



OUR VIEW



Fourth Quarter Review

The bull market in stocks continued in 2021. There were significant shifts in sentiment and market leadership during the year, with some similarity to the pattern in 2020. Equities rose in response to widening vaccination progress early in the year, with the market rally led by segments of the market expected to benefit the most from economic reopening. During the middle of the year, stocks continued to move higher albeit at a slower pace with favorable Covid trends and policy stimulus providing a positive backdrop for growth. With Federal Reserve policy becoming more restrictive and the Omicron variant becoming the dominant strain of Covid-19, the latter part of the year was more turbulent as market sentiment frequently shifted between optimism and pessimism.

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Global equities, as represented by the MSCI All Country World Index, rose by more than 19% for the year. The S&P 500 gained 28.7%, reaching 70 new all-time highs during the year. U.S. small company stocks gained nearly 15%, losing momentum after a strong start to the year. Developed international stocks, as measured by the MSCI EAFE Index, rose by more than 11%. Emerging markets stocks faded badly in the second half of the year, losing more than 2%. Chinese regulatory actions, restrictive policy measures, and “zero-Covid” approach were major factors in the poor year for emerging markets.

Value led growth early in the year in the U.S. large company stock asset class, but growth stocks rebounded to outperform value for the year. The Russell 1000 growth index outperformed its value counterpart by more than 4%, a much smaller margin than last year’s record. Returns were markedly different in the small company and international equity asset classes, as value stocks handily outperformed growth stocks. The Russell 2000 Value Index outperformed the Russell 2000 Growth Index by more than 25%. In S&P 500 sector terms, energy stocks gained more than 50% for the year; the real estate, financial services, and technology sectors gained more than 30% for the year. The utilities and consumer staples sectors were relative laggards for the year, though both sectors provided returns in the high-teens.

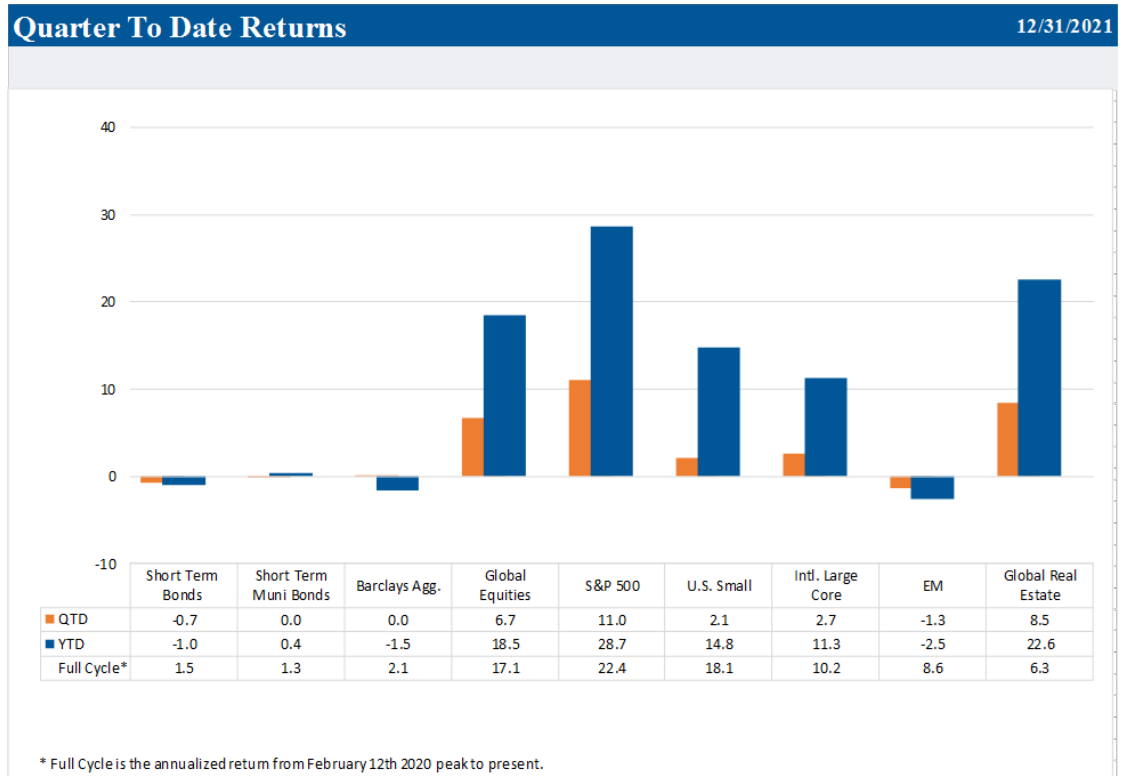
The strong returns of U.S. equity indexes masked a stealth bear market that was evident during the latter part of the year. Many companies with promising long-term business prospects, but little or no near-term profits suffered steep corrections because of rising interest rates and greater uncertainty about economic growth and



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inflation. More than half of U.S. small company stocks fell at least 20% and more than 10% of U.S. large company stocks fell at least 10% in the last third of the year.

The bond market was largely uninspiring in 2021. Rising interest rates led to negative returns for government bonds. Corporate bonds outperformed government bonds, helped by a recovering economy. Municipal bonds were also relative outperformers, with municipal finances healing dramatically from the dire conditions faced in the early days of the pandemic.



We expect equities to provide solid returns in 2022 that fall short of the outsized gains of recent years but remain superior to the uninspiring returns likely from the bond market.

TFC client portfolios rose strongly in absolute terms during 2021 and performed in line with client benchmarks. In a reversal of fortune in comparison with 2020, TFC's value holdings were the best performers as the global economy reopened. 2020 winners that benefited from the "stay home" economy struggled to maintain their momentum in 2021. With interest rates at low levels TFC's short-term, high quality fixed income holdings are providing relatively low returns but were mostly insulated from the spike upward in interest rates in the early and latter parts of 2021.

Market Outlook

We expect equities to provide solid returns in 2022 that fall short of the outsized gains of recent years but remain superior to the uninspiring returns likely from the bond market. Economic and earnings growth should continue to exceed pre-pandemic levels, though rising wages and interest rates will create some pressure on corporate profit margins and valuation multiples.



We expect that the widespread rollout of booster doses, as well as the progressive availability of effective and safe antiviral drugs, will limit Omicron's impact on economic activity to the first half of 2022, and that the pandemic will recede in importance in comparison to 2021.

Covid-19 and inflation are among the risks to our favorable market outlook. 2022 began with a surge in Covid-19, with more than 1 million new cases reported after the New Year's holiday. The Omicron variant appears to be far more contagious than Delta but so far is causing fewer hospitalizations and milder symptoms for most of those infected. Investor sentiment appears to reflect the belief that Covid will never be completely eradicated and that we must "learn to live with Covid." Most countries show reluctance to reinstate the restrictive measures employed during earlier stages of the pandemic. China's "zero-Covid" policy is a notable exception. J.P. Morgan's David Kelly sees Omicron as "equivalent to pumping brakes on the economy." His view, in line with the emerging consensus, is that Omicron will slow economic growth but not cause growth to stall. We expect that the widespread rollout of booster doses, as well as the progressive availability of effective and safe antiviral drugs, will limit Omicron's impact on economic activity to the first half of 2022, and that the pandemic will recede in importance in comparison to 2021.

Inflation in 2021 reached levels not seen in decades. The surge in inflation is attributable in part to factors that we are confident will slow or reverse course during 2022. Goods demand should decline from peak levels, easing supply chain challenges creating congestion at and around major U.S. ports. The pandemic created a spike in demand for goods such as desks, computer equipment and recreational gear that became necessities for a world on lockdown. That surge in demand is not likely to be repeated, even if the Omicron wave continues for longer than current expectations. New and used car prices have been major contributors to the inflation surge and should stabilize as semiconductor production increases to catch up with demand. Rising U.S. rig counts and increasing production from OPEC + make it likely that oil prices will not repeat the rapid rise that created strains for consumer finances last year. Wage pressures are a key area to monitor -- we are watching trends in the labor market as the most significant threat to the intermediate and long-term outlook for inflation.

Federal Reserve policy will be influenced by the stickiness of near-term inflation pressures and changes in long-term inflation expectations. Market-implied inflation expectations signal that investors expect inflation to stabilize at rates slightly above pre-pandemic levels. De-globalization, aging demographics and a continued downturn in immigration are among the factors likely to push long-term inflation above pre-pandemic levels. The market expects inflation to settle in the 2.5% to 3% range over the next couple of years; the Fed is likely to act more aggressively to raise rates if long-dated inflation expectations rise meaningfully above that range. A more aggressive rate hike cycle would increase the risk of a Fed-policy induced recession. The Fed's actions will also be influenced by the labor market, with the supply of labor a key factor that may cause the Fed to move sooner rather than later. The economy may not return to pre-pandemic levels of labor participation, as some of the workers who left the workforce to retire or care for the young or old may not be coming back. Net immigration is at the lowest levels since the 1980s, creating additional strains for



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labor markets. We expect the Fed to raise rates in March, sooner than many analysts expect. However, we also think it likely, that the Fed will move fewer times in 2022 than is currently forecasted by market prices.

Portfolio Positioning

TFC is currently positioned in line with long-term strategic targets for equities, with the intention to move to a slightly overweight position reflecting our favorable outlook for stocks relative to bonds. Continued strength for the global economy and for corporate profits should help equities, with strong household balance sheets, accumulated savings, and rising wages providing a positive backdrop for consumer spending in 2022. Although we expect tighter fiscal and monetary policy in 2022, we do not think policy will be restrictive enough to push the economy into recession.

Diversification and selectivity within the equity portfolio continues to be important because the rotational shifts we have seen in recent years are happening so quickly. Diversification must be emphasized not just across sectors, but also across market cap, geographies, asset classes, and within asset classes. Just as important as diversifying, is thoughtful rebalancing to trim back on areas that have outperformed and add to areas that underperformed.

The S&P 500 and NASDAQ indexes are now dominated by a small number of stocks that have been the big winners from technology-driven innovation and from changes in how we work, where we work, and the nature of how our economy works that accelerated in response to the pandemic. Elevated valuations, potentially unrealistic growth expectations, and heightened antitrust scrutiny are risks to the outlook for the companies that now dominate U.S. indexes, reinforcing our belief that it makes sense to have a well-balanced portfolio that includes but isn't dominated by a small number of companies.

We think that selectivity is critical within the small cap asset class. Although many of tomorrow's market leaders will come from the ranks of today's small companies, a far greater number of small companies will stagnate or shrink in value. We see particular risk among the many small cap technology and biotech companies have high valuations and minimal near-term revenues, making them more vulnerable to rising interest rates that cause far-in-the future earnings to be discounted more steeply. Consequently, we think it important to invest with fund managers we think can distinguish between winners and losers in this high potential but high-risk segment of the market.

Valuations outside the U.S., particularly in emerging markets, are at extremely low levels relative to U.S. stocks. International stocks ended 2021 trading at more than a 30% discount to the valuations of U.S. stocks, a greater discount than we've seen in decades. Pure cheapness isn't enough to create a rally in international stocks, as

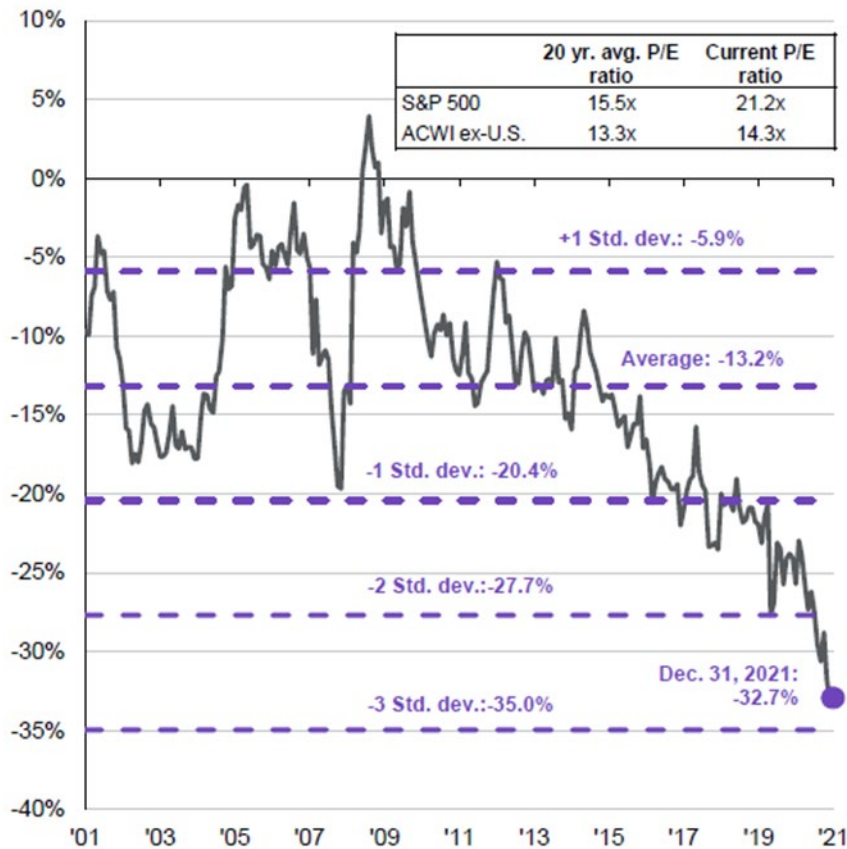


absent a meaningful catalyst, valuation differentials can remain in place for many years. We are optimistic about potential catalysts for the valuation gap to close in 2022. A Chinese economic recovery is one such catalyst, and the latest numbers suggest that China's credit cycle has bottomed which would help the growth and earnings outlook for the second half of 2022. Given the importance of Chinese growth to the rest of the world, a rebound in China would also help the more cyclical economies of Europe and Japan. A shift from dollar strength to dollar weakness would also help non-U.S. markets.

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International: Price-to-earnings discount vs. U.S.

MSCI AC World ex-U.S. vs. S&P 500 Indices, next 12 months



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management. Guide to the Markets – U.S. Data are as of December 31, 2021.

Within bond portfolios, we continue to emphasize a core of short-term, high quality fixed income holdings that will provide safety and liquidity but unfortunately not a lot of coupon income in a low-rate environment. Short-term bond yields should continue to be restrained by central banks, while longer-term bond yields are likely to drift upward. The risk-reward trade off in longer-term bonds is unattractive, but a



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well-diversified allocation to bonds remains a necessary counterweight to equity risk. We expect incremental income relative to government bonds from our corporate and mortgage-backed bond holdings.

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As always, we welcome your comments and questions.

Sincerely,

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