

The FINANCIAL UPDATE

DAY & ENNIS, LLC
FEE-ONLY FINANCIAL PLANNING



Fourth Quarter 2021

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An In-Depth Report For Investors On Key Economic Fundamentals

Supply chain problems, often cited in the media as the main cause of inflation, are expected to diminish greatly by the end of the year. The high inflation rate on goods is expected to revert to the normal 2% rate experienced for the decade preceding the pandemic by the end of 2022, and prices on some goods may even be rolled back to pre-pandemic levels. For example, lumber prices at Home Depot soared in the Spring of 2021 but reverted to pre-pandemic levels by early Fall.

Price hikes imposed on services are unlikely to be rolled back. Price hikes on services have been triggered by the need for employers to pay higher wages, resulting in wage inflation. For example, McDonald's CEO, Chris Kempczinski, at a quarterly earnings call with investors on October 27th, said prices on its menu in 2021 have risen by 6%. He blamed a tight labor market for making it harder to keep restaurants open late and said wages at corporate-owned restaurants in 2021 soared more than 15%.

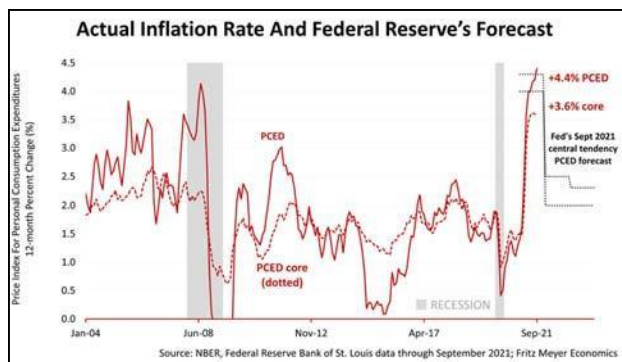
The labor shortage. The pandemic convinced Americans to drop out of the labor force. Many baby Boomers, an oversized percentage of the U.S. population, are now 65 or older and have "aged out" of the labor force. They've retired, shrinking the work force. Many individuals 65 and older who were expecting to work until age 70 likely decided not to risk their health by working outside of their home during the pandemic.

In addition, many parents with school-age children left the

labor force to stay home with their children. Coronavirus made paying for child-care just to be able to work much less attractive financially. Many Americans may have viewed the pandemic as an eye-opening event, causing a reprioritization of their goals in life, dialing back financial goals, and moving to a lower-cost place of residence.

About one and a half million more workers than expected retired, creating the labor crunch and sending wages higher. However, wage inflation is not expected to get out of control.

Inflation. The inflation rate, as measured by the Personal Consumption Expenditure Deflator (PCED), is shown in this chart. The PCED is slightly different from the Consumer Price Index (CPI), which is the inflation benchmark most often referenced in the consumer press, but PCED is the inflation index referenced in Fed policy statements. The dotted red line shows the PCED but excludes food and energy prices because their volatility often distorts the picture. The most important data are shown in the gray lines, which represent the range of forecasts of the 19 members of the Federal Open Market Committee – central bankers on the



(Continued on page 4)

Omicron Variant: What It Means To Investors?

Since the Omicron variant was recently cited by the WHO as a "virus of concern," stock prices for the last three stock-trading days (11/26/2021 to 12/01/2021) have gyrated.

The variant's characteristics – its transmissibility, resistance to vaccines, and treatability – are likely to continue to dominate the headlines over the next two weeks, which means even more volatility should be expected. But that doesn't mean the bull market is over.

Since the Covid bear-market bottomed in late March 2020, stock prices have soared. And they continued soaring after the Delta variant in May unexpectedly stalled U.S. economic growth. Why?

It's because yields on bonds are lower than ever before in U.S. history. This significantly changes the valuation investors historically attributed to stocks relative to bonds. This new valuation paradigm of stocks versus bonds is now in place and it must be understood before making investment decisions in this period of wild swings in stocks prices.

More bad news about the Omicron variant should be expected over the next two or, possibly, three weeks. The financial press is making the variant's effects melodramatic and sensationalizing the situation.

"I think it's a major moment," *The New York Times* quoted a hedge fund manager saying. "The Fed is finally sort of putting their stake in the ground and saying that the bubble has gone on long enough." The financial press, even the best outlets, has a long history of sensationalizing major news events, like the Omicron's effects on a long-term investor's portfolio.

Bubble talk from speculators misleads individual investors about the financial economic situation. Please do not let the headlines divert you from your strategic plan or long-term investment policy.

Sincerely,
Day & Ennis, LLC

Why Now's A Great Time For A Financial Crisis Plan

For the five years through June 30, U.S. stocks

were the No. 1 performing investment of major securities indexes! The S&P 500 index more than doubled in value, despite the pandemic! Remarkably, U.S. stocks were No. 1, not only for this five-year period through June 30, 2021, but for the past five five-year periods ended June 30! And, as the end of the third quarter neared, the S&P 500 kept breaking records.

This is precisely the right time to ask yourself: What could go wrong?

The stock market has been treating American investors to outsized gains year after year, and the party could continue - the good times could roll for another five years or get even better! As professionals, however, we believe it's wise to plan for a stock market slump, to plan what you would do if things go



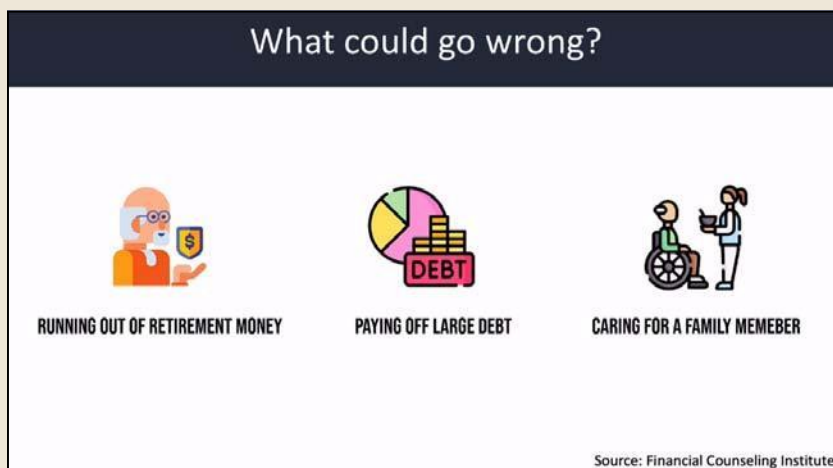
wrong with your business, your job, or God-forbid, your health.

With the stock market and housing values sharply higher than a year ago,

based on your experiences and personality characteristics. So everyone has their own very personal reaction to life's risks. Even if your

financial nightmare is

financial future is looking bright at this moment, writing your crisis plan now, rather than in the throes of a crisis, can help ensure you will continue to sleep soundly even if your worst financial nightmare were to come true. That's why now is the right time for financial crisis planning. ●



A Framework For Investing For Life

Modern Portfolio Theory, or MPT, is a framework for investing. It provides part of the intellectual underpinning of our firm's approach to managing investments. So, it is important to explain it periodically.

Just as constructing the framework for a home is strategically designed by connecting one piece of wood with another, MPT provides a system for constructing a portfolio based on measurable dimensions of investments - history and quantitative characteristics.

Owning different kinds of investments is less risky than owning only one type of asset, and MPT is a system for diversifying across a wide

range of assets based on their statistical characteristics.

Classifying investments based on their distinct characteristics - such as the aggregate value of a company's shares outstanding, profit growth, and share-price variance - imposes a quantitative discipline for selecting combinations of investments based on historical data. Investments revolve around a world that is always changing, however, and not enough statistical history of different kinds of investments exists to make investment predictions about the future with certainty. MPT is a way of managing that uncertainty.

Just as every stud and joist in a home

has its own mathematical dimensions, investments have their own unique shape and characteristics. MPT organizes statistics that measure the characteristics of different kinds of investments used to construct a portfolio. It's a way of building a portfolio so that the return you expect over the long run is maximized for a given level of risk.

Just as a home can be built to your personal needs and preferences, so, too, can a portfolio be custom-built to suit your personal risk tolerance specifications. To be clear, cookie cutter portfolios is not what we do. Each portfolio can be tailored to an investor's preferences.

A Crucial Investment Lesson From A Difficult 20 Years

The commemoration of 9/11 and pullout of U.S. troops from Afghanistan marked the passing of 20 difficult years. Historians will debate the lessons to be drawn from this tumultuous time for decades to come. For investors, however, a crucial investment lesson to be drawn is clear: In the past 20 years, amid the tumult and difficulties, broadly diversifying paid off, and quite convincingly at that!

These are the chief findings of a study of the 12 asset classes for which risk and return data are available for at least 20 years. The author of the study, Craig Israelsen, Ph.D., is a professor of finance for over three decades and an expert on portfolio design.

According to Dr. Israelsen, the Standard & Poor's 500 stock index averaged a 7.5% return annually for the 20-year period ended December 31, 2020 and had a standard deviation – a measure of its risk – of 17.8%. In contrast, a broadly diversified portfolio comprised of 12 assets equally weighted delivered 91% of the

return of stocks but with only 69% of the risk.

A portfolio with 12 equal weightings of different investments had a standard deviation of 12.3 and a return of 6.8%. That's a good tradeoff for investors: accepting about 10% less return with a 30% reduction in volatility.

would have had to endure wild swings in the value of your portfolio that annually averaged 17.8%. For example, in the five-week Covid bear market of February-March 2020, instead of suffering the 33.9% drop in value on the all-stock portfolio, the 12-asset portfolio suffered a much more tolerable 21% loss. Wild ups

and downs make investors more prone to selling at market bottoms.

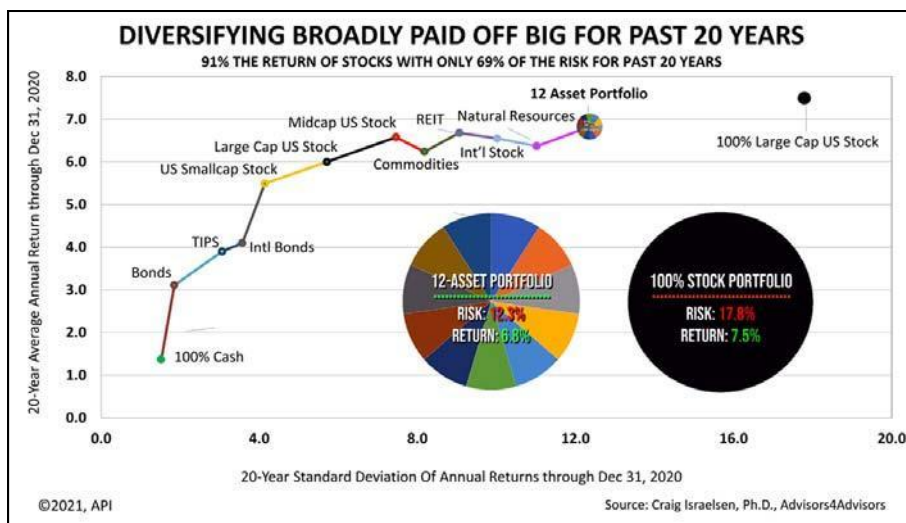
To better understand this concept so crucial to investor success, the multicolored line charts the standard deviation and return of each of the 12 asset classes for the 20 years ended

December 31, 2020. Each dot plots the risk and return annually averaged for an asset class.

The risk and return statistics all are based on indexes that track the 12 assets. The 12 assets are tracked by Dr. Israelsen because they form a broadly diversified portfolio, meaning they have different characteristics that can be measured statistically. In addition, they are indexed and, thus, enable a low-expense investment management approach.

Starting with the least volatile of the 12 assets, the multicolored line shows what each of the 12 assets added to the portfolio. Adding each of the 12 assets in equal amounts for the 20-year period created the very favorable risk/return curve in this chart. The combination of all 12 asset classes yielded the most efficient portfolio, compared to any combination of one or more assets.

Strategically investing in a broad set of assets worked even during one of the most difficult 20 years of the modern era. ●



It's clear evidence that, even over a 20-year period of world-shaking events, a strategic approach of broad diversification worked.

A one-asset portfolio having 100% in a high-risk, high-reward investment, like stocks, averaged a strong 7.5% annualized return, but you

Economist Harry Markowitz introduced MPT in a 1952 essay. He was awarded a Nobel Memorial Prize in Economic Sciences in 1990. Thus, it took from 1952 to 1990 – 38 years – for Markowitz to be recognized by the Nobel committee. This provides insight into the how long it takes for knowledge to be accepted.

Over the last 70 years, the power of Modern Portfolio Theory has grown to be understood. It is now the framework for investing embraced by most

institutional investors worldwide and it is now a foundational element in teaching finance at the world's best colleges and universities.



MPT is a starting point for constructing a quantitatively driven portfolio based on fundamental economics. Just as the laws of physics are relied upon for building a

home, fundamental factors of economics are relied upon in constructing a portfolio using MPT. ●

Dealing With Financial Fear

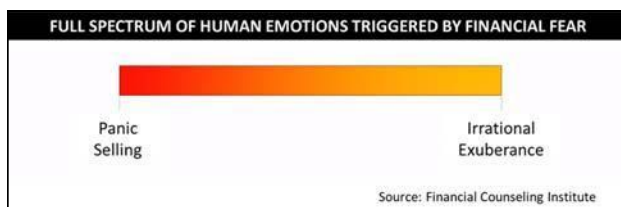
If you suffer from financial fear and anxiety, talking about it is likely to help.

In talking about it, according to Dr. Frank Murtha, a financial psychology expert, you go through a process of recognizing, understanding, and constructively reacting to your fear, rather than keeping it inside you and causing anxiety.

Whether your fear is running out of money in retirement, paying back a large debt, or caring for a family member with special needs, Dr. Murtha says personal financial issues evoke the full spectrum of human emotions -- from panic to irrational exuberance and everything in between -- but fear is the emotion that stands out as most impactful.

Professors Daniel Kahneman and Amos Tversky, founding fathers of the burgeoning social science of behavioral economics, famously discovered that people do not fear risk in investing; people fear a loss, specifically, a loss of control of the future.

In fact, investors who have



suffered an investment loss or financial setback often will actively seek out risk to break even and avert the loss. Of course, “doubling down” may actually compound a financial problem.

How we experience fear is partly dependent on physiology -- your brain chemistry. The fear center of the brain is called the amygdala and it triggers several instinctual reactions to fear. The “fight” instinct can be evoked.



Although this reaction may come in handy when you're getting physically attacked, it is not helpful in financial dealings.

A more common reaction to fear is flight -- the desire to remove the reason for experiencing fear, to retreat to safety and get back in control of your situation. In financial terms, the flight instinct may make you want to sell a losing investment at the height of a pandemic or amid a global financial crisis.

The other lesser-known neurobehavioral fear reaction is another F word. Can you guess what it is? The answer is “freeze.” Freezing is a typical reaction in times of rising fear. You become too afraid to do anything! “People get stuck, unable to make a decision to change a situation and they let anxiety get the best of them,” says Dr. Murtha. “A big part of dealing with financial anxiety is simply getting unstuck.”

Talking about financial anxiety can help you unburden yourself and that is often the first step toward re-instilling a sense of control, which is the key to fighting fear. ●

Key Economic Fundamentals

(Continued from page 1)

Federal Open Market Committee at the Fed, who set U.S. interest rates.

They are forecasting an abrupt end of the high inflation experienced in the pandemic in January 2022. The upper gray line represents the average low forecast of the FOMC, and the lower gray line shows their average forecast at the top of the range. Unless FOMC members suddenly changed their minds since meeting in late September, they predict inflation will plunge to 2.2% in January 2022.

Keep in mind, the FOMC members have changed their inflation forecasts considerably in recent months. In June, the committee hiked their inflation forecast by 50% over March, and in September they

hiked their forecast an additional 20%. However, the consensus forecast of 60 economic professionals surveyed quarterly by *The Wall Street Journal* agree with the 12 central bankers. That's significant. Even though the Fed has been wrong about how high inflation will head and how long it will last, the consensus of economists believe inflation will be temporary.

To be clear, the Fed says inflation will revert to its trend rate of 1.5% annually, to which it clung for a decade before the pandemic disrupted the supply chain and caused a labor shortage. The consensus believes the FOMC's assertion the current spate of inflation will dissipate over the next year.

The 60 economists surveyed in early-October 2021 see a continued expansion over the four quarters just ahead. A 4.8%

growth rate is forecasted by *The Journal's* panel of 60 economic experts for the final quarter of 2021, and they expect much higher U.S. growth for not just the last quarter of 2021 but also for the following three quarters. Inflation will not end the expansion.

The central bankers and consensus of economists is that supply chain problems will, for the most part, be resolved in the 12 months ahead and the spike in wages is not the start of a wage inflation spiral that will be with us long-term. Wage inflation will bring workers back who have sidelined themselves during the pandemic. With above-average growth expected through the end of the third quarter of 2023, the consensus of economists and central bankers' projections are for a continuation of the economic expansion. Expect robust growth in 2022. ●