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Sound Investments Inc.

4th Quarter 2021

DJIA 36,338.3 S&P 500 4766.1 Nasdaq 16,905

Summary

We plan on contacting you with a view to raise some cash.

The prospect of multiple interest-rate rises, cooling growth and inflation at 40 year highs, has the market on edge. Since last year, we have been rotating out of growth stocks into equities that focus on Financials, Energy and Consumer Staples which trade at lower price to earnings ratio and generally pay dividends.

The last graph on the back of this page shows the amount of uncertainty and concern that interest rates may be pushed too high too quickly. An increase in uncertainty among investors has historically produced an uneven performance for the U.S. stock market.

While we remain positive on the economy we are cognizant or aware of the effects of higher interest rates. **We monitor the situation daily.**

This investment letter is mailed quarterly to our clients and friends.

Stocks Blissfully Ignored Woes of 2021.

U.S. Stocks posted double digit gains for the 2nd year in a row despite worries about the new coronavirus variants and shifts in monetary policy. The broad market closed at all time highs. Although 2021 was a strong year it was narrowly focused, with weakness among some of the lower quality and high price technology names. While the Russell 3000 ended the year at an all time high, a large portion of the stocks in the index are more than 30% below their 52 week high.

Strength see-sawed between sectors and styles during the year. Energy started off strong, was the worst performing sector in three different months, but ended up gaining the most of any sector, up 53.3 %, followed by Real Estate and Banks.

American markets dominated international markets again in 2021 with the S&P 500 gaining more than any single country. The developed foreign markets like Europe gained 11.5% and undeveloped or emerging markets lost 3.6%. The once high flying BRIC (Brazil, Russia, India, & China) lost 11.8%.

First, Some Good News About Covid or Omicron

Omicron appears to have peaked in the U.K. It was first detected in England on Nov 27th. As of Jan 14th the daily average of new cases being reported was 138,268 which is below the 14 day average for the first time in approx. 8 days. The last time the 14 day average was higher than the 7 day average was on Nov 8th. Hospital admissions have started to fall in English hospitals as well. The number of people severely ill in the hospital has been significantly lower with Omicron.

Inflation and Labor Markets

As per the chart on the back of this page consumer prices or inflation rose 7%, the fastest pace in nearly 4 decades. Let's take a minute to define what inflation is. **Inflation is the result of total spending running ahead of the economy's capacity to supply goods and services.** Once it gets going, inflation has a momentum to it. For instance, housing prices tend to go

Inflation Hits Fastest Clip Since '82

The oil crisis contributes to inflation's rise to 12.3%.

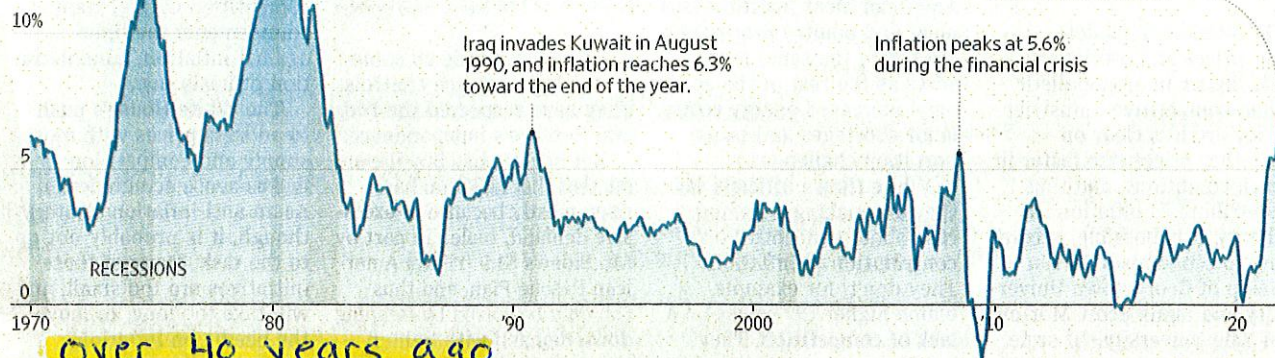
Inflation reaches 14.8% in the wake of the Iranian revolution, which sends oil prices up sharply.

Consumer-price index, change from a year earlier

Inflation reaches 7%, its highest point since June 1982

Iraq invades Kuwait in August 1990, and inflation reaches 6.3% toward the end of the year.

Inflation peaks at 5.6% during the financial crisis



Consumer-price index for select categories, change from a year earlier

MEATS POULTRY
FISH AND EGGS

12.5%

NEW VEHICLES

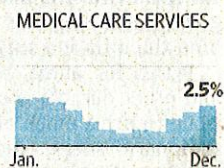
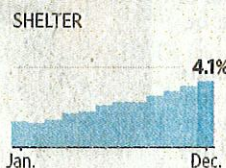
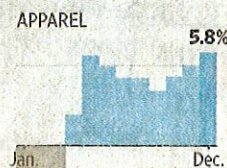
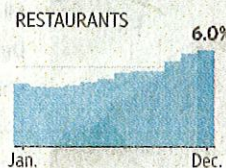
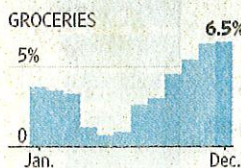
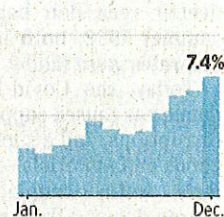
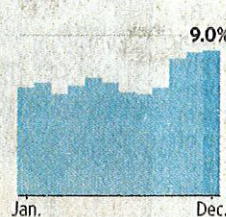
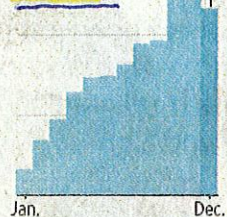
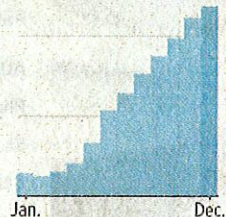
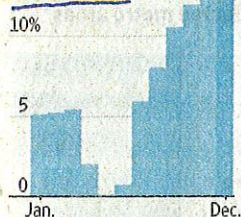
11.8%

HOUSEHOLD
ENERGY

11.6%

TOBACCO

FURNITURE



Kurt Wilberding/THE WALL STREET JOURNAL

25%

20

15

10

5

0

-5

Monthly

1991

'95

2000

'05

'10

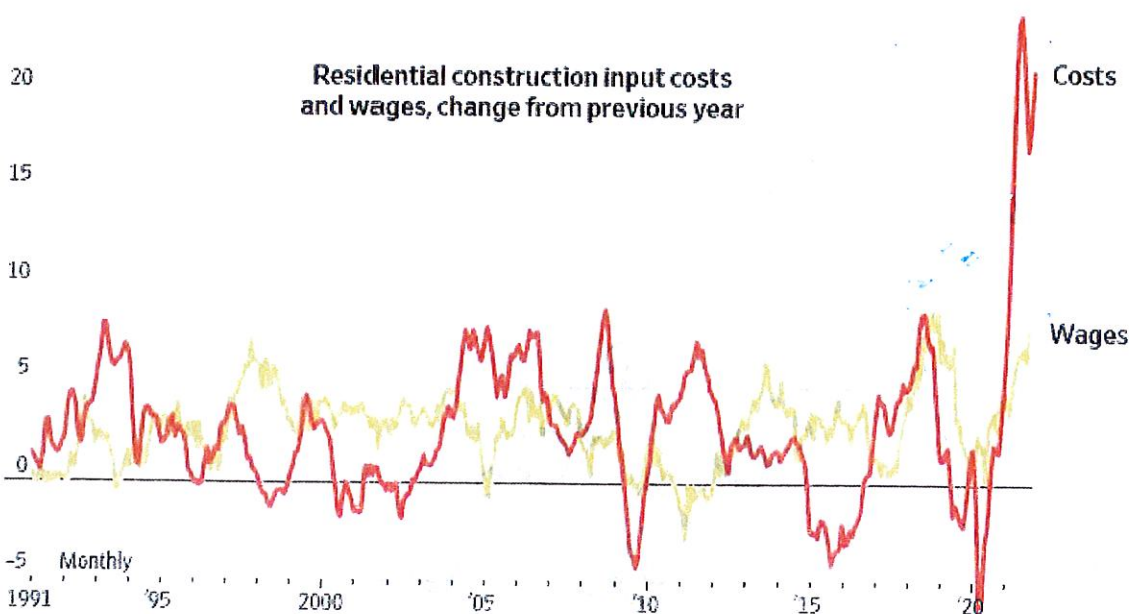
'15

'20

Residential construction input costs
and wages, change from previous year

Costs

Wages



higher than they should as strong demand meets a limited supply of homes. Consumers are flush with cash from savings and government stimulus while supply chain shortages have limited supply. As a result, furniture prices have jumped 17.3% and used cars soared over 30%. Demand for workers is also strong. Job openings now stand at the 2nd highest on record which equates to three openings for only two workers. The quit rate is near an all time high of 2.8%, another sign of a tight labor market. Again, this is putting upward pressure on wages and inflation. See attached article on rising prices turning into a wages spiral.

As mentioned previously, inflation is currently running at 7%. Many economists, including Fed Chairman Jerome Powell, expect to increase interest rates 3 times in 2022 and think inflation will moderate and eventually go back to the 2% range in 2023. James Dimon, the Chairman of J.P. Morgan, thinks 6 or 7 rate hikes are possible this year. It is hard to predict the future but our feeling is that interest rates will end up being higher in the 3 to 4% range. The stock market is trading at an all time high at roughly 21.2 times earnings (historically it is 17 times) so with higher inflation, equities may have a harder time particularly in the first half of the year. With this in mind, we plan on contacting you with a view to raise some cash.

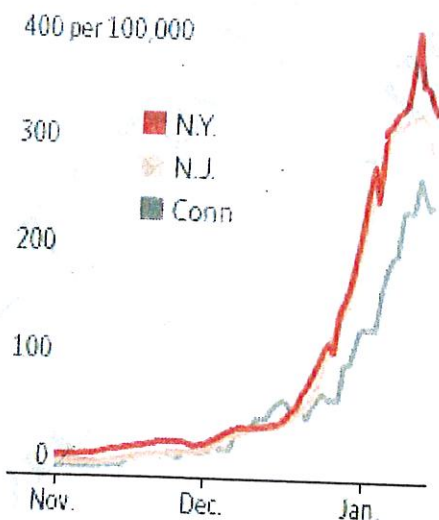
So, What's Ahead?

As I write this letter, 4th quarter earnings are coming out and almost every company commented on how higher wages and material costs are affecting their sales and earnings. This is to be expected as we recover from the pandemic but overall, things aren't too bad. What's concerning the market is higher interest rates. The prospect of multiple interest-rate rises, cooling growth and inflation at 40 year highs, has the market on edge. Since last year, we have been rotating out of growth stocks into equities that focus on Financials, Energy and Consumer Staples which trade at lower price to earnings ratio and generally pay dividends.

Conclusion

The last graph on the back of this page shows the amount of uncertainty and concern that interest rates may be pushed too high too quickly. For example, if interest rates increase too fast it could slow down the economy and if interest rates are kept too low it could cause the economy to speed up which could cause more inflation. An increase in uncertainty among investors has historically produced an uneven performance for the U.S. stock market. Thus, we believe a well-diversified portfolio of quality equities is the best near-term investment strategy ahead of what is likely to be a period of less supportive monetary policies by the central bank. In a rising interest-rate environment, we think bonds should be given smaller weighting in one's portfolio. While we remain positive on the economy we are cognizant and aware of this. We monitor the situation daily.

We welcome your calls.



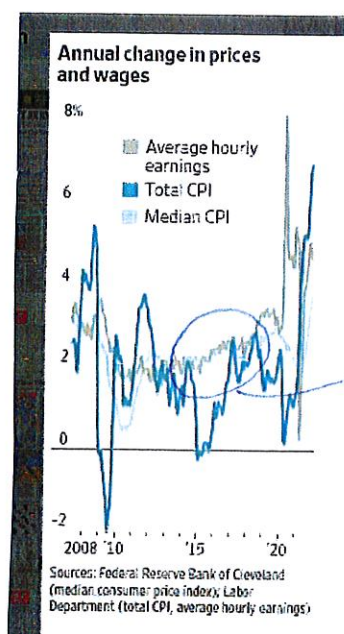
Source: Johns Hopkins Center for Systems Science and Engineering

Omicron Eases In Some Areas

The flood of Covid-19 cases that began in December is showing signs of easing in some parts of the U.S.

Seven-day average of daily reported cases per 100,000

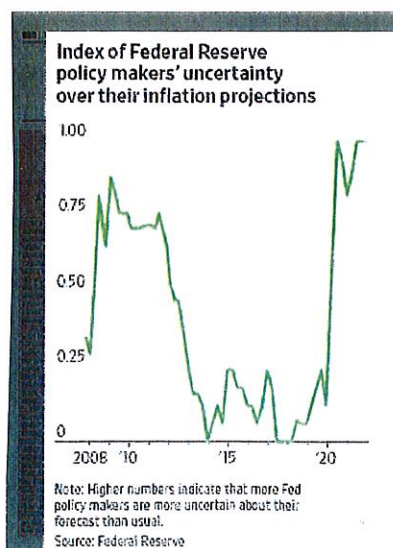
The Wall Street Journal



← Wages outstripping other costs.

From 2015 to 2018 real wages or purchasing power increased.

The Wall Street Journal



Note: Higher numbers indicate that more Fed policy makers are more uncertain about their forecast than usual.
Source: Federal Reserve

uncertainty caused by whether interest rates increased too sharply, which would slow the economy, or rates not increased enough, which would cause the economy to speed up thereby causing more inflation.

Watch for Rising Prices Turning Into Wage Spiral

Increasing inflation has had more to do with the pandemic than labor costs. But that could change.

Inflation is high, and the job market is tight. Both of those things have a lot to do with the pandemic, but how much do they have to do with each other?

The Labor Department on Wednesday said its measure of consumer prices rose 7% in December from a year earlier, marking the steepest gain since June 1982. Core prices, which exclude food and energy items in an attempt to better capture inflation's trend, were up a somewhat milder 5.5%, but that was their biggest increase since February 1991.

This comes on the heels of Friday's jobs report, which showed the unemployment rate slipping to 3.9% last month, and average hourly earnings up 4.7%. The Federal Reserve is getting ready to raise rates as soon as March, and the combination of rising inflation and a tightening labor market is giving it cause to.

What the Fed doesn't want to see is an environment where wage increases are pushing prices significantly higher, while a tight labor market and expectations of higher inflation are leading workers to command outsize wage increases. That could lead to infla-

tion remaining well above the central bank's 2% target, forcing it to raise rates sharply and risk a recession.

To a degree, the rise in inflation over the past year reflects a rebound from the early stages of the pandemic, when prices cooled significantly. Even so, core prices have risen at a 3.3% annual rate over the past two years, which is the fastest pace since June 1993.

That pickup is entirely the result of increased goods prices, while service price gains have been muted. Core goods prices rose at a 6.1% annual rate over the past two years, the most since March 1983. Core services prices rose at a 2.6% rate over the past two years, which is lower than during the two years before the pandemic.

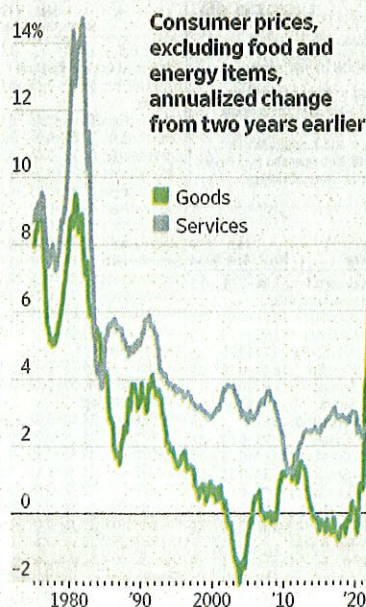
Goods—particularly big-ticket items such as cars and appliances—have been where supply problems have been the most pronounced. Goods also have been at the receiving end of the demand shift the pandemic brought on: Unable or unwilling to spend money on services such as airline tickets, Americans bought more stuff instead.

Rising wages have surely put some upward pressure on prices, too, but thus far they are largely secondary. If the pandemic loosens its grip, helping to alleviate supply-chain problems while provoking a shift in spending back toward services, inflation will cool.

How much it will cool is the big question. Rising labor costs could put a floor on how much price gains can moderate. A lot will depend on whether more people return to the labor market after the Omicron-driven surge in Covid-19 cases ends, easing hiring strains. And a lot will depend on how successful companies will be in passing rising labor costs on to their customers.

The tight job market and high inflation might not be feeding one another now, but that doesn't mean they won't in the future.

—Justin Lahart



Source: Labor Department

IAN 4 - WSJ. Heard ^{on} The Street.

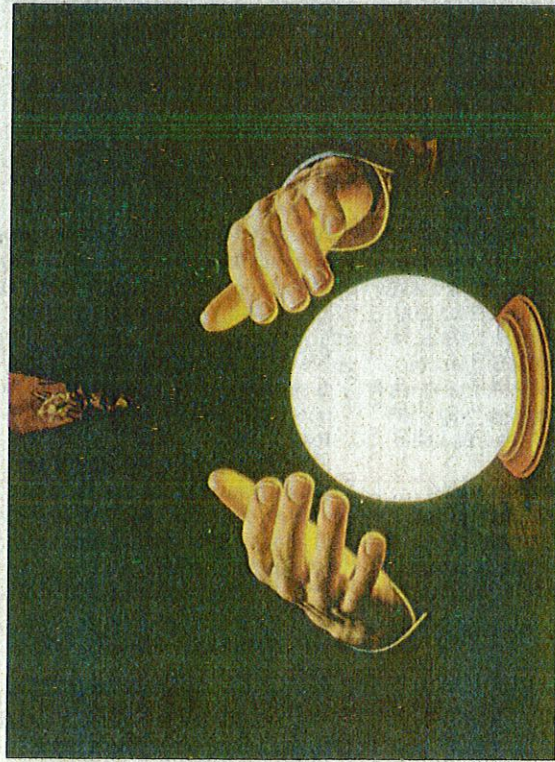
Forget About Trying to Forecast 2022

At best, economic predictions can be as elaborate as a Rube Goldberg contraption—and this year could be trickier than usual

In a contraption for emptying ashtrays dreamed up by the late cartoonist Rube Goldberg, the bright full moon (A) causes two lovebirds to become romantic, (B) causing their perch to tip (C) and pull a string, (D) upsetting a can, (E) which sprinkles water on a woolen shirt, (F) which after several more steps eventually leads to a fuse (M) getting lit, causing a rocket to shoot out the window disposing of ashes.

As anybody who has tinkered with building even a rudimentary version of a Goldberg machine knows, getting to the point where the perch actually tips would be a minor miracle. But year-ahead forecasts often look a bit like Goldberg machines—and when it comes to 2022, the forecasts might be even more complex.

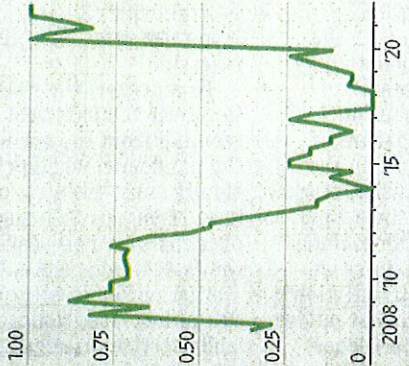
For example: Perhaps Covid-19 worries will ease enough that (A) global supply-chain problems are ironed out, (B) leading to an increased availability of goods, (C) a shifting of consumer demand toward services, (D) and greater labor availability, (E) all of which ease inflationary pressures, (F) allowing the Federal Reserve to raise rates only marginally (G) while the economy strengthens (H) and stocks rally (I). It is a plausible-seeming scenario—one that, if it came true, people might say, “Of course, that’s how it worked out.”



With so many steps in economic forecasting, many things could go wrong.

But with so many steps, so many things could go wrong. A bad Omicron outcome, or yet another worrisome coronavirus variant, could worsen bottlenecks. Older people who left the workforce might not return, leaving labor tight. And so on. Other scenarios also seem Goldberg-esque, such as one where persistent bottlenecks (A) leave inflation elevated, (B) ratcheting consumer inflation expectations higher, (C) which, in combination with a continued tight labor market, (D) leads to inflation-adjusted wages rising significantly faster than productivity, (E) and companies pushing through price increases (F) to offset rising labor costs. For a look at how poorly forecasts can turn out during the uncertainty of a pandemic, one need only look at what people said 2021 would look like. Federal Reserve policy makers, for example, projected that the unemployment rate would average 5% in the fourth quarter and that their preferred

Index of Federal Reserve policy makers' uncertainty over their inflation projections



Note: Higher numbers indicate that more Fed policy makers are more uncertain about their forecast than usual. Source: Federal Reserve

measure of inflation would be up by 1.8% in the fourth quarter from a year earlier. It turns out that the unemployment rate is nearing 4% and inflation is over 5%. Private economists' forecasts were, if anything, even further off. So the odds of the Fed's latest projections—showing that unemployment will average 3.5% in the fourth quarter of 2021 and inflation will slip to 2.6%—coming true might not be so hot. The Fed has acknowledged as much. Indexes of forecast uncertainty created by the central

bank show policy makers are highly doubtful of their own estimates. The point here isn't just to poke fun at year-ahead forecasts, but to recognize that while it is useful to think about what things might look like in a year, it is more important to have a good idea of what is happening now and what could happen next—especially considering how much uncertainty the pandemic has created.

At the moment, the economy is growing strongly; strained supply chains and heavy demand for goods are pushing prices higher; the labor market is tight and Covid-19 cases are rising rapidly.

Some important questions to ask are the degree to which goods demand might be sated; whether recent indications that supply chains are easing portend a shift; how much reduced government support for households might pull people back into the labor force; how much Covid-19 concerns might keep them away and, finally, what Omicron will look like over the course of the winter.

Policy makers, investors, businesses and ordinary Americans who can come up with reasonable estimates for what the next few months might look like could be much better prepared for 2022 than those who try to guess what might happen over the entire 365 days.

—Justin Lahart