Fourth Quarter 2021

Market Recap
Performance Review
and Near-term Outlook

Market Recap

U.S. stocks rode reopening tailwinds to new all-time highs in 2021, overcoming multiple bouts of risk-off turbulence fueled by Covid-19 variant outbreaks, rising domestic labor costs, global supply-chain disruptions, and the U.S. Federal Reserve's late-year pivot to a less accommodative tone. Beneath the index-level numbers, however, there was great volatility, dramatic rotations, and in the end significant performance divergence.

After a flat start, by mid-March large-company growth stocks began to gain on their small-company cyclical peers. This coincided with another reversal of interest rates, this time to the downside, reigniting demand for high growth-rate stocks. During Q4, that demand for growth was narrowing to just a handful of high-quality stocks, those of the world's largest (mega-cap) companies. That weakness in market breadth first emerged around Thanksgiving, sparked in part by the emergence of the Omicron variant, and persisted throughout the rest of the year.

By mid-December, five stocks – Apple (AAPL +33.82%), Microsoft (MSFT +51.21%), Google (GOOGL +65.30%), Nvidia (NVDA +125.29%), and Tesla (TSLA +49.76%) – representing in aggregate 23% of the weight of the S&P 500® Index, accounted for 51% of the Index's return since the start of the March rotation. The overwhelming size effect of these *mega-cap* companies, in propping up impressive index returns, masked the increasing divergence between the year's winning and losing stocks happening beneath the surface

This concentration of returns created a significant hurdle for U.S. investment managers. According to Bank of America, just 1.0% of active *growth* managers outperformed the S&P 500® Index during 2021. And only 1-in-4 of all active managers, unless imprudently concentrated in those five names, by practice a deep-value manager or otherwise loaded with oil company and real estate stocks, or just had a crystal ball, outperformed the S&P 500® Index.

It happens. Some years are considered "stock picker years", so termed because performance opportunities are more abundant during years with low volatility and a "normal" distribution of returns. However, during high volatility years like 2021, when returns are asymmetrically distributed, significantly skewed to a small group of names, beating a broad market index via individual stock selection will be an unforgiving, and exceedingly low-probability bet.

Besting their domestic small-company counterparts, trouncing foreign developed market stocks, and with emerging market stocks and U.S. bonds in negative territory for the year, U.S. large-company indexes were the undisputed winners for 2021. Some easily doubled – a few nearly tripled – their historical average annual returns. The S&P 500® Index provided a total annual return of +28.71% (+10.5% historical average), while the Nasdaq Composite and Dow Jones Industrial Average increased +22.18% (+10.7%) and +20.95% (+7.8%), respectively.

Sustained resilience of indexes due to those mega-cap companies was evidenced by the fact that the S&P 500® Index hit 70 new all-time highs during 2021, a record second-only to 1995's 77 new all-time highs. Not once did the Index trade below its 200-day moving average, a feat not pulled off since 2017. Most surprising is that it was the 3rd straight year of double-digit gains for the Index, remarkedly the 2nd of the Covid-19 era. Yet 2021 also saw the spread between the number of stocks hitting 52-weeks lows versus those hitting 52-week highs expand to greater than 10-to-1.

As discussed throughout the year, we did expect a bounce-back in the high-growth names. This expectation was why we did not rotate with the market during the post-election period of 2020 and did not alter our long-term strategic allocations during 2021. On a macro-basis, on a transaction-cost basis, and certainly on a tax-basis for the many taxable accounts we manage, we believe that it was the right call. Even if 2021 proved to be a photo-finish at the end.

> The stock market is designed to transfer money from the active to the patient.
>
> Warren Buffett

As measured by the Russell 3000 Index, a measure of 3,000 U.S. companies and a proxy for the *complete* U.S. stock universe, U.S. stocks finished 2021 with a total return of +25.66%. The tech-heavy growth component of the Russell 3000 Index gained +25.85%, while the cyclical-oriented value component gained +25.37% on the back of strength in energy, real estate, and banks. Photo finish.

Sector finishes more clearly illuminate the divergent nature of performance during 2021. With the overwhelming influence of the five mega-cap companies detailed above, one could reasonably assume that technology, communications, or the consumer discretionary sector lead performance for 2021. Not so.

- The energy sector dominated performance during 2021 with a +46.44% return on the backs of "dirty" petroleum and natural gas companies. Devon Energy (DVN, +178.62%) lead *all* S&P 500 company returns in 2021. Marathon Oil (MRO, +146.18%) finished in second place. We own no individual energy stocks and do underweight the energy sector in our ETF strategy. That did negatively impact client performance during 2021. As an aside, 9 of the 10 major "clean" energy ETFs finished will losses during 2021.
- The real estate sector finished a close 2nd, with a +41.71% annual return. This was surprising to most given the challenging environment for rental and commercial markets during the Covid-19 pandemic. Extra Space Storage (EXR, +95.69%) and Simon Property Group (SPG, +87.35%) were the sector leaders. We do not own REITs and we underweight the sector overall in our ETF strategy. Again, this negatively impacted client performance during 2021. Lake Jericho clients tend to hold a significant percentage of their personal net worth in their primary residences, and many hold additional investment real estate. We think it unwise to double down on those concentrations within client security investment portfolios.
- After a slow start, the technology sector, where we do maintain a significant overweight, finished 3rd. With a +33.73% annual return, one might reasonably conclude that our tech-heavy individual stock portfolios should do equally well. But again, even within the technology sector, annual performance was dominated by just a few mega-cap names. Owning three of those mega-cap stocks in more prudent percentages, along with owning a diversified mix of other names, most winners, but a few losers, could not mathematically keep pace. For example, one of our core technology holdings, Intuit (INTU, +69.34%), had a banner year! But at a 5% allocation, even Intuit's contribution could not keep pace when mega-cap allocations represent 50% of total market return.
- Similarly, our overweight exposure to the medical technology and devices industry performed reasonably well. Via our ETF strategy, the sector provided a +20.71% annual return. Our individual stock account holdings in the space – Danaher Corp. (DHR, +48.11%), Thermo Fischer Scientific (TMO, +43.25%), Johnson & Johnson (JNJ +8.70%) and Medtronic (MDT, -11.69%) – provided a weighted average return of +20.18%. Though both strong historical performance numbers, neither approach kept pace with S&P 500® Index for 2021.
- We also maintain more modest, but still overweighted, exposure to the communication sector. But here again, neither our individual security selection nor our exposure to the sector via ETF (with a more modest +15.12% annual return) kept pace. While Google delivered a +65.30% return as part of our communications sector stock holdings, we also owned meaningful allocations of T-Mobile (TMUS, -13.99%) and Disney (DIS, -14.51%). The weak performance of TMUS, DIS, and other sector heavy weights, such as AT&T and Netflix, meant the communications sector was a drag on client performance for 2021.

Performance Review

Lake Jericho managed and advised portfolios are typically invested in some variation of either one of two strategies - either (1) a global-macro strategy broadly diversified by geography, asset type, and sector, executed via exchange traded funds (ETF), or (2) a concentrated individual stock/bond strategy heavily biased towards U.S. large-company technology, health care, and consumer-focused stocks. Within each strategy the sector weights, asset types, and geographic diversification or concentrations, have meaningful impact upon returns. Further, within the individual stock strategy, these macro factors can overwhelm individual stock selection and performance in the short run.

Throughout each *Review*, we generally discuss market performance relative to the S&P 500® Index simply because it is the most widely followed measure of equity market performance. Because our investment horizon is, most typically, long-term, and we do actively manage macro positioning, sector allocations, and other performance factors, our performance during any single quarter, or even a full year (as with 2021), might significantly deviate from any single equity market benchmark.

Additionally, most Lake Jericho clients hold risk profiles that are not appropriately benchmarked against an all-equity index. We provide the bulleted benchmark returns immediately below, and the iShares (by Blackrock) Core Allocation ETF Portfolio Series benchmarks within the tabled data at the end of this *Outlook*, for a proper, relative performance comparison against independent, objective, balanced, globally diversified strategies managed to standardized risk profiles.

- The Dow Jones Industrial Average – a price-weighted measure of the performance of 30 "blue-chip" U.S. companies with significant technology company influence but more balanced with meaningful representation from health care, financial, and industrial companies - finished Q4 with a gain of +7.87%, for a one-year total return of +20.95%.
- The technology and consumer-cyclical heavy NASDAQ Composite Index finished Q4 with a gain of +8.45%, for a one-year total return of +22.18%.
- The S&P 500® Index, a broadly diversified but committee selected index of 500 large U.S. companies, finished Q4 with a gain of +11.03%, for a one-year total return of +28.71%.
- Small- and mid-sized companies, as a group measured by the Russell 2500™ Index, finished Q4 with a gain of +3.82%, for a one-year total return of +18.18%.
- International developed markets, as measured by the MSCI World (ex-USA) Investable Market Index, finished Q4 with a gain of 2.71%, for a one-year total return of +12.40%.
- International emerging markets, as measured by the MSCI Emerging Markets Investable Market Index, significantly trailed their developed markets counterparts throughout the year to finish Q4 with a loss of -0.98%, for a one-year total loss of -0.28%.
- The Bloomberg Barclays U.S. Aggregate Bond Index, a measure of the performance of the U.S. investment grade bond market, finished Q4 with a modest loss of -0.03%, for a one-year total loss of -1.63%.

Near-term Outlook

It has been a rough start to 2022. Hitting the last intraday all-time high on New Year's Eve, markets quickly flipped the script entering the new year. With volatility spiking out of the starting gate, nearly all last year's stock market winners have now experienced sharp reversals. Except for continued strength within the energy sector, which is the only S&P sector in the green thus far during 2022.

This is all firmly rooted in Q4 - when equity indexes rose in aggregate, but under the surface markets were already breaking down. Not just U.S. markets. Foreign developed and emerging markets. Not just equity markets. Fixed income too. Certainly, the crypto space which has essentially been cut in half. You name it. Fear of slowing economic growth has investors of all types re-evaluating their real appetite for risk.

Yes, this is a risky time in financial markets. Uncertainty abounds. The economy is entering a period of decelerating growth. Inflation remains unsurprisingly persistent. The quantity of fiscal stimulus being poured into the economy is rapidly shrinking. Most worrisome, it seems, is what is likely to be rapid Fed Funds rate increases during 2022.

As I've often written about, markets hate uncertainty more than they loathe certain bad news. So, choppiness is here, and is most likely to continue in the short-run. Now is not the time for knee-jerk reactions. Rather, now is the time to be tactical and measured, according to well-defined investment disciplines. And this is exactly what we are doing for you.

We believe the adage "time *in the* market beats *timing* the market". We believe it because the data supports it. Anyone can get lucky every great once-in-a-while, calling a market top or a market bottom. But no one on the planet can do so with sufficient precision, often enough, to make it a profitable strategy. We were somewhat holding our nose putting money to work at those late-2021 elevated valuations. Conditions had been getting less rosy for some time, but catalysts for corrections remain unpredictable. So, we persisted. Because the evidence supports the wisdom of doing so.

And now that we are technically in correction territory, our approach for this correction is the same as it has always been for any correction (downturn of >10%) or bear market (downturn of >20%). Until we reach a point in the macro-environment where significant strategic change is necessary, we view every selloff as an opportunity to buy, adding value for clients in the long-run. Even if markets continue lower after that, and performance is further harmed in the short-run, we will continue to buy. As, again, the data supports a higher probability that long-run performance is enhanced via this discipline than efforts to time a market bottom.

While 2022 is off to another turbulent year as markets continue to rotate, I stand by my long-held belief that long-run deflation is far more of a concern than short-run inflation. Although the FOMC, and most market participants, hold the view that the Fed is behind the curve in raising short-term interest rates, I believe the Fed is forecasting too aggressive a pace of increases. And although more persistent than I first forecast, I believe the recent rate of inflation will reverse and decline. We will ultimately find ourselves with rates of economic growth lower than pre-pandemic levels, and a reversal in the direction of interest rates once again.

As always, I am available to discuss anything within this Outlook, or your own specific portfolio performance questions. And if there are any changes in your personal/financial situation that we have not already discussed, we need to schedule a more in-depth review!

Please reach out at any time, any day of the week. Until then, be well. And thank you for your continued trust and support.

A.J. Walker, CFA CFP® CIMA®
Founder, President, and CEO
Lake Jericho, LLC

Lake Jericho is an independent, fee-only, registered investment advisory firm (CRD #173782). Headquartered in Chicago, registered in both Illinois and Kentucky, Lake Jericho serves many types of clients across the country. Lake Jericho adheres to the fiduciary standard in the provision of financial research and education, financial planning and advice, and discretionary investment management services to individuals and their families, trusts, foundations, endowments, qualified plan sponsors, the not-for-profit and the for-profit business communities. Additional information about Lake Jericho is available on the SEC's website www.adviserinfo.sec gov.

Performance quoted within this work is past performance and is not a guarantee of future results. Diversification does not eliminate the risk of loss or guarantee expected investment outcomes. Opinions and estimates offered constitute our judgment at the time of writing and are subject to change without notice, as are statements of financial market trends, which are based on market conditions at the time of writing. We believe the information provided here is reliable, but despite diligent efforts, mistakes happen. Therefore, we do not warrant accuracy or completeness. This material is not intended as an offer of service, or solicitation for the purchase or sale of any financial instrument. The views and strategies described will not be suitable for all investors. This includes, perhaps, you and your specific situation. This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, accounting, legal or tax advice. References within to future returns, or expectations for future returns, are not promises of actual returns a client portfolio may achieve. Any forecasts contained herein are for illustrative purposes only and are not to be relied upon as advice or interpreted as a recommendation for any audience other than an intended recipient.

The iShares Core Allocation ETF Portfolio Benchmark Series

Total Return Comparisons For Comparable Risk and Allocation Profiles

All Periods Ending December 31, 2021

Core Allocation Portfolio (Ticker)	Q4 2021	2021 Annual Return	3 Year Total Return	5 Year Total Return
Conservative (AOK)	2.03%	4.80%	30.38%	38.79%
Moderate (AOM)	2.74%	6.93%	35.93%	45.97%
Growth (AOR)	4.10%	11.14%	47.54%	60.99%
Aggressive (AOA)	5.51%	15.43%	59.60%	76.71%

The iShares Core Allocation ETF Portfolio series is designed to meet the needs of investors who would like to maintain fixed target levels of exposure through a portfolio diversified across domestic, international, and emerging market equities, bonds, and other instruments. The Core Conservative Allocation Strategy seeks approximately 30% exposure to global equity markets. The Core Moderate Allocation Strategy seeks approximately 40% exposure to global equity markets. The Core Growth Allocation Strategy seeks approximately 60% exposure to global equity markets. The Core Aggressive Allocation Strategy seeks approximately 80% exposure to global equity markets. Presented here is the iShares Core Allocation ETF Portfolio Benchmark NAV total return performance as reported by iShares, constructed with no investment advisor fees, and with no transaction costs, while Lake Jericho portfolio performance is actual performance, net of all fees, including investment management, administration, and transaction expenses.