SLOAN INVESTMENT MANAGEMENT, LLC

2021 Year End Letter

2021 brought us a year of remarkable transition. While the Covid-19 pandemic remains a part of our lives in certain ways, it no longer dominates our everyday lives. Our growing understanding of the virus, combined with significant scientific advancements, have prevented a repeat of the widespread lockdowns of early 2020. Our economy is now on solid enough footing that the monetary and fiscal stimulus programs which helped us get through the early stages of the pandemic are now winding down. The Federal Reserve is set to begin raising short term interest rates this year to control inflation. As we enter 2022, our team is keenly focused on the market implications of this ongoing transition.

Looking back at this past year, the sustained surge in demand for goods and services was met with global supply chain disruptions that contributed to inflation readings well above the historical average and the Federal Reserve's long-term target of 2%. While higher inflation is likely to persist for the next several quarters, we do expect that the supply-demand imbalances will normalize to an extent and inflation numbers will retreat in 2022 from the recent highs. During this inflationary period, most businesses have been able to pass on increased input costs to consumers, protecting profit margins and earnings.

Fed Prepares for Liftoff

Another contributing factor to inflation this year has been the Federal Reserve's loose monetary policy, providing stimulus to an economy that has been running beyond capacity since the second half of 2020. In response, the Fed made a hawkish pivot at their December meeting by announcing its intention to gradually end its quantitative easing program by further reducing monthly purchases of treasury and mortgage securities in the open market. Many market participants believe the Fed will initiate raising the Federal Funds rate as early as March.

We anticipate this transition from quantitative easing to tightening will lead to more market volatility than we experienced in 2021. The Fed has made it a point to be more transparent with their plan but has also said they will stay nimble, and the path of their program remains data dependent, not on auto pilot. Each rate hike cycle can play out differently, and we will be actively analyzing the data and positioning client portfolios accordingly during this cycle.

Positioning Portfolios for 2022

While our clients' portfolios have performed well during the recovery, our team has repositioned portfolios entering 2022 to hedge against near term market risks by holding on to a larger than normal cash position along with the fixed income allocation in the portfolios. We have made investment allocations that our team believes will serve as a hedge in a rising interest rate environment, such as banks/financials and senior secured floating rate fixed income instruments.

Our position in energy acts as a hedge against near term inflationary pressures and we have reduced or eliminated other sectors in portfolios that have heightened sensitivity to interest rate increases, such as homebuilders. Our banks/financials holdings have historically benefited when the Fed embarks on rate hike cycles as their net interest margins expand as interest rates rise. Banks have also been releasing recession era loan loss reserves which will continue to support earnings and they have posted strong results from recent stress tests.

One of the sectors we continue to be most constructive on is energy. Demand for energy has recovered to near pre-pandemic levels. The supply, however, has not kept up with demand due to under investment in production and OPEC holding their oil output levels mostly steady, creating an imbalance which has led to dramatic price increases across energy and other commodities. As contrarian and tactical investors, we tend to take notice of out of favor asset classes where the fundamental thesis remains strong. Energy companies represent just a small percentage of equity indices which has contributed to dramatic under ownership in the energy sector. We would expect earnings in the energy sector to be strong this year as commodity prices are likely to remain elevated. This sustained improvement in fundamentals, coupled with the inflation hedging properties of energy, along with a significant lack of existing exposure to the sector among investors, should attract investor interest moving forward.

Corporate and Consumer Fundamentals Are Strong

Despite uncertainty surrounding the pandemic and the pace in which the Fed will raise interest rates, corporate fundamentals in the US remain solid. Corporations are on pace to book record earnings in 2021 and consensus estimates for the coming year are forecasting earnings growth of 8-9%. Corporate balance sheets are strong, as evidenced by companies holding nearly $4 trillion in cash on their balance sheets going into year-end. This enormous amount of liquidity provides flexibility. Several companies have stated that they are planning for larger than normal stock buyback programs and dividend increases to make up for pausing these programs over the last couple of years.

U.S. consumers also remain on solid footing. Spending increased in 2021, as pent-up savings were unleashed, and the impact of the wealth effect was felt across the economy. Household balance sheets are in their best position since before the financial crisis. The record rise in real estate values and the continued recovery in financial markets have boosted confidence. Debt service ratios are at the lowest level in 40 years due to mortgage refinancing and wage increases.

The strong demand for labor and the expiration of enhanced unemployment benefits will continue to heal the labor market. The unemployment rate currently stands at 4.2%, a dramatic improvement from a peak of 14.8% in April 2020. It is projected to improve even further, returning to the pre-pandemic 50 year low of 3.5% by the end of 2022.

While monetary policy will be much less supportive (and even restrictive) in 2022, the strong position of corporations and households should provide a constructive backdrop for markets this year. As the market reacts to continued headlines about the pandemic and the balancing act of the economic recovery, inflation, and the path of interest rates, we would expect periods of volatility this year and we have positioned our clients' portfolios accordingly.

We wish you and your family peace, health, and happiness in 2022.

The Sloan Portfolio Management Team

214-720-7500 | 100 Crescent Court, Suite 1130. Dallas, TX 75201 | www.sloanim.com