Fourth Quarter Report 2021

LUCIEN, STIRLING & GRAY ADVISORY GROUP

"Smart Decisions About Serious Money"

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A Message From The President

Thomas G. Twombly

If the second year of this pandemic taught us anything, it's that the pace of disruption in our world isn't slowing down any time soon. On the other hand, neither is human ingenuity, creativity, and drive. That's an important point for all long-term investors to recognize and remember.

But it is not easy to keep a faithful, patient, and disciplined eye on the far horizon when all around you seems so tumultuous. With the kind of economic volatility, medical uncertainty, and socio-political complexity we've all been struggling through in the last 24 months, and now with the financial and investment ambiguity we are suddenly facing due to an inflationary spike that outstrips anything we have seen in 40 years, it takes deliberate effort – especially when headlines keep provoking reactivity.

Fatigue becomes a very *real* danger to well-laid financial and investment plans in environments like this. It can make us fearful or angry, it can provoke us to react impetuously, or it can tempt us to bury our heads under the covers and hope the challenges will go away if we just ignore them. And truth is, you might not be human if you haven't experienced a serious sense of that fatigue at some point or other over the last couple of years. I know I have – in many different corners of my life.

How then to inoculate oneself? Where does one get a booster shot of courage and determination to just adapt and handle *whatever* happens as we move forward; to continue to act with purpose and discipline on the important long-range plans we've laid out, and not to waste crucial time, energy, and resources obsessing over the complete unpredictability of what new surprise might or might not happen *next*?

For me, it's always about stepping back and taking in a broader perspective. It helps immensely to look backwards over history – both my own arguably narrow but instructive professional experience, as well as the longer-range financial history that surrounds and predates me – to remind myself of the important investment lessons I've learned and bolster the convictions I've developed, so I can navigate an unknown and unknowable future with a renewed sense of determination.

The dawn of this particular new year is an especially poignant time for me to do that. 2022 will mark Lucien, Stirling & Gray Advisory Group, Inc.'s 30th anniversary, and my 38th year in this profession - every single one of which was full of uncertainty, and some of which seemed flat out terrifying at the time. With the benefit of hindsight, all of those years brought significant long-range opportunities. But experienced in real time, all of them also brought dire headlines warning of compelling reasons to be fearful, and *not* to invest – not unlike the shrill voices of fear and anxiety we hear now.

To revisit just one example I've raised before, since 1980, which spans a timeframe just a bit longer than my career, the average *annual* price de-

cline of the S&P 500 Index has been about 14%. In other words, history makes it clear that if one is going to be an investor in large capitalization U.S. stocks, one must expect that disquieting volatility will happen – all the time. It might be uncomfortable, but it's *normal*. One year in five during that time frame, the index experienced declines that averaged nearly twice that. And twice during my career (2000-2002 and 2007-2009) it actually halved. Other equity asset classes can and have been even more volatile than that. It's why people often think of equity ownership as "risky."

Yet the S&P 500 came into 1980 at a level of 106. It just closed out 2021 at a level of 4766, an increase of almost 45x - not including dividends. With all dividends reinvested over those years, and despite all the interim volatility, the average annual total return of the S&P 500 exceeded 12% over those 42 years, and a *single* hypothetical investment of $100,000 made in January of 1980 and left alone would have grown to well over $8 million by the end of 2021.

Those data, and all my professional experience, underscore my conviction that the most efficient means of building lifetime and multi-generational wealth, is to stalwartly **own** the great businesses of the U.S. and the world as a critical component of a long-range investment portfolio. They also bolster my conviction that the biggest challenge to successful long-term equity ownership (and indeed to successful business leadership) is not intellectual, and it's not financial. It's *temperamental*. Success in the long run is based on how one reacts - or disciplines oneself **not** to react - to regular and inevitable setbacks, and to the disquieting emotions they provoke. Because setbacks are one thing we must always count on. In fact, they can be tremendously beneficial to investors with patient, even-handed temperaments and long-range objectives, because they provide periodic opportunities to capitalize on *other people's* impatience and lack of discipline. Take a deep breath, and practice equanimity.

We know that the economy cannot consistently be forecast. More importantly, we know that markets cannot consistently be timed. The only way I know, therefore, to be reasonably sure of capturing the full long-term benefit of equity ownership, is to be determined to ride out those frequent, sometimes violent, but historically always *temporary* declines. Because the engine for wealth-building in equities is compounding, and the most important objective is not to interrupt that compounding unnecessarily.

Human beings have a remarkable capacity to survive – even to thrive – in the face of all kinds of challenges. This is the overriding lesson of this pandemic, and indeed of our lifetimes. And motivated teams of human beings working *together* to **be** significant, to **do** something special, and to **create** something lasting - which at their very core is what great businesses are comprised of – make up the only investable asset class that fully captures that innate ingenuity, adaptability, and drive. Don't ever lose sight of that.

Thank you for being our clients. It is a privilege to serve you.

Thomas G. Twombly
President

Investment Commentary

As we enter 2022, U.S. financial markets as a whole are facing slowing earnings growth, elevated valuations, rising inflationary pressures, and a far less accommodative macro environment than has been seen for some time. This suggests that we can expect higher levels of potential volatility among all asset classes going forward, along with more frequent and perhaps more dramatic corrections along the way. Serious investors of all stripes, including all of our clients, would do well to reaffirm their long-range views, buckle their seat belts, and prepare themselves, financially and *temperamentally*, for a range of intermediate-term possibilities. This is a challenging environment rife with ambiguities, and one where individual investor behavior, and composure, will likely have an outsized impact on long-term results.

Nonetheless, it's our view that while economic growth will slow, it will not stall altogether. Furthermore, we believe global equities will likely remain in a secular bull market that began in 2009, and that in spite of (or perhaps because of) the likelihood of more bumps along the way, this long-term trend may remain intact for some years to come – albeit at a slower overall pace for the foreseeable future than what US markets in particular have experienced in the recent past. We believe it's important to remain invested in a wide array of asset classes, because the so-called "safe harbors" that

people have reflexively sought during tumultuous times in the past will likely provide scant protection in a climate of rising inflation and Fed tightening and tapering, and they may in fact prove quite damaging over time.

In the U.S., corporations as a whole are now coming off of a period of historically high profits attributed to very strong revenue growth coupled with relatively suppressed levels of worker compensation, interest expense, and taxes. Just before Thanksgiving, in fact, the Bureau of Economic Analysis reported that after-tax profits in the third quarter of 2021 reached 11% of GDP, an all-time record in a quarterly series dating back to 1947.

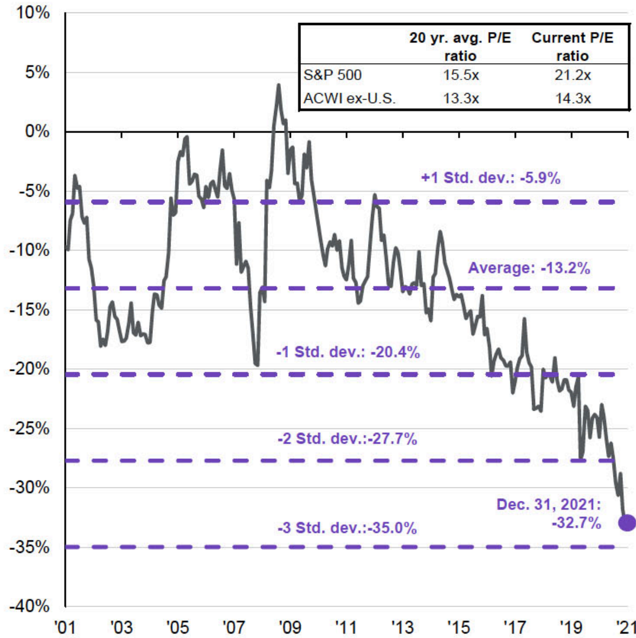
Now, however, with many people having left the labor force recently due to burgeoning Baby Boomer retirements, the necessity to provide in-home childcare due to COVID restrictions in schools and day care centers, and effects of the so-called “great resignation”, companies are finding it necessary to raise wages considerably in order to compete for a shrinking pool of talent. The unemployment rate dropped to 4.2% as of November, well below the 50-year average of 6.3%, and all indications are that it is soon headed lower still. Wage growth has now risen to 5.9%, well above the long-term average of 4% for the same timeframe. Unlike other contributors to the current overall inflation rate that may prove more transitory over the long run, such as computer chip prices, used car prices, food prices and oil prices, compensation is likely to be stickier, even when more workers eventually return to the labor force. And while higher wages are a welcome change for employees, and for the overall health of the economy, they’ll likely have a reductive effect on corporate profit margins. In an environment where many growth companies find their stock priced for perfection, this could lead to some share value repricing in all but the most dynamic of businesses.

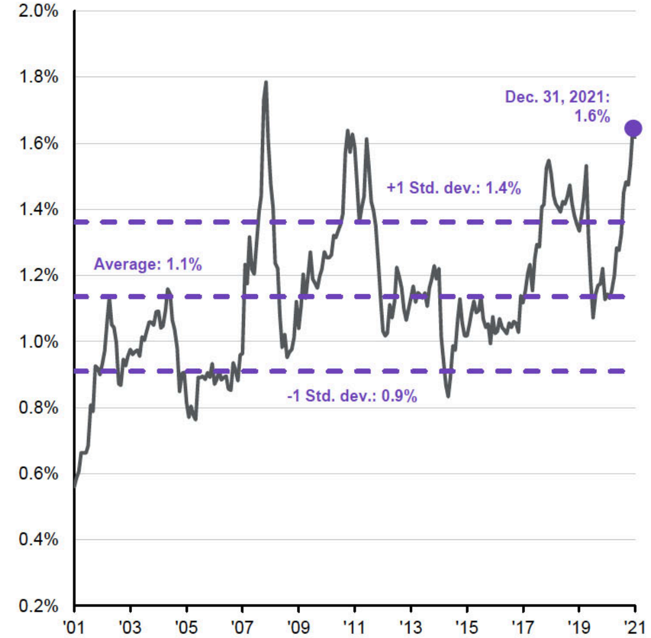
Outside the US, conditions are notably different. Overall, price to earnings multiples overseas persist in being much lower than those of US companies, and dividends are considerably higher, as is displayed in the embedded chart from J.P. Morgan Asset Management on page 4. Additionally, unlike the U.S., where much of the economic stimulus injected into the economy to combat the effects of the COVID shutdown was front-end loaded, in European economies, many of the government stimulus programs were designed to be back-end loaded. As a result, those economies may enjoy a fiscal policy tailwind moving forward while the U.S. is actively scaling back on stimulus efforts. Aided by the fact that European businesses overall have greater concentration in cyclical industries such as industrial materials, commodities, and banks, which tend to enjoy a competitive advantage in an inflationary environment compared to growth companies (which have been the primary drivers of US markets in recent years) we believe non-US developed market equity markets may finally have their day in the sun as we move into 2022 and beyond.

We believe the same may finally prove to be true for emerging market economies as well. In addition to commonalities with those of European economies listed above, many have been much harder hit by COVID in the past two years than has the US, and China in particular has taken an extreme approach to shutting down the spread of the disease. This has also had the effect of substantially decreasing theirs and their neighbor’s economic growth rates. The Chinese government also took some pretty draconian steps last year to curb the excesses occurring in their real estate markets and other areas of their economy they deemed socially disruptive. But having done so, they are now actively lowering interest rates to reignite growth. With a massive and growing middle class, and with many peripheral economies such as Malaysia, Indonesia, Vietnam, and Thailand surrounding them and benefitting from their economic strength, there is plenty of long-range potential to be found.

We continue to employ broad diversification across all portfolios, including disciplined allocations to select managers of large, medium, and small-cap stock portfolios in both US and non-US developed markets; long-term allocations to experienced teams specializing in emerging markets equities; and judicious amounts entrusted to managers of higher-quality, shorter-term fixed income holdings as important ballast. Given the inflationary pressures we’re now seeing, along with the continuation of historically low interest rates, we believe that it will be very difficult to achieve positive real returns in fixed income holdings, and that it will prove unwise to hold too much cash in long-term investment accounts. Nevertheless, used wisely, both of those asset classes can still provide a valuable anchor to windward in rough seas, and that particular attribute shouldn’t be ignored in the type of environment we anticipate. As always, if you would like to discuss our perspective or your personal situation, we would welcome the opportunity.

International valuations and dividend yields





Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of December 31, 2021.

General Market Results

	3rd Quarter	YTD	One Year	Three Year	Five Year	Ten Year
Barclays Agg Bond	0.01	-1.54	-1.54	4.79	3.57	2.90
S&P 500	11.03	28.71	28.71	26.07	18.47	16.55
DJI	7.87	20.95	20.95	18.49	15.51	14.21
S&P 400	8.00	24.76	24.76	21.41	13.09	14.20
Russell 2000	2.14	14.82	14.82	20.02	12.02	13.23
NASDAQ	8.45	22.18	22.18	34.26	24.97	20.96
MSCI EAFE	2.69	11.26	11.26	13.54	9.55	8.03
MSCI EM	-1.31	-2.54	-2.54	10.94	9.87	5.49

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