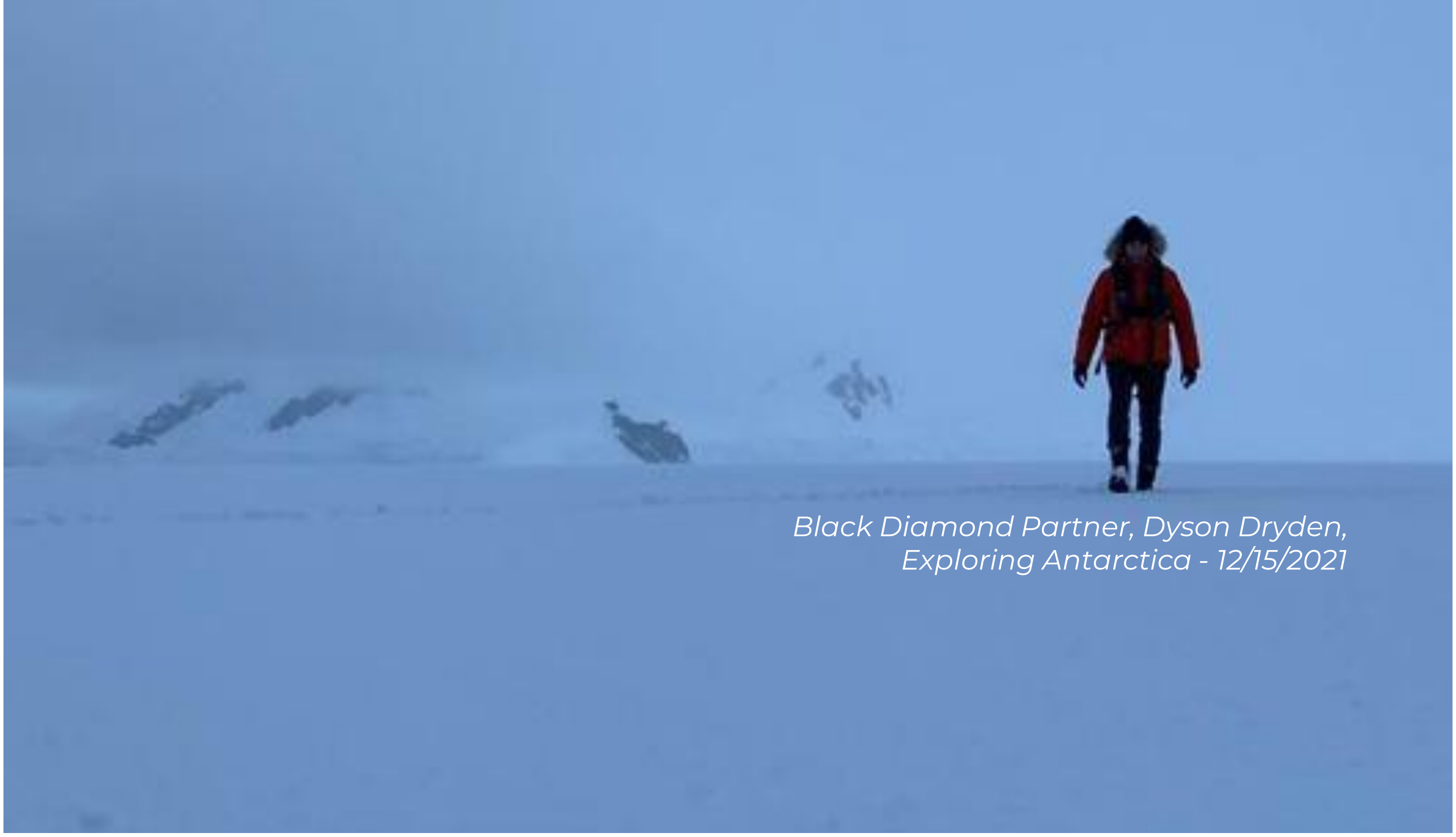
BlackDiamond Financial

INVESTMENT INSIGHTS

FOURTH QUARTER 2021

Key Topics

- Record Highs and Low Volatility Contribute to Strong Year for Stocks
- Stocks Perform Well During Inflationary Periods
- Federal Reserve Plans to Fight Inflation



Black Diamond Partner, Dyson Dryden,
Exploring Antarctica - 12/15/2021

MARKET UPDATE

Economic Rebound Sends Stocks to All-Time Highs

Record Highs and Low Volatility Contribute to Strong Year for Stocks

In 2021, central bank measures helped bolster the global economy during the unprecedented global health crisis. The Federal Reserve was steadfast in its support of the U.S. economy maintaining a Federal Funds target range of 0.00% - 0.25%, despite concerns over rising inflation. This, in part, led to corporate earnings reaching all-time highs and household balance sheets remaining very strong. The risk of higher taxes from the Build Back Better plan also appears to have been eliminated.

The successful authorization and distribution of vaccines enabled the reopening of the world economy. Still, as we head into 2022, there are concerns the Omicron variant may lead to further disruptions. While many people are hurting today, there is growing evidence that the worst could be over very soon. Increased federal government testing and new drugs such as Pfizer’s Paxlovid are expected to substantially reduce hospitalizations and mortality rates.

Real estate was the top-performing asset class in 2021, up 43.1%. U.S. equities were also exceptional, led by large-company U.S. stocks that rose 28.7%. Bonds were little changed this quarter and produced a negative 1.5% return for the year.

The stock market was far less volatile than expected in 2021. The S&P 500's largest drawdown from a peak was just 5%, which is abnormally smooth. However, individual stocks within the index experienced significant volatility, with 93% of the index's constituents dropping by at least 10% during the year. Furthermore, the average drawdown across all S&P 500 stocks was 19%. Interestingly, the individual constituents of the NASDAQ index were more than twice as volatile as the S&P 500, with an average drawdown of 42%. This data exemplifies the benefits of diversification, which can substantially reduce volatility compared to owning a small group of individual stocks.

Comparative Returns

		Annualized Performance			
	Q4 2021	1 Year	3 Years	5 Years	10 Years
Large Cap U.S. Stocks[1]	11.0%	28.7%	26.0%	18.5%	16.6%
Small Cap U.S. Stocks[2]	2.1%	14.8%	20.0%	12.0%	13.2%
International Stocks[3]	1.8%	7.8%	13.2%	9.6%	7.3%
Real Estate[4]	16.3%	43.1%	18.5%	10.8%	11.3%
U.S. Bonds[5]	0.0%	(1.5%)	4.8%	3.6%	2.9%

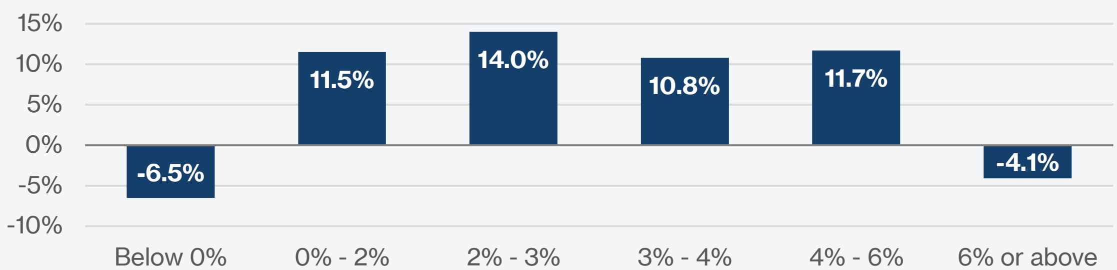
1 S&P 500 index, which includes 500 of the largest U.S. companies in all sectors of the economy
2 Russell 2000, which includes the 2000 smaller stocks of the Russell 3000 index
3 MSCI ACWI ex-U.S. index, which includes large and mid capitalization stocks from developed and emerging international markets
4 MSCI U.S. REIT index, which includes domestic publicly traded real estate stocks
5 Bloomberg Barclays Aggregate Bond index, which includes a representation of the performance of the entire U.S. investment grade bond market

Stocks Perform Well During Inflationary Periods

Inflation remained high across most economies in 2021, driven by higher demand as pandemic restrictions were lifted and lower supply resulting from global labor and input shortages. CPI was up 6.8% from November 2020 to November 2021, growing at the fastest pace since 1982. A return to 1970s-style stagflation is not expected, but inflation could remain elevated as the forces of supply and demand take time to stabilize. As shown in the graph below, heightened inflation rates have not been correlated with sub-par stock market returns until the inflation rate exceeds 6% per year. Although 2021 exceeded this benchmark, inflation will likely decline in 2022. On the other end of the spectrum, stocks tend to fall when inflation is negative and asset values decline throughout the economy.

Average Annual Equity Returns at Different Inflation Rates

1970 – 2020



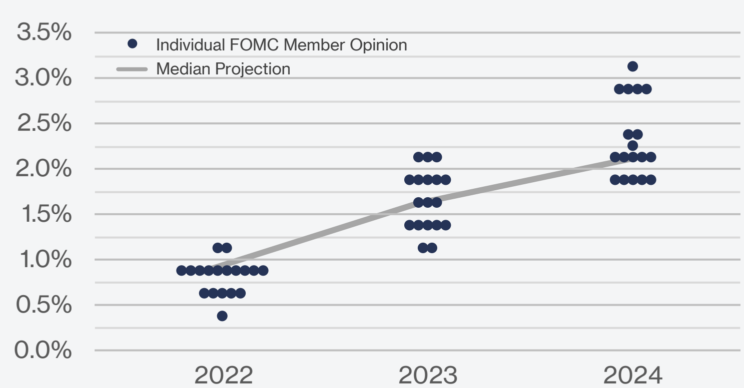
Source: Capital Group, Bloomberg, Morningstar, Standard & Poor's. All returns are inflation adjusted real returns. Equity returns represented by the S&P 500 Composite index. Inflation rates are defined by the rolling 12-month returns of the Ibbotson Associates SBBI U.S. Inflation Index.

Federal Reserve Plans to Fight Inflation

Concern over rising inflation has accelerated the Federal Reserve's plan to raise interest rates and dampen the pace of rising prices. The market closely watches the Fed's "dot plot" where each dot on the graph represents the Federal Funds interest rate expectation for one of the 18 Federal Open Market Committee members for each year-end. Over the last three months, the dot plot has shifted from expecting no changes in 2022 to expecting three 0.25% rate increases. Based on the dot plot, expectations suggest three additional 0.25% rate increases in 2023, putting the Federal Funds rate between 1.5% and 1.75% by the end of 2023.

As the Fed Funds rate increases, rates on savings accounts, CDs, short-term bonds and consumer loans tend to rise similarly. The stock market closely watches the Fed for guidance on interest rates and reacts quickly to surprises. Typically, stocks do well during periods of slowly rising rates and they have reacted positively to the Fed's recent guidance.

Interest Rate Projections Rise



Source: Federal Reserve December 2021 Projections

BlackDiamond Financial

ABOUT US

Black Diamond Financial, LLC is a fee-only registered investment adviser with a unique and holistic focus on preserving and enhancing wealth. Our mission is to help you achieve your financial goals through the use of low cost, tax-efficient investment strategies. We create individualized investment portfolios for each client that are risk-appropriate, returns optimized, and tax-efficient. Furthermore, we believe cost is a critical factor in any successful investment strategy and therefore offer fully transparent pricing that is well-below industry standard. As an employee-owned firm focused on our fiduciary duty, we make our clients' interests our highest priority.

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