

2022 outlook: Less is more



Over the past year, equity markets indulged on excess GDP growth, corporate profits and stimulus. This combination produced a steady string of record highs and returns that were well above average.

2022 will be a year of moderation, in our view, with the economy and corporate earnings expanding again, but at a more modest pace, while monetary stimulus dials back amid a transition toward higher

interest rates. The good news is we think less is more in the year ahead: Less extraordinary levels of growth and Fed liquidity can still support more bull market gains, accompanied by more volatility along the way.

Here are 10 key views for 2022:

1. The reopening's next phase gives the economy a second wind
2. The unemployment rate falls below 4%
3. Inflation stays above 3% before dropping back in the second half of the year
4. The Fed begins hiking interest rates, but the cycle is shallower than in the past
5. 10-year Treasury yields rise toward 2%
6. A correction emerges but does not lead to a bear market
7. Equity market returns moderate as earnings growth normalizes
8. The global rebound supports better international equity performance
9. Expect better balance in underlying investment performance
10. Less air for speculative bubbles

1. The reopening's next phase gives the economy a second wind

The delta variant stunted the economic reopening in 2021, producing a soft patch in GDP growth in the third quarter. The omicron variant presents a similar threat: We suspect the leisure, hospitality and entertainment areas of the service sector will face renewed headwinds into 2022.

While much is still unknown about omicron, we think the economic impact will delay, but not derail, the rebound in the pace of growth. We see the economy catching a second wind in the latter part of 2022, spurred by healthy consumer financial positions and progress in clearing some supply bottlenecks.

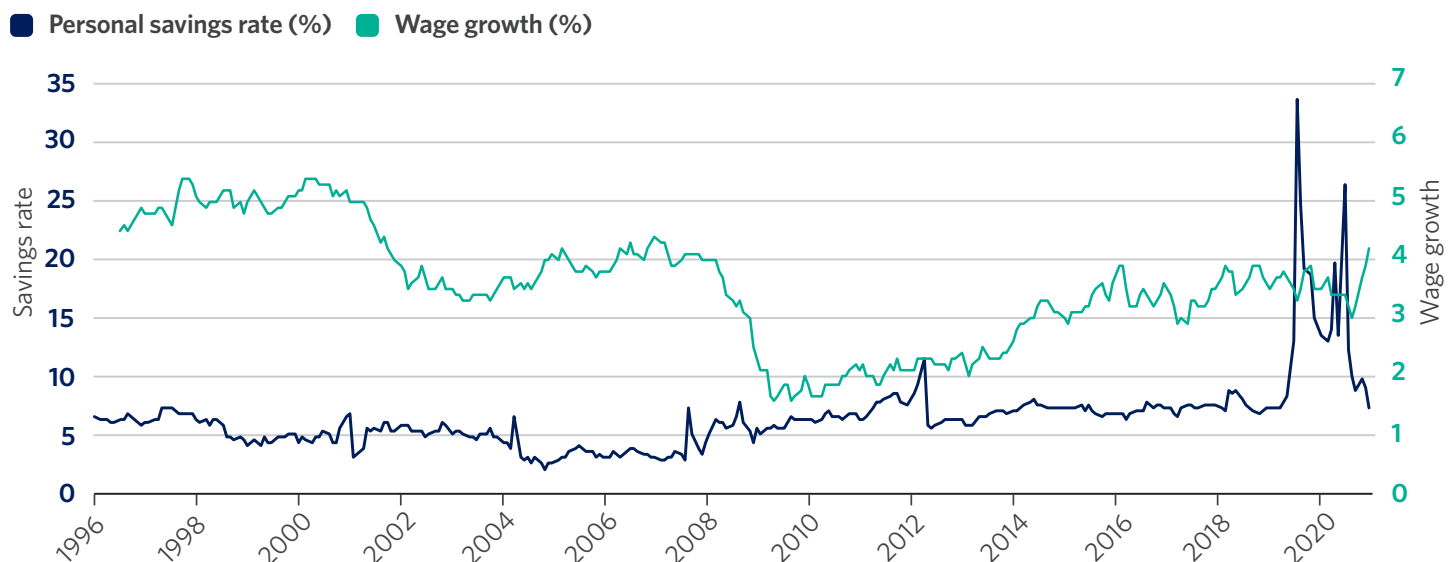
The fate of the economic expansion lies primarily in the hands of the consumer, with household consumption accounting for the majority of GDP. Consumption growth fell from more than 11% in the first half of 2021 to below 2% in the third quarter as the stimulus boost faded, while delta variant impacts and supply disruptions curbed spending.

Omicron is likely to blunt consumer spending growth as we start 2022, but the consumer remains a bright

spot as the year progresses. The personal savings rate averaged 13% over the past year, compared with an average of 6.6% over the past two decades. Meanwhile, ongoing – though fading – labor shortages should support above-average wage growth. We think this combination will sustain consumer demand, with spending shifting from goods to services as the economy more fully reopens.

Supply chain disruptions have impacted economic growth and stoked inflation pressures, as higher demand outstrips available supply. We think these bottlenecks will persist through the first half of the year before beginning to clear. Increased semiconductor production and shipments, as well as stabilization in recent manufacturing PMI readings, signal to us that the worst is behind us. We see inventory rebuilding and a renewed capital expenditure (capex) cycle as businesses invest in productivity enhancements, capacity and increased production. These forces should contribute to ongoing growth and help relieve some inflationary pressures over time.

Above-average wage growth and savings rates



Source: FRED.

2. The unemployment rate falls below 4%

The U.S. economy has recovered about 80% of the jobs lost in March and April 2020, but there are still 4.2 million fewer jobs than there were before the pandemic. A rebound in education, health services and leisure/accommodation employment will likely drive strong payroll gains in the year ahead.

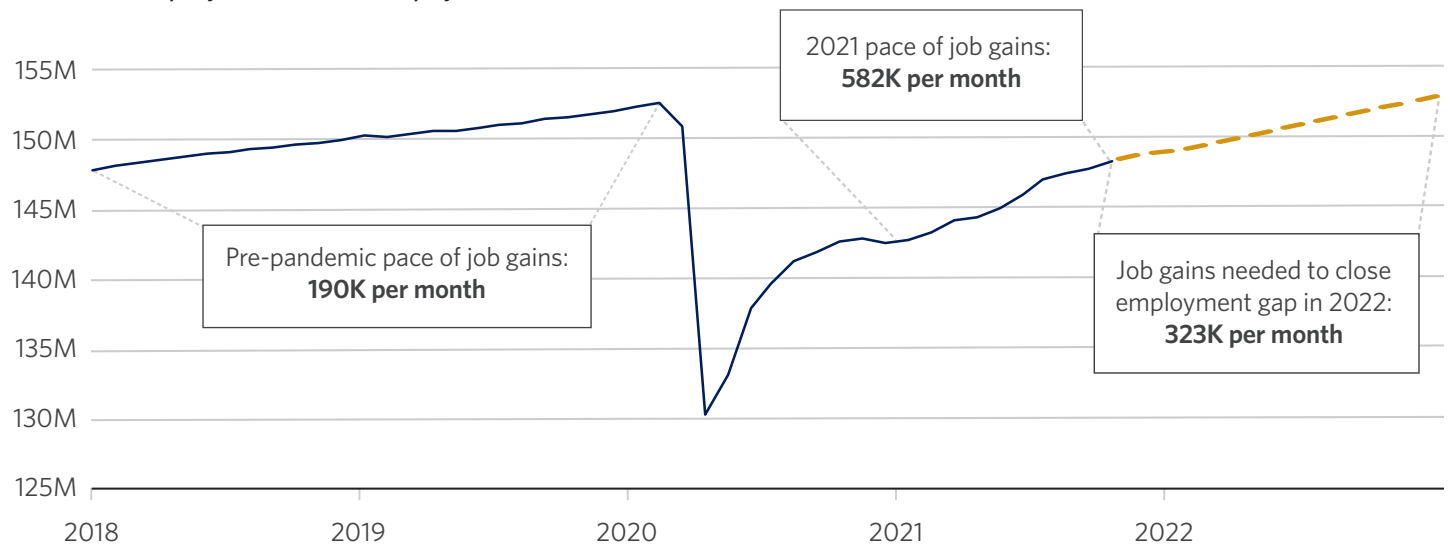
We expect strong job gains and a return to full employment in 2022, with the unemployment rate falling below 4%. Improving labor conditions suggest the expansion and bull market will continue in 2022. For perspective, recessions have historically begun on the heels of a rising unemployment rate.

Early retirements, caregiving burdens and virus fears contributed to a sharp decline in the labor force participation rate, which shows the percentage of the population in the workforce.

With the number of unemployed per job opening at its lowest since 1960, labor shortages are driving wages higher. As pandemic conditions continue to improve (albeit with periodic setbacks as new variants emerge), we expect more workers to go back to work. However, because of increased retirements and other demographic reasons, the labor force participation rate will likely remain below its pre-pandemic level. Wage growth could stay elevated through 2022.

Solid job gains on pace to pre-pandemic highs

Total U.S. employment (nonfarm payrolls)



Source: FactSet, 11/30/2021. Edward Jones calculations.

3. Inflation stays above 3% before dropping back in the second half of the year

2021's sharp price increases have begun to dent consumer sentiment and pressure central banks to tighten policy. Inflation is a key risk for the markets in 2022: We expect it to peak and then moderate, while staying above the Federal Reserve's 2% long-term target.

A key inflation driver has been a surge in demand for goods, coupled with supply constraints and material shortages. Lingering bottlenecks are likely to keep consumer prices higher in the first half of the year. But as supply rises to meet demand and year-over-year comparisons become more difficult (with prices compared against last year's elevated levels), inflation will likely cool in the second half.

Skyrocketing automotive prices show how a handful of categories had an outsized impact on the consumer price index (CPI) in 2021. As supply

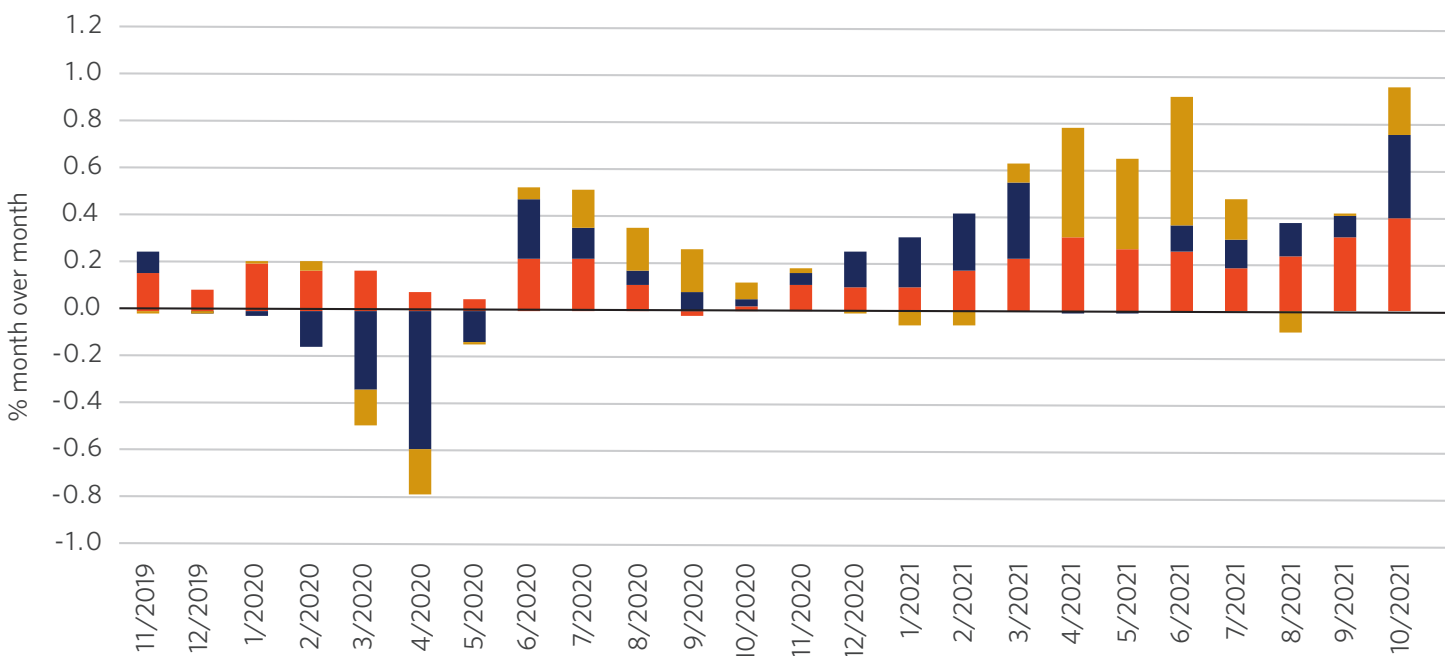
chains normalize and consumer spending shifts back to services from goods, we think some of these price gains will reverse in 2022. Energy prices are also likely to cool, but even if they remain unchanged, they will likely be a drag on the CPI in 2022, since inflation is measured as a rate of change.

There are signs that price increases are broadening and cyclical pressures are building, which is why we expect inflation to stay above the Fed's 2% long-term target. The recent increase in home prices and rents, which account for about a third of the consumer basket, is likely to prove sticky in 2022. Also, wages continue to rise amid signs of labor market tightness. Investments in automation could drive productivity higher, helping to curb wage inflation, but the post-pandemic shift toward deglobalization could have an offsetting effect.

Inflation is likely to ease gradually

Contribution to monthly inflation (CPI)

- Vehicle-related (used, new, rental cars) & pandemic-affected services (airfare, hotels, restaurants)
- Energy
- Other CPI components



Source: FactSet, 11/30/2021, Edward Jones calculations.

4. The Fed begins hiking rates, but the cycle is shallower than in the past

We expect the Fed to embark on an accelerated balance sheet tapering process, which will likely conclude by the first quarter of 2022, and then remain deliberate and patient with rate hikes. While the latest Fed “dot plot” indicates three rate hikes for 2022, this may change as the economic picture adjusts in the U.S.

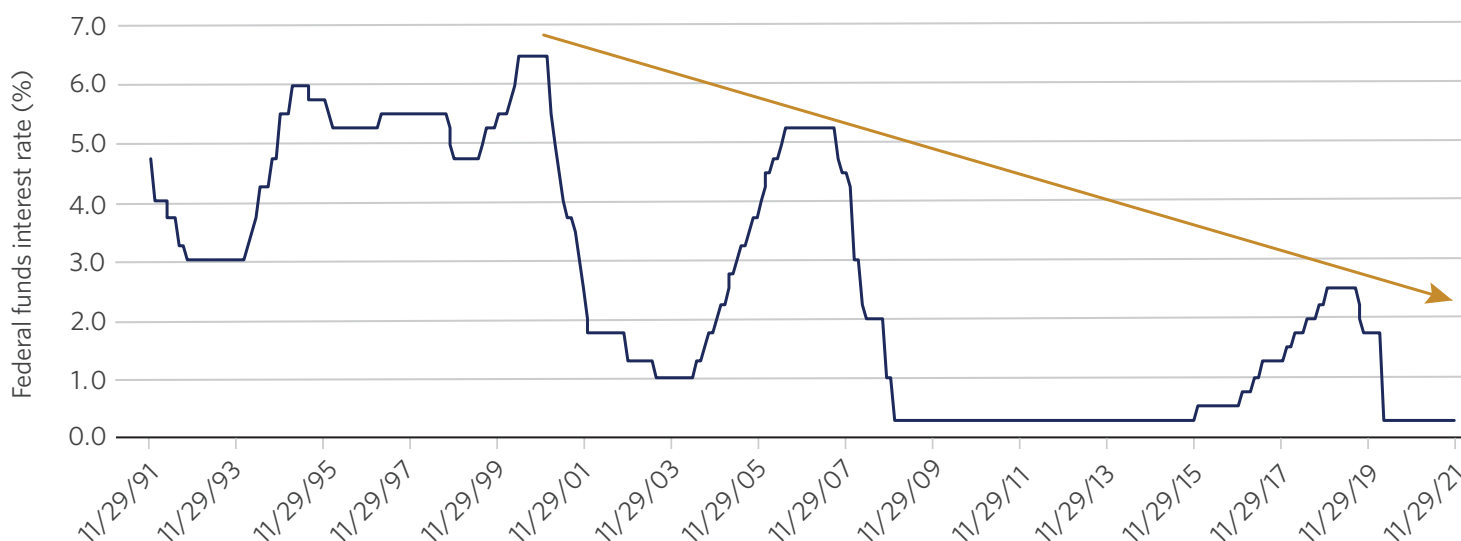
The Fed has seemingly shifted its focus for now onto battling inflation, which will likely remain elevated in the first quarter of 2022. If inflation remains hot while labor market conditions continue to improve and growth in the U.S. remains above trend, we expect the Fed to begin raising rates in the first half of 2022.

However, as we progress further into 2022, our expectation is that inflation will moderate – perhaps alongside economic growth – and the Fed will have

less immediate pressure to keep raising rates and more room to assess economic and financial conditions. Also, midterm elections are set for Nov. 8. Typically, the Fed prefers not to raise rates or move markets around election periods. This may mean the November Federal Open Market Committee (FOMC) meeting may be off the table as well.

It’s important to remember the level of a rate hike is as important as its timing. In our view, this Fed rate-hiking cycle may be shallower than those in the recent past, perhaps bringing the federal funds rate to 1.5%-2.0% (versus 4.25% and 2.25% in the last two cycles). This would keep the target federal funds rate relatively low when compared to historical levels and make interest rates more palatable for the markets and economy broadly.

Shallower Fed rate hikes over the past two years



Source: FactSet.

5. 10-year Treasury yields rise toward 2%

Ten-year Treasury yields fluctuated in 2021, ranging from 0.9% to 1.7%. We believe yields will grind higher toward 2.0% in 2022. We see this move driven by continued above-trend economic growth in the U.S., as well as inflation remaining above the Fed’s target range. In addition, the start of the Fed’s rate-hiking cycle in 2022 could support higher rates broadly across the yield curve.

However, we don’t expect the move in rates to undermine the broader economic expansion. While the yield curve has flattened as the short end of the curve has moved higher with monetary policy expectations, we continue to see the possibility of a steeper yield curve in 2022, as long Treasury bonds adjust higher – which would support more

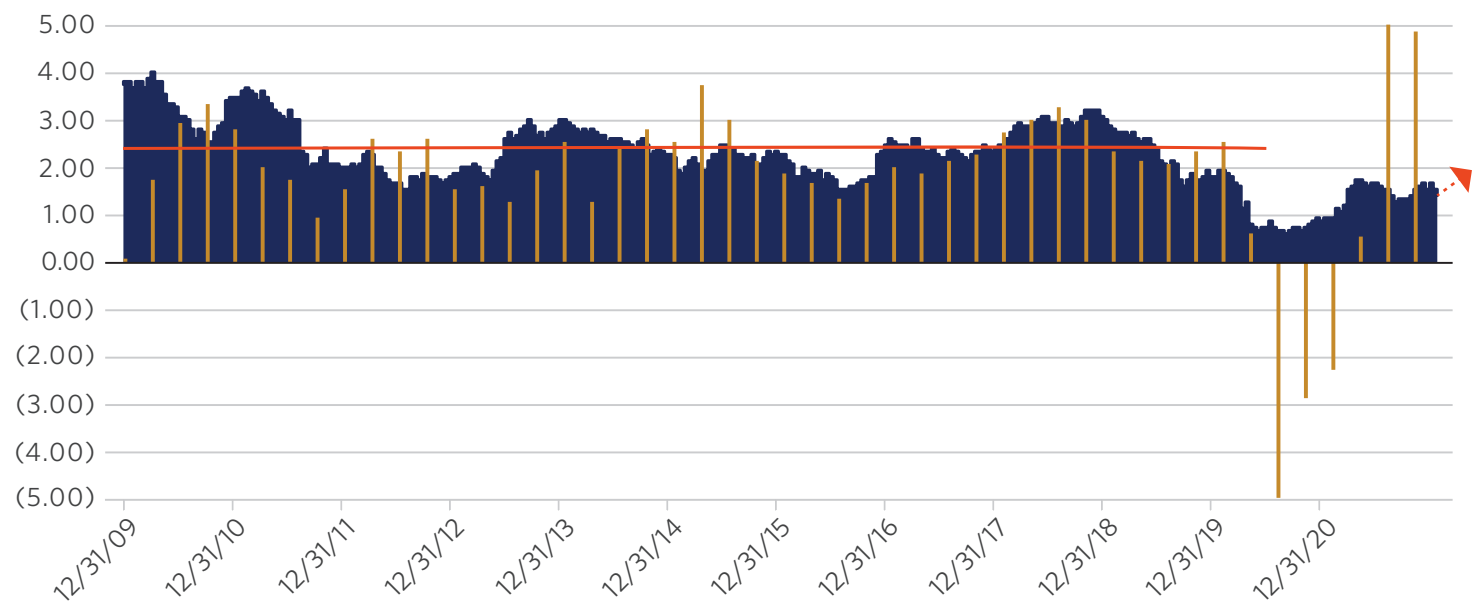
cyclical parts of the economy as well. More broadly, with yields closer to 2.0% in this cycle, we believe interest rates will continue to support above-trend consumption in 2022, especially as mortgage, credit card and corporate borrowing rates remain largely contained.

Longer term, we expect 10-year Treasury yields to remain in line with trend growth and inflation levels. If potential U.S. growth ranges from 1.5% to 2.5% and inflation falls to these levels over time, we would expect yields to remain in this range as well.

Keep in mind, global yields tend to anchor U.S. yields. If U.S. Treasury yields move out of line versus global relationships, global supply and demand pressures tend to bring U.S. yields back in line again.

10-year Treasury yields trended with real GDP growth pre-pandemic

■ U.S. 10-year Treasury yield (%) ■ U.S. real GDP (YoY %)



Source: FactSet.

6. A correction emerges but does not lead to a bear market

In 2022, we believe market volatility will return to more normal levels. Historically, we've seen on average three to four corrections a year in the 5% to 10% range. But in 2021, we saw only one 5% drawdown in the S&P 500 index, which also came after 12 months of no corrections.

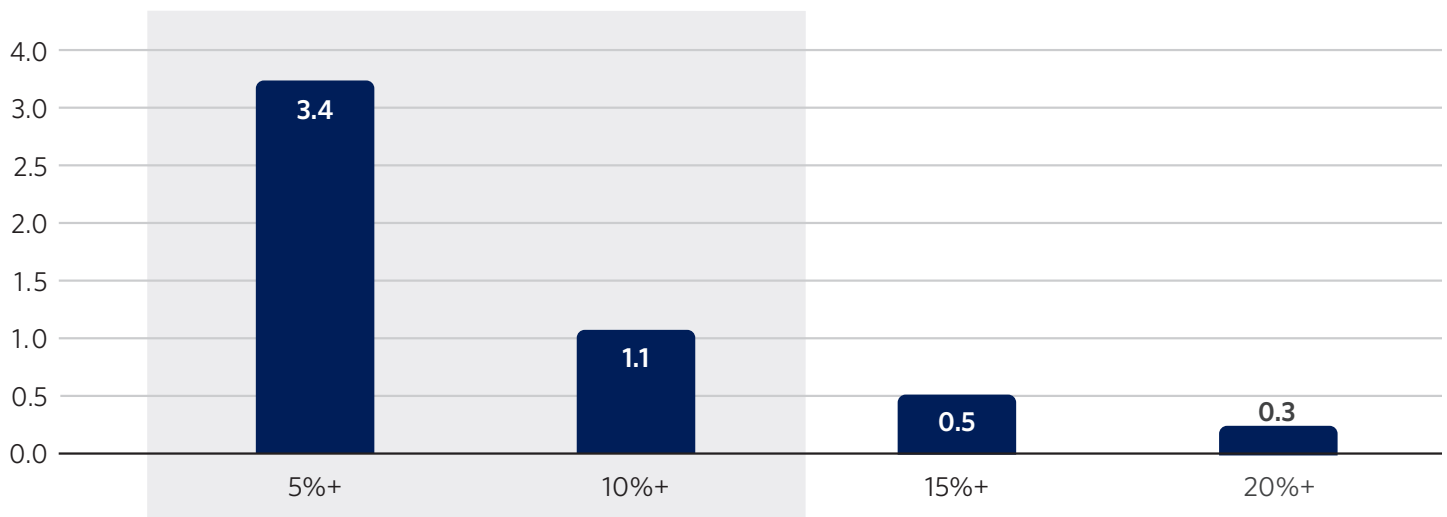
What could drive bouts of market volatility? We believe 2022 may be a year of transition: After nearly 6% real GDP growth in the U.S. and the Fed providing unprecedented liquidity to markets in 2021, we see growth slowing in 2022, albeit still above trend levels. The Fed also will reduce the pace of its monetary stimulus and

likely raise rates. This slower growth and reduced liquidity, combined with higher inflation and periods of uncertainty around COVID-19, raises the prospect of a larger market correction in 2022 than we experienced last year, in our view.

Importantly, however, we don't believe such a correction will usher in a more severe bear market decline of 20% or more. These tend to occur when the economy is entering or already in a recession, or the Fed is toward the end of its tightening cycle, none of which we see in place for 2022. Periods of market volatility or corrections may offer opportunities to add to or diversify portfolios.

Watch for a return to more normal volatility

Average number of S&P 500 index pullbacks per year



Source: Ned Davis Research, Edward Jones.

7. Equity market returns moderate as earnings growth normalizes

We continue to believe the U.S. economic cycle remains in its middle innings, with above-trend GDP growth in 2021 and 2022. For investors, this means the bull market still likely has room to run.

While market performance may continue to be positive, we do expect the pace of gains to moderate and volatility to broadly increase. After three years of solid double-digit gains, we see market returns in 2022 more in line with earnings growth, which we expect to be in the single digits.

On the downside, earnings growth may face margin pressure, driven by inflation and wage trends. Market valuations can also compress at this stage of the cycle, putting further stress on returns.

On the other hand, if demand remains high as reopening trends resume and supply starts to come back online, we could see some upside to growth in 2022. Overall, our base case is for mid-single-digit returns in 2022.

Return scenarios for the S&P 500

		Calendar-year 2022 P/E multiple				
		19.5x	20.5x	21.5x	22.5x	23.5x
Calendar-year 2022 EPS growth	-4%	-13%	-9%	-4%	1%	5%
	0%	-9%	-5%	0%	5%	9%
	4%	-5%	-1%	4%	9%	13%
	8%	-1%	4%	8%	13%	18%
	12%	3%	7%	12%	17%	21%
	16%	7%	11%	16%	21%	25%
	20%	11%	15%	20%	25%	29%

Source: Edward Jones estimates. Table shows varying price-to-earnings (P/E) multiples and earnings growth rates.

8. The global rebound supports better international equity performance

The global recovery is still speeding along, but with economic and equity market performance on different paths across regions in 2021. With a larger fiscal boost, faster vaccine distribution and an earlier easing of restrictions, the U.S. economy reclaimed its pre-pandemic peak in the second quarter, while European and Japanese activity remains below 2019 levels. We see significant catch-up potential for international markets as overseas economies more fully reopen.

We expect emerging-market equities to find their footing in 2022, supported by improved China trends. The decline in credit growth, strict COVID-19 restrictions and a regulatory crackdown across sectors contributed to a sharp downshift in China's

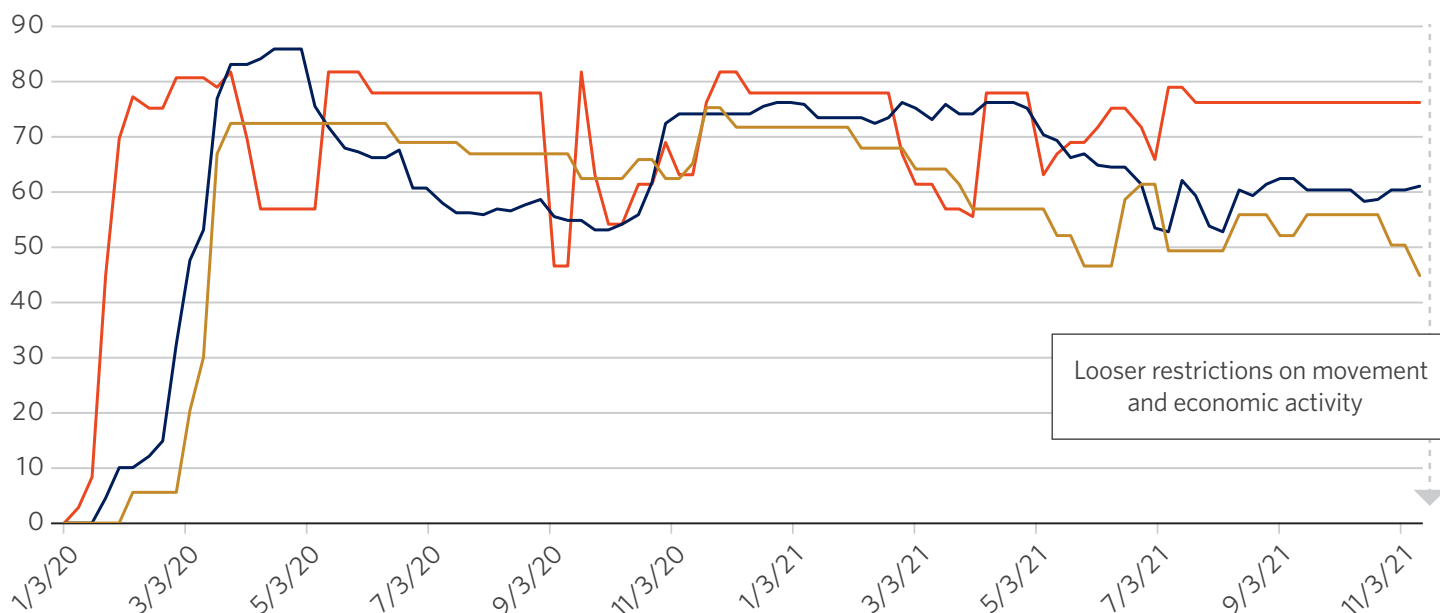
growth in 2021. We don't expect a repeat of these conditions this year, as policymakers hint at policy easing to help growth. A slowdown in property construction poses a risk. However, the sizable valuation discount to U.S. equities already reflects this uncertainty, in our view.

We also favor international developed small- and mid-cap stocks, which are tied more closely to the cyclical global rebound and have historically benefited from higher inflation. Inflation pressures are more acute in the U.S., which is why we think the Fed will hike rates before other central banks. While this supports a stronger U.S. dollar, the likelihood of solid global economic growth in the year ahead could mean a weaker dollar.

The next phase of reopening benefits global economies more

COVID-19 stringency index

China EU (average of Germany, France, Italy) U.S.



Source: Oxford COVID-19 Government Response Tracker, 11/30/2021.

The stringency index is a composite measure based on nine response indicators, including school closures, workplace closures and travel bans, rescaled to a value from 0 to 100 (100 = strictest).

9. Expect better balance in underlying investment performance

While leadership rotated between value and growth investment styles in 2021, cyclical sectors were on track to finish the year strong. The energy sector logged its best performance in over 30 years, and financials rose the most since 1997.

We expect value and cyclical sectors to continue to benefit from above-trend economic and earnings growth, especially in the first half of the year. However, with the Fed dialing back its accommodation and the fiscal stimulus boost fading, the underperforming staples, utilities and health care sectors are likely to hold up better than they did in 2021. As this chart shows, the relative performance of cyclicals over defensives is at the high end of its 10-year range, suggesting a more balanced approach to sector positioning is warranted.

The bull market has plenty of mileage left, in our view, but we are past the early recovery phase, which is usually the strongest point of the cycle. As the pace of market gains slows and pullbacks become more frequent, proper diversification across asset classes becomes more important to help manage risk.

U.S. large-cap equities remain well supported by robust corporate earnings trends. Yet, even with earnings growth outpacing the S&P 500 by nearly double (46% vs. 25%) in 2021, valuations remain elevated, and expectations are high. We recommend investors overweight more attractively priced asset classes, such as international equities, and slightly favor value over growth.

More balanced performance between cyclicals and defensives

Cyclicals vs. defensives relative performance



Source: FactSet, Edward Jones calculations. Cyclical sectors include financials, industrials, materials, consumer discretionary and energy. Defensive sectors include utilities, health care and consumer staples.

10. Less air for speculative bubbles

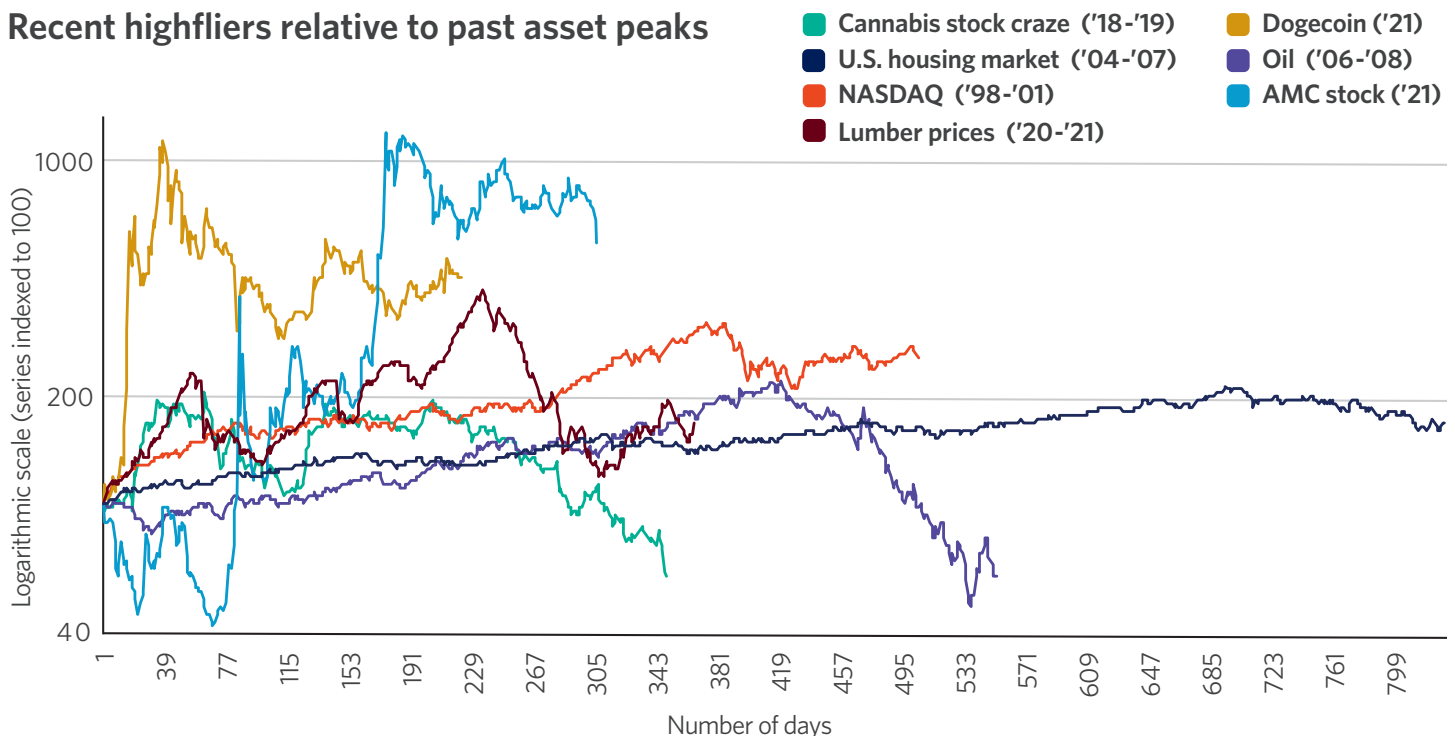
While 2021 marked three consecutive years of double-digit gains for equities, it was the meteoric rise in certain speculative assets that perhaps best characterized the investment climate. So-called meme stocks, digital collectibles such as non-fungible tokens (NFTs), special purpose acquisition companies (SPACs) and myriad cryptocurrencies experienced extreme price increases. We'd attribute this to the "animal spirits" that often emerge amid a strong bull market, along with fiscal and Fed stimulus.

We would consider this performance froth, if not mania. We don't see this as a systemic threat to the broader market. However, certain speculative investments could be a risk to investors chasing unsustainable gains. At the broader market level, we believe equities are more vulnerable to bouts of temporary volatility than a bubble-induced bear market.

We don't think the highfliers of 2021 are poised to collapse in 2022. In fact, we think risk taking and cyclically oriented investments can be rewarded as the fundamental foundation of this bull market remains intact. However, we don't think the gains in these types of speculative investments will be repeated as we advance.

The Fed is poised to take bond purchases from more than \$1 trillion per year to zero by mid-2022. At the same time, the middle phase of a market cycle often produces positive, but more moderate, equity market returns. In an environment of less Fed accommodation and young-but-maturing economic and business cycles, we think investments with bankable fundamentals – including durable earnings growth, cash flow, rising yields and compelling underlying business growth strategies – may curry more favor as the cycle advances.

Recent highfliers relative to past asset peaks



Source: FactSet, Edward Jones calculations. Cannabis represented by Canopy Growth, 00's energy represented by the TI NYMEX global spot price, Dogecoin represented by the Doge futures contract (closing price), AMC represented by the AMC closing price, lumber represented by the continuous lumber futures price, housing represented by the MSCI U.S. REIT. The NASDAQ is an unmanaged index and cannot be invested in directly. Past performance is not a guarantee of future results.

Actions to consider in 2022

Opportunistic asset allocation guidance

	Underweight	Neutral	Overweight
Equity	•	●	•
U.S. large-cap stocks	●	•	•
Real estate	•	●	•
International large-cap stocks	●	•	•
U.S. mid-cap stocks	•	●	•
U.S. small-cap stocks	•	●	•
International small- and mid-cap stocks	•	•	●
Emerging markets	•	•	●
Fixed income	•	●	•
U.S. investment-grade bonds	•	•	●
U.S. high-yield bonds	•	●	•
International bonds	●	•	•
International high-yield bonds	•	●	•
Cash	•	●	•

Actions to consider in 2022 *(continued)*

The new year and the shifting investment landscape present a timely opportunity to review your portfolio's positioning and performance expectations, if you haven't done so lately. The next phase of the reopening is likely to bring more modest returns and higher volatility, offering opportunities for disciplined investors.

We recommend neutral allocations to equities and fixed income, aligned with our strategic (long-term) asset allocation targets of your investment strategy. We believe equities have additional room to run and offer inflation protection for well-diversified portfolios over time. Fixed income, on the other hand, can deliver diversification benefits and provide a source of funds during temporary market dips, in our view.

While diversification remains important, we expect more cyclical or value-oriented equity investments to benefit from a global rebound. We favor economically sensitive international stock asset classes, such as emerging-market stocks and international small- and mid-cap stocks, over large-cap stocks. As interest rates glide higher in the coming months, we believe investors should overweight U.S. investment-grade bonds, which offer higher yields and lower interest rate sensitivity than international bonds.

Our opportunistic (short-term) asset allocation guidance can help you take advantage of opportunities in today's market without deviating too far from your long-term investment strategy.



Talk with your financial advisor to help ensure your portfolio stays within your comfort with risk and is aligned with your long-term goals, so you can continue making progress toward what matters to you.

Diversification does not ensure a profit or protect against loss in a declining market. Investors should understand the risks involved in owning investments, including interest rate risk, credit risk and market risk. The value of investments fluctuates, and investors can lose some or all of their principal.