Quarterly Commentary

January 2022

RWA ROBERTS WEALTH ADVISORS

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Outlook 2022

2021 was the year that everything was to return to normal. Instead, we have learned the path through a global pandemic is anything but predictable. Despite the myriad challenges that faced policymakers, individuals and corporations, each constituency navigated a route through the year and are poised to thrive in a more normal 2022.

The equity markets reflected the optimism of market participants, continuing an upward trajectory that began in the dark uncertainty of March 2020. The S&P 500 rose 28.7% in 2021, a rate of growth that far exceeds a 'normal' year. Small company stocks and international stocks also posted solid calendar year returns of 14.8% and 11.8% respectively.

With the wildly contagious and disruptive Omicron variant of COVID-19 running rampant, inflation surging well above historical levels, and employers struggling to lure workers back to the workforce, we enter 2022 still a far cry from normal, but optimistic that the equity markets will build on the momentum established over the previous twenty-one months. Our outlook stems from several factors which we are closely monitoring.

Economic Growth. Prior to the pandemic, the U.S. economy, as measured by Gross Domestic Product (GDP), was delivering real growth of between 2-3% annually. The opportunity heading into 2022, with strong corporate balance sheets, consumers flush with savings, and legislature intent on providing fiscal stimulus, is to more than double that growth rate. The domestic investment markets across all economic sectors are primed to benefit.

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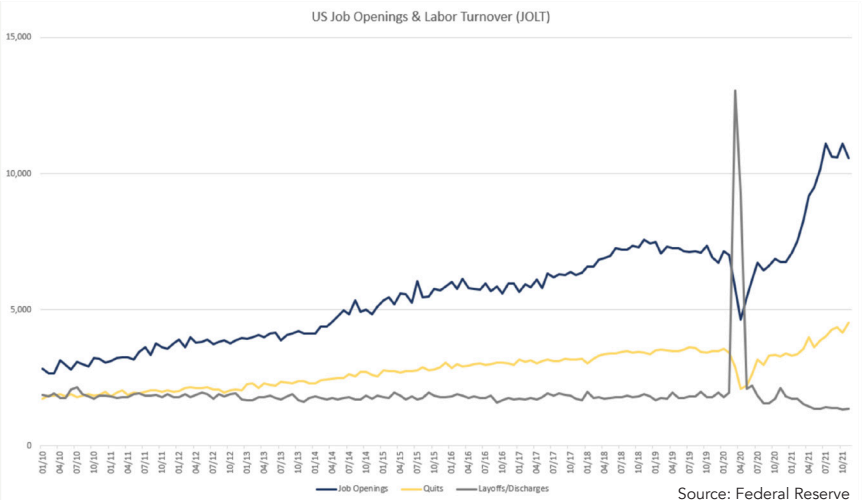
The FOMC. The Federal Open Market Committee (FOMC) led by Jerome Powell has done their best to be transparent and signal intent for future action. In the early weeks of the pandemic, the FOMC reduced Fed Funds rates to 0% and established an emergency bond buying program intended to stabilize and provide liquidity to investment markets. From June of 2020 to October of 2021, the FOMC expanded their balance sheet by $120 billion per month as a result of this bond buying program. In the fall of 2021, Chairman Powell indicated a tapering of this program starting in November of 2021, reducing purchases until they reach zero in March of 2022. The elimination of bond purchases reduces a monthly infusion of cash into the U.S. economy. The U.S. economy grew by 5.9% in 2021, well above the 2.0% trend line it had established over the previous decade. Unemployment is down to 3.9% and job seekers have a thriving job market. The credit quality of U.S. corporations is very strong with bankruptcies near historical lows. States like California are finding themselves projected to have budget surpluses. In short, the infusion of cash from the FOMC's bond buying throughout the pandemic served its purpose well and the U.S. economy no longer requires its support.

Inflation. Inflation, as measured by the Personal Consumption Expenditures (PCE), rose sharply in the second half of 2021, igniting concern that it would increase uncontrollably. It is likely that inflation will continue at a rate above the 2.0% target the FOMC has established. Inflation is a key concern which we address in greater detail in our **Special Topic: The Federal Reserve and Inflation.**

Labor Force. Policymakers have long endeavored to create policy and programs to generate employment opportunities for the workforce. As of November, the Job Openings and Labor Turnover (JOLT) survey showed that 10.5 million jobs were unfilled in the United States. This represents a 6.6% job open rate. The inability for employers to fill jobs is concerning as wages are a significant component of corporate costs. Wages are likely to increase as an incentive to lure workers back to the workforce, compromising corporate profit margins. It is uncertain whether workers left the workforce due to temporary pandemic related requirements or have permanently departed. If the departures are permanent, corporations will be challenged to find the resources necessary to execute on growth opportunities during the economic recovery.



Source: Federal Reserve

Stretched Stock and Bond Valuations. In the last two calendar years combined, amidst the pandemic, the S&P 500 has returned over 50%. During this same time frame, corporate earnings have increased 15%. The disparity indicates the return has been partially fueled by valuation expansion, pushing the forward P/E of the S&P 500 to 21 times anticipated 2022 corporate earnings. The 30% premium relative to the historical average of this measure reveals that market participants are optimistic for the prospects of future earnings growth. This heightened valuation metric also indicates an increased probability of disappointment and the potential for price volatility. In an environment such as this, stock selection becomes more critical. Corporations continue to enjoy a robust marketplace in which to generate revenue and earnings growth. We expect 2022 to be a year of strong revenue growth with opportunities provided by economic growth and an insatiable consumer appetite to spend. With profit margins nearing highs, the ability for companies to manage inflationary pressures will dictate their ability to grow earnings in step.

The bond market continues to be a conundrum. Despite the elevated inflation statistics, bond yields remain near historically low levels. The current real rate of return on a 10-year Treasury Bond (10-year Yield adjusted for inflation) is a negative -3.45%. Additionally, the premium spread earned by an investor for lower credit rated high yield bonds are the lowest they have been in a decade. This suggests that bond investors are not being compensated for either the credit risk they are absorbing or the risk of interest rates rising. In the current environment, rather than increase our exposure to riskier bonds with questionable return prospects, our bond portfolios remain in high quality short-term bonds.

Our outlook for 2022 is for continued growth in equity markets, but with increased volatility. The fundamentals are in place to successfully transition policy and activity away from the pandemic economy of the previous two years. The current environment is not without its risks, be it from additional variants or both foreign and domestic political risks, but the last two years have been instructive on how resilient and adaptive both consumers and businesses will be when faced with adversity.

Build Back Better | Where Does It Stand?

We have been planning and bracing for the impact of the tax hikes signaled by current legislators as part of the proposed Build Back Better (BBB) plan. On November 19th, 2021, the House of Representatives passed a version that looked vastly different from the one discussed in September. In fact, many of the widely expected tax reforms were not included in the bill at all. The Senate is now hammering out a version of their own, and although negotiations have cooled in recent weeks, we can break down what is included in the House version, or perhaps we should start with what is not included in the bill.

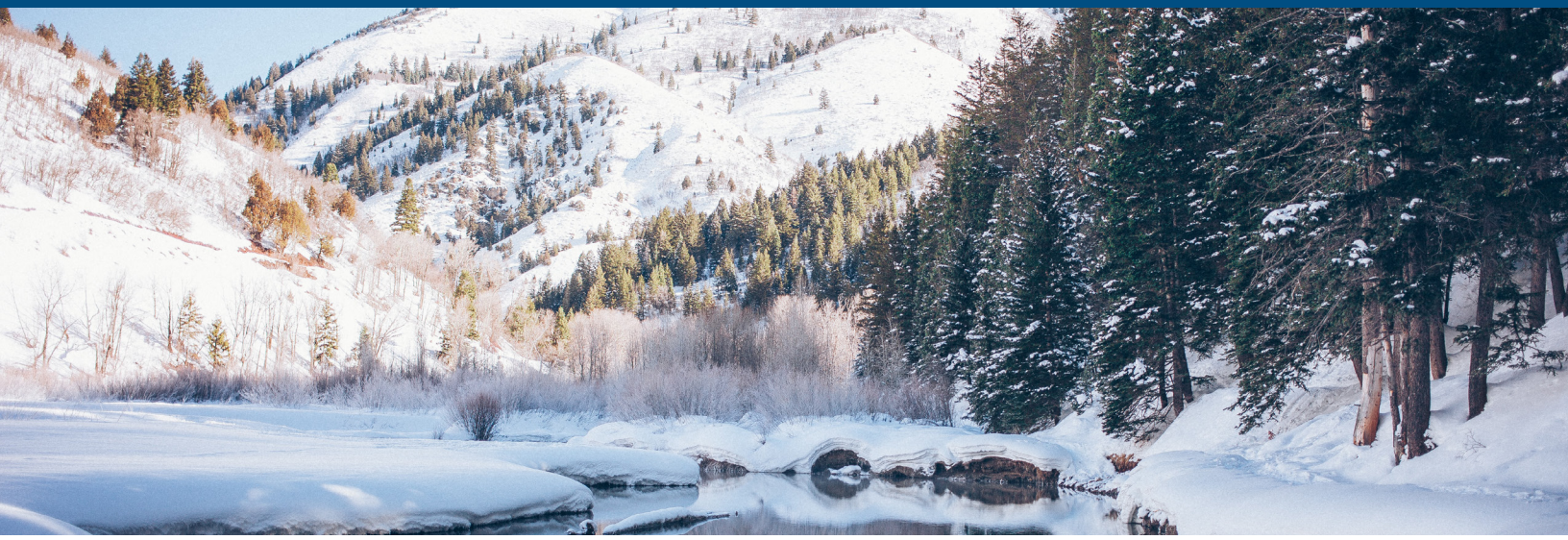
The proposed increase to the top marginal tax rate on ordinary income to 39.6% was eliminated along with the increase to the highest marginal capital gains tax rate to 25%. Additionally, there is no mention in the bill of reducing the current estate tax exemption of $12.06M. If not addressed, this exemption level (adjusted for inflation) would remain intact until its scheduled expiration of 12/31/2025. The version passed by the House includes some relief to the State and Local Tax (SALT) deduction limit. As expected, there will not be a full repeal; however, the deduction limit will increase from $10K to $80K and will remain in effect until 2030. There is currently no income threshold, but pressure from lawmakers to limit the application of this deduction by taxpayers with income over certain amounts lingers.

The originally proposed 5% surcharge on high-income individuals, estates, and trusts remains in the bill. This applies to modified adjusted gross income (MAGI) over $10M ($5M for MFS and $200K for an estate or trust). An additional 3% tax is applied to MAGI over $25M ($12.5M MFS and $500K for an estate or trust). The prospect of these taxes on high income levels likely spurred some of the selling of their holdings in company stock by corporate executives, like Elon Musk, at the end of the year.

The plan retains limits on contributions to traditional and Roth IRA accounts of high-income taxpayers if the contribution would cause the total value of an individual's retirement accounts to exceed $10M. This applies only to single or married filing separate with income over $400K and married filing joint with income over $450K. Additionally, if the combined balance of the taxpayer's retirement accounts exceeds $10M, a distribution equal to 50% of the amount over $10M would be required in the following year. If the aggregate balance of the retirement accounts exceeds $20M, a distribution of 100% of the excess is required, followed by the 50% RMD.

The bill would also effectively end the "back door" Roth strategy. Starting in 2022, the bill prohibits all employee after-tax contributions to a retirement account from being converted to a Roth account, effective 12/31/2021. Additionally, it eliminates Roth conversions for taxpayers making over $400K/$450K (S/MFJ). This adjustment would not kick into effect until 12/31/2031 and is intended to accelerate tax revenue from conversions for the next ten years.

To be clear, the Build Back Better legislation has not been passed. Some of these current provisions may not survive and some may end up significantly altered. As it stands today, many of the most impactful tax reforms are unlikely to be part of successful legislation. The Build Back Better bill has drifted from its original course and only time will tell if it's dead in the water.



Firm Announcements

As we reflect on 2021, Roberts Wealth Advisors has proudly hit many firm milestones. In July, we opened a second office location in Park City, UT. Our team doubled as we added three talented, new members, Ben Adams, Ella Pepin and Ryan Walsh. In November, we celebrated our one-year anniversary. Our team would like to take a moment to wish you all a Happy New Year! We are grateful for the relationship with each of you and look forward to connecting in the new year.

Portfolio Activity

In a year that was rife with antagonists, from waves of new COVID-19 outbreaks, supply chain disruptions, global semiconductor shortages, inflation, and rising interest rate expectations, the stock market continued its bullish run in the fourth quarter, closing out 2021 at record high levels. Despite the pessimistic headlines we saw throughout the year, the earnings of companies within the S&P 500 continued to grow and finished the year up 34.5%, providing a significant catalyst to the S&P 500's overall return in 2021.

During the fourth quarter, we were able to execute strategic adjustments within our portfolio and did so by initiating positions in PayPal (PYPL) and Williams Sonoma (WSM). We view WSM as a leader in the home furnishings e-commerce space with significant scale and superior profitability. As a major disruptor in the large, and relatively fragmented, specialty retail industry, it looks best positioned to capitalize on the appetite for home furnishings. It is likely that WSM will continue to benefit from a strong U.S. housing market and millennial household formation. PayPal is our featured stock for this quarter. We elaborate on our thesis for adding it to the portfolio later in this commentary.

We also added to existing positions in Adobe (ADBE) and Salesforce.com (CRM) while trimming our positions in Qualcomm (QCOM), Oracle (ORCL), and Home Depot (HD). Although we still hold and believe in the long-term durability of these companies, their share prices appreciated considerably over the course of the year, prompting us to realize profits in these names and reinvest proceeds in companies that provide more attractive return potential moving forward. We consider Adobe to be a core holding within the portfolio and view the name as the clear market leader in creative design products and solutions. Adobe has grown its flagship creative cloud suite at over 20% annually and has consistently reinvested back into its business. Adobe's software as a service (SaaS) business model has proven highly successful in generating recurring revenues from its creative products. The Digital Experience segment provides solutions, including data collection and analytics, targeted social marketing, digital experience management, and cross-channel campaign management. All of which should significantly help the company deliver high-margin growth in the years ahead.

We believe Salesforce.com is well-positioned to capture digital, transformation-related spending. Changes in consumer behaviors and shifts to digital channels brought on by COVID-19 are likely to persist well beyond the pandemic era. In addition, the company's Customer 360 platform has proven to be a critical competitive advantage, utilizing artificial intelligence (AI) tools to develop a valuable comprehensive view of their customers across all touchpoints.

Index Performance	Q4	YTD
Dow Jones Industrial	7.87%	20.95%
Standard & Poor's 500	11.03%	28.71%
MSCI EAFE (International)	3.53%	11.78%
Russell 2000 (Small Company)	2.14%	14.82%
MSCI ACWI (Global Stock)	6.33%	19.04%
Barclays Intermediate Term Bond	0.01%	-1.54%
Barclays Municipal Bond	0.72%	1.52%
Barclays Short Term Bond	-0.72%	-0.97%

TOP 10
U.S. HOLDINGS

- Amazon
- Microsoft
- Apple
- Alphabet
- Illumina
- Disney
- First Republic Bank
- Qualcomm
- Salesforce
- Medtronic

Technology Stack

RWA leverages technology to identify and implement opportunities for our clients. We have embraced tools that allow us to service clients remotely or in-person, resulting in a deeper, more meaningful relationship. We feel that our multichannel technology suite is imperative for our collective engagement in your financial picture. As we kick off into 2022, we want to provide a high-level overview of our technology stack and encourage you to engage with it. If you have any questions about our technology integrations or are interested in learning more, please don't hesitate to reach out to our team.

User Tip:

Avoid having to visit multiple websites by using the Single Sign On (SSO) function inside the RWA Client Portal to access your eMoney profile. Click on your profile name in the top right corner and select "eMoney" to enter your login credentials for the first time. Once the connection is established, you can easily access your eMoney profile by simply clicking the SSO link inside your RWA Client Portal.

Schwab Alliance is Schwab's online and mobile platform that grants you full access to your Schwab accounts. Schwab Alliance provides detailed and secure account information and is required to electronically authorize requests or future paperwork. Many of our clients find the Schwab Mobile app a useful tool to access account information and authorize requests on the go.

Your RWA Client Portal can be accessed from our website, roberts-wa.com. Your Client Portal provides an overall view of your investment portfolio (allocations, holdings detail, and performance). This is also where we post your Quarterly Report Packages and other firm announcements. It also houses your Document Vault. This is a secure folder both you and the firm can use to send and receive sensitive information.

eMoney is an integrative financial planning software that offers a comprehensive view of your net-worth. Within your eMoney profile, both you and RWA can work together to compile your financial information by linking assets under our management and assets held away. The ability to view everything under one platform allows for an all inclusive wealth plan to better reach your short and long-term financial goals.

Featured Stock: PayPal Holdings, Inc. (PYPL)

PayPal Holdings, Inc. (PayPal) is one of the world's largest providers of financial and digital payments technology that enables digital and mobile transactions on behalf of both merchants and consumers. The company holds the enormous competitive advantage of serving more than 400 million active users while it works to transform the commerce experience to a digital wallet-based ecosystem that connects merchants and consumers in mutually beneficial relationships.

PayPal's inherent strength comes from its ubiquity in the online payments space, but its future strength will largely be supported by its push into merchant and consumer services, in-store acceptance, and higher use and use cases of its service, Venmo. In addition, while most other Buy Now, Pay Later companies offer their services at a premium, PayPal offers its own as a complimentary piece of the overall business relationship. Further, as merchants look to expand online and consolidate their omnichannel offerings, they will look to reputable payment processors for help. PayPal's depth in the online market is an advantage few others can match.

Finally, millennials and younger generations are shifting their banking habits to rely more on debit, less on credit, and towards the most convenient and tech-enabled offerings. The ability to use Venmo for banking and shopping and PayPal to round out the financial spectrum with investments will, we believe, leave PayPal as one of the few winners in the new era of finance. PayPal, and the payments space in general, had a difficult second half of 2021, and that weakness allowed us to start building a position as it came down in price.

Source: YCharts

The Federal Reserve & Inflation

Special Topic

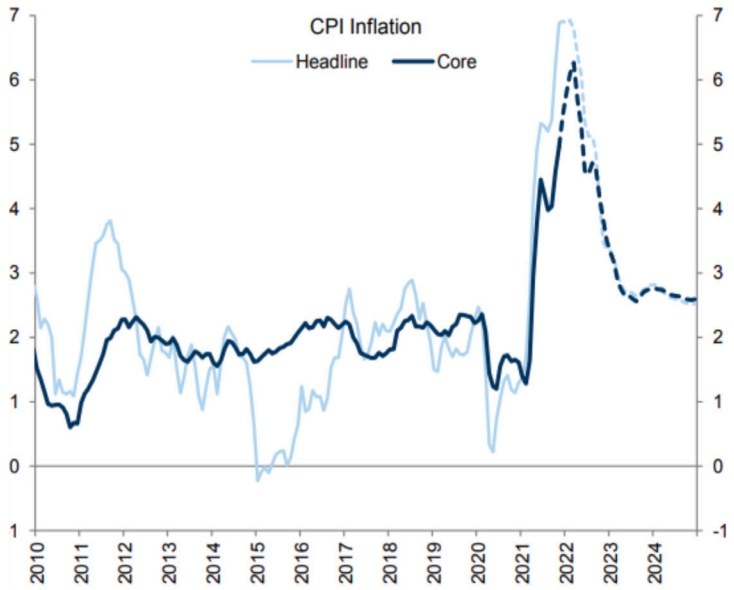
The last three months of 2021 witnessed a continuation of the inflation debate that has raged since earlier in the year, albeit with newfound strength and with the data to support it. Core personal consumption expenditures (PCE) inflation, the Federal Reserve's preferred measure of inflation in the economy, rose 0.5% in November from the prior month, and 4.7% from the same measure in November of 2020. That year-over-year increase was the highest reported in almost forty years and has been supported by numerous other inflation measures as well.

While much of that is likely due to the snapback in demand after a year of limited spending by consumers, the surge in demand has been met on the other side by limited supply. Evidence of this mismatch has been seen in long delivery times, backups at ports, and by the gradual increase in prices for everyday items and durable goods. The American Farm Bureau, for example, estimated the cost for the average Thanksgiving meal this year rose 14% from last year. More recently, the cost for Christmas trees was estimated to be 20% higher for live trees and 25% higher for artificial trees this year as compared to last year.

As the quarter matured, however, we began to see signs that fractures in supply chains were easing. Surveys conducted by Morgan Stanley throughout the quarter indicated that nearly two-thirds of businesses saw supply conditions deteriorate in October, while in December that gauge had dropped to under 30%. That optimism has been somewhat dampened by continued cost increases and more durable sources of inflation like higher wages, but in general, conditions do appear to be easing, if only mildly.

One of the lingering questions as we move forward is how the U.S. Federal Reserve (Fed) will react to higher inflation and if those actions will be sufficient to prevent spiraling inflation. In its meetings this past month, the Fed agreed to put an end to its purchases of U.S. government securities at an accelerated pace and to begin raising shorter-term rates thereafter. The Fed's direct control of short-term rates will allow those rates to move up, while economic theory suggests that with the Fed withdrawing from the market as a buyer, longer-term rates should also move up. How fast and to what degree these two events transpire remains one of the primary questions to investors, but in general, the Fed appears willing to do what it can to thwart significantly higher inflation.

Thus, inflation is likely to remain elevated for a time while the world works its way through continued coronavirus variants and hiccups in our global supply chains. What happens longer-term is less predictable, but we would highlight the old adage of 'don't fight the Fed.' We don't intend to, and we believe diversification and an emphasis on secular trends will continue to be our strength.



Source: Goldman Sachs