



## 2021 Year in Review

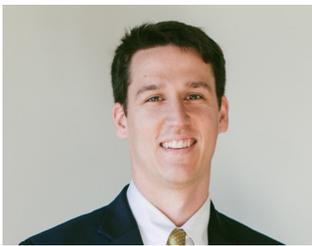
2021 is officially in the books, and what a year it was! Markets shook off meme stock mania in January, February's deep freeze in Texas, supply chain disruptions following the blockage of the Suez Canal in March, April's implosion of the over-levered hedge fund, Archegos Capital Management, the Cyberattack shutdown of the main pipeline supplying gas to the east coast in May, the increasing threat of inflation in June, Delta's rise to thwart the "return to normal" in July, and the fall of the Afghan government in August. September and October saw the increasing bottleneck at the L.A. Port as container ships were left waiting offshore, followed by the rise of Omicron as a "variant of concern" in November, and ending the year with the highest inflation print in 39 years in December.

There were maybe just a few headlines throughout the year that could have shaken markets, but none of them did. Instead, it was a remarkably resilient year. The S&P 500 closed at a record high 70 times (the most since 1995) as it gained 28.71% in 2021. That is quite an impressive feat following the 18.40% jump in 2020 and the 31.49% gain in 2019. In fact, over the last three calendar years, the S&P 500 has gained more than 90% – by far its best three-year performance since 1999. Finally, the S&P 500 outperformed the Nasdaq for the first time since 2016. Despite the large gains in major indices over the past year, valuations have actually dropped as corporate earnings growth outpaced the steady rise in markets.

Perhaps stoking some of the rise in stock prices last year was the potent combination of easy monetary policy and plenty of fiscal stimulus to boot. In early 2021, the Federal Reserve balance sheet was growing between 70-80% on a year-over-year basis. Today, that number has come down some, much closer to about 20% year-over-year growth. Despite the ever-expanding balance sheet, the Federal Reserve could not keep interest rates down. Market forces and inflationary concerns have proved to be a bit stronger. The 10-year U.S. Treasury closed the year around 1.51%, well above the 0.92% from the start of the year. The change in the 2-year has been even more remarkable. At the end of 2020, the 2-year U.S. Treasury yielded 0.12%. Today, it's closer to 0.73%. The Federal Reserve's actions coming out of the pandemic did a remarkable job of quelling volatility in equities, but those actions have been unable to stamp out any sort of volatility in the bond market. The VIX, which is often used as a measure of the expected volatility of the stock market, fell throughout the year as it continued its relative downtrend since its COVID spike. This has certainly aided the rising stock market over that same time frame. However, the MOVE index (a similar gauge to the VIX, just applicable to the broader bond market) has been rising steadily since the 4th quarter of 2020.

That's enough looking in the rearview though, 2021 is behind us after all. So, what of the current backdrop and what lies ahead? Well, COVID and Omicron remain ever-present. At the time of writing, the 7-day average for new cases in the U.S. was well above any previous high. Inflation is still a concern as well, as costs continue to rise. But both of these

concerns were present throughout 2021. Perhaps then, a greater risk to the market is the removal of easy monetary policy. The Federal Reserve has already begun tapering its balance sheet purchases – which in and of itself could be construed as tightening monetary policy. The taper, which began in November, has also coincided with a broader market that has been rather range bound. Furthermore, the market is pricing in the first Fed rate hike in March, with another likely in June. Tighter financial conditions are typically a headwind, not a tailwind. Looking ahead, it also seems unlikely that 2022 is as devoid of volatility as 2021 was. 70 record closes in one year is impressive, as is the S&P 500's 90% gain over the past three years. From a probability standpoint, it seems unlikely that the party is going to be as good as it has been. That certainly doesn't spell doom and gloom though, perhaps just moderation. Earlier, we mentioned how some of the rise in stocks last year could be attributed to the loose monetary and fiscal policy that was present. Some of the rise was also certainly attributable to the massive earnings growth seen as well. According to S&P, 2021 earnings are estimated to be 65% higher than 2020 – that earnings boom was a boon for stocks. 2022 earnings are estimated to grow ~9%. That growth certainly pales in comparison to 2021, but it is above average relative to the past 30+ years of earnings data that S&P publishes. Are headwinds present moving forward? Yes, no doubt about that. A healthy bull market though always climbs a wall of worry.



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*The Standard & Poors 500 Index (S&P 500) is an index of 500 stocks.*

**The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the Fund, and it may be obtained by calling 1-877-743-7820 or visiting [www.castleim.com](http://www.castleim.com). Read it carefully before investing. Distributed by Rafferty Capital Markets, LLC Garden City, NY 11530.**

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