MORSE ASSET MANAGEMENT, INC.
23 Old Kings Highway South, Suite 200, Darien, CT 06820

January 21, 2022

4Q 2021 Investment Commentary

The fourth quarter of 2021 was volatile with two 5% swings in the equity index as the push from positive earnings faded into year-end tax selling. A Santa Claus rally took markets back to new highs but did not have the breadth to carry into the New Year. Continued uncertainty around supply chains, inflation and potential monetary policy shifts dominated headlines, causing investors to step back despite continued strength in the economy.

The start of 2022 has been jarring for markets. The 10-year Treasury rate rose 25% in the first 3 weeks of the year to a post-COVID high, from 1.51% to over 1.90%, causing a steep selloff in equities. Fears of accelerated monetary tightening intensified due to lingering inflation extremes causing valuations to compress. All major indices lost ground, with the growth-concentrated Nasdaq falling into a correction. Value and cyclically oriented stocks initially fared better as money rotated out of growth names. Fear and panic should subside, putting earnings back into the driver's seat to support stock prices.

Market corrections with a strong economy are largely temporary, historically resulting in flat prices for six to eight months, but they are "normal" and ultimately healthy for continued expansion. Improving earnings create cheaper valuations, and increased demand for stocks. Moderate earnings growth should equate to positive equity returns, but heightened volatility is to be expected as we transition away from accommodative monetary policies.

We expect that economic growth will remain strong in 2022 but decelerate from the extremes seen last year. Reopening should continue to drive demand as COVID fears fade supporting economic and corporate earnings above trend. Consumers will continue to spend the $5.4 trillion in accumulated savings since the coronavirus pandemic began. Consensus economic outlook for 2022 calls for real GDP growth moderating to 3.5%-4.0%, still well above pre-COVID levels.

Recent economic indicators have been mixed reflecting the impact of the Omicron variant but overall are still positive. The Institute for Supply Management's Manufacturing and Services index both pulled back from highs but are still firmly expansionary. Recent job reports have been sending mixed signals, with fallout from the Omicron variant causing increased layoffs and diminishing job gains. The Conference Board's Leading Economic Index has been stable, most recently ticking up, pointing to continued growth.

One of the biggest wildcards coming into the year is the Federal Reserve tightening monetary conditions. Transition away from record accommodation has been expected, as unemployment and inflation levels have technically crossed the Fed's thresholds, but the timing and pace is uncertain. Historically, the speed of rate hikes is correlated to subsequent stock market performance (Chart).

In their last meeting, the Fed changed to a markedly hawkish tone. The Fed is preparing markets for the first interest rate hike in March, three additional hikes in 2022, and the start of quantitative tightening to reduce their balance sheet. As this hawkish narrative is becoming consensus, there is potential risk to the upside for markets if the Fed slows this pace. Without inflation normalizing this is unlikely.

Inflation continues to linger at extreme levels but is showing early signs of normalizing. CPI (Consumer Price Index) inflation is projected to moderate to 3.0-3.5% this year, half the pace of 2021. Prices should then settle around the Federal Reserve's target rate of 2% in 2023. The Institute for Supply Management Price Index, which is focused on industrial components and a leading indicator of CPI and PPI (Producer Price Index), is one of the indicators capturing this promising trend (Chart). However, the heavy weighted components of CPI, like housing and autos, may take longer to normalize. Inflation and its impact on central bank policy will continue to exert outsized influence on equity market volatility so the longer it takes to normalize the worse the potential impact.

According to Factset's *Earnings Insight* on January 13th, the S&P 500 year-over-year earnings growth rate for the fourth quarter of 2021 is expected to be 21.8%%. Estimates have begun to catch up to results and we are unlikely to see the magnitude of upside surprises. For the 2022 calendar year ahead, analysts are projecting a healthy earnings growth of 9.4%. (Chart)

Investor sentiment is not euphoric. The economic outlook is positive. Liquidity is more than ample for the time being. Indicators are showing signs of the market cycle maturing, but the weight of the evidence remains positive.

Our playbook continues to focus on significant secular trends, durable and high-quality businesses, and above-average growth potential. We are adjusting portfolio risk according to the prevailing market environment. Geopolitical events, specifically rising tension in Ukraine, are not currently price into markets and remain of concern. The long-term expansionary economic cycle isn't ending, but stock market conditions will be more difficult this year, so we must be dynamic.

We have shifted defensively in order to balance economic growth and inflation/rate risks between high-quality growth stocks and cyclical allocations. We see opportunities across both value and growth styles, with a cyclical bias, but will be patient for market stress to subside.

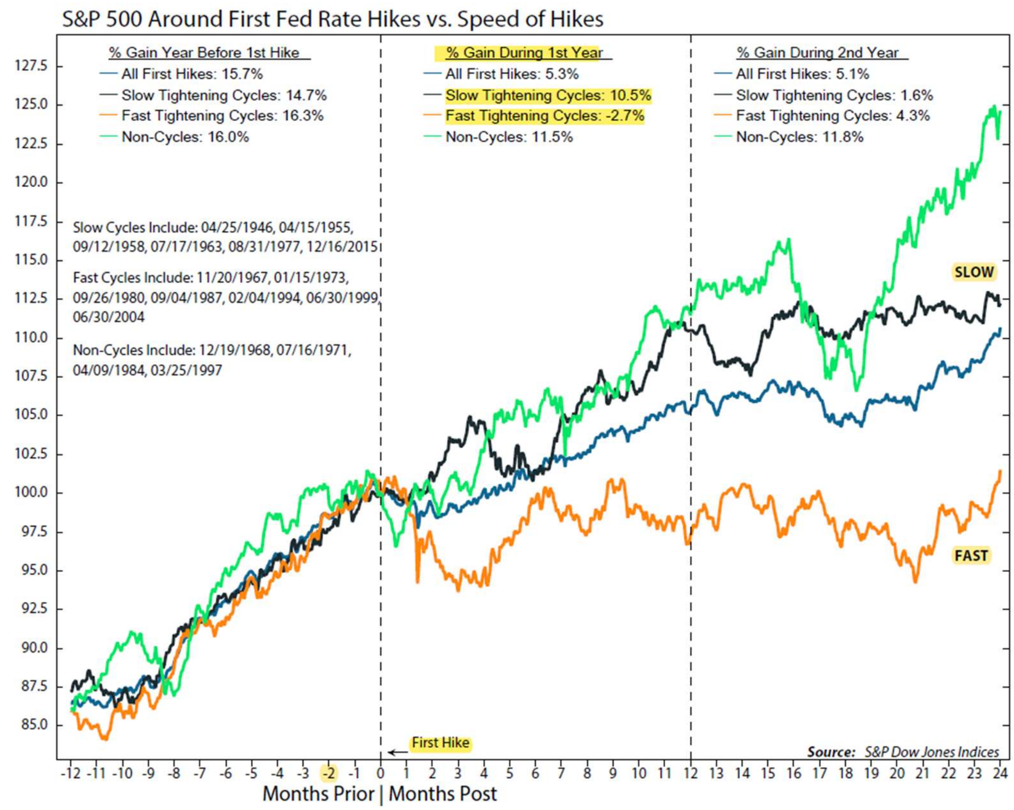
Morse Asset Management Investment Team

Robert B. Morse, Jian Wang, James Cushing

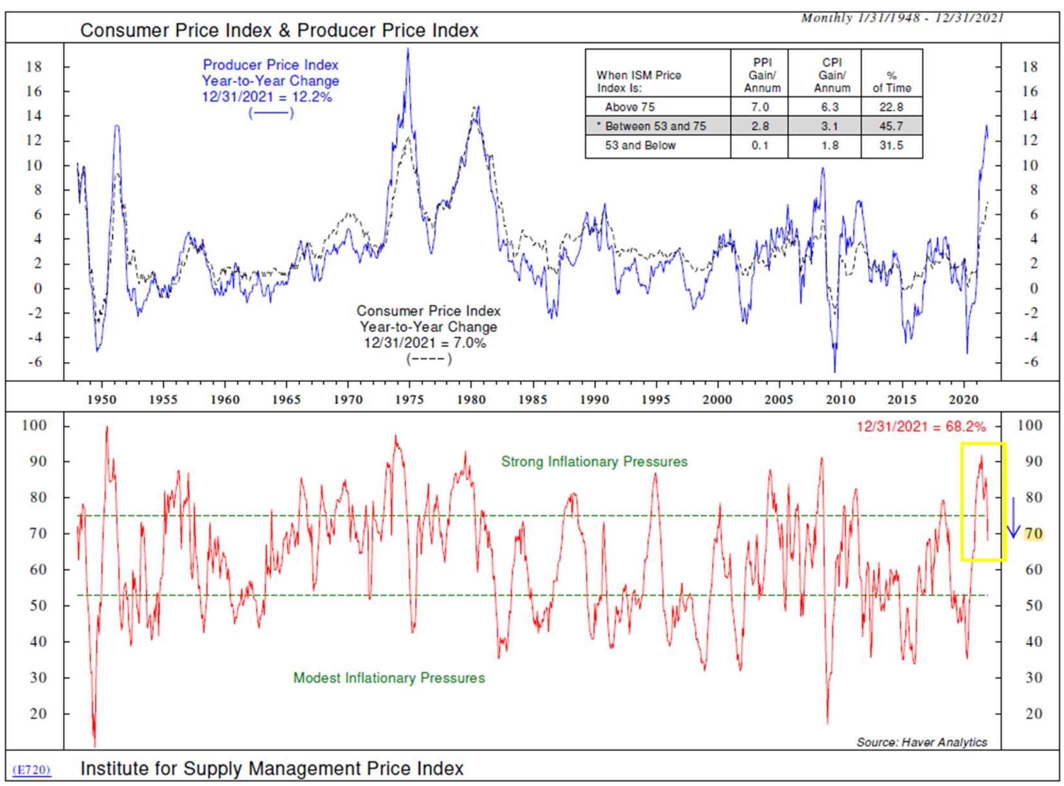
MORSE ASSET MANAGEMENT, INC.

23 Old Kings Highway South, Suite 200, Darien, CT 06820

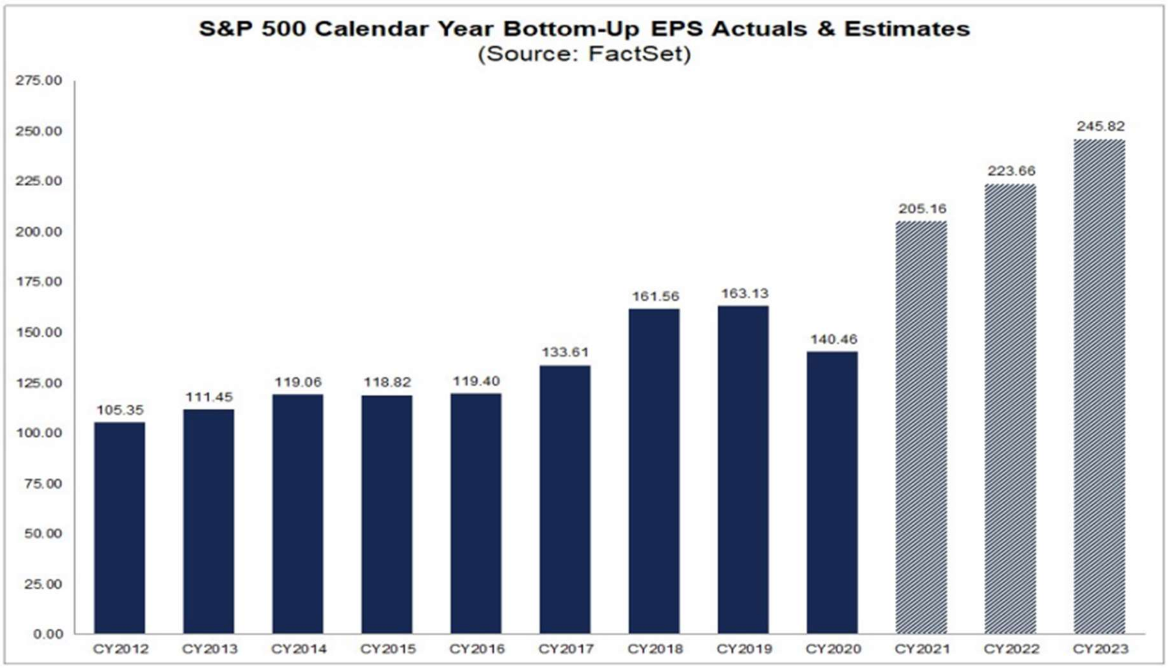
1.



2.



3.



S&P 500 Calendar Year Bottom-Up EPS Actuals & Estimates
(Source: FactSet)
275.00
250.00
225.00
200.00
175.00
150.00
125.00
100.00
75.00
50.00
25.00
0.00
105.35
111.45
119.06
118.82
119.40
133.61
161.56
163.13
140.46
205.16
223.66
245.82
CY2012
CY2013
CY2014
CY2015
CY2016
CY2017
CY2018
CY2019
CY2020
CY2021
CY2022
CY2023