4th Quarter 2021

Vanderbilt Avenue Asset Management is forecasting higher **economic growth** than the consensus outlook. Growth will continue to be primarily driven by the consumer sector of the economy (approximately 70% of GDP). Consumer spending is reflected in recently strong retail sales numbers for both in-person and online shopping. The National Retail Federation expects US retail sales to jump by approximately 10% over the next several months. The strong labor market has supported consumer spending. The labor market has recovered three-quarters of the 22 million jobs lost during the pandemic and lowered the unemployment rate to 4.2%. The 4.2% unemployment rate is down from the previous month's 4.6% which is a large decline for a one-month period.

| | Current | Average 2015-2021 | Average 2000-2021 |
|---|---|---|---|
| Unemployment Less Job Openings | -1.40% | 0.26% | 2.84% |
| Unemployment Less Quits | 2.30% | 2.26% | 4.07% |
| Unemployment Rate | 4.20% | 5.10% | 6.10% |

Household finances are in a strong position. Consumers saved and paid down debt during the pandemic. Furthermore, a sharp run up in home values, stocks and other assets has boosted wealth for many Americans, fueling stronger demand. Total US household net worth was up to $2.4 trillion dollars by the end of the third quarter of 2021. However, in a recent poll 64% of households described their finances as good while only 35% felt that the US economy was in good shape.

In short, while US economic fundamentals are solid, the consumer is not showing much enthusiasm over the economic recovery. The reason may have to do with the fact that the pandemic has once again raised its ugly head. Many workers have not yet returned to their offices and it seems a sense of normalcy remains elusive.

In addition, corporate balance sheets are strong. Financial leverage has been declining and the cash/debt ratio continues to rise as issuers hold onto cash as a safety net. Corporate earnings have been strong. Companies have been able to maintain profit margins and third quarter profits exceeded estimates for 96% of the S&P 500 companies.

| | 3Q-21 Earnings | | | |
|---|---|---|---|---|
| Sector | Total | Positive Surprise | Negative Surprise | % Positive |
| Information Technology | 68 | 63 | 2 | 94% |
| Health Care | 60 | 54 | 5 | 92% |
| Consumer Discretionary | 49 | 37 | 10 | 90% |
| Financials | 61 | 51 | 9 | 90% |
| Consumer Staples | 26 | 20 | 6 | 87% |
| Industrials | 65 | 54 | 10 | 86% |
| Communication Services | 25 | 19 | 5 | 79% |
| Real Estate | 29 | 21 | 3 | 79% |
| Energy | 22 | 18 | 1 | 78% |
| Utilities | 28 | 18 | 8 | 75% |
| Materials | 28 | 20 | 8 | 68% |
| Total | 461 | 375 | 67 | 96% |

The path of **inflation** is critical as it will dictate the course of monetary policy. VAAM forecasts inflation will remain high through the first half of 2022 and will only begin to lessen in the second half of the year. U.S. inflation reached a nearly four-decade high in November as strong consumer demand collided with pandemic-related supply constraints. The consumer price index on a year-over-year basis rose 6.8% in November while the core CPI (excludes the more volatile food and fuel categories) rose 4.9%. Inflationary pressures from supply side constraints should be easing as we go through 2022.

| **Rising Prices** | Current | Average 2015-2021 | Average 2000-2021 |
|---|---|---|---|
| CPI | 6.80% | 1.80% | 2.20% |
| PCE | 4.70% | 1.89% | 1.79% |

There have recently been indications that supply-chain constraints may be easing as China's factory output and exports have risen, U.S. West coast ports have shown some initial easing of their backlogs and retail inventories are full. In fact, potential inventory buildups could ultimately result in downward price pressure to clear inventory levels. The inflation problem is a combination of both demand pull and cost push pressures. A shortage of available workers is affecting inflation and the overall economy, pushing companies to raise prices to offset higher labor costs. While working remotely has boosted productivity, productivity has not risen enough to offset higher wage costs thereby causing unit labor costs to rise.

While we expect inflation to moderate, it may take until the middle of 2022 to show up clearly in the year-over-year data. This is partly due to the low inflation readings in January-February of 2021. In order to get a feel for the post pandemic underlying trend in inflation it is useful to look at the service sector. Core services are less affected by bottlenecks than goods and were up 3.4% year-over-year in November. Ultimately, the big determinants of where inflation goes in the future will probably be the extent to which workers' wages keep climbing, and how successful businesses are at passing on those labor costs to consumers. Considering how workers have increased their leverage, it seems likely that wage pressures will persist, and companies might be able to raise prices at least to some extent.

The Biden administration plan to release 50 million barrels of oil (the net number is closer to 32 million barrels) from the Strategic Petroleum Reserve to lower oil prices will only be of a temporary nature and will not impact oil prices longer term. The U.S. consumes 18 million barrels of oil daily and the one-time SPR release is relatively small. We are forecasting higher oil prices as the demand side for oil will hold up and the supply side is being negatively impacted as large oil companies reduce their capex and reserves begin to gradually decrease.

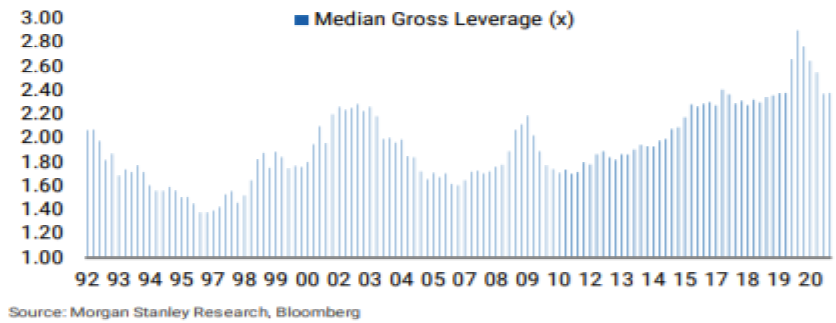
Confidence in restraining inflation depends in part on the Fed's willingness to act if prices rise too quickly. The Fed may be slightly behind the inflation curve because it is the most dovish Fed in decades and policy may be slow to react. The Federal Reserve recently executed a pivot in their **monetary policy** in order to place priority on their stable inflation mandate versus their full employment mandate. Recent labor market data support the idea that the Fed has found itself out of position, with a monetary policy that is looser than it should be at a time when the labor market is quite healthy and with inflation far above its target. Core PCE, the Fed's preferred gauge of inflation, rose 4.7% in November year-over-year. The Fed's forecast is for this rate to decline to 2.7% in 2022 and to 2.1% by 2024. This is in line with their long-term objective of 2%. Even after supply chain bottlenecks and shortages abate, the Fed is still concerned about the potential for demand to push up prices (such as rent) and wage cost pressures. The Fed reduced their pace of U.S. Treasury and Agency MBS purchases by $30 billion a month, putting the program on course to end in March rather than June. This will clear the deck for the Fed to begin raising the fed funds rate (currently near 0%). The Fed forecast three interest rate increases in both 2022 and 2023 and two increases in 2024. In case the Fed forecast proves wrong on their inflation outlook, there would be adverse ramifications to the investment markets as the pace and level of interest rate increases would jump. One risk is that three quarter-point rate increases over the course of next year won't be enough to cool inflation. In that case, the Fed will be in a situation in which it keeps having to reset its rate expectations higher-an especially worrisome outcome for investors. Historically when the Fed has gotten behind the curve on rates, it has tended to tighten to the point that the economy eventually falters.

| **Moderate Long-Term Interest Rates** | Current | Average 2015-2021 | Average 2000-2021 |
|---|---|---|---|
| 10yr UST Yield | 1.49% | 1.94% | 3.10% |
| BBB Corp Yield | 2.46% | 3.46% | 4.72% |
| B Corp Yield | 4.61% | 6.26% | 7.84% |
| Fed Funds | 0.08% | 0.97% | 1.47% |

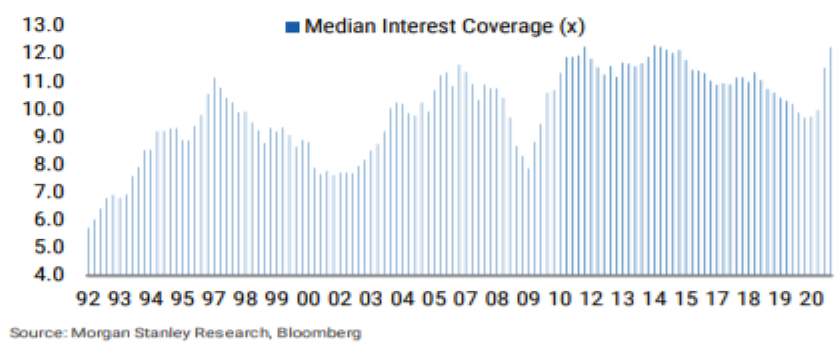
**Corporate Bonds**
**4th Quarter 2021**

The fourth quarter was marked by continued strength in investment grade corporate fundamentals as demonstrated by overriding positive earnings surprises, deleveraging of debt, and improving coverage ratios. Despite the healthy corporate balance sheets, however, spreads on corporate bonds, widened from the summer tights. The Intermediate Investment Grade Corporate Bond Index started the quarter with an option adjusted spread ("OAS") of 59 and finished the quarter with an OAS of 74. Most of this spread widening occurred during November in response to Chairman Powell's hawkish testimony indicating that the Federal Reserve will expedite tapering of treasuries and mortgage-backed securities purchases, begin raising rates sooner, and likely raise rates three times in 2022 (as opposed to twice as the market had been expecting). While his statements resulted in an increase in medium-term rates, specifically the 2-year and 5-year treasuries, creating a flatter yield curve, they didn't change the fundamentals of the companies whose credit underlies the bonds in your portfolio, or our outlook for 2022.

For the most part, corporate debt decreased, earnings increased, and as a result, leverage (as measured by amount of earnings necessary to cover debt) also decreased to pre-COVID levels (see chart below).

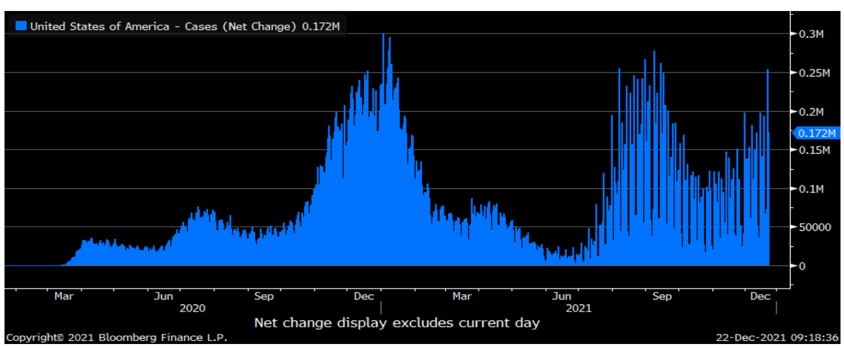



From the lows of 2020, companies that survived the pandemic have experienced a strong recovery to earnings, with most earnings announcements beating analysts' expectations. This, along with debt repurchases, has positioned them well for the new year. As companies are repurchasing debt, the levels of cash on their balance sheets are at recent highs. High cash levels, lower debt and increasing earnings has also resulted in strong interest coverage ratios (as measured by EBITDA (earnings) divided by interest payments on debt). The chart below demonstrates the rapid recovery to earnings that corporations experienced, bringing interest coverage ratios to a 30 year high.




Among the securities in your portfolio, banks performed well in the fourth quarter, specifically Morgan Stanley and Bank of America, both of which reported significant positive earnings surprises. Like the rest of 2021, the fourth quarter saw a continuation of M&A activity, which bolstered investment banking fees. Auto manufacturer, General Motors, also posted a positive earnings surprise, with stronger fundamentals than its peers, and is looking to invest in electric vehicle facilities, including partnering with LG. Lastly, Microsoft, with a modest yield pickup of 25 basis points over treasuries, offers solid fundamentals, a significant positive earnings surprise, and one of the few AAA-ratings. Corporate bond fundamentals remain strong as we look out into the beginning of 2022, and we continue to overweight them in your portfolio.

The **Covid-19** variants create several uncertainties. The beginning of the fourth quarter saw a daily new case number 0f 44,222 per day grow to 188,798 new cases per day as we go to press, an increase of over 326%. While it is much more transmissible, it appears to be less severe than Delta and the vaccine and booster shot early on appear to be effective against Omicron. At this point, the degree of economic lockdowns does not appear to be as severe as under the Delta variant. Omicron could reduce willingness to work which would slow progress in the labor market, putting further upward pressure on wage costs and intensify supply chain disruptions. Furthermore, absent another round of government support that helps prop up savings, Omicron could also make people less willing to spend than they were during earlier Covid waves. There are however a couple of encouraging news items. The area in South Africa where Omicron originated has just recently experienced a downturn in hospitalizations. In addition, Pfizer announced a pill with very high efficacy in stopping hospitalization and deaths when treating Omicron patients within the first five days of contracting the variant. This has the potential to treat those that do not want to receive a vaccination. This would also be an important treatment for third world countries that have had difficulty obtaining and storing the vaccines.




**Bitcoin** has grown as an asset class. We view this asset class as having a high degree of price volatility and further risk in the future. Furthermore, there is a possibility for greater regulation. The growing size of bitcoin raises concerns about its size relative to the money supply and at what point it could become a systemic risk to the financial system. There has been some talk as to whether the government would create a digital wallet with a stable one-dollar value. This would permit the utilization of blockchain technology without investing in bitcoin. We believe blockchain is the major contribution of the Bitcoin revolution. Blockchain is a unique ledger database underlying the technology that powers Bitcoin. The database stores information in groups or blocks which are then chained together. Blockchain is referred to as a 'distributed ledger' because a copy of the ledger is transmitted and stored publicly on millions of computers, it is not a centralized network and is non-hackable. Although there are private blockchains, they are not Bitcoin based. Once information is stored on the public chain via the process of mining Bitcoins, it cannot be changed or tampered with because they are in a highly encrypted and coded format (a random string of alphanumeric — that change for each transaction). Bitcoin cannot be used as a store of value for the time being given its high degree of volatility, it is not simply a substitute for gold. It is also difficult for Bitcoin to be used as an exchange medium given that credit card transactions are much faster to process than Bitcoin transactions. However, the blockchain technology can make a major impact with regards to ‘Smart Contracts’ and is already being utilized in that regard. The digital industry as a whole has shown tremendous deal growth in 2021. This is a trend that is likely to continue into 2022.