



Sage 2022 Investment Outlook

2021 REVIEW:

- U.S. and international developed market stocks experienced strong returns in 2021, while emerging markets struggled with negative returns, and bonds saw varying performances.
 - In what proved to be a record year of profits, U.S. large-company stocks surged 26.5% for the year. Companies fared well internationally, too. While emerging market stocks declined by 2.5%, international stocks gained 7.8% overall.
 - Rising interest rates caused high-quality investment-grade bonds to fall 1.5% in the fixed-income space, while unconstrained bonds had slightly positive returns. Strong economic growth and consistent demand for tax-exempt assets supported municipal bonds, which rose 1.5%. However, emerging market debt fell 1.8% in 2021 as COVID-related headwinds weighed on economic growth.
- Despite predictions that inflationary pressures would ease last year, inflation has remained elevated into 2022, caused mainly by disruptions in Southeast Asia and extended financial aid for citizens in the U.S. As the old joke goes, *"Why did God create economists?... To make weathermen look good."*
- Sage's diversified portfolios performed well in 2021, helped by the fact that we used:
 - Nontraditional bonds, equities, and other asset classes, which tend to perform well during a strong economy and in inflationary environments, and
 - Asset classes such as alternative and traditional bonds for diversification during volatile periods throughout the year (i.e., asset classes that have little, or negative, correlation with the rest of the portfolio, tend to reduce overall portfolio fluctuations).
- Our approach to portfolio management is not to time the markets. Instead, we stick to a disciplined, well-diversified strategy that involves rebalancing through market fluctuations and periodically recommending tactical changes based on economic conditions and our outlook.
- In our view, this approach leads to the highest probability that each of our clients will realize good returns that enable them to reach their financial goals.

2022 ECONOMIC OUTLOOK:

- After the initial rebound in growth following the 2020 recession, we think that the economy is shifting from the early to middle innings of the economic cycle.
- We have identified three major themes, which we believe may have the most impact on 2022 economic growth and thus are driving our outlook on major asset classes around the world:
 - Strong consumer demand for goods and services
 - Less accommodative monetary policy
 - Evolution of the COVID virus
- While risks remain, our base-case scenario is that the U.S. economy will grow by 3.5-4.5% in 2022 year-over-year. Conditions for corporations remain positive (i.e., revenue growth, margins, etc.) and should support equity returns.
- Overall, we expect global growth to exceed 4% in 2022. In addition, we expect emerging market growth to rebound following a year of poor performance.



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Three Major Themes of 2022

- *Consumer Demand Remains Strong*
 - U.S. consumer spending comprises roughly 70% of the U.S. economy, and consumers have built up “excess savings” (i.e., savings above what would have been natural without the pandemic) of \$2.5 trillion.
 - Historically, excess savings are spent over 3-5 years following an economic downturn, but we expect the suppressed demand for services (e.g., travel, restaurants, etc.) to pull more spending into 2022.
- *Less Accommodative Monetary Policy*
 - 2022 is likely to be a challenging year for central bankers, who need to balance higher inflation and a tight labor market. Inflation is likely to decelerate from its current level as supply chains normalize and spending shifts somewhat to services from goods. In addition, the unemployment rate recently fell to a very low 3.9%, putting more upward pressure on wages.
 - Central banks are becoming moderately more aggressive, signaling a faster pullback of bond purchases than previously expected and the introduction of higher rates this year.
 - Because economic growth remains strong, we believe that the backdrop for equities is positive. However, less accommodative monetary policy, leading to higher interest rates, could mean more volatility for stocks and bonds.
- *Evolution of the COVID-19 Virus*
 - COVID continues to evolve in terms of the virus itself and the response by government officials, citizens, and the medical community. There were three impactful new COVID variants in 2021, of which Omicron was the most contagious.
 - The most important variable with Omicron, and any other new variant, has become disease severity. While the virus spread quickly in countries like South Africa, the infection waves have receded faster than expected, without significant increases in hospitalizations or deaths.
 - On a positive note, the lower severity (so far) of Omicron suggests that there are unlikely to be additional economic restrictions. Additionally, if the South African pattern holds in other countries, the waves of infection may recede faster than in the past.

PORTFOLIO IMPLICATIONS:

Fixed Income:

- We believe that rates will rise modestly over the next year but largely trade within a range. This is because demand for yield will likely cap rates earlier in the current economic cycle. We also think that high-quality bonds will provide diversification benefits, despite lower yields than pre-2020.
 - *United States:* In the U.S., bond yields are likely to move higher but sustainably and gradually. In recognition that fiscal budget deficits are expanding and there is potential for above-trend economic growth, our portfolios are positioned with less duration than we would generally expect to have over the long term.
 - *Foreign bonds:* Many developed market bond yields remain negative and/or significantly below U.S. bond yields, lessening investment attractiveness. Therefore, we prefer emerging market bonds with higher yields (greater than 5% annualized) and a backdrop of expected economic growth.



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Equities:

- Equity markets have several tailwinds, including continued strong economic growth and pent-up demand from consumers and corporations.
 - *United States:* Given our outlook for above-trend (3.5-4.5%) GDP growth in this continued recovery, we anticipate maintaining our slight overweight to U.S. stocks with a relative bias for small-caps due to more attractive valuations.
 - *Foreign stocks:* We are biased towards overweighting foreign equities based on more attractive valuations.
 - The performance of the U.S. and international developed markets (defined by MSCI EAFE) has rotated over time. The current period of U.S. outperformance has been the longest in duration, dating back to 1970. Still, developed market equities have had long periods of outperformance, such as during the 1980s and 2000s, a pattern that may repeat.
 - We expect that China, the world's second-largest economy, may be poised to bounce back in 2022, despite changing government policies, which should provide a supportive backdrop for emerging market stocks.
 - Emerging market stocks, generally, despite weakness throughout most of 2021, may present attractive return opportunities due to fast-growing populations, fair valuations, and commercial innovation.

BENEFITS OF DIVERSIFICATION:

- Diversified asset allocation is the cornerstone of some of the world's largest and most successful portfolio management companies. It is also how Sage Financial Group has been approaching investment management since its founding in 1989.
- Given low current interest rates and tight bond spreads (the difference in yield between high-quality and lower-quality bonds, from a fixed-income perspective), and average or somewhat elevated U.S. stock valuations (from an equity perspective), we believe that a diversified portfolio will be more likely to deliver a more consistent return over time.
- We will continue to monitor and consider opportunities to add diversifying strategies in 2022. For example, incorporating nontraditional asset strategies could provide additional sources of potential return because portfolios may not be able to rely as heavily on traditional U.S. stocks and bonds for above-average returns in the coming years.

CONCLUDING THOUGHTS:

- Markets had a strong year in 2021 after a tumultuous 2020, although this past year presented its own challenges. Corporations registered substantial profit growth in 2021, despite navigating through choppy markets fraught with pandemic-related economic issues.
- In 2022, we expect three themes to drive financial market returns: strong consumer spending, inflationary pressures leading to tighter monetary policy, and the evolution of the COVID-19 virus. We also expect that the positive environment for corporations will foster continued higher profits and a favorable backdrop for stocks.
- We continue to recommend a mix of U.S. and international bonds, stocks, and alternative investments because we believe, over time, portfolios appropriately mixed with diversifying assets are likely to help clients advance toward their financial goals in a consistent manner with their risk-return profile.



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- As always, we will continue to closely monitor, analyze, and evaluate market, geopolitical, and economic data, consider any implications for investors, and advise you of significant developments that could impact your investments.