Palisade
CAPITAL MANAGEMENT

Fourth Quarter
2021

Private Wealth Management

Year-End Update and 2022 Outlook

	Dec. 31, 2021	Dec. 31, 2020	% Change
S&P 500® Index	4,766.2	3,756.1	+26.9%
Dow Jones Industrial Average	36,338.3	30,606.5	+18.7%
NASDAQ Composite Index	15,645.0	12,888.3	+21.4%
Russell 2000® Index	5,580.2	4,908.0	+13.7%
VIX Volatility Index	19.7	23.6	-16.5%
Barclays Bond Index – ETF "AGG"	114.1	118.2	-3.5%
10-Year U.S. Treasury Yield	1.51%	0.92%	+64%
Baltic Dry Index – Spot (Ocean Cargo Shipping Rate)	2217	1366	+62.3%
Gold ($ per ounce) – NY Spot	1,830	1,898	-3.6%
Oil ($ per barrel – West Texas intermediate)	75.21	48.35	+55.6%
Bitcoin ($)	47,985	29,220	+64.21%

Source: FactSet Research Systems, Inc.

What a year! The bellwether Standard & Poor's 500® index of domestic stocks rose by 27% during the last twelve months, one of its best showings in the last twenty years. If key events from the "real world" of 2021 had been known to us *last* January, we would not have predicted such a rosy outcome; a pileup of disruptions might have been expected to produce a market headwind. Among these events were the unconceded presidential election (and the January 6 Capitol insurrection), ubiquitous supply chain breakdowns, a sharp acceleration of price inflation, and – not least – the forever pandemic of the Covid-19 virus and its variants. So why did markets perform so well last year? In two words: *recovery* and *cash*.

Recovery. The prospect of a robust post-pandemic economic recovery, so tantalizing in the first weeks of the vaccine roll-out in December 2020, became reality last year. Nearly 13 million Americans were vaccinated just in the first few weeks of the program in mid-December (2020), and from that time on economic activity grew as did consumer and investor confidence. By the second and third quarters of `21, the U.S. gross domestic product grew by 16.8% and 9.8%, respectively, well above the economy's 10-year average growth of 3.8% per year. And by the September quarter, corporate after-tax profits ran 27% ahead of the same period in 2020 (fourth quarter data is not yet available).

Cash. We can't ignore the importance of excess personal savings – liquidity – in fueling the growth of financial asset prices last year. This surplus, estimated to have ballooned to $2.6 trillion (12% of GDP) by last spring, arose from multiple rounds of direct federal aid to individuals and households, as well as support programs like loan forbearance and child credits. Anecdotally, it appears that *some* of that cash found its way into traditional stocks, as well as more speculative investments like cryptocurrencies, non-fungible tokens, SPACs (special purpose acquisition companies), and "meme stocks" (shares of marginal companies embraced by cohorts of allied retail investors).

Excess cash may have helped fortify an ancient emotion – envy – best expressed by the acronym FOMO (fear of missing out), which describes one's feeling of seeing another person (one less deserving than oneself, of course!) enjoy a ride on a valuation rocket like Bitcoin (up 64% last year and up 1,200% in the past three years). Excess cash may have precipitated something else: the acronymically described feeling of YOLO ("you only live once"). It's been estimated that 4.3 million Americans have left the workforce since the start of the pandemic, some perhaps forever. In part, it's because the job leavers' windfall may have afforded them the freedom to drop out, or at least seek better paying employment. A by-product of The Great Resignation, as it's been called, has been tight labor markets and rising wage inflation. This may be the reason that the Federal Reserve recently said it will conclude its $120 billion/month bond

purchase program months earlier than planned, and perhaps raise the central bank's foundational interest rate, the discount rate, by as many as three times in 2022.

The questions we are asked most often are: (1) Is it time to move out of stocks? (2) Can you explain cryptocurrency, and should it have a role in my portfolio? And (3) Has the long run of strong stock market performance for technology shares ended?

Is it time to move out of stocks? The simple answer is no. Stocks have been a consistent engine of wealth creation for decades – better than bonds and certainly superior to cash (treasury bills). Maybe the better question is this: What market sectors should we focus on now? A few ultra-large stocks sucked up a massive share of the recent growth in the market's value. Just three stocks – Alphabet (Google), Apple, and Microsoft – accounted for 25% of the S&P 500's® *total* growth last year. Many smaller stocks saw little benefit from the growth of the indices last year; they could be due for a catch-up. Higher interest rates might clip the valuations of the mega-caps, most of which trade at price/earnings ratios above the general market; higher rates tend to impact the valuations of high P/E stocks more than lower P/E stocks. It's our job to identify the "best of the rest" – those somewhat overlooked but growing and profitable smaller companies, particularly in sectors likely to benefit from the market's shifting dynamics. For example, financial issuers like banks could benefit from rising interest rates. Perhaps, too, shares of certain industrial and materials companies could profit from the +$1 trillion that Congress has earmarked for infrastructure outlays over the rest of the decade.

Will the indices suffer a major correction? An intra-year drawdown of 15-20% is entirely possible, as such corrections occur with some frequency, but then usually prove to be short-lived. Trying to time the market is usually a foolish pursuit. For all the current bearishness evinced by writers of market letters, the outlook for corporate earnings is encouraging. Market data firm FactSet Research Services reports that US corporate earnings are expected to rise by 9% this year, and by another 10% in 2023. That compares well with the 7%/year growth of corporate earnings over the past 15 years.

What about crypto? Digital currency, or cryptocurrency, is worth $3 trillion today, an impressive number to be sure, but still less than 1% of the value of the world's stocks, bonds, and circulating currencies. Crypto is not money in the way economists define money – a store of value, a medium of exchange, and legal tender. But we believe crypto *can* be legitimate money if its value were tied to a reserve currency like the dollar or the euro ("stable coin") and regulatory oversight were implemented to thwart hackers and other miscreants. Crypto could be a cheaper, faster, and safer way of transferring funds than the current system of bank wiring services and clearing houses. At this moment, though, Bitcoin and other cryptocurrencies are *investment assets* whose valuations are untethered to any notion of intrinsic worth. Bitcoin could be just as easily priced at $100 or $100,000, and to assert otherwise is merely to state an opinion, not to offer a reasoned demonstration of value.

Is it game-over for digitally focused shares? After a long and impressive run, large cap technology shares seem to be losing ground. Over the last twenty years, the IT exchange traded fund XLK grew by a factor of 12 times versus 5 times for the S&P 500® itself. A rest may be in order, as no industry sector can maintain stock market leadership forever. The technology sector now comprises 29% of the S&P 500®, larger than the next largest sector (health care) by a factor of 2.2. But a rest is just a period of inactivity to restore vigor. Technology is now, and will likely continue to be, the connective tissue underlying all industries and companies in their drive to enhance growth, raise productivity, and serve the interests of shareholders, employees, and society. To be sure, there are some bad actors and bad practices in the tech sector, but that does not diminish the generally beneficial aspects of digital technologies.

Thank you for allowing us to manage your investments. We aim to reward your faith with creativity, diligence, and good results.

Sincerely,

Palisade Capital Management, L.L.C.

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The S&P 500® Index is an unmanaged index that is widely recognized as an indicator of general market performance. The S&P 500® Index does not have a defined investment objective, unlike the indices above, nor does it charge fees and expenses.

The Dow Jones Industrial Average is a price weighted index comprised of 30 of the largest and most widely held public companies in the United States.

The NASDAQ Composite Index measures all NASDAQ domestic and international based common type stocks listed on The NASDAQ Stock Market.

The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. It consists of approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. Source: London Stock Exchange Group plc and its group undertakings (collectively, the "LSE Group"). © LSE Group 2022. FTSE Russell is a trading name of certain of the LSE Group companies. "Russell®" is a trade mark of the relevant LSE Group companies and is used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote, sponsor, or endorse the content of this communication.

VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500® Index options.

The Barclays Bond Index – ETF "AGG" tracks an index of US investment-grade bonds. The market-weighted index includes Treasuries, agencies, CMBS, ABS and investment-grade corporates.

The Baltic Dry Index (BDI), is issued daily by the London-based Baltic Exchange. The BDI is a composite of the Capesize, Panamax, and Supramax Timecharter Averages. It is reported around the world as a proxy for dry bulk shipping stocks as well as a general shipping market bellwether.

West Texas Intermediate (WTI) is a grade of crude oil used as a benchmark in oil pricing and is the underlying commodity of the New York Mercantile Exchange's oil futures contracts.