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Midland Wealth Management

Market Outlook

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A Look Ahead

Looking back a year, we had all hoped that by now COVID would not be impacting our lives still. However, as we are all aware, COVID continues to influence what we do, how we do it, and where we go. Modern medicine has certainly allowed our economy and lives to reopen and move closer to a "normal" life with widespread vaccinations and newly developed antiviral drugs, but new variants continue to limit a complete return to pre-COVID life. Many people are tired of it and are ready to move on, but we are reminded daily that we cannot control everything around us. We will likely need to learn to live with this virus for some time in the future.

As we head into 2022, the headlines may focus on the negative impact of COVID, but the U.S. economy continues an upward growth trajectory. Consumers remain confident, jobs are plentiful, and strong housing and equity markets have increased household net worth. The focus has been on the wealthy benefiting the greatest from the equity market, which may be true, but anyone invested in a retirement plan also benefited from the rising equity tide. When all is tallied, 2021 will be the fastest-growing economic year since the mid-1980s and will have the highest annual inflation rate as measured by the Consumer Price Index (CPI) in 40 years. Supply chain issues, labor shortages, and strong demand have led to higher prices across the board. As we discussed last quarter, some inflationary pressures will subside in 2022, but a higher inflationary environment than we have experienced in several years will remain.

With the higher inflationary environment, the Federal Reserve (Fed) has begun to taper bond purchases and anticipates March as an end date. Once tapering is completed, it opens the door for the Fed to begin gradually increasing the overnight rate. Since March 2020, the Fed has been accommodative and provided substantial liquidity to the market. In addition, fiscal stimulus from mid-2020 to earlier this year added liquidity to the market. At the time these programs were first implemented, it was a strong and bold response to provide support to the economy to avoid a long-term downturn. The reopening of the U.S. economy, which began in late 2020, along with the high levels of accommodation and stimulus, have resulted in strong demand, strong markets, and inflation. As we enter 2022, fiscal stimulus will be far less with no imminent bills being passed. Liquidity will be substantially less than experienced in the last 21 months and should result in slower economic growth, less speculation in the market, and with slower growth, potentially lower inflation.

While we anticipate GDP growth in the 3% to 4% range, there are risks to our outlook. One risk is whether the Fed moves more aggressively raising rates than the market anticipates. We do not believe the Fed will do this but need to be cognizant of the risk. Chairman Powell stated that the rate moves are data-dependent and specifically mentioned the supply chain issue, inflation, and tight labor market. Its mandate is full employment and a 2% inflation level. Currently, we believe that we are at or near full employment, but the inflation rate is higher than the Fed is comfortable with. We are anticipating it will lessen as the supply chain issues are worked out over the next 12 months. If the Fed raises rates too aggressively, the tighter monetary policy could lead to a dramatic slowdown and a potential recession in 2023. We believe the probability of this happening is extremely low at this time.

The second risk to our outlook is that the Omicron variant, or any other COVID variant, leads to shutdowns during 2022. Europe is currently limiting many activities due to the spread of Omicron. However, in the United States, only sporting events, theater shows, and other events have been canceled because of illness among performers and athletes. The economic ramifications from the 2020 shutdown are still lingering, and the long-term impact is yet to be determined. While the odds of another shutdown are minimal, we do not want to ignore the potential risk.

Since March 2020, there has been minimal volatility in the markets with a fairly straight upward trajectory. We believe the equity market will provide more opportunity for investors in 2022 than the fixed income market. We are anticipating greater volatility as the market digests the Fed actions, inflation, and company earnings. Fixed income investors will see minimal positive returns and potentially even negative returns if interest rates increase during the year. Our outlook for the markets leads us to remain overweight equities in our portfolios and underweight fixed income. Within the equity holdings, we believe that the developed international market will see a reopening trade, and we favor it slightly over domestic equities. High-quality companies with stable earnings growth will be preferred both domestically and internationally. Within the fixed income portfolio, we favor average maturity shorter than the targeted benchmark.

As always, we appreciate your trust in us and wish each of you a happy, healthy, and prosperous new year.

The Wind Down of Global Central Bank Stimulus

As we close out the year, fixed income investors certainly don't have as much to cheer about as equity investors do. Bond yields have been volatile this year. The faster than expected reopening of the economy early in the year led to a surge in the 10-year Treasury yield during the first quarter, only to be followed by a plunge in yields during the summer as COVID cases rebounded. The yield curve has flattened as the 10-year Treasury yield has fallen back to around 1.50% despite higher inflation. Most bond indices' performance is flat to slightly negative for the year, as short-term yields have moved up to the highest levels since early 2020 in anticipation of tighter monetary policy. The Barclays U.S. Aggregate Bond Index is slightly negative for the year (-1.33%), as of this writing.

All eyes continue to remain on the Fed for any clues on when it will begin to adjust the overnight borrowing rate. At the November meeting, the Federal Open Market Committee (FOMC) announced it will begin to reduce quantitative easing purchases (tapering) over the next six months. Since that meeting, it has turned more hawkish and announced a faster pace to the taper with an end date target of March 2022. To achieve this, it will cut its asset purchases by $30 billion per month, a reduction from the original $15 billion per month. Once this tapering is completed, it opens the door for the FOMC to begin raising interest rates.

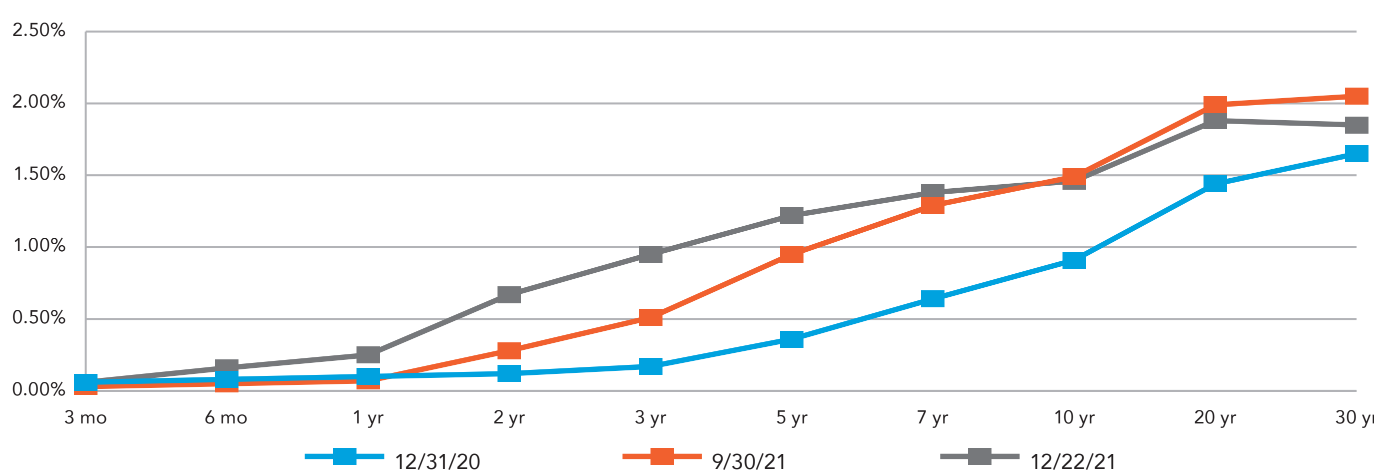
As the economy continues to improve and inflation remains higher, both investors and the FOMC are now anticipating three quarter-percentage-point interest rate hikes by the end of 2022. In fact, there is currently a 50% probability the Fed may raise rates as soon as March. The highest probability for a rate increase is in June of next year. Just like the stock market, the bond market is forward-looking, and the 2-Year Treasury has already priced in two rate hikes for next year. The 2-Year Treasury started the year around .20% and is currently yielding 0.67%.

One trend that is clear for 2022 is that the ultra-loose monetary policies from central banks around the globe are gradually coming to an end. Many central banks are beginning to end their bond-buying programs and raise interest rates. As the economy continues to normalize, bond yields will likely move higher for all maturities next year as this support from easy monetary policy unwinds. As yields move higher, we expect bonds to have another difficult year in 2022. Fixed income continues to offer value in a diversified portfolio by helping to provide both income and stability during uncertainty. To reduce price volatility as interest rates rise, our investment strategy continues to favor a well-diversified bond portfolio with an average duration of fewer than four years.

Proceed with Caution

As 2021 comes to an end, many investors have been bogged down by new variants of COVID that have stalled some countries around the globe from reopening, specifically in the European Union (EU). However, if there is one word that seems to be overused, thrown around, and quite frankly sums up the most talked about topic of the year, it would be that inflation is "transitory." A simple

Treasury Yield Curve



Google search of how many times economists and the Fed, specifically Chairman Powell, have used the word this year will render limitless news articles begging people to stop calling our inflation "transitory." As the year closes out, it seems the Fed has received the cue from investors. Heading into the new year, investors are expecting a minimum of two rate hikes in 2022, with the greatest odds of the first hike happening in May or June. This is the most hawkish we have seen the Fed over the last few years with its main priority being to tame inflation as quickly as possible.

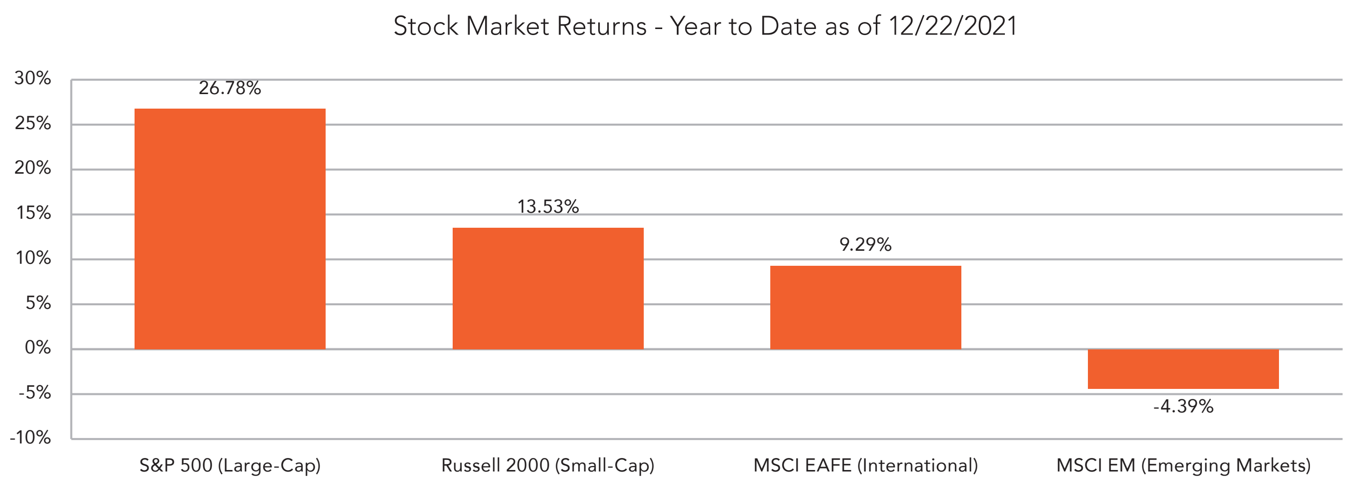
What will the expected interest rate hikes, higher inflation, tighter corporate balance sheets, Fed tapering, competitive labor markets, lower expected earnings, and new COVID variants potentially mean for the markets? As we enter the new year, we will have a slight overweight allocation to equities with some excess cash on the sideline to deploy as opportunities present themselves. The month of December has been volatile to say the least, as the FOMC has officially taken a hawkish stance as it pertains to monetary policy. This has likely created a near-term oversold condition that could lead to the much-anticipated Santa Claus rally. In general, U.S. equity valuations are near all-time highs, primarily driven by a concentration of large technology stocks. Upon closer observation though, the average stock is actually down more than 10% from its 52-week high, which we believe offers significant opportunities for growth. Specifically, our focus is on high-quality U.S. companies that generate strong cash flows with low debt.

Historically, after a 20% plus return year in the S&P 500, the index will typically follow up with a positive return the next year as well. The question that might be on some investors' minds, including ours, is what the opportunities across the pond in the developed international space are. With the amount of money that has been pumped into the U.S. economy and rising inflation, the expectation of a weakening dollar could become a reality, ultimately making international companies more attractive. In addition, much of the EU has not had the same reopening phase as we have had here in the U.S. There is still pent-up demand. As restrictions ease, we could see a second wave of growth internationally, similar to what we experienced here in the U.S. The biggest headwinds in the EU will likely be the same as we are facing here in the U.S.: more restrictions and supply chain issues, both of which we have become accustomed to over the last 21 months. On a positive note, supply chains seem to be improving over the last few weeks as the number of California cargo ships "in waiting" is down nearly 33%.

The new variant of COVID has become a concern for most. Preliminary data has shown Moderna and Pfizer vaccines are effective against the new variant. Within the last three weeks, the Delta variant went from being 99.3% of all cases to 26.6% of new cases in the U.S. The Omicron variant has now become the dominant strain at 73.2% of the cases. As scientists scramble to determine the severity of Omicron, one thing is certain, there is still a lot to learn about the new variant. Cases are on the rise every day, but we are not currently expecting any more restrictions or shutdowns.

While we believe that the equity market will perform well in 2022, we want to warn investors to taper expectations. We don't expect to see the same 23.3% YTD returns (as of 12/21/2021) in the S&P 500 Index next year. In fact, 2021 was an exceptionally strong year for the S&P 500, which would be extremely difficult to duplicate. First, the S&P 500 posted a new record high every month throughout the year, which has only happened twice in history, 2014 and 2021. Second, the S&P 500 has seen 67 record closes throughout the year. This performance has only been surpassed by the 77 record closes in 1995.

We expect 2022 will bring an increase in market volatility. Since Thanksgiving alone, the CBOE Volatility Index (VIX) has been rising and falling, breaking away from the 14.10 lows we saw earlier in the year. The biggest note we can stress to clients is to have patience with the market over the next year. Having a clear-cut vision of long-term goals and objectives will help investors weather the volatility storm we may experience next year.



The Age of the Electronic Will

Over the past two years, conducting business that requires document signings has been a challenge. If witnesses are required, it's been even more problematic. No business has been more affected by the effects of social distancing than the estate planning world. However, some states, including Illinois, have taken steps to alleviate these issues when it comes to signing a will. The age of the electronic will has now arrived.

Before looking at the new Electronic Wills and Remote Witnesses Act in Illinois, let's first review a very brief history of the electronic will in general.

The National Conference of Commissions on Uniform State Laws adopted the Uniform Electronic Transactions Act (UETA) in 1999. Although that act specifically excluded wills from its provisions, Nevada enacted the nation's first electronic will statute in 2001. While that statute was officially on the books, it was not really viable as the technology needed to comply with its requirements had not yet been developed. Nevada revised its electronic wills statute in 2017 with Indiana, Arizona and Florida following suit in 2018, 2019 and 2020 respectively. In addition, the National Conference of Commissions on Uniform State Laws adopted the Uniform Electronic Wills Act in 2019.

On July 26, 2021, Illinois became the most recent state to enact its own version of an electronic will statute, the Electronic Wills and Remote Witnesses Act (the Act). The purpose of the Act is to provide for the execution, attestation, self-proving and probate of electronic wills, paper copies of electronic wills and wills attested to by witnesses through audio-video communication. Although not addressed in this article, the Act also provides for the valid execution, attestation and witnessing of documents, other than wills, through audio-video communication.

The Act specifies that to be a valid electronic will, the testator must execute the will (or have someone else in the testator's presence execute the will at the testator's direction) and that two or more credible witnesses must provide their attestation in the testator's presence. The Act defines "presence" to mean either physically being in the same location and close enough to see and know that the testator is signing the will; or being in a different physical location but able, using audio-visual communication, to see, hear, communicate, and know that the testator is signing the will in real time.

To execute the will, the Act allows for the testator to use a wet signature or an electronic signature. "Electronic signature" is defined as a signature in electronic form that uses a security procedure outlined under the Electronic Commerce Security Act. After the testator has signed the electronic will, each witness must then also sign with an electronic signature while still in the presence of the testator. If the will is signed without witnesses, the witnesses are still permitted to sign but only after the testator acknowledges a previously made signature as the testator's act.

Although the above guidelines for executing the will may seem relatively straight forward, the Act goes on to provide detailed instructions on what Is considered a valid attestation through audio-video communication. First, the attesting witnesses must be physically in the United States at the time of attestation. Second, the witness must make a positive determine of the testator's identity. To establish identity, the witnesses must personally know the testator or view government issued identification or other pictured ID during the video conference. And third, if the will consists of separate signatures pages, attestation clauses, or affidavits forming a part of the will, a paper copy must be generated of the witnesses' signatures and attached to the paper copy containing the testator's signature within 10 business days of the attestation.

In some instances, Illinois law requires that a will be presented or retained in its original form. The Act specifies that a certified copy of an electronic will satisfies that requirement. To be considered certified, the paper copy must be designated as such by the person who converts the electronic record to a paper copy. Certification must include the all the following: date the paper copy was prepared; the name of the person who prepared it; the date the person obtained the electronic record; a description of how the record was obtained; a confirmation that the paper copy is a complete and correct copy of the electronic record; and confirmation that the electronic record is a tamper-evident electronic record. To be deemed tamper-evident, the electronic record must have a feature whereby any change to the electronic record is displayed whether in the electronic record or paper copy form.

The above is just a glimpse into the new electronic age dawning in the estate planning world. What started timidly twenty years ago gained momentum during the age of covid and is likely to keep on picking up steam. In Illinois, while there are conveniences associated with the idea of remote signings and electronic records, there are also many new items for consideration such as having the necessary electronic capabilities to comply with all the requirements mandated under the new statute. Unlike the Nevada law enacted in 2001, technology does currently exist to allow the new Electronic Wills and Remote Witnesses Act to be implemented. Now it is up to attorneys to ensure they have access to and possess the necessary understanding to ensure the documents created comply.

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Save the Date

Join Midland Wealth Management for a 2022 Outlook webinar!

Grab your lunch and listen in
Tuesday, January 25th, at 12:00pm (CST)
Call-in details to follow.

Important 2022 Dates for Client Tax Forms

- Forms 1099-R and 1099-MISC will be mailed out by end of January
- 1099-DIOB combined tax forms are targeted to be mailed out by February 21st
- Other tax forms, including grantor letters and Schedule K-1s, begin mailing February 21st through end of March
- Form 5498s will be mailed out in May

Market Insights communications are now shared in place of our Quarterly Webinar - save **wealthmanagement@mkt-midlandsb.com** in your email contacts!

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