

Client Note – 2021 Review & Looking Forward

2021 was another reminder that forecasts are close to worthless. After a somewhat surprisingly positive year in 2020 one could have been forgiven for predicting negative returns in 2021. Not only did that not happen, 2021 turned out to be a very strong year for global equities.

Often what concerns investors is very different from what drives market behaviour as we have seen since Covid emerged in early 2020. As a result, the last two years has seen a surprising period of positive returns in financial markets generally. The reasons for these positive returns are many. Among them the introduction of Quantitative Easing by global governments, low interest rates which have resulted in no real return from deposits and bonds, coupled with the rapid expansion of technology on multiple fronts.

The table below provides a summary of 2021 returns for several major equity, bond, commodity and currency markets/indices.

2021 Gains / Losses	
Index, Currency, Bond	Gain/Loss
MSCI World Index (€)	29.26%
FTSE World Index (€) (x-US)	13.20%
S&P 500 Index (€) (US)	35.80%
FTSE Asia Pacific Index (€)	4.50%
FTSE Emerging Markets Index (€)	4.40%
Euro Stoxx 50 Index (€)	21.00%
ISEQ (Irish Stock Exchange)	15.66%
Gold Price (€) *	3.30%
Commodities Index (€)	37.10%
Dollar Trade Weighted Index	6.40%
Sterling Trade Weighted Index	5.20%
€/\$ Exchange Rate	-7.00%
US 10-Year Bond Yield	0.92% - 1.51%
German 10-Year Bond Yield	-0.0039

* Gold is priced in US Dollars and when converted resulted in a -3.6% real return.

Multi Asset Approach – The Best Strategic Strategy for a Conservative Investor

For a multi-asset strategy, equities, inflation-linked government bonds and even gold (when measured in euro terms) delivered positive returns. Fixed income government bonds delivered modestly negative returns and bank deposits yielded nothing.

Strong US Equity Returns

For euro-based investors, the MSCI World Index (global shares) gained 29.26% in euro terms (19.89% in dollar terms). In contrast, if we exclude US equities, the FTSE World x-US Index gained a far more modest 13.2% in euro terms (5.9% in dollar terms). The lower returns from non-US equity markets reflected, to a significant degree, the much more modest returns from both the Asia Pacific (+4.5% in euro terms) and emerging (+4.4% in euro terms) markets. Eurozone equities gained 21%.

China – A Poor Performer

The relatively poor returns from Asia Pacific and the Emerging equity markets largely reflects the hammering that the Chinese stock market took in 2021. This was mainly down to a negative shift in the regulatory environment weighed on China's largest companies, dragging the Chinese equity market into significant negative territory for the year.

Interest Rates

Long-term interest rates rose modestly with the US 10-year bond yield rising from 0.92% at the start of the year to 1.51% by year end. German 10-year interest rates rose from a negative yield of -0.57% at the start of 2021 to -0.18% by year end. **This directly impacts on Irish deposit holders with the introduction of negative deposit rates by Irish Financial institutions in 2021. Banks are passing on the negative rates to deposit holders to cover their costs.** Rising bond yields mean lower bond prices, so that fixed income government bonds delivered modest low negative returns in 2021.

Currency Update

In currency markets the US dollar gained 7% on the Euro in 2021. More recently, £1 Sterling is now at €1.20. This presents an opportunity for those waiting to exchange funds from Sterling to Euro. The Turkish lira was the standout loser in foreign exchange. The instability was punctuated by turnover in the country's finance minister position. While most other emerging economies raised interest rates to fight against inflation, Turkey has continued cutting rates and looks set to default on its external debt.

Commodities

The outlook for commodities is more delicate. Most commodities had a very strong 2021 except for Gold. When we look at the soaring inflation rate of 2021 investors would have expected a stronger performance in Gold due to its defensive nature.

Despite most physical and digital commodities seeing price gains, precious metals such as gold (-3.6% when we look at the US dollar valuation) and silver (-11.7%) struggled to hold onto their value. Whereas industrial and battery metals like lithium (477.4%) and cobalt (207.7%) surged. The likelihood of higher interest rates and a greater emphasis on controlling inflation is a bad omen for precious metals such as gold and silver.

All that glistens is not Gold – Cryptocurrencies

The gold price was up 3.3% in euro terms for 2021 (although down 3.5% in dollar terms). A disappointing outcome in a year when inflation surprised to the upside. Some analysts feel this reflects the emergence of cryptocurrencies with bitcoin being the new digital gold.

As some of our clients know, we are still very sceptical on cryptocurrencies but only time will tell. Money has been defined as having five characteristics - **divisibility, durability, consistency, convenience** and **an alternative use value**. If you are deciding whether to invest in cryptocurrencies, these are the attributes you should consider. If you can't trade widely in a currency, it's not money.

Gold – An Enduring Asset

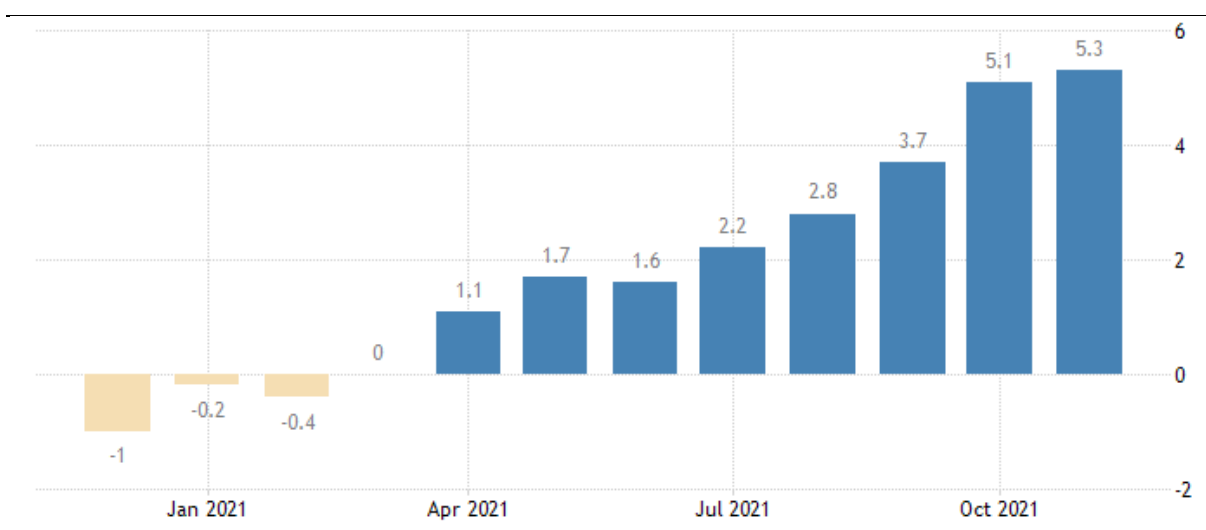
To have enduring value an asset must either exhibit 'use value in and of itself' or have a revenue stream that provides an income to its owner. Gold has value, if not as a currency, then for purchase of items such as jewellery and/or industrial purposes. Demand from these sources alone, underpins the gold price, irrespective of its use as money. Businesses (companies) and property assets provide owners with an income stream. Companies that can grow their income (earnings) at an above average rate over the long-term are rare and often have a competitive advantage that keeps competitors at bay. Cryptocurrencies lack these characteristics and alternative use values.



Inflation – The silent Erosion of Value

Inflation is a major risk for long term investors, particularly to clients who need to preserve the wealth that they have accumulated, or those sitting in cash. If one adds in negative returns on those cash funds, it can result in a significant loss in value of which many investors are currently unaware. The insidious erosion of purchasing power needs to be taken seriously; even at what appears to be relatively benign levels of inflation, it is still a major concern.

The chart below outlines Irelands Consumer Price Inflation rate (CPI) for 2021 at 5.3% in December, rising from 5.1% in November and is at its highest reading since June 2001. The most notable changes in the year were increases in *Transport* (+17.1%), *Housing, Water, Electricity, Gas & Other Fuels* (+14.3%), *Restaurants & Hotels* (+3.9%) and *Alcoholic Beverages & Tobacco* (+3.4%).



Source: Central Statistics Office Ireland

Most at Risk – Retirement Quartile

In simple terms, if you had €100,000 on deposit in January 2021, with a 5.3% inflation rate this is now worth €94,700 in January 2022 - a loss of €5,300. And that's before one factors in negative rates on cash and deposits. Although inflation is certainly better now than during the peaks of the 1970s and early 1990s, it is still a very substantial risk. Particularly vulnerable are those who are in retirement or approaching retirement.

Purchasing Power can be Diminished

A rough rule of thumb for estimating how many years it takes to halve purchasing power of money at a specific rate of inflation is the 'Rule of 72'. One simply divides 72 by the rate of inflation. On this basis, inflation at 10% will halve purchasing power in just over 7 years. Even at 2.5%, the value of money halves in under 30 years.

Portfolio Construction

When constructing investment portfolios, we are very aware of the inflation risk that exists. We structure portfolios using growth assets (equities and alternative assets) as the main building block that can help to mitigate it. Growth assets are the main way to protect against inflation.

Looking Forward

As the global economy emerges further from Covid in 2022, there is cautious optimism. The early signs are of a rapid economic recovery that will lead to a period of sustained growth for economies around the world. The performance of equity markets throughout 2021 was significantly buoyed by this view.



US equity markets have outperformed other global equity markets in 2021 as highlighted in the above chart. Corporate earnings grew strongly in the US in 2021 and on the surface it would seem that this justified the 36% (€) advance in US equities.

Areas for Concern

The concern is that we have not previously seen such growth in US earnings over such a short period and it may simply reflect a massive and continuing build up in US debt. How this is consistent with ultra-lower interest rates and higher inflation in our view is where the risks lie.

Coupled with this, there is a growing sense that the phase in financial markets illustrated in the chart above is coming to an end and that we are entering a new phase with market returns unlikely to come near the levels seen in recent years.

Looking Forward

In addition, looking forward the pattern of returns could well be a lot more uneven compared to what investors have become used to. As we start out in 2022 much of the 'good news' – insofar as corporate and economic performance and outlook is concerned – are reflected in valuations. The big question is are we facing into one or more events which could tip the markets in the other direction?

The risk of course is that a downward shift in markets could be substantial due to a number of factors which are evident, including:

- a) High valuations
- b) Substantial 'new money' in markets more prone to panic
- c) High levels of passive investment which could accentuate negative spirals
- d) The US midterm elections in November which are seen as a significant global geopolitical threat

Trigger Events

History has taught us that the trigger event for a market correction cannot be foreseen as such (if it were markets would already have moved). That said, there are plenty of potential flashpoints out there from which such a trigger event could be generated. These include the following:

- A new variant resulting in a significant worsening of the Covid situation globally
- Long term inflation taking hold
- A further rise in US - Russia / China tensions
- War breaking out between Russia and the Ukraine

The latter of these possible events appears to have kicked off already over recent weeks. It remains to be seen what the ultimate impact on markets will be. Each year there are similar such events which are cause for concern and yet markets continue to grow over time. All things considered, we can expect another volatile year in 2022. If it works out as well as it has for markets over the last 2 years investors won't complain.

Achieving a Balance - Between Short- and Long-Term Considerations

As we have previously advised when investing it is about finding a balance in your portfolio between growth assets (equities) and defensive assets (deposits & bonds). It is about calculating your short-term needs in line with the risk of longer-term investments.

The Signs are Still Positive

We remain optimistic following on from a strong 2021. Fiscal stimulus coupled with low interest rates and further row back of Covid restrictions should continue to support equity performance in the year ahead. There will always be negative surprises in the markets to trigger short term dips. However, overtime, the great companies of the globe continue to generate profits and growth. These are the opportunities in which you should invest.

Equities Offer Protection against Inflation

Equities over the longer term have proven to offer the best returns and to protect against the impact of inflation. Therefore we believe that the only reliable way to capture the full long-term return of equities is to ride out their frequent but historically always **temporary declines**.

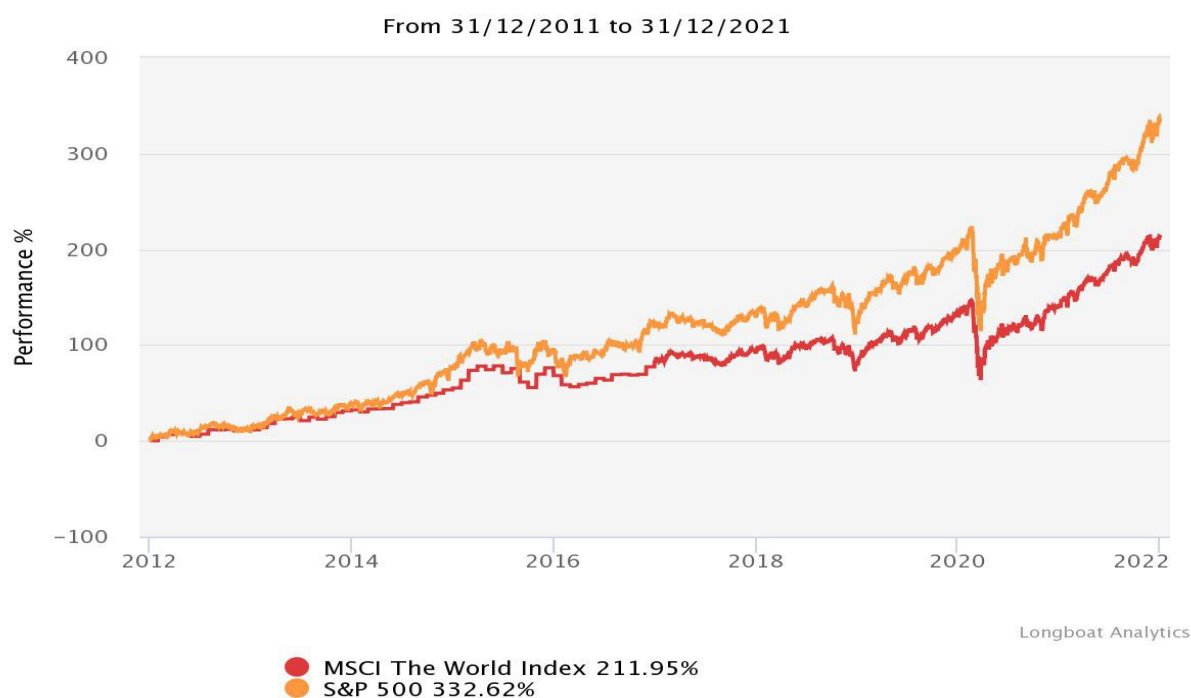
In the next month, we will be issuing a more detailed note on the long term impact of inflation and how we assist clients to protect their finances.

A note on Oakwood Financial Advisors and our investment approach

For investors, it can be easy to feel overwhelmed by the relentless stream of news about markets. Being bombarded with data and headlines presented as affecting your financial well-being can evoke strong emotional responses from even the most experienced investors.

Staying Invested to Produce Better Returns

For many, feelings of elation or despair can accompany turbulent headlines. We should remember that markets can be volatile and recognise that, in the moment, doing nothing may feel paralyzing. However, if one had hypothetically invested €100,000 * in global developed stocks MSCI World Index in January 2012 and stayed invested, that would be worth approximately €211,100 at the end of 2021. If the funds were invested solely in the US S&P 500 your funds would be now worth €332,620.



* The performance figures assume reinvestment of dividends each year and gross of charges. Typical charge net 1% pa.

If we include the Global Financial Crisis of 2008 (markets dropped circa 50%+) in the figures and look at the same amount invested the €100,000 would still be worth today over €152,590 and €289,670 respectively over a 15 year term.

Long Term Benefits

When faced with short-term media noise, it is easy to lose sight of the potential long-term benefits of staying invested. While no one has a crystal ball, adopting a long-term perspective can help change how you view market volatility and help look beyond the headlines.

General Principles

- At Oakwood Financial Advisors we are long-term, goal-focused, plan-driven advisors with an emphasis on equities. We believe that the key to lifetime success in equity investing is to **act continuously** on a specific, written plan. Likewise, we believe substandard returns and even

investment failure proceed inevitably from **over reacting** to (let alone trying to anticipate) current economic/market events.

- We are convinced that the economy cannot be consistently forecast, nor the markets consistently timed. Therefore we believe that the only reliable way to capture the full long-term return of equities is to ride out their frequent (but historically always) **temporary declines**.
- If we look at the most popular global equity index – the US S&P 500 - in the last four decades, the **average annual price decline** from a peak to a trough in the S&P 500 exceeded 15%. One year in five, the decline has averaged at least twice that - **minus 30%**. And on two occasions (in 2000-02 and 2007-09), the Index has actually gone down 50%. Yet the S&P 500 came into 1980 at 106, and finished 2021 at **4766**. **Over those 42 years, its average annual compound rate of total return (that is, with dividends reinvested) was more than 12%**.
- These data underscore our conviction that the essential challenge to long-term successful investing is neither intellectual nor financial, but temperamental: it is how one reacts, **or chooses not to react**, to market declines.
- These principles will continue to govern the essentially behavioural nature of our advice to you in the coming year....and beyond.

Current Observations

- It would seem to be counterproductive to look at these past 12 months in isolation. They were, rather, the second act of a drama that began early in 2020, the precipitant of which was the greatest global public health crisis since the Spanish Flu over 100 years ago.
- Governments elected to respond to the onset of the pandemic essentially by shutting down the global economy—placing it, if you will, in a kind of medically induced coma. If we look at the largest global economy, the US, it experienced the fastest economic recession ever, and a one-third decline in the S&P 500 in just 33 days.
- Governments and Central Banks responded all but immediately with a wave of fiscal and monetary stimulus which was, and remains, without historical precedent. This point cannot be overstressed: we are in the midst of a fiscal and particularly a monetary experiment which has no direct predecessors. This renders all economic forecasting - and all investment policy based on such forecasts - hugely speculative. I infer from this that ***if there were ever a time to just put our heads down and work our investment and financial plan - ignoring the media frenzy - this is surely it.***
- If 2020 was the year of the virus, 2021 was the year of the vaccines. Vaccination as well as acquired natural immunity are in the ascendancy. That is regardless of how many more Greek-letter variants are discovered and trumpeted to the skies as the new apocalypse. This fact, it seems to me, is the key to a coherent view of 2022.
- In general, I think it most likely that in the coming year
 - (a) the mortality rates from the virus continues to decline
 - (b) the world economy continues to reopen
 - (c) corporate earnings continue to advance

(d) Central Banks will begin withdrawing excess liquidity from the banking system, with some resultant increase in interest rates,

(e) inflation recedes somewhat, and

(f) barring some other unknown variable - which we can never really do - equity values continue to advance, though at something less (and probably a lot less) than the surprising pace at which they've been rising since the market trough of March 2020.

- **Please do not mistake this for a forecast.** That being said, to me, these outcomes seem more likely than not. Our investment policy is driven entirely by the investment plan we've made, and not at all by the vagaries of current events and media headlines.
- These have undoubtedly been the two most shocking and terrifying years for investors since the Global Financial Crisis of 2008-09. First the outbreak of the pandemic, next the bitterly partisan US presidential election and attempted putsch. This was followed by the pandemic's second major wave, and most recently, a 40-year inflation spike. You might not be human if you haven't experienced serious volatility fatigue at some point. I know I have!
- But like that earlier episode, what came to matter most, was not what the economy or the markets did, but what the investor himself/herself did. If an investor fled the equity market during either crisis and sat in cash - his/her investment results seem unlikely ever to have recovered. If on the other hand he/she **kept acting on a long-term plan** rather than reacting to current events, **positive outcomes followed**.

As always, I welcome your comments, questions and concerns. We cannot predict, but we can plan.

Thank you for your continued support and looking forward to working with you in 2022 and beyond.

Ronan McGrath
Managing Director
Oakwood Financial Advisors
M: +353 (0) 86 6098615
E: ronan@oakwoodfinancial.ie

7th Jan 2022

Legal Information and Disclosures

This document expresses the views of the author as of the date indicated and such views are subject to change without notice. Oakwood Financial Advisors has no duty or obligation to update the information contained herein and past investment performance is not an indication of future results. Additionally, wherever there is the potential for profit there is also the possibility of loss.

*The information contained herein **does not constitute and should not be construed as an offering of advisory services** or an offer to sell or solicitation to buy any investments, securities or related financial instruments.*

Certain information contained herein concerning economic trends and performance is based on or derived from information provided by independent third-party sources. Oakwood Financial Advisors believes that the sources from which such information has been obtained are reliable; however, it cannot guarantee the accuracy of such information and has not independently verified the accuracy or completeness of such information or the assumptions on which such information is based.

Warnings:

Past performance is not a reliable guide to future performance.

The value of your investment may go down as well as up.

If you invest in any of the funds you may lose some or all of your money.

The information contained in this document does not constitute financial advice.