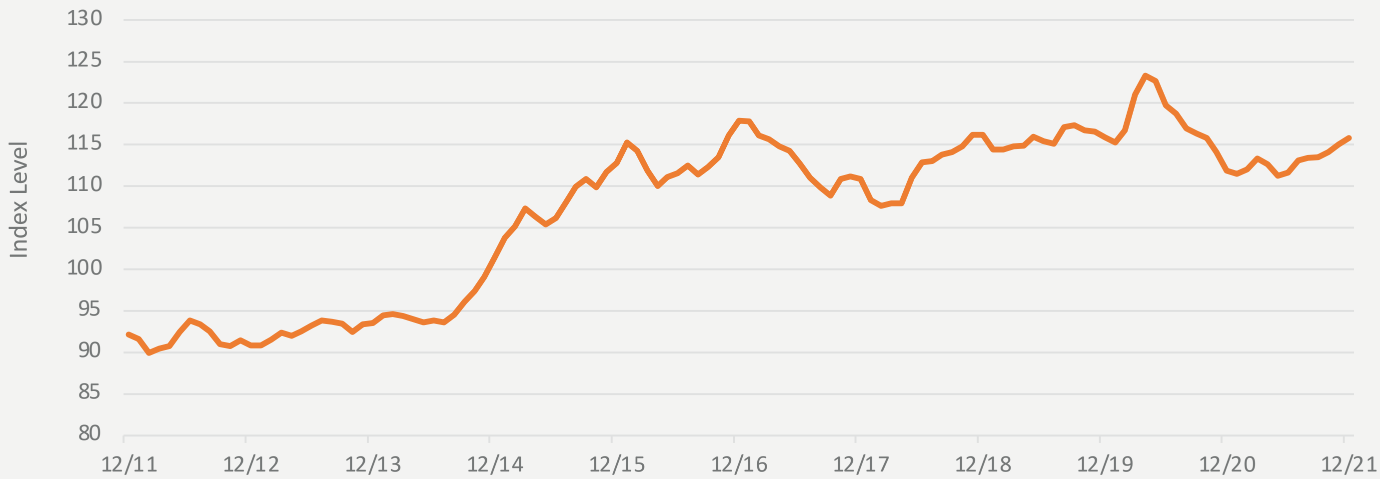
Separately, on November 19, the House of Representatives passed the Build Back Better (BBB) Act, which contains many "soft" infrastructure initiatives such as paid family leave, green energy initiatives, childcare subsidies, universal pre-K, housing, and health care, etc. The BBB legislation now sits in the Senate. The Senate should eventually approve a slimmed-down version of the bill or components of BBB may be approved as separate pieces of legislation. Passage is certainly not guaranteed in an evenly divided Senate.

The BBB could have some positive supply-side effects. Productivity growth could be boosted by the upgrades to infrastructure, and some elements of the BBB legislation, such as more childcare subsidies and universal pre-K, could potentially raise the labor force participation rate which would increase economic output. Other than the BBB, no additional major pieces of fiscal policy legislation are likely to be enacted ahead of the 2022 midterm elections.

U.S. Dollar

Given the Fed's accelerated timetable for tapering its bond buying program and raising interest rates, we expect to see the dollar continue to strengthen. Interest rates in the US are expected to rise faster than rates in Europe as the European Central Bank (ECB) has expressed less concern than other central banks about inflationary pressures. This divergence between the outlook for ECB policy and a faster-acting Federal Reserve leads us to expect a weaker euro relative to the US dollar.

U.S. Dollar Trade-Weighted Index



Source: Board of Governors of the Federal Reserve System

Eurozone

Real GDP for the euro area is anticipated to grow by over 3% in 2022, putting output only slightly below its pre-pandemic trajectory. With the pent-up gains from reopening mostly exhausted, consumer spending will return to pre-pandemic patterns as demand moves away from goods and into re-opened services. As in the U.S., consumers will remain the key driver of the economy, benefiting from plenty of accumulated savings, the rebound in disposable incomes, and reduced uncertainty.

Emerging Markets

Pandemic-induced supply-side constraints will continue to weigh on the performance of export-dependent Asian economies. The slowdown in China has been a concern, not just for other Asian economies, but also for resource-rich nations such as Chile and Brazil which are tightly connected to Beijing in global supply chains.

Economic performance has varied greatly by country depending largely on the effectiveness of policymakers in containing the virus and in providing fiscal and monetary stimulus. The economies and finances of many are strained. Rising global interest rates and falling currency values could push debt-dependent countries to the brink. A debt crisis would be catastrophic and could trigger political instability, asset price volatility, and diminished growth.

The recent pick-up in commodity prices should bode well for the commodity-dependent Latin American economies. But exporters and factories have continued struggling with scarce inputs, shipping delays and chronic port congestion. Faced with growing inflationary and currency pressures, central banks in Brazil, Russia, Mexico, and Chile have already raised interest rates, risking their embryonic recoveries. More countries are expected to follow suit in the next year.

Market Outlook

Recap

2021 was another stellar year for equities while most bond sectors turned in negative returns as interest rates began to rise as a result of growing inflationary pressure. As has been the story for much of the past decade, the major technology companies helped US large-cap equities outpace both smaller cap domestic stocks as well as international and emerging market equities. A record bounce-back in corporate profits and an increase in corporate stock buybacks both helped boost U.S. stock prices.

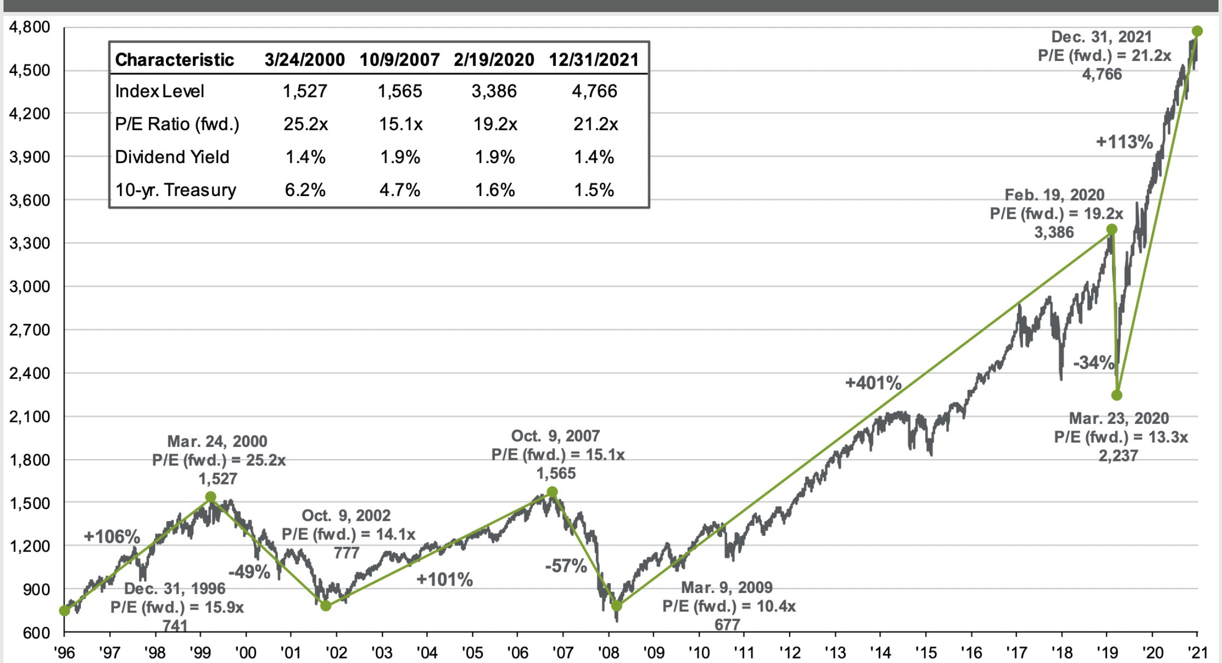
US economic growth and corporate profits reached multi-decade record levels while the Federal Reserve maintained its highly accommodative policy stance through most of the year. The S&P 500 rose 11% during the fourth quarter and posted a 28.7% return for the year. This compares to domestic midcaps and small caps as measured by Frank Russell Company which returned 22.6% and 14.8% respectively during 2021. The MSCI EAFE (European, Australian, and Far East Index) returned 11.3% while the MSCI Emerging Markets Index posted a 2.5% loss, largely driven by a 21.7% drop in China.

The top sectors of the S&P 500 were Energy (+55%), Real Estate (+46%), and Financials (+35%). For large companies, growth slightly outperformed value, but in small and mid-caps, value stocks were much stronger.

Outlook

The driving factors behind the growth of the stock market have been strong, above-trend economic growth and record levels of corporate per-share earnings growth. Because of pandemic related shut-downs in 2020, earnings growth in 2021 relative to 2020 was unusually high. While economic growth is expected to continue to be strong in 2022, the rate of earnings increase will probably be less than half the 2021 rate and should slow even further in 2023. As a result, US equity performance is also expected to slow significantly. High valuations relative to historical norms also represent a risk to equity market performance.

S&P 500 Price Index



Characteristic	3/24/2000	10/9/2007	2/19/2020	12/31/2021
Index Level	1,527	1,565	3,386	4,766
P/E Ratio (fwd.)	25.2x	15.1x	19.2x	21.2x
Dividend Yield	1.4%	1.9%	1.9%	1.4%
10-yr. Treasury	6.2%	4.7%	1.6%	1.5%

Source: JP Morgan

The bond market is also facing significant uncertainty. While rates rose during 2021, they didn't move much. Long-term interest rates remained low, fluctuating between about 1.2%-1.7% for the benchmark 10-year US Treasury. The market is apparently unconvinced that inflation poses a major threat to bond investors. This may change as the Federal Reserve shifts monetary policy to a less accommodative stance in 2022. What seems likely is that the US dollar will remain strong given both our relative economic strength and the anticipated rise in U.S. interest rates. These factors should attract foreign capital, which may support the bond market despite average yields likely falling well below inflation.

There remains a litany of other factors that will have an impact on earnings and stock and bond prices in the year ahead. The first is how much the Fed raises short-term rates, and how much this shifts the entire yield curve. Other influential issues include the gradual healing of supply chain issues, the absence of new stimulus money going into household bank accounts, the 2022 mid-term elections, and increased wages and decreased Covid risk drawing people back into the workforce.

Vaccines, treatments and our collective experience have helped us develop a better working knowledge about how to manage our way through life during a pandemic. We should now be able to put all this to work in more effective ways than was possible just 12 months ago.

Sources: Capital Market Consultants, Department of Labor, Department of Commerce, Morningstar, Bloomberg, Standard & Poor's/Case-Shiller, European Commission, European Central Bank

INVESTMENTS / PLANNING / IMPACT

COLORADO CAPITAL MANAGEMENT provides investment management and financial planning to high-net-worth individuals and their families. As fee-only advisors, we place your interests first as we develop prudent and thoughtful financial strategies designed to both limit risk and meet specific long-term goals. We also offer sophisticated impact investing strategies for investors wishing to combine financial returns with positive social and environmental impact.

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