Ironwood Investment Counsel, LLC constructs and manages customized investment and wealth management programs designed to meet our clients' unique goals and objectives. Our distinctive process maximizes performance through return enhancement, risk reduction, tax efficiency, and cost containment.

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Fourth Quarter 2021 Market Commentary

Equities raced ahead in the final quarter of 2021, closing out another very profitable year for US stock markets. With the strong performance last year, domestic equities have provided double digit returns for three consecutive years, leaving most Ironwood portfolios with significant earnings over that time period. Our focus on larger capitalization US based businesses was accretive as they led the way in the fourth quarter. More specifically, the S&P 500 appreciated by 11% and more than 20% for the year. Smaller capitalization companies in the US were also positive for the quarter and year, producing a return of 2.1% and 14.8%, respectively.

Once again, domestic equities outperformed international, as the MSCI EAFE gained 2.4% for the fourth quarter and 8.8% for the year. A strong US dollar detracted from international equity results as the "Greenback" ended the year up 6.3% following a rocky start. While Ironwood has little allocation to emerging markets, the EM segment produced one of the few negative returns in 2021 with a decline of 2.5%. The index is heavily influenced by Chinese equities which plunged by more than 21% for the year.

Most fixed income securities had less favorable returns during 2021 relative to stocks. The Bloomberg US Aggregate Bond Index was flat for the quarter and declined by 1.54% for the year. Over the course of 2021, the 10-Year US Treasury yield increased by more than 60% (0.9% to 1.5% at the end of the year and 1.8% at the time of this writing). As yields increased, bond prices declined by more than the income or yield offered. A bright spot in fixed income were lower credit quality investments as the S&P Levered Loan index and Bank of America Fixed Rate Preferred index returned 5.2% and 2.2%, respectively, for the year. While the increasing interest rate environment is challenging in the short run, savers will ultimately benefit as their conservative securities will offer a higher yield going forward. For this reason, Ironwood maintains fixed income portfolios with shorter average maturities and an allocation to preferred securities.

As investors ease into 2022, we are reminded that predicting economic outcomes is exceedingly difficult from year to year. Further, as economic and financial issues mount, the "crystal ball" for most investors becomes even more opaque (Ironwood included). By way of example, the Federal Reserve indicated that the fourth quarter of 2021 would be characterized by 5% unemployment and 1.8% inflation. In actuality, the unemployment rate dropped to 3.9% and Core inflation soared by over 5.5%.

As the cost of goods and services continued to rise beyond what market pundits had originally predicted, Federal Reserve Chairman Jerome Powell's term of "transitory inflation" subsequently seemed stretched beyond its definition. The Labor Department reported in early January that the Consumer Price Index rose 7% in December relative to a year earlier. According to the WSJ, this marked the sharpest rise since June of 1982.

The root causes of the current inflationary problems are hotly debated in academic circles. Some of the more common rationales are severely clogged supply chains and unusually high spending on goods versus spending on services. Such a rise in prices has prompted Federal Reserve officials to significantly alter their expectations for the pace of upcoming interest rate increases and the withdrawal of pandemic induced monetary stimulus. A key consideration is whether the Federal Reserve will be able to head off a possible surge in wage pressure which could ultimately impact company earnings.

Another troubling issue is the vast labor shortages effecting many sectors of the economy. Currently, there are over 10 million open positions in the United States. Surprisingly, this is 3 million more available jobs than before the start of the pandemic. Additionally, labor force participation is 1.5% below pre-pandemic levels. While the onset of the new Omicron variant is certainly not helping the current labor situation, it has not resulted in widespread economic shut downs thus far.

On a more positive note, strong earnings growth has been supportive of increasing stock prices over the last year. Specifically, operating earnings per share for the S&P 500 companies are projected to have increased in excess of 44%, following a 13% decline in 2020. Current expectations are for more normalized earnings growth of about 7% in 2022. While the S&P 500 forward PE multiple currently resides at a 30% premium compared to the 25-year average (over 21 times earnings), we are encouraged by the relative discount in many of the businesses we invest in on behalf of clients and in our own portfolios. Conversely, the “frothy” technology companies that we avoid are trading at levels that are still unsustainable in our humble opinion.

We do not profess to know exactly how inflationary issues and labor shortfalls will play out in the short-term. The FED predictions from a year ago for the fourth quarter of 2021 serve as a harsh reminder that even those with superior data cannot accurately forecast the outcome of opaque economic and financial conditions. We view the remedy for such opacity in the financial markets to be a meticulous focus on diversification and quality. In the case of resurgent inflation, we look for companies that can generate free cash flow and pay dividends to shareholders under any economic condition, and quality fixed income instruments that offer shorter maturities and floating rates of interest. With the added prospect of higher interest rates and sticky inflation, our portfolio return expectations are modest for the new year.

We are grateful for the strong performance our equity portfolios realized over the past year. Our commitment to investing in quality gives us a high degree of confidence that our client portfolios will thrive over the long term regardless of the difficult issues characterizing today’s economy. We thank you for the continued confidence you have placed in us.

As always, please let us know if you would like to set up a time to review your financial objectives and portfolio structure.

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