



Dear Clients and Friends,

Happy 2022! Unfortunately, it has not been a very happy start to the year for stock and bond markets so far after an excellent year for most asset markets in 2021. In this letter we share an update on BRAVE, our KISS approach to the markets at present, how we are implementing that approach in managing our client portfolios, and a couple administrative items.

BRAVE Family Advisors Update

BRAVE has continued to grow and evolve in recent months to ensure we can continue to provide excellent service to our growing number of clients. We moved into a new, larger office in Tiverton last summer. Our Summit office will be moving across the hall into a larger, more modern, and efficient space this spring once renovations are completed.

Angelica Ramos recently started working with us in our Summit office where she will be working closely with Suzie. Angie most recently worked for seven years at the law firm Proskauer Rose, LLP, in Manhattan as a conference services coordinator and executive receptionist. She lives in Roselle Park, NJ, with her husband, Richard, and their two-year-old son, Sylas. In her spare time Angie enjoys spending time with her family and traveling, trying new foods, fishing, and singing karaoke. You can reach Angie at (908) 522-8822 or at aramos@bravefamilyadvisors.com.

We are also excited that Will Swart, who worked as a summer intern in our RI office last summer, has accepted a position at BRAVE as an analyst when he graduates from Bryant University in May.

Increased IRS Limits

An effect of the current high inflation rate is that the Internal Revenue Service increased the 2022 annual limits on gifting and certain types of retirement savings plans.

	<u>2021</u>	<u>2022</u>
Annual per person gifting limit	\$15,000	\$16,000
401(k) plan contribution limit	\$19,500	\$20,500
Catch-up 401(k) contribution limit over 50 years of age	\$26,000	\$27,000
SIMPLE IRA contributions	\$13,500	\$14,000



Market Thoughts

KISS, which is an acronym for Keep It Simple, Stupid, is a philosophy that argues that a simple approach is usually the best approach. That pretty well sums up our view on how to invest in financial markets **at present**. Sometimes markets can be influenced by multiple important competing forces and trying to determine the outcome of those forces can be very challenging. We don't believe that this is one of those times. We think it is currently pretty simple: markets are historically expensive and the primary factor that justified those valuations, government stimulus, is in the process of being taken away which is going to result in increased volatility and lower returns.

U.S. stock prices remain at historically expensive valuation levels despite their recent minor declines. By many long-term measures, the U.S. equity market is as highly valued as it was at the peak of the dot-com bubble in 2000 and the high in 1929; by some measures it has even exceeded those historical peaks. The S&P 500 is currently trading at 20.0 times forward earnings which is well above average in absolute terms; this multiple has declined in recent months from a high in excess of 22.0 times as earnings estimates have continued to rise while stock prices have declined in recent weeks. The U.S. total market capitalization as a % of GDP remains at a modern high (**Chart 1**). The current CAPE ratio (Cyclically Adjusted Price to Earnings ratio) of 3X indicates that stocks are at among their most expensive levels in the last 100 years only exceeded just before and just after the 2000 peak (**Chart 2**). U.S. stocks also remain expensive relative to those in other regions of the world trading more than four standard deviations above their 50-year valuation mean relative to European stocks (**Chart 3**). Within the U.S. market, growth stocks had a brief bout of underperformance relative to value stocks in recent months but bounced back strongly late last year to set yet another all-time high in relative performance (**Chart 4**). The percentage of the S&P 500 total market capitalization comprised of companies in the Information Technology and Communications Services sectors continues to rival the peak seen in 2000 (**Chart 5**).

Chart 1: Wilshire 5000 Total Market Capitalization to US Annual GDP





Chart 2: Long-term Historical Cyclically Adjusted PE Ratio with Recessions

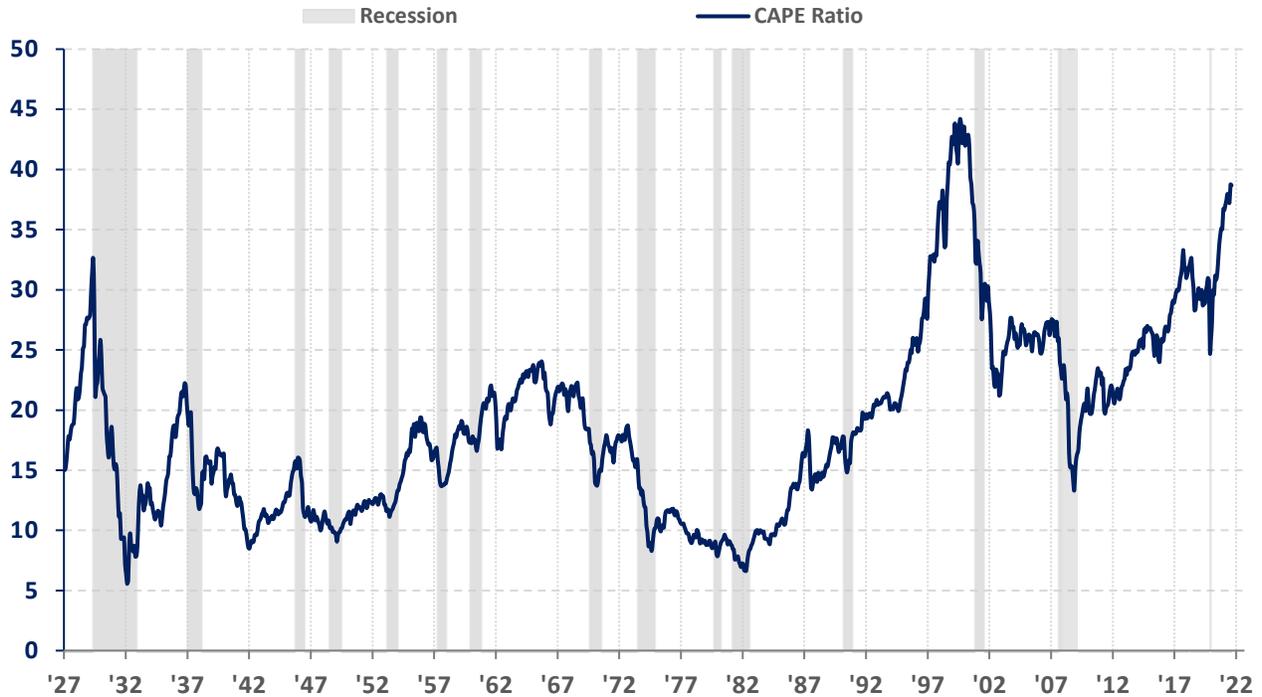


Chart 3: MSCI United States Index vs. MSCI Europe Index

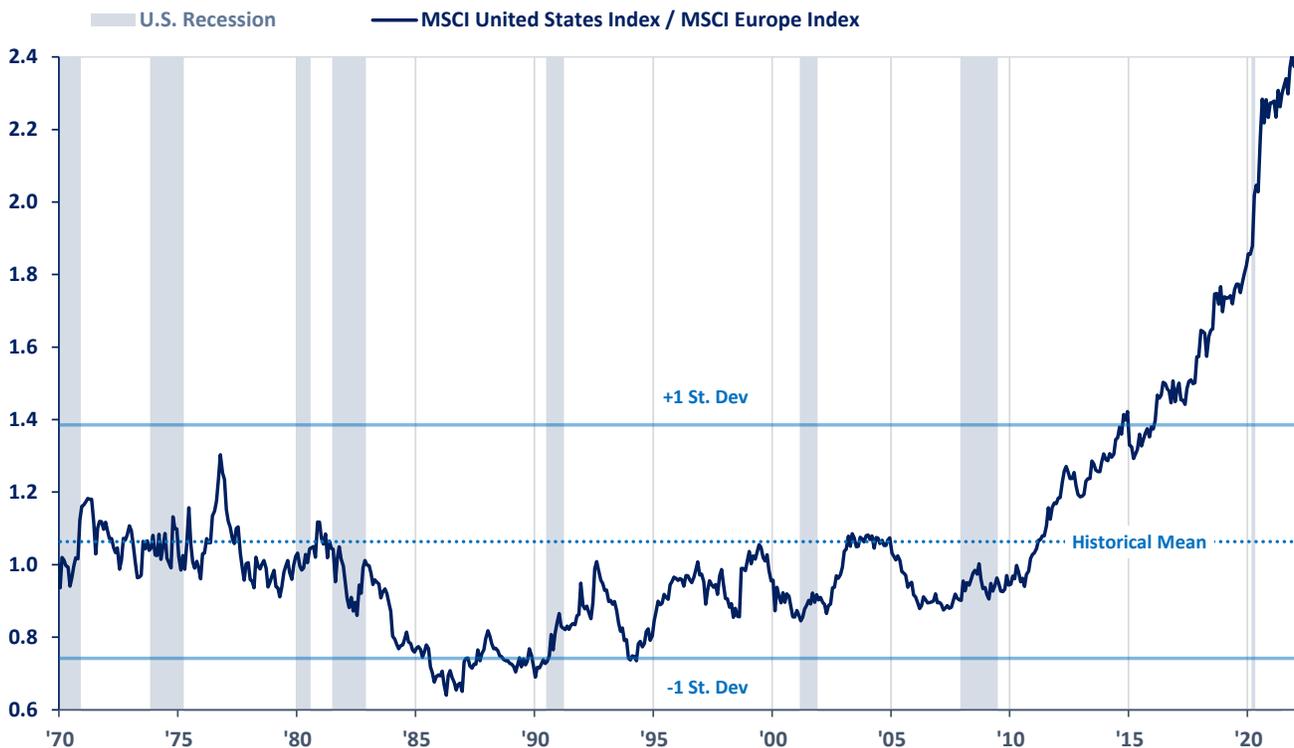
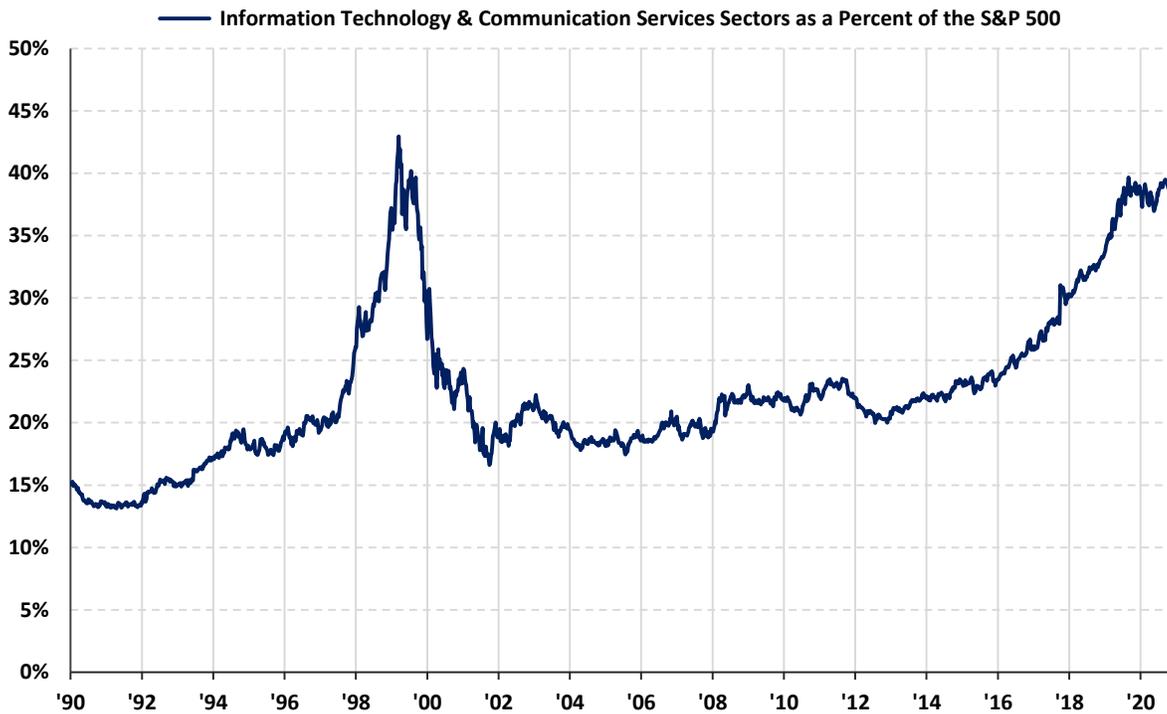




Chart 4: Russell 1000 Growth Index vs. Russell 1000 Value Index



Chart 5: Technology Sectors as a Percent of the S&P 500





These valuations have been driven by the extreme level of fiscal and monetary stimulus over the last two years as some of that money found its way into asset markets pushing stocks (and real estate) to record levels. The U.S. government pumped massive amounts of money into the economy in an effort to counter the effects of the Covid pandemic. The country's Federal debt has increased from 108% of GDP to 122% of GDP over the last two years (**Chart 6**). The Federal Reserve cut short-term interest rates to 0% and engaged in quantitative easing in the form of purchasing \$120 billion worth of bonds each month resulting in a more than doubling of its balance sheet over the last two years (**Chart 7**).

Chart 6: Federal Debt as a Percent of GDP

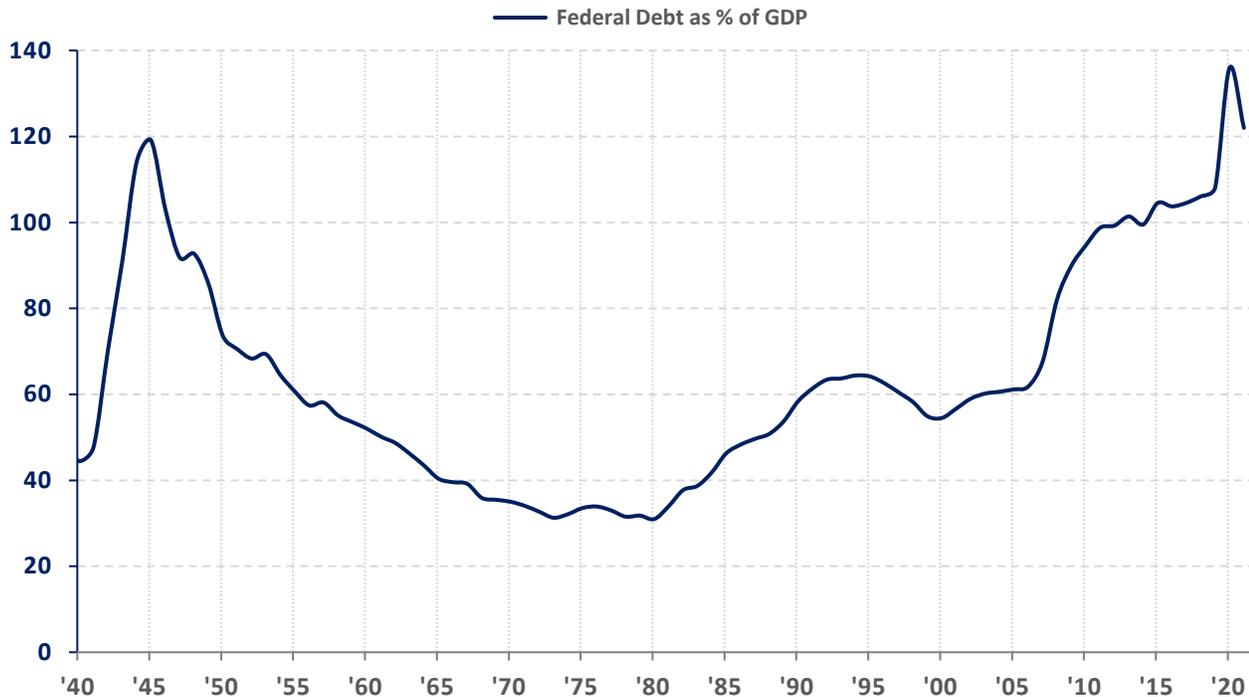
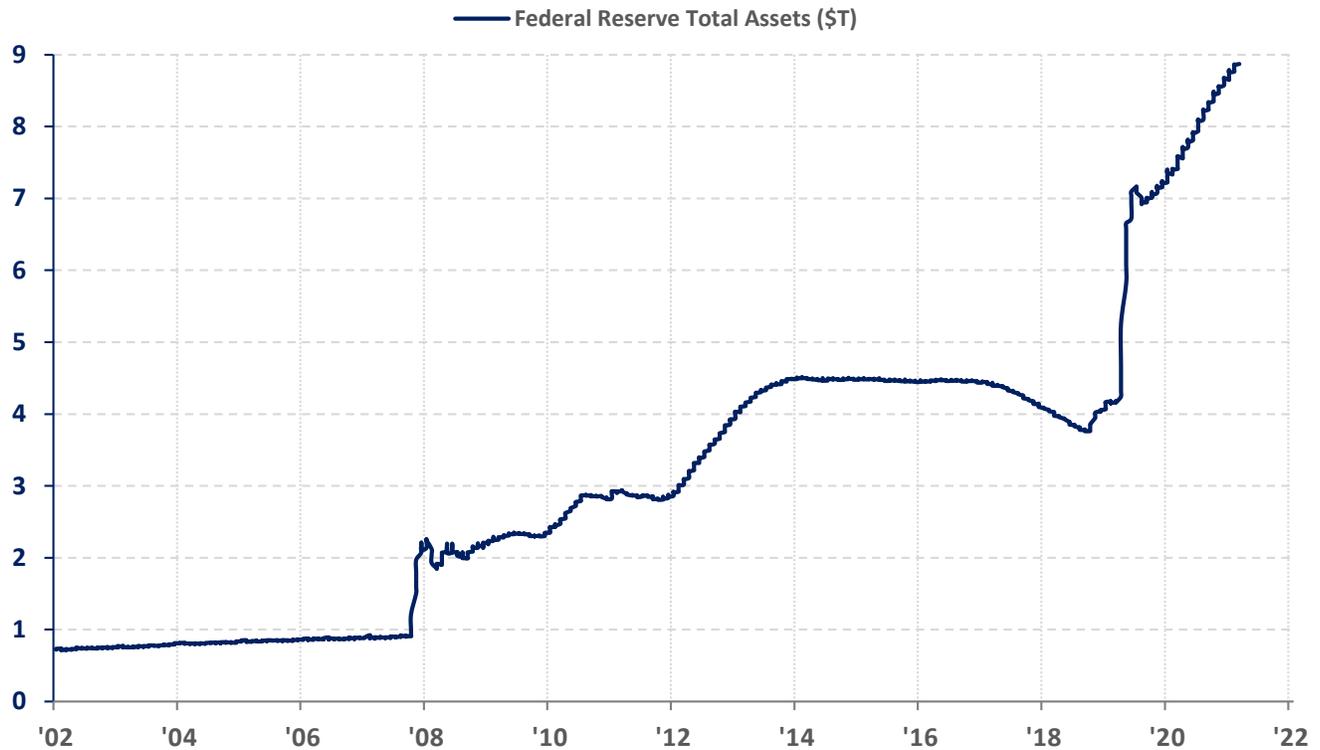




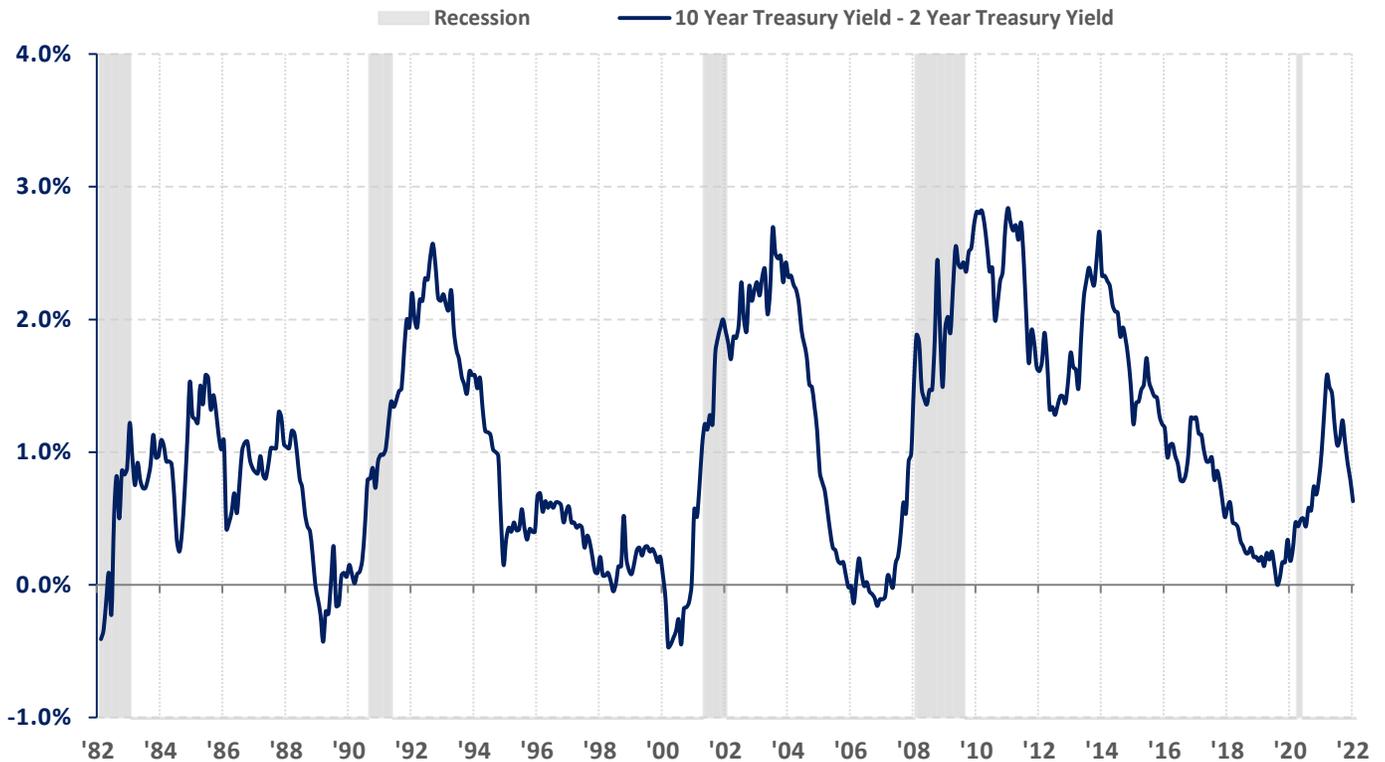
Chart 7: Federal Reserve Balance Sheet Total Assets (\$Trillions)



This valuation support is now coming to an end. The inability to pass the “Build Back Better” bill in the U.S. Senate likely signals the death knell for any additional significant fiscal stimulus for at least the next three years barring another economic crisis. The Federal Reserve is in the process of reversing its monetary policy stance due to the significant pick-up in price inflation. It began tapering its bond buying in November of last year and plans to cease it completely next month. This will be followed by a slow reduction in the balance sheet as the holdings mature. The futures market is now indicating expectations of up to five increases in the Fed Funds rate this year. The yield on the 2-year Treasury note has increased to over 1.30% from 0.10% a year ago. This rise in interest rates is being accompanied by a flattening of the U.S. yield curve as rates for longer-dated Treasuries are not rising as fast (Chart 8). An inversion in the yield curve (yields on short-dated Treasuries rise to levels in excess of those on long-dated Treasuries) has been a reliable leading indicator of economic recession in the past. We are not there yet, but it bears careful watching.



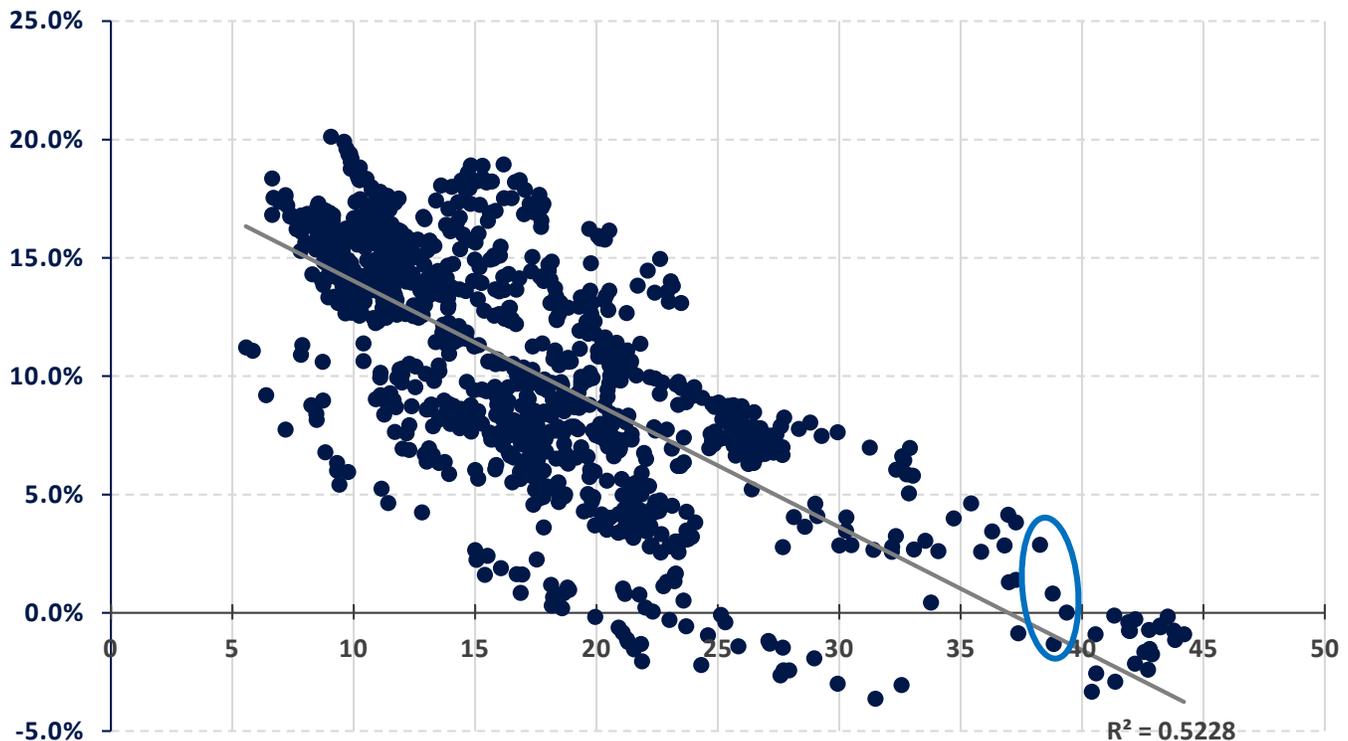
Chart 8: 10 Year Treasury Yield – 2 Year Treasury Yield



We remain of the belief that the high valuation of U.S. stocks doesn't necessarily mean that disaster for stock returns lies ahead; however, it does suggest that future equity returns are likely to be well below historical averages. There is a strong correlation between current valuation levels and future returns. Typically, the cheaper stocks are, the higher future returns will be and vice versa. This relationship can be seen in [Chart 9](#) which illustrates the relationship between the beginning CAPE ratio and stock market returns over the next 10 years. A beginning CAPE ratio of around the current level of 39 has yielded 10-year future annual average returns in a range of -1% to +4% over the last 94 years. Due to the limited experience with valuations at this level there is not a lot of historical data; however, what is available suggests that investors may need to adjust their expectations to something less than the historical average equity return of close to 10% per year.



Chart 9: Next 10 Year Annualized Returns of S&P 500 Index (Vertical Axis) vs. Beginning CAPE Ratio (Horizontal Axis)



Portfolio Management

If our cautious outlook for stock and bond markets comes to pass, positioning of portfolios will be more important over the next year than it has been in the last two years when virtually everything went up in value. We have been shifting exposures in equity portfolios over the last year to reflect our valuation concerns. We have increased holdings of value and financial and international stocks. After the peak of the Dot.com bubble in 2000, value stocks enjoyed seven years of significant outperformance versus growth stocks. We expect that financial companies will continue to benefit from higher interest rates and international stocks would be beneficiaries of a potential decline in the U.S. dollar. Earlier this year we also established a position in the “ProShares UltraPro Short QQQ” ETF (Ticker symbol SQQQ) which moves inversely to the Nasdaq 100 Index in an effort to hedge exposure to growth stocks and to generally reduce equity allocations to below target. In our fixed income portfolios, we started reducing the duration of holdings beginning in the spring of 2020 under the belief that rates had likely reached a generational low. We have continued that process over the last two years and now hold mostly bonds that mature in less than two years which are quite insulated from the increase in interest rates. We also have a larger amount of money in money market funds than is typical. There will come a point when higher interest rates have their effect on inflation and economic growth for us to redeploy fixed income money further out on the yield curve in order to lock in higher rates for a number of years.



Administrative Items

The 2021 1099R forms for retirement accounts have been issued by Pershing. The 1099s for regular investment accounts will be issued between February 1, 2022, and March 15, 2022, by Pershing. Please log into the NetXInvestor site to obtain your tax documents. You can find the tax documents under the Communications tab. We are happy to help your tax advisor as long as you provide us with authorization to speak to them. Please send an email to Suzie with their contact information.

You have until April 15 or when you file your tax return, whichever is earlier, to make a 2021 contribution to a ROTH or traditional IRA for 2021.

As always, we welcome your comments and questions. Please don't hesitate to call, visit, or email at any time.

Your team at the BRAVE