Investor Insights & Outlook

January 2022 4th Quarter **Concorde Investment Management**

Domestic Economic Overview

> **A Message from Concorde Investment Management**
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Another quarter, another variant, this time being Omicron. Omicron spread rapidly and effectively and as of this writing it looks like the disease spread has peaked and is receding nationwide. Omicron was much less lethal than previous variants, either through its nature, vaccination, or previous immunity.

Regardless, the domestic economy for the quarter didn't seem to be impacted given the timing of when Omicron showed up. Q4 GDP was 6.9% (annualized), faster than the expected gain of 5.5%, driven by sizable increases in inventories and consumer spending. The total for the full year 2021 was 5.7%. These are both real gains, meaning nominal growth less inflation. Nominal growth for 2021 was 10%, increasing $2.1 trillion over 2020 to $22.99 trillion for the year. We've mentioned in the past that this is one of the goals of central bankers and the government. Nominal increase in growth reduces the ratio of debt to GDP. As we've discussed, inflation remains highly elevated and is eating into real wage gains. The core personal consumption expenditures price index which is the preferred inflation gauge for the Federal Reserve rose 4.9% from a year ago, the biggest gains since 1983. Inflation will be the focus for the Federal Reserve Bank and the Biden Administration going forward. The toolbox for the Fed tends to be limited to adjusting interest rates and we are not optimistic that increased rates will have the desired effect.

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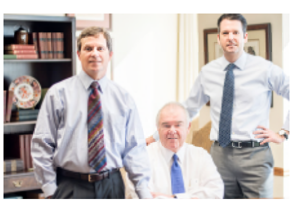
The Concorde Team



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Domestic Economic Overview (continued)

We've mentioned before that job openings are at all-time highs which gives workers pricing power. Companies have too many jobs and not enough workers. Wage price inflation will continue which will feed into consumers having more money to spend which contributes to inflation pressure.

From an activity standpoint, we've started to review high frequency data that shows spending by category and consumer credit transactions are above where they were two years ago, hotel occupancy was above previous levels however dipped slightly at the end of the year due to Omicron, and dinners and airline traffic were almost back to the same levels as two years ago. Essentially, the public is learning to live and function with Covid-19. The disease is turning (has turned?) endemic and will most likely continue to be around in some form or fashion for years and therefore we don't expect much economic impact, if any, from any future iterations of the disease.

International Economic Overview

Every aspect of the global economy continues to be impacted by Covid. IHS Markit has a survey where they determine delivery times by asking participants in 44 different countries "Are your suppliers' delivery times slower, faster, or unchanged on average than one month ago?". In our last report we indicated this reading was at all-time lows, meaning slower delivery times. The indicated number had not improved as of the end of November, which was before Omicron swept over the globe. The more concerning survey for the global economy continues to be the input and output prices of the Purchaser Manager Index. Input prices are leading output prices and they were continuing to rise as of the end of November, the last reading. Input and output prices are dramatically above historical readings and continue to rise. The idea of inflation being transitory continues to fade as global economic indicators point to sustained rising prices. The hope that prices will come down has to do with the 'bullwhip' effect. Meaning producers have inventory issues so they order more in anticipation of demand which further exacerbates supply chain issues. Eventually, producers will have a glut of inventory in silicon chips, toilet paper, etc.

We'd be remiss if we didn't mention the looming conflict in Ukraine. Expectations for a kinetic war have increased and we don't see any reason to be optimistic of Putin backing down. We are not foreign policy experts and so we won't try to guess why Russia is choosing now to invade the Ukraine, however given the troop and heavy machinery movement, conflict looks imminent. As soon as field hospitals are set up we'd expect the conflict to begin. From a global economic perspective, energy prices will continue to rise. The US is threatening shutting down the Nord Stream pipeline which delivers gas to Europe and in particular Germany. The Germans aren't thrilled with this threat given they are already having dramatic price increases in energy and thus will exacerbate the issues. Energy is, of course, an input price in any manufacturing process which means prices globally are not going to recede anytime soon.

Fixed Income

The yield on 10-year Treasury notes (baseline for credit markets) was flat in the fourth quarter but significant changes were found elsewhere in fixed income. As investors began to absorb the reality that the Fed would likely raise short-term rates multiple times in 2022, the yield on 2-year Treasury notes rose from around 25 basis points (0.25%) to 73 basis points at year-end, a dramatic move. Shorter term corporate yields rose in sympathy although credit spreads only widened modestly, indicating confidence in those issues. Despite the recent phenomenon of surging inflation, the 10-year implied inflation rate derived from TIPS and nominal Treasury yields plateaued and has even dropped in the new year to around 2.4%. We believe this reflects the near certainty of less accommodative policy to combat inflation. Whether the Fed is truly behind the curve or can assist in taming the surge that is persisting remains to be seen but will be key to both fixed income and equity valuations, and thus performance, over the next two years.

Our thoughts which drive strategy are that we will eventually see bond yields move somewhat higher than levels in 2018 and 2019. The equity markets can likely handle this if there are not dramatic increases (over 3% on the US Treasury 10-year), however a rise to 2-3% will cause some damage for core fixed income holdings.

Treasury yields have continued to rise in the new year with the 2-year yield rising to 1.15% and the 10-year to 1.80% as of late January. With regard to strategy, we are maintaining our shorter maturity emphasis to avoid principal loss as yields rise and maintain medium to high quality credits with some exposure to lower risk income strategies that should hold up well in this anticipated environment.

Equity Markets

The domestic stock market completed a strong recovery year with good fourth quarter gains. A divergence appeared during the quarter as value stocks of all sizes rose, however only large capitalization growth stocks generated strong gains. The value outperformance reflects the exposure to more economically sensitive sectors. Many smaller and medium growth stocks have been struggling for several quarters as investors have shunned many securities with low or no income or free cash flow. Many large growth stocks have strong fundamentals. Sectors which performed very well include energy, financials, real estate (traditional value sectors) along with technology.

Internationally, the developed western European markets performed well along with the US markets for the final quarter and year to date. Significant losses were incurred in Hong Kong, Brazil, Japan and Russia for the quarter, with some incurring losses for the full year. Certainly, risk is higher for many regions outside North America for multiple reasons and despite historically low valuations we continue to believe modest exposure in these markets is still warranted.

Regarding current valuations and prospects going forward, despite most indices being close to all-time highs as the year ended, there are many individual stocks and some sectors that are far from peak levels. The correction in many high-flying "price to revenue" valuation driven public companies since the first half of 2021 is probably healthy for overall market conditions. Large cap stocks, reflected by the S&P 500, rose 26.9% for the year while earnings actually rose 30% and the multiple on these earnings shrunk. A large part of the earnings growth was generated by improving margins as a result of 2020 pandemic induced cost reductions. We believe increasing input and labor costs will reverse some of the margin widening however technology and structural changes will likely allow for net improvements going forward compared to 2018-19.

Many of our individual holdings are in what we consider to be a fair valuation range, and this is the case much of the time for equities of excellent businesses. We will trim back or sell positions when they stretch beyond that range. In today's market, we continue to find a reasonable number of stocks of good to great businesses that sell below fair valuation and will buy them to replace more expensive holdings. We continue to use fundamental valuation analysis including assumptions including higher interest rates over the next several years. With all that said, selectivity is more important than ever in constructing a portfolio with some downside protection yet providing long-term growth potential.

Leave your Legacy through Planned Giving

There comes a point in life where you want to begin sharing or gifting all the things you've collected over the years—stories, wisdom, financial wealth. And unlike the Ancient Egyptians believed, you cannot take your worldly goods with you when your light goes out. You can share your stories wisdom in a manifesto or through funny tales to your family, but what about the money? Like most, you have (or should have) a will and most of your assets are likely going to friends and family. But, what about the causes and organizations you care about the 501(c)(3)s that depend on kind donations to continue doing the greatest good than you could do as an individual? Who is going to make your annual donation when you're gone?

Planned giving is the answer. Just like it sounds, planned giving is the act of creating a contribution of non-probate transfer vehicles (such as savings and checking accounts, investment funds, real estate), real property, or non-cash assets (like securities or retirement accounts), that is usually dispersed after an individual's passing. However, there are plenty of people who utilize planned giving options of a "retained life estate" or a "charitable remainder trust" during their lifetimes.

A Taxable Difference

Planned giving should feel good knowing you'll be a philanthropic force of support and aid to the people and causes you care about even after you're gone. And, the advantageous tax breaks are the cherry on top. Tax benefits are governed by state and federal laws that define what and when charitable donations make for deductions (income/estate/etc.). To be sure your gift is irrevocable (a contracting term that is usually required for tax benefits), and that you're doing right by your finances, it's wise to talk to your trusted financial advisor and lawyer. Some charities will retain a professional consultant available to help as well.

Surprise!

Many donors of planned gifts make them a surprise. You don't have to tell an organization you're planning on giving them a major donation, but it could help them plan out their budget. Notice of a planned gift is called the bequest intention and isn't legally binding...but it may be of benefit to the receiving organization. Planned giving represents, often, a huge piece of donor gift pie.

Types of Gifts

Not all planned gifts are allocated the same and it's important to know what time of donation you want to give.

- **Charitable bequest:** An official statement in a legal document (such as an estate plan or will) that designates either a specific amount, percentage amount (such as a percentage of total assets), or a remainder amount (what's left over after everything else in the will or plan has been paid out).
- **Charitable gift annuity:** An agreement between the donor (while alive) and the organization where the donor gifts a large sum to the nonprofit. The nonprofit then pays the donor a set portion of that sum for the remainder of the donor's lifetime, where payments usually end with the donor's death and the organization than keeps the remainder of the gift. While this sounds a little funky at first it can have major tax benefits! But, laws on charitable gift annuities range from state to state, so it's wise to check your jurisdiction.
- **Charitable remainder trust:** A trust fund is created and gifted to an organization that then pays trustees an annual amount. When it's all said and done the charity then receives the remaining funds after the trust term is complete. (A charitable remainder unitrust pays a percentage of the leftover trust fund once the term is closed.)

No matter what you want to leave your mark on, be sure to have a plan that sets both you and your intended beneficiaries up for success and to reap the benefits.

Article Source: Advisor Websites