As of 12/31/2021

Q1 2022

Spectrum Investor® Quarterly Newsletter

SPECTRUM INVESTMENT ADVISORS

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Newsletter Summary:

Economic Rebound Expected to Continue
Inflation and Omicron Reset Expectations
Federal Reserve to End Stimulus

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Stocks rallied higher in 2021 as the economy took major strides in reopening from COVID-19. For the third year in a row, the S&P 500 stock index (US large blend) rose by double digits, finishing up 28.71%. US small cap stocks and international stocks trailed the S&P 500 by about half, but still posted double digit returns. An improving economy meant rising interest rates, leading the Bloomberg US Aggregate Bond index to post its first calendar year decline since 2013. *Cannot invest directly in an index. Past performance is not a guarantee of future results.*

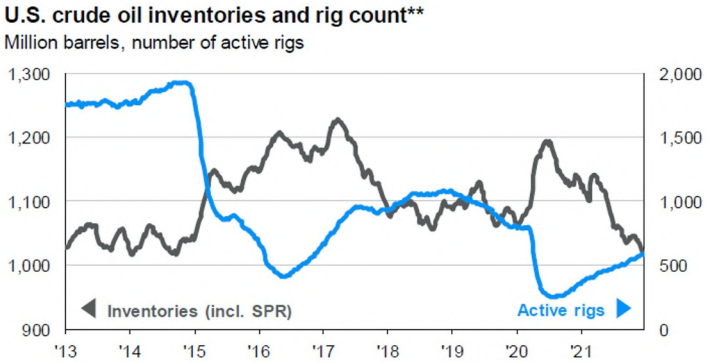
2021 Year in Review: Surge economy, surge inflation. Between the vaccine rollout, stimulus, and pent up demand, the economy was set to surge in 2021. And it did. The US economy likely grew at a pace that was 2-3 times faster than the average over the last decade. It was a stressed growth however, as demand far exceeded supply in many areas, leading to higher prices. The Consumer Price Index reached a 40-year high of 7% in December 2021. Inflation is a cause for concern, but for many businesses, higher prices led to higher margins and earnings in 2021. Fourth quarter earnings are estimated to have grown 21% for S&P 500 companies (FactSet, 1/13/22). It would be the fourth straight quarter of earnings growth over 20%.

2022 Outlook. According to the *Wall Street Journal* survey of economists (as of 1/17/22), both growth and inflation are expected to stay above average in 2022, but at lower levels from 2021. The expectation is for inflation to remain elevated through the first half of the year, particularly with the Omicron variant causing further supply chain disruption. S&P 500 earnings growth is expected to be 9.4% for the calendar year 2022, with industrials, consumer discretionary, and energy leading the way. There are three key differences for 2022 vs 2021: **1) Inventories have been drawn down, 2) the workforce has improved, 3) the Federal Reserve will be removing accommodation to fight inflation**.

According to Mark Zandi, Chief Economist of Moody's Analytics, "2020 was the year of the pandemic, 2021 was the year of recovery, and 2022 will be the year of getting back to normal."

Inventories. Inventories present both a challenge and an opportunity. Early on, lack of inventory will be a problem as there is a risk that companies may miss sales opportunities due to lack of product or consumers becoming more sensitive to price increases. On the other hand, once production is able to come back on line, there is opportunity not only to meet demand, but also to exceed it in order to replenish normal inventory levels. The oil industry was one of the hardest hit in 2020 and producers have been reluctant to rebuild inventory as COVID variants threatened demand growth. The chart to the right shows that oil inventories have been drawn down to seven year lows. During that drawdown, US crude oil surged more than 50% to $70 per barrel. Low inventory does present a risk of short-term supply shocks, but with higher prices and low inventory, producers may be more willing to increase production. The US Energy Information Administration is predicting an oil surplus by year end, which should help limit the price of oil and gas.

Workforce. There are still over 10 million job openings in the United States, more than the number of people who are unemployed and looking for work. While labor will continue to be a challenge in 2022, both in terms of availability and cost, the situation has improved compared to over a year ago. The economy added more jobs in 2021 than any year since 1984. Unemployment fell from 6.7% to 3.9%, falling below 4% a full year faster than most had predicted. The economy regained 82% of the 22.4 million jobs lost in the spring of 2020.



*Source: JPMorgan Asset Management; EIA; Baker Hughes. **US crude oil inventories include the Strategic Petroleum Reserve (SPR). Active rig count includes both natural gas and oil rigs. Guide to the Markets – U.S. Data as of 12/31/2021.*

Federal Reserve. *"Goodbye, punch bowl. We're going to miss you." - Lauren Rublin, Forbes (1/17/22).* The Federal Reserve is expected to end quantitative easing by March and begin raising interest rates with estimates calling for short-term interest rates to rise 0.50% to 1.00% in 2022. This change should be tolerable for the economy because there is still pent up demand to work through. It can, however, lead to a more volatile stock market as investors may worry that the Fed will overreact and raise rates too quickly.

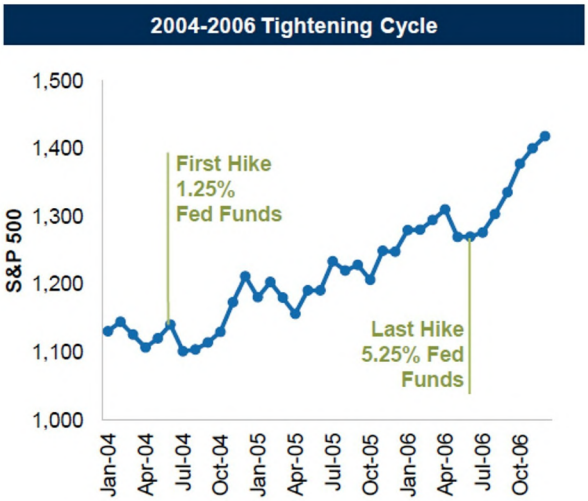
The change in tone at the Federal Reserve (some call the "Powell pivot") moved from patient to impatient over just a few months, leading to growing discomfort for investors in early January 2022. However, according to Bradford Neuman, Director of Market Strategy at Alger, the economy has historically grown through Fed tightening cycles and the S&P 500 averaged a 7% return for the 12 month period following the first hike.

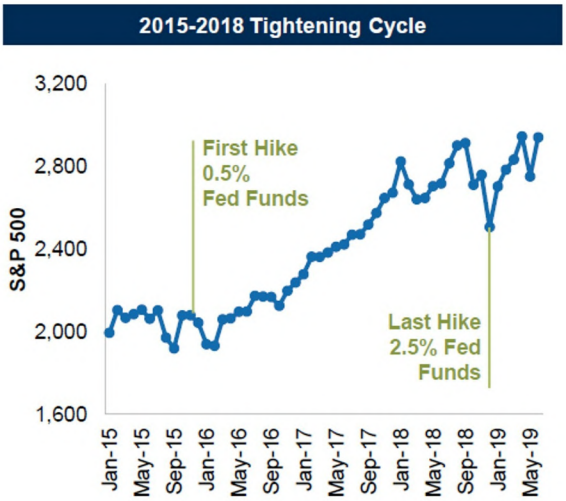
Stay the course. The chart on the following page is a reminder to not let your emotions drive your investment decisions. While there was volatility early, over time markets did continue higher, even in a rising interest rate environment. As long as interest rates don't rise too much, such as when

Quarterly Economic Update Continued

Fed Chairman Paul Volcker raised the Fed's benchmark interest rate from 11% to a record 20% in late 1980 to shrink inflation at 14%.

Stocks with higher valuations (growth) may be more sensitive to rising rates early. Value stocks are currently at the cheapest levels relative to growth since 2000. Financials, industrials, and energy (value) tend to do well in a growing economy. As always, we suggest staying diversified with a blend of both growth and value.





*Source: FactSet, U.S. Bureau of Economic Analysis, Federal Reserve. *Average of the four most recent tightening cycles beginning in February 1994, June 1999, June 2004 and December 2015. The performance data quoted represents past performance, which is not an indication or a guarantee of future results.*

Valuations. Despite positive gains in 2021, stock valuations actually declined in 2022 as earnings grew faster than the increase of stock prices. The year-end forward P/E ratio of the S&P 500 was 21.2x earnings. This is still above the long-term average of 16.8, but down from 22.3 as of the end of 2020. For comparison, this is still below the tech bubble valuation of 25.2x on March 24, 2000.

COVID-19. In our first quarter 2020 newsletter we talked about there being two types of coronaviruses: those that are lethal but fade quickly and those that are mild but persistent. COVID-19 has been a challenging middle ground between the two, even variant by variant, in how fast it spreads and the threat posed to public health. The latest variant, Omicron, is highly contagious, but top health experts say it appears to cause milder symptoms than the dangerous Delta variant and there are signs it may fade quickly. Until then, according to the president of the Federal Reserve Bank of Minneapolis, Neel Kashkari, families will continue to spend less on services and more on goods, which causes more supply chain issues.

Yield Curve. Historically, the best indicator of an economic hard landing is the relationship between the US Treasury 2-year note and the 10-year note. When the 2-year yield rises above the 10-year yield, which is called a negative yield curve, a recession usually begins within a year. Currently, the yield on the 2-year note is approximately three quarters of a percentage point below the 10-year note, which gives the Fed some room to raise short-term interest rates, hopefully without tipping our economy into a recession. Dr. David Kelly, Chief Global Strategist at JPMorgan, pointed out that 8 of the 10 leading economic indicators (LEI) are strongly positive. You can see the full chart on the bottom of page three of this newsletter.

Upcoming Webinar: January 25, 2022, 9am (CST) Dr. Brian Jacobsen, Sr. Investment Strategist at Allspring Global Investments. Dr. Jacobsen will be joining us at our January investment webinar for the second year in a row. He was recently seen on Bloomberg Television as well as CNBC. A year ago, Dr. Jacobsen called for year-end unemployment to be near 4%. Unemployment was 3.9% as of December 31, 2021.

To register for the webinar click the following link: **Global Markets Outlook with Dr. Brian Jacobsen**. All registrants will receive a recording of the webinar and it can also be viewed on our website at www.spectruminvestor.com under the Resources tab after its completion.

Spectrum Investor® Update

Morningstar Category Averages	4th Qtr	1 Year	3 Year
Intermediate-Core Bond	-0.24%	-1.48%	4.81%
Allocation 50%-70% Equity	4.79%	13.89%	14.85%
Large Cap Value	8.42%	26.22%	17.82%
Large Cap Blend	9.47%	26.07%	23.83%
Large Cap Growth	6.91%	20.45%	29.54%
Mid Cap Value	8.09%	29.32%	18.85%
Mid Cap Blend	7.39%	23.40%	20.74%
Mid Cap Growth	2.76%	13.05%	27.47%
Small Cap Value	5.86%	31.57%	18.37%
Small Cap Blend	5.47%	24.19%	19.73%
Small Cap Growth	1.74%	11.89%	25.87%
Foreign Large Cap Blend	2.55%	9.72%	13.56%
Real Estate	14.24%	38.73%	18.90%
Natural Resources	8.76%	29.56%	19.73%

Source: Morningstar, 3 yr return is annualized. Morningstar classifies categories by underlying holdings and then calculates the average performance of the category. Past performance is not an indication of future results. Returns in Blue = Best, Returns in Red = Worst. Please see Benchmark Disclosures on pg. 4.

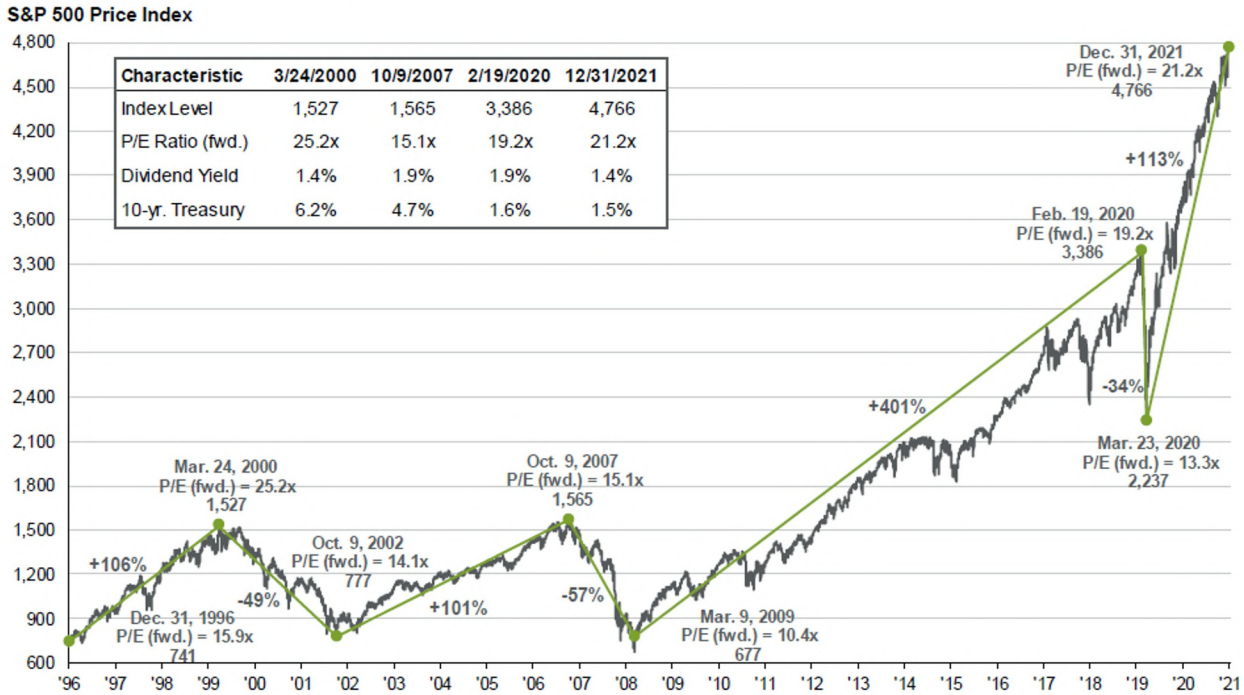
DOW: 36,338
NASDAQ: 15,645
S&P 500: 4,766
10 Yr T-Note: 1.51%
Inflation Rate: 7.0% (12/21)
Unemployment Rate: 3.9%

Data as of 12/31/21 unless otherwise noted. The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors. The S&P 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. Barrel of Oil: West Texas Intermediate. Inflation Rate: CPI. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index. Indices cannot be invested into directly.

To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

S&P 500 Index at Inflection Points: The chart below illustrates the performance history of the S&P 500 from 12/31/96 to 12/31/21. As of 3/23/20, the S&P had dropped 30%, but recovered, down 8% as of 6/30/20. The S&P finished up 18.4% as of 12/31/20 and is up 28% year-to-date as of 12/31/21. As of 12/31/21 the 10-year treasury rate is now 1.5%, which compares to the dividend yield of the S&P 500 at 1.4%. When the current yield on bonds is close to even with the yield on stocks, we continue to suggest slightly over-weighting stocks.

S&P 500 Index at inflection points



Characteristic	3/24/2000	10/9/2007	2/19/2020	12/31/2021
Index Level	1,527	1,565	3,386	4,766
P/E Ratio (fwd.)	25.2x	15.1x	19.2x	21.2x
Dividend Yield	1.4%	1.9%	1.9%	1.4%
10-yr. Treasury	6.2%	4.7%	1.6%	1.5%

Source: Compustat, FactSet, Federal Reserve, Refinitiv, Standard & Poor's, J.P. Morgan Asset Management. Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price to earnings ratio is a bottom-up calculation based on J.P. Morgan Asset Management estimates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns. The S&P 500 Index is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenue are based in the US. Guide to the Markets – U.S. Data as of 12/31/2021.

Year Over Year Change in the LEI: Despite the recent volatility of the stock market 8 of the 10 Leading Economic Indicators (LEI) are in the green and are up. Consumer expectations and sentiment are still showing negative.

The year-over-year growth rate of the LEI likely peaked in April, but it's still in positive territory

"The U.S. LEI rose sharply again in November, suggesting the current economic expansion will continue, although inflation and continuing supply chain disruptions, as well as a resurgence of COVID-19, pose risks to GDP growth in 2022."

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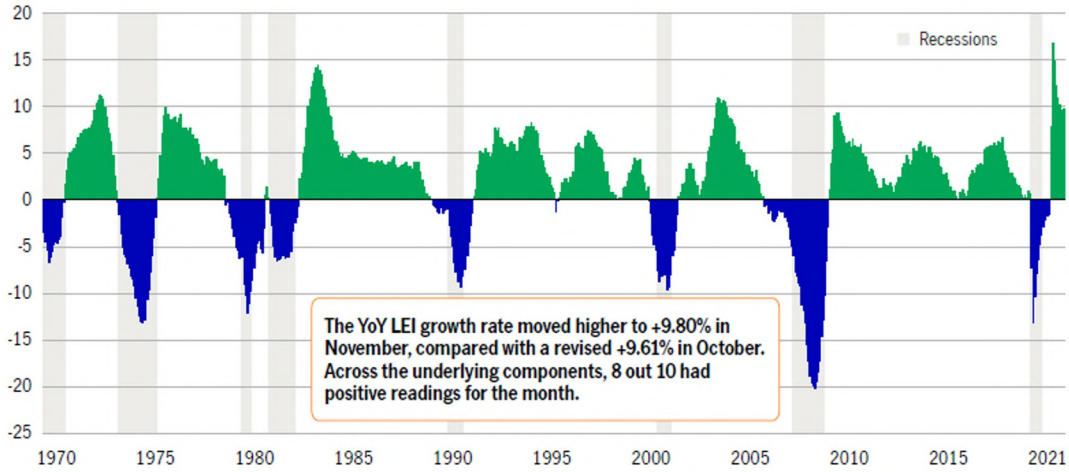
YoY change in the LEI (%)

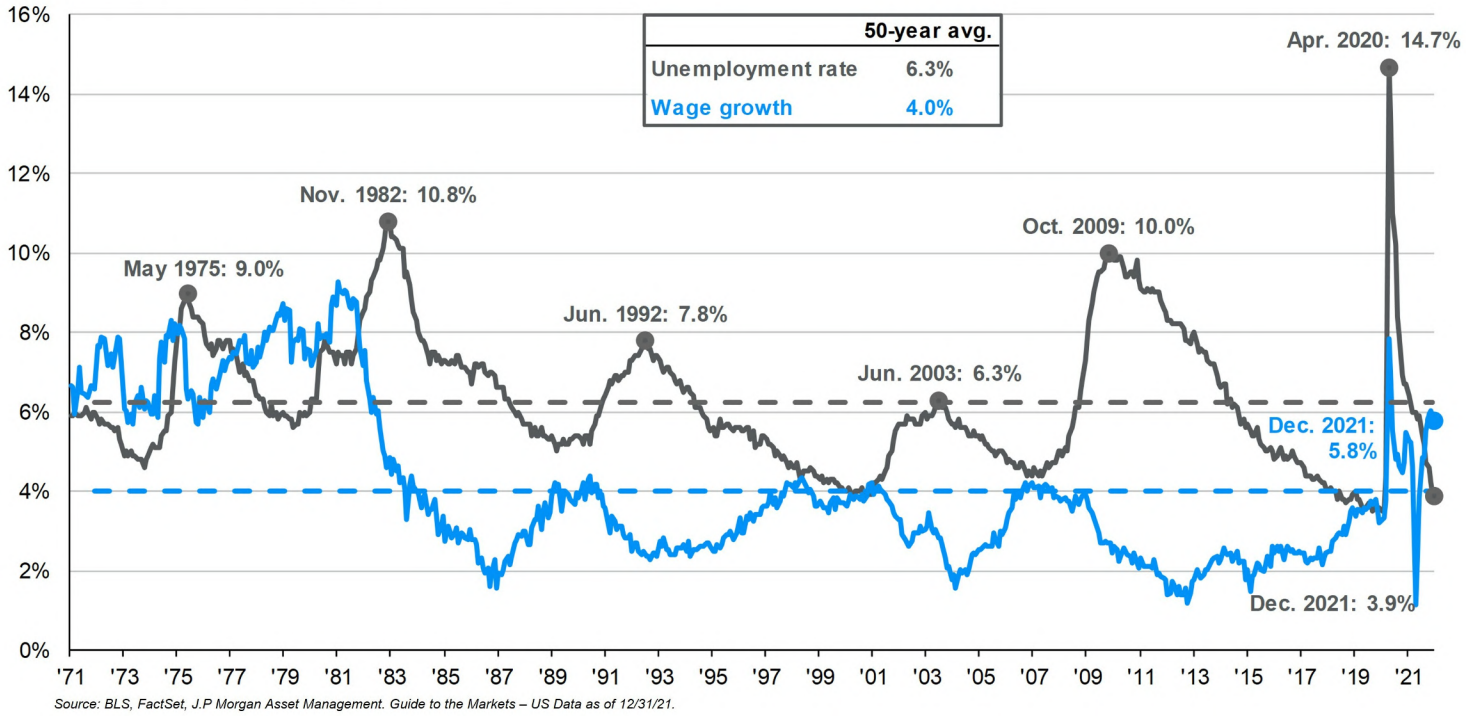


LEI (ranked by weighting in the index)		
Weekly manufacturing hours worked	28%	▲
ISM Index of New Orders	16%	▲
Consumer expectations	14%	▼
Yield spread	11%	▲
New orders of consumer goods and materials	8%	▲
Leading Credit Index	8%	▲
New orders of nondefense capital goods	4%	—
Stock prices	4%	▲
Weekly unemployment claims	3%	▲
Building permits	3%	▲

Source: The Conference Board as of 11/30/21. The Composite Index of Leading Indicators (LEI) is published monthly by The Conference Board and tracks 10 economic components whose changes tend to precede changes in the overall economy. It is not possible to invest directly into an index. YOY refers to year over year. Past performance does not guarantee future results.

Unemployment and Wages: US unemployment spiked to 14.8% in April 2020, but has settled back to 3.9% as of 12/31/2021. Due to the shortage of employees, the US has experienced significant wage growth, up to 5.8% as of 12/31/21. Wage growth can be an issue regarding potential inflation that the Fed will need to monitor. For a number of years in our past newsletters we have mentioned that when wage growth exceeds unemployment, it's going to force the Federal Reserve to begin raising interest rates and that time has arrived, with the first rate hike likely before the end of the first quarter, 2022.

Unemployment and wages



Source: BLS, FactSet, J.P Morgan Asset Management. Guide to the Markets – US Data as of 12/31/21.

Benchmark Disclosures

Morningstar Category Averages: *Morningstar classifies mutual funds into peer groups based on their holdings. The Category Average calculates the average return of mutual funds that fall within the category during the given time period. The following indexes and their definitions provide an approximate description of the type of investments held by mutual funds in each respective Morningstar Category. One cannot invest directly in an index or category average.* ***Intermediate-Term Bonds: Bloomberg US Agg Bond Index****–Measures the performance of investment grade, US dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS, ABS and CMBS.* ***Allocation 50%-70% Equity****–These funds invest in both stocks and bonds and maintain a relatively higher position in stocks. These funds typically have 50%-70% of assets in equities and the remainder in fixed income and cash.* ***Large Cap Value: S&P 500 Value Index****–Measures the performance of value stocks of the S&P 500 index by dividing into growth and value segments by using three factors: sales growth, the ratio of earnings change to price and momentum.* ***Large Cap Blend: S&P 500 Index****–A market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenue are based in the US.* ***Large Cap Growth: S&P 500 Growth Index****–Measures the performance of growth stocks drawn from the S&P 500 index by dividing it into growth and value segments by using three factors: sales growth, the ratio of earnings change to price and momentum.* ***Mid Cap Value/Mid Cap Growth: S&P MidCap 400 Index****–A market cap weighted index that covers the complete market cap for the S&P 400 Index. All S&P 400 index stocks are represented in both and/or each Growth and Value index.* ***Mid Cap Blend: S&P MidCap 400 Index****–Measures the performance of mid-sized US companies, reflecting the distinctive risk and return characteristics of this market segment.* ***Small Cap Value: Russell 2000 Value Index****–Measures the performance of small-cap value segment of Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.* ***Small Cap Blend: Russell 2000 Index****–Measures the performance of the small-cap segment of the US equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.* ***Foreign Large Cap Blend: MSCI EAFE NR Index****–This Europe, Australasia, and Far East index is a market-capitalization-weighted index of 21 non-US, developed country indexes.* ***Small Cap Growth: Russell 2000 Growth Index****–Measures the performance of small-cap growth segment of Russell 2000 companies with higher price-to-value ratios and higher forecasted growth values.* ***Real Estate: DJ US Select REIT Index****–Measures the performance of publicly traded real estate trusts (REITs) and REIT-like securities to serve as proxy for direct real estate investment.* ***Natural Resources: S&P North American Natural Resources Index****– Measures the performance of US traded securities classified by the Global Industry Classification Standard (GICS) as energy and materials excluding the chemicals industry and steel but including energy companies, forestry services, producers of pulp and paper and plantations. Past performance is no guarantee of future results. This report is for informational purposes only and should not be construed as a recommendation or solicitation to buy or sell any security, policy or investment.* ***PE Ratio*** *is the measure of the share price relative to the annual net income earned by the firm per share.*