ANEET P. DESHPANDE, CFA, SENIOR MANAGING DIRECTOR, CHIEF INVESTMENT STRATEGIST

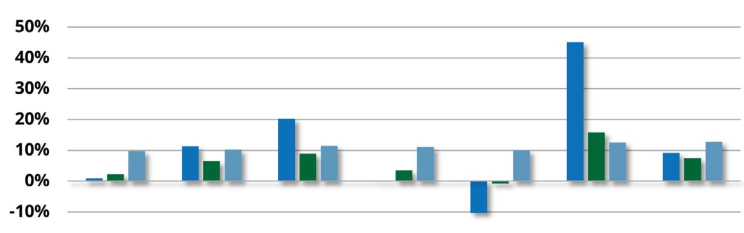
STEALING FROM THE FUTURE

BY ANEET P. DESHPANDE, CFA, SENIOR MANAGING DIRECTOR, CHIEF INVESTMENT STRATEGIST

What do you get when you combine zero interest rates with trillions of dollars in fiscal spending? Corporate profits approaching 50% year-over-year growth and a period of lower returns going forward.

This time last year, market expectations for corporate earnings growth for the calendar year (2021) were for an increase of over +20.0%[1] on a year-over-year basis. By the end of 2021, corporate America delivered earnings growth of nearly +45.0%[1] year-over-year—*the economy recovered enough to deliver nearly **+25 percentage points more in earnings growth** than originally anticipated thanks to higher revenue growth and higher profit margins*.

IMPROVING PROFIT MARGINS BOOST EARNINGS



	2016	2017	2018	2019	2020	2021	2022E
Earnings Growth	0.9%	11.3%	20.3%	-0.1%	-10.3%	45.1%	9.2%
Sales Growth	2.3%	6.5%	8.9%	3.5%	-0.7%	15.8%	7.5%
Net Profit Margin	9.8%	10.3%	11.5%	11.1%	10.0%	12.6%	12.8%

Earnings Growth **Sales Growth** **Net Profit Margin**

Source: Clearstead, Factset Earnings Insight, as of 17-Dec, 2021 includes actual results with Q4 estimates.

SUSTAINABLE CLEARSTEAD

Clearstead recognizes the importance of not only being a steward of client capital, but of being a responsible corporate citizen. This means delivering on our corporate social responsibility by upholding our commitments to all stakeholders, including clients, employees, and the broader community in which we operate.

In 2020, we established Sustainable Clearstead as an umbrella for our various endeavors and to formally recognize our longstanding initiatives. Sustainable Clearstead comprises our Diversity & Inclusion Council; EmpowHER, our women's initiative; the Clearstead Foundation; the Clearstead Scholarship Fund with the Ohio Foundation of Independent Colleges; and the volunteer efforts and civic board service of our partners and employees.

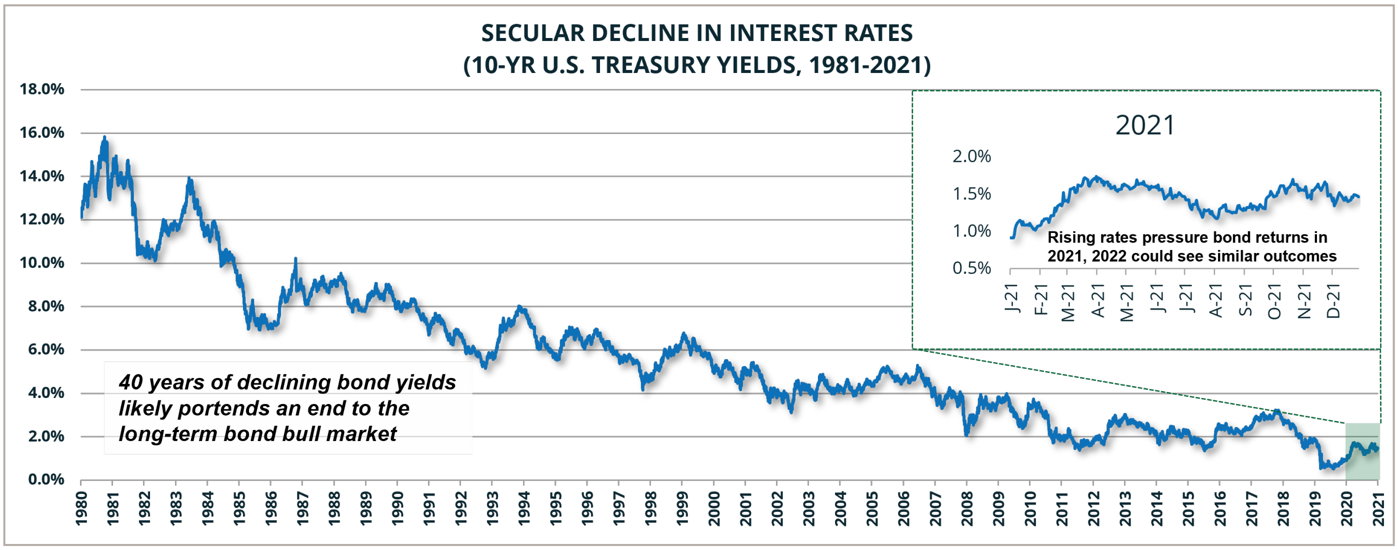
Our 2021 Sustainable Clearstead Impact Report describes these activities, among others. The report, and more about Sustainable Clearstead, can be found on our website: https://www.clearstead.com/sustainable/.

STEALING FROM THE FUTURE

BY ANEET P. DESHPANDE, CFA, SENIOR MANAGING DIRECTOR, CHIEF INVESTMENT STRATEGIST

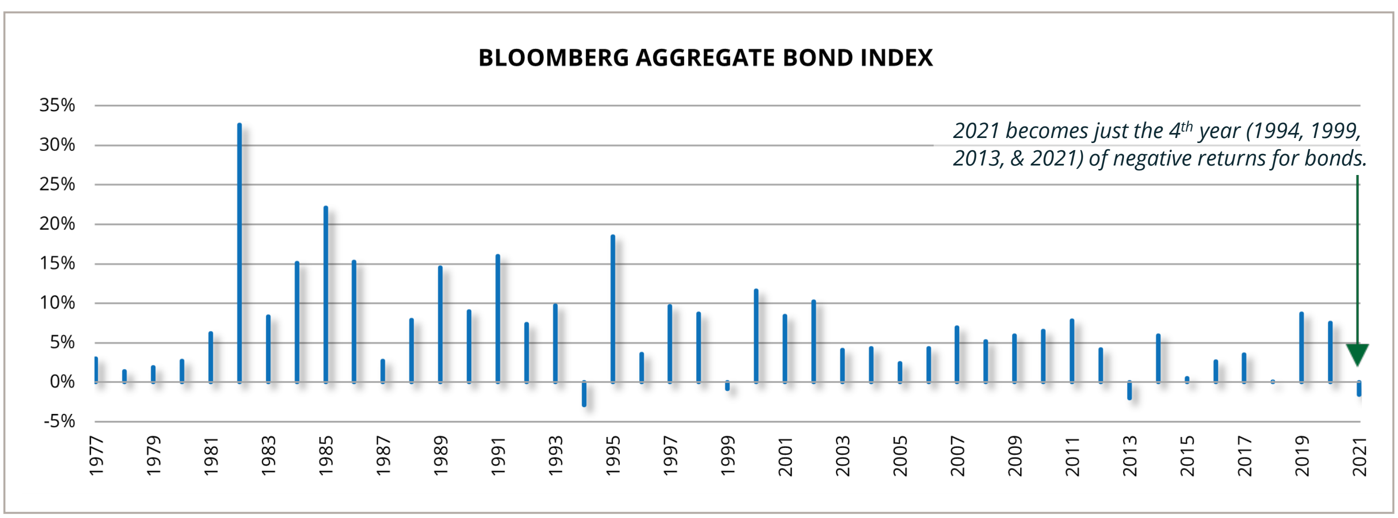
Not surprisingly (in the spirit of stocks following earnings), domestic equity markets responded, with the S&P 500 Index posting gains of 28.7%[2] in 2021 and closing the year at fresh all-time highs.

Meanwhile, treasury yields began 2021 low enough for us to note that return prospects in fixed income were destined for disappointment and a focus on credit would be important during the year. The 10-Yr U.S. Treasury yield would grind higher from .92% to 1.51% by year end leading to broad fixed income market losses (Bloomberg U.S. Aggregate Index) of -1.5%[2] in 2021, while credit—high yield (Bloomberg High Yield Index) in particular—gained 5.3%[2].



Source: Clearstead, Bloomberg LP, as of 28-Dec, Daily U.S. Treasury yields, 1981-2021.

For 2022, fixed income remains in the same precarious position as 2021, and perhaps more so now under the backdrop of higher inflation and with the Federal Reserve (along with other global central banks) embarking on a tightening cycle that is expected to begin mid-2022. The Fed is anticipated to cease its bond buying (quantitative easing) program in the early part of 2022 as it prepares for its first interest rate hike since December of 2018. Based on Fed Funds futures markets, a total of three rate hikes of 0.25% are expected over the course of 2022, the first of which is anticipated in May.[2] Disappointing returns seem to be the anticipated path for most fixed income markets in 2022 and we continue to have a relative bias towards private credit and non-traditional income markets—public and private. Remarkably, if the bond market (Bloomberg Aggregate Bond Index) does produce negative returns in 2022, it would mark the first time since the index's inception of 1977 that bonds would have had back-to-back years of negative returns!

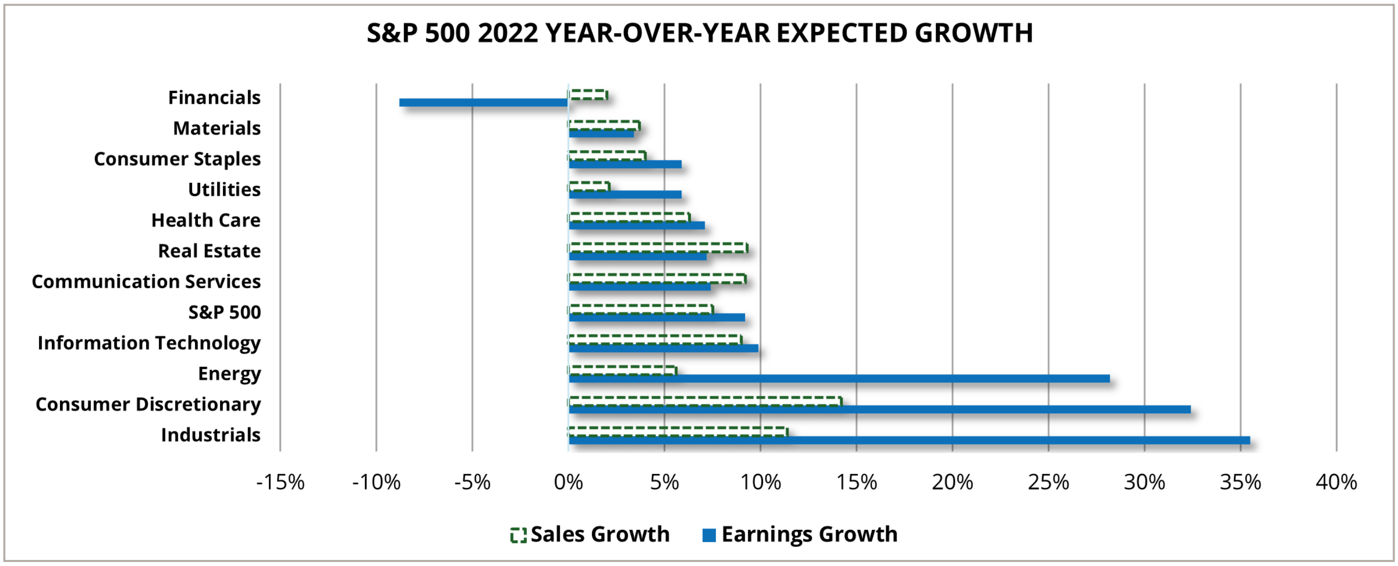


Source: Clearstead, Bloomberg LP, Calendar year total returns, as of 31-Dec.

STEALING FROM THE FUTURE

BY ANEET P. DESHPANDE, CFA, SENIOR MANAGING DIRECTOR, CHIEF INVESTMENT STRATEGIST

In stocks, fundamental strength remains, though we think it unlikely for another +25 percentage point surprise to earnings growth. That said, expectations are for S&P 500 earnings growth of +9.2% on a year-over-year basis for 2022 led by the industrials, energy, technology, and consumer discretionary sectors.



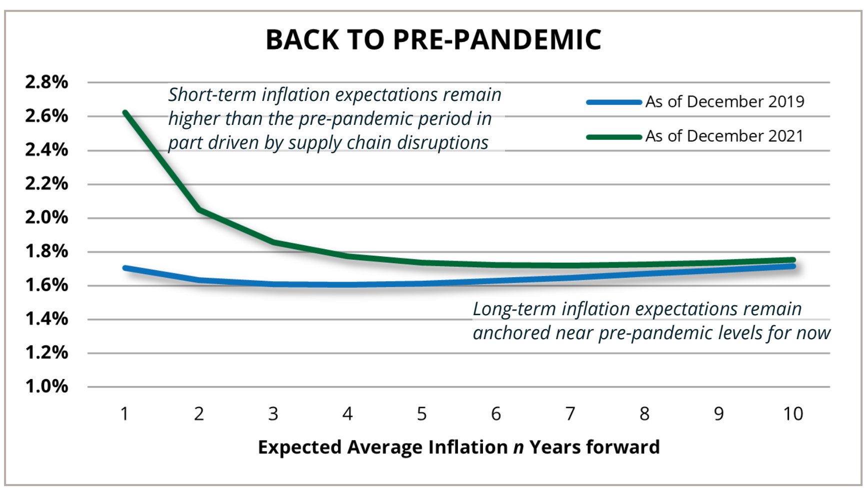
Source: Clearstead, Factset Earnings Insight, as of 17-Dec.

One-year guesses are clearly difficult for equity markets but, once we consider the impact of high single digit expected earnings growth, dividends, and valuations, we would expect high-single to low-double digit returns out of equities for 2022. That may be accompanied by the potential for more volatility, particularly as compared to the sleepy 2021 which saw just one decline of more than -5.0% during the year. Ultimately, the probability of generating the majority of total returns through capital gains in most publicly traded investments is unusually low. The more practical assumption going forward is that income (e.g., dividends) may play a more meaningful role in the total returns of equities. As with any short run forecast, the range of outcomes is wide and, if valuations continue to contract as they did throughout 2021, then equity returns will fall short of our baseline.

ON INFLATION AND PORTFOLIOS

While equity markets tolerated inflation last year, we must recognize that some of that tolerance stems from the real growth the economy witnessed in 2021. Yes, there was inflation, but there was also significant economic growth. While core inflation most recently registered 4.9% on a year-over-year basis, real GDP is likely to have grown by over 5.5%[3] in 2021 (meaning the economy, in nominal GDP terms, would have grown by nearly 11% for the calendar year 2021).

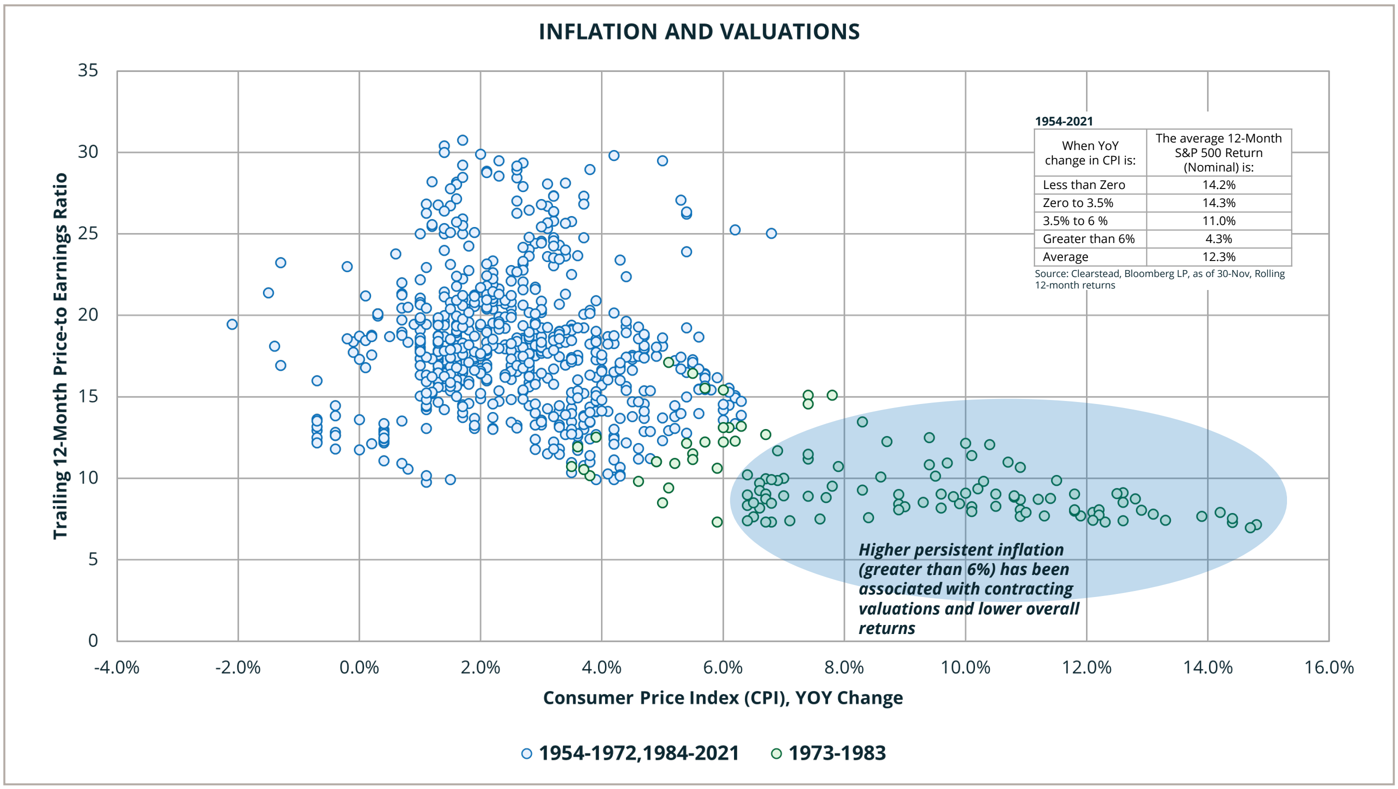
Another critically important factor is that long-term inflation rates remain well anchored—thanks in large part to the disinflationary forces brought on by demographics and technology—despite the pandemic-driven rise in short-term realized inflation.



Source: Clearstead, Cleveland Federal Reserve inflation model, as of 17-Dec, the model incorporates market-based as well as survey-based measures of expected inflation to produce one-to-thirty-year estimates of average inflation expectations.

That said, a potential source of heightened volatility for equity investors may be linked to a further rise or a persistence in short-term inflation expectations above 6.0% (our line in the sand for where we think equities get hurt). During those periods of sustained inflation over 6.0% we have seen empirically that returns and valuations tend to be lower as compared to when inflation is below 6.0%. It may be an overly simplistic observation that minimizes other variables that could have existed during those periods, nevertheless it is a worthwhile illustration.

Side note: If we are being intellectually honest, the impacts of inflation are always most felt by those less fortunate (significant inflation inequalities exist)—those with little tangible and/or financial assets and where the cost of consumption is not offset by gains in income. Further, U.S. investor distrust of inflation and ergo our own currency is somewhat in contradiction to the demand of U.S. dollars by foreign citizens, central banks, and governments alike. U.S. dollar shortages have and may persist in the intermediate-term, and in the game of relative relationships like foreign exchange, this point matters.



When YoY change in CPI is:	The average 12-Month S&P 500 Return (Nominal) is:
Less than Zero	14.2%
Zero to 3.5%	14.3%
3.5% to 6 %	11.0%
Greater than 6%	4.3%
Average	12.3%

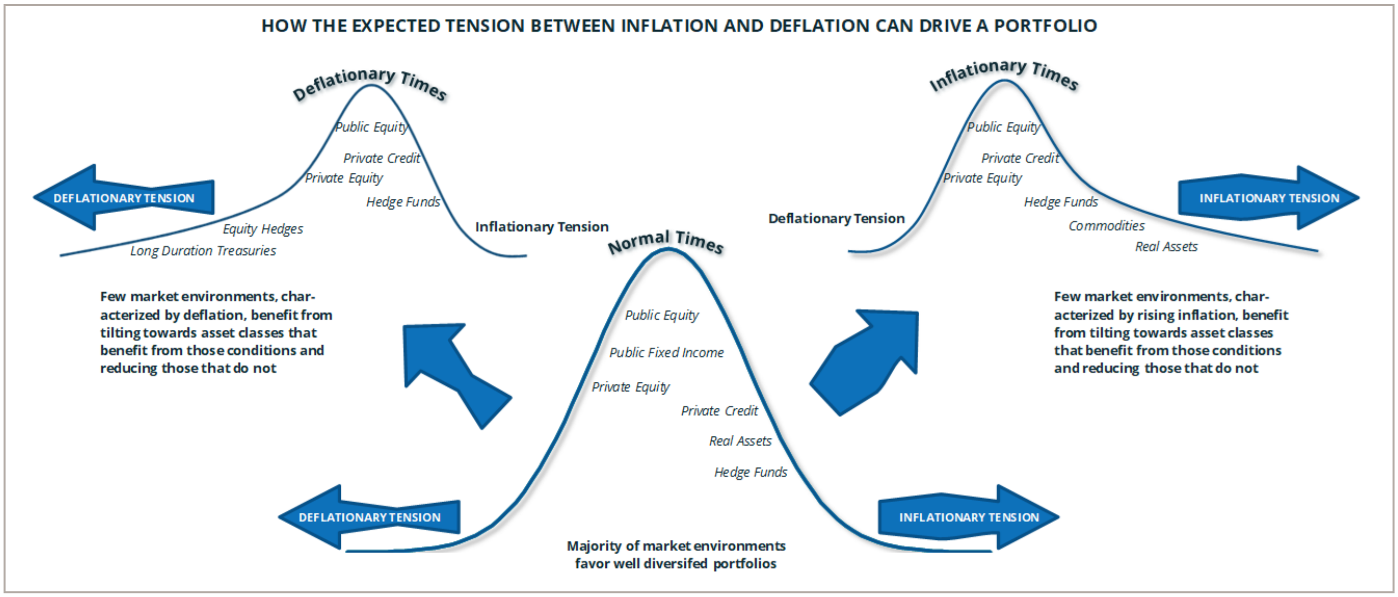
Source: Clearstead, Bloomberg LP, as of Dec 2021.

We would argue that the market's tolerance of inflation would be more logically tested in an environment with much lower expected real GDP growth combined with higher inflation. The former is not our baseline, and we expect those short-term inflation pressures to wane over the year and so 2022 is not expected to be characterized by higher inflation and lower growth (aka stagflation), but rather by lower, albeit respectable, growth (real GDP of 3.5%-4.0%) and declining inflation or at least contained inflation below 6.0%—an environment that could see equity markets grind higher and fixed income markets remain choppy as previously noted. *Consider this the mid-to-late innings of the current business cycle.*

Furthermore, the following illustration may provide some context as it connects inflation to portfolio construction. Importantly, when, and how, client portfolios could change in response to inflation conditions will largely depend on **not only inflation but also real economic growth**.

STEALING FROM THE FUTURE

BY ANEET P. DESHPANDE, CFA, SENIOR MANAGING DIRECTOR, CHIEF INVESTMENT STRATEGIST



Hypothetical asset allocation under varying inflation regimes. For illustrative purposes only. Blue line is inflation tension, area under the curve is an investment portfolio.

However, if we are just talking about inflation, when there is a generally equal tension between accelerating inflation and decelerating inflation, as we have had for a few decades now, a standardized approach to asset allocation (a simple diversified portfolio) has been the best remedy. As that tension is drawn to either accelerating or decelerating inflationary pressures, portfolio asset allocation may need to shift modestly as well. Our job is to understand the drivers that may result in a shift in inflation and align portfolios accordingly. To that end, we continue to test our investment thinking to recommend investment strategies for our clients to meet their inflation-adjusted objectives.

TOP 5 POTENTIAL MARKET SURPRISES

We asked our colleague and industry veteran Jim Awad for his top five surprises that may shake, or shape 2022. Jim's over 50 years of market experience is called upon frequently in our researching of markets and economics. He frequents television as a guest and is a long-standing member of an elite investors group now hosted by private equity giant Blackstone. Jim offered the following, which would be surprises to our base case for the year. Any, or a combination, of these surprises would certainly serve as catalysts for market volatility and we would not consider these to necessarily be low probability events.

1) Fed raises only once as fiscal and monetary drag and virus slow the economy.

2) Democrats keep House and Senate as Democrats move to center.

3) Corporate profits are flat as opposed to consensus expectations of 9% gain.

4) China moves on Taiwan militarily.

5) Both Trump and Biden announce that they will not run in 2024.

STEALING FROM THE FUTURE

BY ANEET P. DESHPANDE, CFA, SENIOR MANAGING DIRECTOR, CHIEF INVESTMENT STRATEGIST

CLOSING

With another good year in equity markets behind us, we begin to downshift expectations for the near future and the longer-term. The significant fiscal support and highly accommodative monetary conditions appear to be removed, or are in the process of being removed, leaving markets and investors to normalize expectations going forward. Further, 2022 will bring plenty of macroeconomic and geopolitical uncertainty back to the fold with mid-term elections looming and a global central bank tightening cycle on the horizon. Equity markets could ultimately cut through the noise as fundamentals may prevail, albeit at a lower rate of change than in the recent past. Meanwhile bond markets may be tested given the backdrop of low beginning yields and rising interest rates. Lastly, our advice continues to focus heavily on private markets where the long-term return potential remains more attractive relative to their public market counterparts. We wish you all a healthy and happy new year.

Sources:
(1) Factset Earnings Insight
(2) Bloomberg LP, as of 31-Dec
(3) The Conference Board, U.S. Economic Outlook, 15-Dec

MARKET BENCHMARK RETURNS

December 31, 2021		1M	3M	12M	YTD
US Large Cap	S&P 500	4.5%	11.0%	28.7%	28.7%
US Small Cap	Russell 2000	2.2%	2.1%	14.8%	14.8%
Developed Intl	MSCI EAFE	5.1%	2.7%	11.3%	11.3%
Emerging Intl	MSCI Em Mkt	1.9%	-1.3%	-2.5%	-2.5%
Real Estate	NAREIT	9.2%	15.2%	39.9%	39.9%
Core Fixed	BarCap Agg	-0.3%	0.0%	-1.5%	-1.5%
Short Fixed	BarCap 1-3Yr	-0.2%	-0.6%	-0.5%	-0.5%
Long Fixed	BarCap LT G/C	-0.8%	2.2%	-2.5%	-2.5%
Corp Debt	BarCap Corp	-0.1%	0.2%	-1.1%	-1.1%

Source: Bloomberg

Past performance is not an indicator of future results.