THE FINANCE COUPLE™

TWO PERSPECTIVES WITH ONE FOCUS... YOU

A Review of 2021 and Preview of 2022

January 2022

"The more things change the more they stay the same." – Alphonse Karr

First off, let me say that I am bewildered in more ways than one that we are actually in 2022. Aside from the fact that we are all probably grateful that 2021 is in the rear-view mirror (and *definitely* grateful that 2020 is even farther back!), I am personally perplexed how it is that I keep getting older – and professionally perplexed how I have become the "experienced" guy that's done this for over 25 years now. Oh well, spilt milk and lost hair are certainly pointless exercises in worry.

As for what happened in 2021, I guess according to our newsletter twelve months ago we were right; the markets did very well and inflation has not been just "transitory". To wit, we wrote that although the U.S. stock market was in a bubble due to pandemic-related fiscal and monetary stimulation, the markets were more likely to continue to go up than down. We reminded everyone that "just because we may be in a bubble does not mean that the markets will come crashing down soon; on the contrary, our best guess is that the markets will continue to inflate in the short-term." "You see markets tend to move to extremes, and though a market may be overvalued and irrational, bubbles can still inflate for weeks, months or years." However, we also said that "our combined forty years of experience, plus extensive research, informs us that markets do eventually rationalize to counter current craziness", and thus "it's the mid to long term that we worry about." For 2022, we see more of the same; though optimistic for the short term (1-3 years) despite the terrible start so far, we worry about the mid to long term (3-20 years).

With that being said, and knowing the future is unknowable, we have always and will always stick with our philosophy of planning, in good times and bad, for good times and bad; this is one of the reasons we took advantage of the runup in the stock market last year. In spite of our short-term outlook, we simply could not ignore the very rapid appreciation, coupled with historically high valuations, in the U.S. indexes – so we recommended to sell some U.S. stock for most everyone last year (and though we are always cognizant of potential tax consequences, we cannot be apologetic for unexpected and wonderful taxable gains).

Twelve months ago we also worried about the consequences of the U.S. government printing money with abandon. Unfortunately, the "transitory" inflation narrative turned out to be much more fiction than the Federal Reserve and most politicians had hoped; now the narrative is that inflation is just "peaking". But there is reason to doubt that inflation, which ran hot at 7% for 2021 according to the Consumer Price Index, is not here to stay, especially since the supply-chain issues that everyone

likes to blame may not be resolved quickly. And don't forget strong demand, the other side of supply, where an inflationary spike may be sustained by recent and ongoing easy money policies. This is why we believe the Fed will have no choice but to raise rates four to five times this year to catch up with what everyone already knows.

As for the U.S. stock market, 2021 was great, but there's interesting data to digest; namely, there were very few stocks in the indexes that actually carried the year, not unlike 1998/1999. For instance, Goldman Sachs noted that only five stocks accounted for over one-third of the S&P 500's return last year. And Sundial Capital noted that although the tech-heavy Nasdaq was down over 7% recently, more than 39% of the stocks in that index were down by more than half! Again, we're not saying the market is going to crash, but it's certainly not emblematic of a healthy market.

As always, the real question is what to do? In line with our common sense asset management approach, we recommend several things: First, maintain the appropriate asset allocation for your specific needs, and use an "asset dedication" approach whereby certain asset classes are designated to fulfill certain needs; over-simplifying, use cash for short-term needs, bonds for the mid-term, and stocks for the long-term.

Two, don't forget that the utility of an asset class is more important than its return. Thus, you should care more that your cash is available to spend rather than the fact that you're receiving a paltry return on your checking or savings account (.5% if you're lucky!). As for bonds, it's true that values may decrease as rates increase (and vice versa), but volatility tends to be much lower than stocks and thus bonds can serve as a better asset class for mid-term needs. As for stocks, remember they are meant for long-term needs (10+ years), and don't get infatuated with any one market. Pay attention to research such as that by market historians Elroy Dimson, Paul Marsh, and Mike Staunton, that shows that the U.S. hasn't always been so exceptional (from 1950 to 2010, U.S. stocks returned 6.9% a year above inflation, including dividends, while the rest of the world returned 7.6%).

Last but not least, never get caught up in the euphoria or despondency of the moment or year. After twenty-five years of working with individuals on their financial planning and asset management, I've seen a lot, and the one thing that always stays the same is that fear or greed can cause more harm than most anything else.

As always, thanks for friendship and trust, thank you for your referrals, and have a great 2022!

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