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The Financial Solutions Advisor

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Economic & Market Perspectives

We began last year with high hopes, given the rapid development of vaccines – and those hopes were realized. Several powerful engines drove global stocks – especially developed market stocks – higher: monetary stimulus, fiscal stimulus and the distribution of effective vaccines. In addition, global earnings growth was strong in 2021.

Inflation proved to be a significant issue in 2021. The reopening of economies resulted in higher spending levels, driven by pent-up demand and elevated household savings. Continued waves of COVID-19 caused supply chain disruptions, exacerbating inflationary problems. However, for the most part, markets seemed to look through this.

2021: Markets in a Nutshell

Stocks. Global stocks posted double-digit gains for the year. US stocks outperformed international stocks. Emerging market stocks posted relatively weak returns, dragged down by Chinese equities. The Hang Seng Index was the worst-performing major index as a series of regulatory actions intended to achieve China's "common prosperity" vision caused a sell-off in these stocks.

Bonds. Core bonds underperformed non-core fixed income such as high yield and convertible bonds.

Alternatives. Real estate investment trusts and commodities performed well. Within commodities, energy and precious metals experienced strong gains while gold and silver fell.

Top 10 predictions for 2022

1. The Omicron variant will be a negative force in the short run, exacerbating supply chain disruptions and aggravating inflation. Within a few months, however, Omicron is likely to be a positive force if it remains as mild as we have seen thus far.

2. Emerging markets stocks will have a very bumpy start to 2022, given the spread of the Omicron variant. However, for the full year, emerging markets equities are likely to outperform developed market equities, including US equities. Emerging markets growth will accelerate while US and European economic growth decelerates to more normal levels. Unlike 2021, Chinese equities are likely to help drive EM equities higher in 2022, helped by a re-acceleration of China's economic growth, thanks to monetary and fiscal stimulus.

3. Expect at least one significant geopolitical crisis in 2022 (Russia invading Ukraine is at the top of the list of possibilities), but markets will shrug it off within days after it occurs. In recent years, only trade woes have had a lengthier impact on markets, and even then it has been relatively short-term in nature.

4. There is likely to be a US stock market correction in the first half of 2022, but expect a relatively swift recovery. It's been so long since we have had a sizeable correction that the odds of one have grown — and increasing the odds is the fact that the Federal Reserve is starting to normalize monetary policy in the first half of 2022 and may start to hike rates.

5. Global stock and bond market volatility should increase as the Fed begins to normalize monetary policy. But the Fed has the potential to positively surprise with less tightening than markets currently expect.

6. The Fed will not hike rates in March. It's just too soon, especially given the spread of the Omicron variant. However, the Fed seems eager to start reducing its balance sheet.

7. Cyclical stocks will outperform defensive and secular growth stocks in the US early in 2022 in anticipation of a post-Omicron recovery, but that for the full year, growth will outperform.

8. US inflation is likely to rise further, especially given the spread of the Omicron variant and its potential impact on supply chains and labor, but it should peak by mid-2022 and then slowly decelerate.

9. The 10-year US Treasury yield will end 2022 higher than it is now, as the Fed begins to normalize monetary policy.

10. Finally, expect to see more interest in environmental, social, and governance (ESG) investing in 2022, driven in part by a dramatic acceleration in electric vehicle adoption in the US, Europe, and China.

Source: Kristina Hooper, Chief Global Market Strategist, Invesco US

2021 Returns

S&P 500	*28.71%*
NASDAQ	*27.51%*
Russell Small Cap	*25.66%*
Russell Mid Cap	*22.58%*
MSCI EAFE	*11.26%*
MSCI World	*21.82%*
Barclay US Agg. Bond	*-1.54%*
Barclay Municipal Bond	*1.52%*

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P/E Ratios Offer Multiple Perspectives on Value

Many factors go into decisions on buying or selling shares of a particular stock, but the price/earnings (P/E) ratio can be a helpful starting point for evaluating whether a company's stock is under- or overpriced. The P/E ratio is calculated by dividing a stock's current price per share by the company's earnings per share over a 12-month period. This ratio quantifies what investors may be willing to pay for one dollar of earnings.

For example, a P/E of 20 means an investor would pay $20 for every $1 the company earns over the 12-month period. By this standard, a stock with a P/E of 25 could be considered more "expensive" than a stock with a P/E of 20, regardless of the share price. A higher multiple also indicates that investors may expect higher growth from the company compared to the overall market.

Past and Future

There are two main types of P/E ratios. *Trailing P/E* is based on the company's actual reported earnings per share for the previous 12 months. Because earnings are reported quarterly, that part of the equation will generally remain the same for the entire three-month period, but the stock price may change every trading day.

Forward P/E is based on the company's projected earnings over the next 12 months. The forward P/E can also fluctuate with stock prices and as earnings projections update.

Trailing P/E is generally considered a more objective metric than forward P/E, because earnings projections are essentially opinions that may not turn out to be accurate. However, some investors prefer to focus on forward P/E, because a company's past performance may have little to do with its future prospects.

Use Ratios Wisely

Knowing a company's P/E ratio may provide some insight, but only if you use it to make appropriate comparisons. It is generally more meaningful to compare ratios of companies in the same industry or one company against the industry average. This is because P/E ratios can vary widely among industries and may also change for an entire industry as it faces challenges or goes in or out of favor with investors.

You might also compare a company's current and past performance, but keep in mind that P/E ratios typically rise and fall with stock prices; if prices rise and earnings stay about the same, P/E ratios increase, and vice versa. So an increase or decrease in a company's P/E ratio that moves with the broader market may not tell you much about the company's performance.

On the other hand, a substantial change in a company's P/E ratio that is not in step with the market could be caused by an unexpected increase or decrease in reported or projected earnings, or by a shift in investor confidence in the company.

Different Industries, Different Ratios

The S&P 500 is an unmanaged group of securities that is considered to be representative of the stock market in general. The performance of an unmanaged index is not indicative of the performance of any specific investment. Individuals cannot invest directly in an index. A portfolio invested only in companies in a particular industry or market sector may not be sufficiently diversified and could be subject to a significant level of volatility and risk.

As of October 1, 2021, the average forward 12-month P/E ratio for stocks listed in the S&P 500 was 20.1. This is significantly higher than the five-year average of 18.3 and the 10-year average of 16.4.[1] But that may or may not mean that the market as a whole is overpriced.

It's possible that earnings projections could be off by a wide margin — and that P/E ratios could be more difficult for investors to interpret — until the disruptive effects of the pandemic are well behind us. In fact, it's generally a good idea to consider additional types of data, such as dividends and longer-term growth expectations, when evaluating potential stock investments.

The return and principal value of stocks fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost.

1) FactSet, October 1, 2021

Two Decades of Inflation

After being largely dormant for the last decade, inflation roared back in 2021 due to various factors related to the pandemic and economic recovery. For perspective, it may be helpful to look at inflation over a longer period of time. During the 20-year period ending September 2021, the Consumer Price Index for All Urban Consumers (CPI-U), often called *headline inflation,* rose a total of 53.8%. While the prices of some items tracked the broad index, others increased or decreased at much different rates.

Source: U.S. Bureau of Labor Statistics, 2021 (data through Sept 2021)

Should You Speed Up Your Retirement Plans?

According to a March 2021 survey, an estimated 2.8 million Americans ages 55 and older decided to file for Social Security benefits earlier than they expected because of COVID-19. This was about double the 1.4 million people in the same age group who said they expected to work longer, presumably due to pandemic-related financial losses.[1] Many older workers were pushed into retirement after losing their jobs, and others may have had health concerns. Still, it appears that work-related stress and the emotional toll of the pandemic caused a lot of people to rethink their priorities and their retirement timelines.

Annual increase in the number of retired baby boomers (in millions)

Source: Pew Research Center, 2020

How do you know if you can realistically afford to retire early? First and foremost, determine whether you will have enough income to support the lifestyle you envision. Instead of accumulating assets, you may have to start draining your life savings to cover living expenses. Here are four important factors to consider.

Lost Income and Savings
You may be sacrificing years of future earnings and contributions to your retirement accounts. For example, an early retiree who was making $80,000 per year would forgo about $400,000 of salary over five years or $800,000 over a decade, not counting cost-of-living or merit increases. The 10-year total rises to nearly $1 million when annual raises averaging just 3% are included.

If the same retiree could have contributed 5% of salary to an employer-sponsored retirement plan with a 100% match, he or she would also miss out on $8,000 in contributions in the first year, more than $40,000 over five years, and almost $100,000 over 10 years.

Debt and Other Responsibilities
If you are still paying a mortgage, have other debts, or are supporting children or aging parents, you may not be ready to retire. Ideally, you should be free of "extra" financial responsibilities so you can focus on meeting your own living expenses without a regular paycheck.

Reduced Social Security Benefits
The earliest age you can file for Social Security is 62, but your benefit would be reduced to 70% or 75% of your full retirement benefit — for the rest of your life. So even if you do decide to retire, you might think about waiting to claim your benefit until you reach full retirement age (age 66 to 67, depending on the year you were born) or longer if you have enough income and/or savings to cover your expenses. For every year you wait past your full retirement age, your benefits will increase by 8% (up to age 70).

Higher Medical Costs
If you retire before you (or a spouse) become eligible for Medicare at age 65, you could lose access to an affordable employer-provided health plan. You can purchase health insurance through the Health Insurance Marketplace or a broker, but the age-based premiums are more expensive for older applicants. For two 60-year-olds with a household income of $100,000, the average premium for a silver Marketplace plan in 2021 is $708 per month ($8,500 per year), after subsidies. And if you seek medical treatment, you'll typically need to cover copays, deductibles, coinsurance, and some other expenses (up to the plan's out-of-pocket maximum).[2]

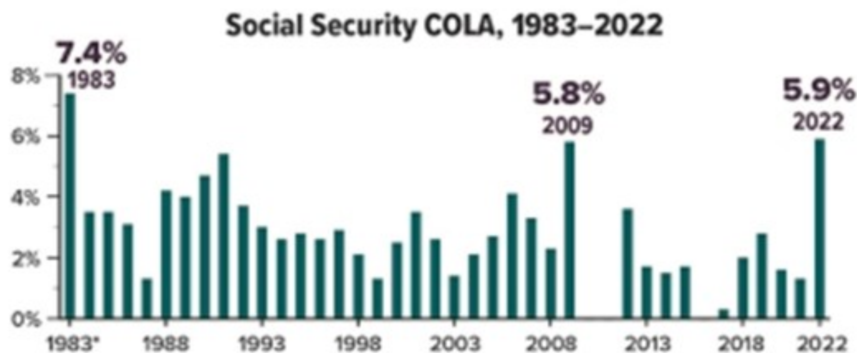
Even with Medicare, it's estimated that a married couple who retired at age 65 in 2020, with median prescription drug expenses, would need $270,000 to have a 90% chance of paying their health-care costs throughout retirement.[3]

The bottom line is that some people might be giving up more than they realize when they retire early. Before you say goodbye to the working world, be sure you have the resources to carry you through the next phase of your life.

1) U.S. Census Bureau, 2021
2) Kaiser Family Foundation, 2021
3) Employee Benefit Research Institute, 2020

Big Boost for Social Security Payments

The Social Security cost-of-living adjustment (COLA) for 2022 is 5.9%, the largest increase since 1983. The COLA applies to December 2021 benefits, payable in January 2022. The amount is based on the increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) from Q3 of the last year a COLA was determined to Q3 of the current year (in this case, Q3 2020 to Q3 2021).



Sources: Social Security Administration, 2021; The Senior Citizens League, August 11, 2021

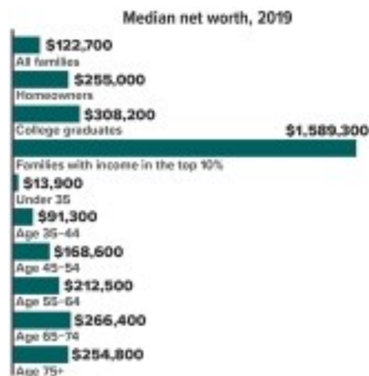
Are You a HENRY? Consider These Wealth-Building Strategies

HENRY is a catchy acronym for "high earner, not rich yet." It describes a demographic made up of young and often highly educated professionals with substantial incomes but little or no savings. HENRYs generally have enviable career prospects, but many of them feel financially stretched or may even live paycheck to paycheck for years, especially if they are working in cities with high living costs and/or facing large student loan payments.

If this sounds like you, it may be time to shed your HENRY status for good and focus on growing wealth — even if it means making some temporary sacrifices. One simple metric that can be used to gauge your financial standing is your net worth, which is the total of your assets (what you own) minus your liabilities (what you owe).

Wealth Snapshot

The net worth of U.S. families varies greatly depending on housing status, education, and income level. But it also takes time to build wealth, so there are significant differences by age.



Source: Federal Reserve, 2021

Pay Attention to Your Spending

It's virtually impossible to increase your net worth if you don't live within your means. After studying long hours and working your way into a good-paying job, you may feel that you deserve to spend some money on fashionable clothes, the latest smartphone, a night on the town, or a relaxing vacation. However, if you can't pay for most of your splurges without relying on credit — or wiping out your savings — then you may need to rein in your lifestyle. Budgeting software and/or smartphone apps can help you analyze your spending patterns and track your financial progress.

Utilize a Workplace Retirement Plan

Making regular pre-tax contributions to a traditional 401(k) plan is a no-nonsense way to accumulate retirement assets, and it helps reduce your taxable income by the same amount. Experts recommend saving at least 10% of your income for future needs, but if that's not possible right away, start by contributing 3% to 6% of your salary to your retirement plan and elect to escalate your contribution level by 1% each year until you reach your target (or the contribution limit). The maximum you can contribute to a 401(k) plan in 2022 is $20,500 ($27,000 if you are age 50 or older).

Many companies will match part of employee contributions, and free money is a great reason to save at least enough to receive a full company match and any available profit sharing. Some plans may require that you remain employed by the company for a certain amount of time before you can keep the matching funds.

Assess Your Housing Situation

Paying rent indefinitely may do little to improve your financial situation. Buying a home with a fixed-rate mortgage could help stabilize your housing costs, and you can build equity in the property over time as your loan balance is paid off — especially if the value appreciates. A home purchase may also afford tax advantages, but only if you itemize rather than claim the standard deduction on your tax return. Interest paid on up to $750,000 of mortgage loan debt is deductible, as are the property taxes, subject to a $10,000 cap on state and local property taxes.

Homeownership is a worthwhile financial goal if you plan to stay put for at least several years. And in many places, owning a home can be less expensive than renting, thanks to low interest rates. But there could be hurdles to overcome, including a hot real estate market, high prices, lingering student debt, and the large chunk of money required for a down payment.

When shopping for a home, resist the temptation to buy more house than you can afford, even if the bank says you can. And don't forget to factor property taxes, insurance, and potential maintenance costs into your buying decisions and household budget.

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