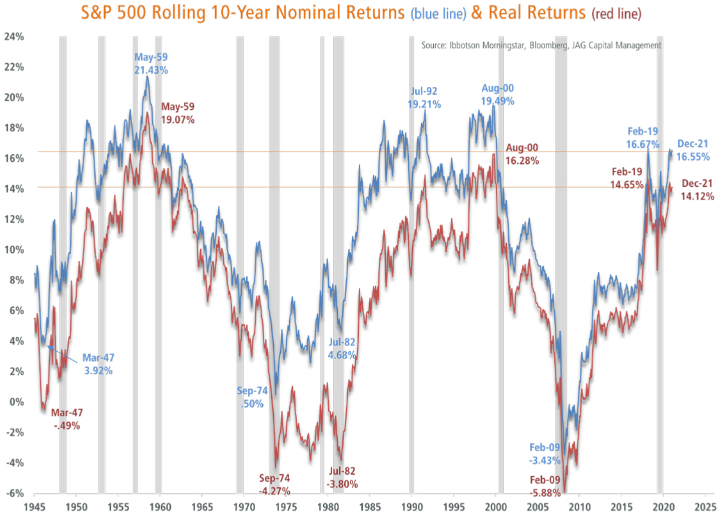
JAG CAPITAL MANAGEMENT LLC

Quarterly Comments

Retrospectives and Perspectives for The New Year

Stocks ramped into year end, notching 2021 as another triumph for the optimists. The S&P 500 logged its third straight calendar year of double-digit returns, despite a resurgence of COVID-19 via the Omicron variant and growing concern over higher interest rates and inflation. Surprisingly — at least to us — corporate earnings growth has been extraordinarily robust over the past year. According to FactSet, the S&P 500 ended 2021 with 36.7% annual earnings growth to trade at 21.1x estimated 2022 earnings of $225.62. This means the index's forward earnings multiple contracted by 7% year-over-year, a relatively rare occurrence during bull markets.

Overall, the last decade has been quite kind to stock investors. As the chart below shows, the ten years ending 12/31/2021 was one of the strongest such periods in the post-WW2 era.



As we alluded to in our **3rd Quarter Commentary**, unpleasant memories of the 2000-2002 and 2008-2009 bear markets still exert their influence on the last 20 years of S&P 500 returns according to FactSet. In fact, less than two years ago, during the early 2020 emergence of the COVID-19 pandemic, the S&P 500 marked one of its worst-ever 20-year returns. Although stocks have done a more than adequate job of preserving and growing purchasing power for long-term investors since 2001, our predecessor investors in the late 1940s and early 1980s have us beat, at least so far.

Source: Tribune Content Agency

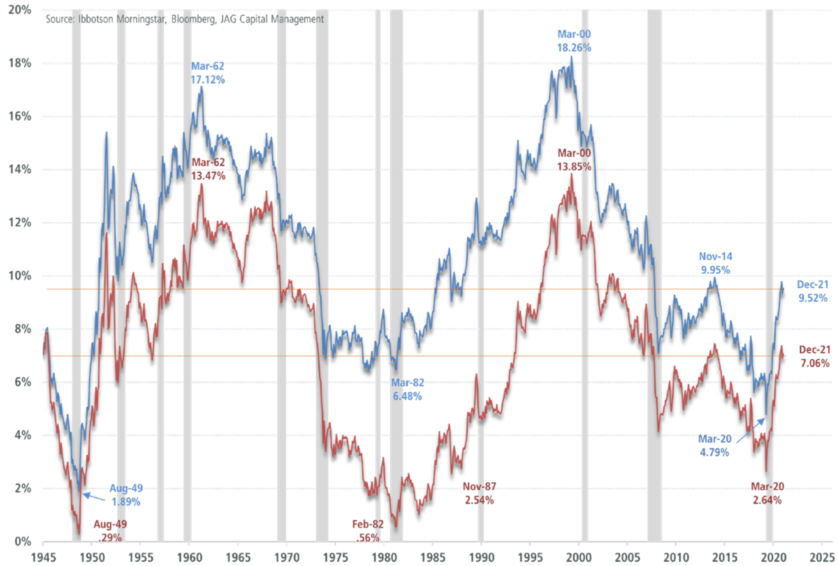
Firm Highlights

- **Welcome George & Adam!**

George Margvelashvili, CFA® joined JAG as an Equity Research Analyst focusing on companies within the technology sector. George previously worked at Fisher Investments as a research analyst primarily covering semiconductor companies. Prior to joining the investment management industry, George was a professional chess player and in 2010 was awarded the Grandmaster title — the highest title a chess player can attain.

Adam Dobin joined JAG as an Investment Operations Specialist. Bringing over 20 years of industry experience, Adam supports JAG's equity trading, reconciliation, and reporting functions. Adam previously worked at TortoiseEcofin Investments, Inc where he was responsible for core operational systems.

S&P 500 Rolling 20-Year Nominal Returns (blue line) & Real Returns (red line)

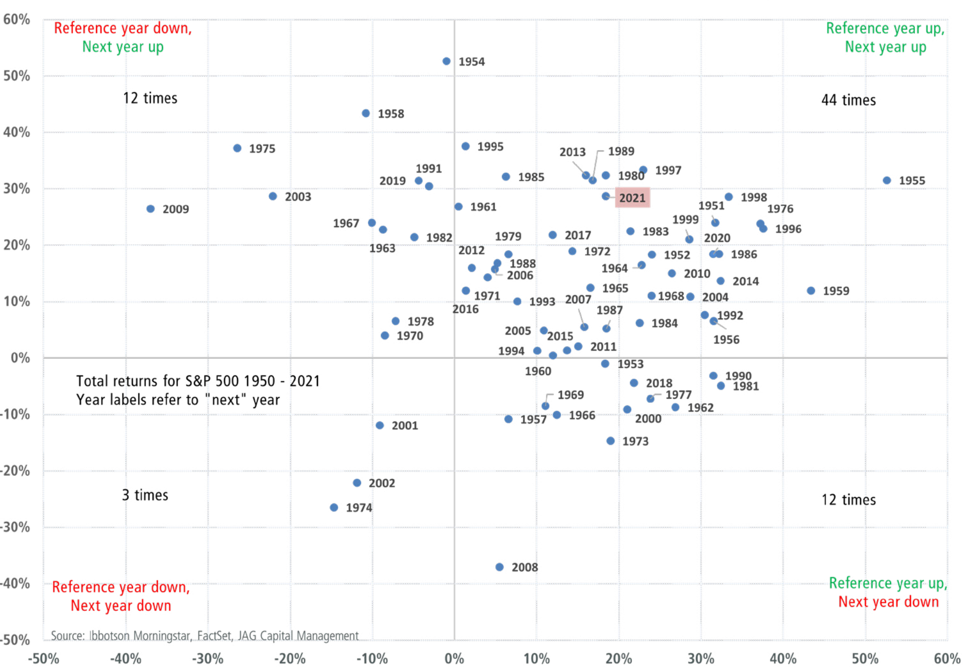


Market Outlook

Historically, up years in the S&P 500 have clustered around adjacent up years. This is somewhat surprising to those of us who assume that "what goes up, must come down." Behavioral finance informs us that investor psychology swings back and forth like a pendulum but clusters as well around extremes. We present this chart as interesting market history, rather than a specific outlook for 2022.

New Year's always bring herds of investment strategists and prognosticators offering precise, decimalized forecasts of where the S&P 500 will close on 12/31/2022. As a rule, most of these forecasts prove to be incorrect. As famed money manager and author Ken Fisher has observed, market forecasts tend to overcomplicate the reality that stocks can only follow one of four paths in any given year: 1. They can be up a lot; 2. They can be up a little; 3. They can be down a little; and 4: They can be down a lot. While investors live in perennial fear of "down a lot" bear market years for stocks, they have occurred in only 11.5% of the last 96 years. "Up a lot" years — like 2021 — have occurred 59.4% of the time. Adding in "up a little" years, the S&P 500 has produced a positive total return in 74% of the years since 1926.

S&P 500 Reference Year Return (x-axis) vs. Next Year Return (y-axis)



As Peter Lynch famously observed in his book Learn to Earn, "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in the corrections themselves." Our long experience has shown this to be true. Common stocks have been superb wealth creation vehicles over the past century, and we believe they will continue to provide good returns for long-term investors in the future: especially compared with zero yield cash and low-yielding Treasury bonds. As we have often noted, the volatility of stocks is a "feature, not a bug." Ironically, the primordial fear of big bear markets prevents many investors from experiencing the long-term benefits of equity investing.

S&P 500 Total Returns by Year 1926 - 2021

Up a Little (14 out of 96 years, 14.6%)		Up a Lot (57 out of 96 years, 59.4%)					
1947	5.7%	1926	11.6%	1963	22.8%	1996	23.0%
1948	5.5%	1927	37.5%	1964	16.5%	1997	33.4%
1956	6.6%	1928	43.6%	1965	12.5%	1998	28.6%
1960	0.5%	1933	54.0%	1967	24.0%	1999	21.0%
1970	4.0%	1935	47.7%	1968	11.1%	2003	28.7%
1978	6.6%	1936	33.9%	1971	14.3%	2004	10.9%
1984	6.3%	1938	31.1%	1972	19.0%	2006	15.8%
1987	5.2%	1942	20.3%	1975	37.2%	2009	26.5%
1992	7.6%	1943	25.9%	1976	23.8%	2010	15.1%
1994	1.3%	1944	19.7%	1979	18.4%	2012	16.0%
2005	4.9%	1945	36.4%	1980	32.4%	2013	32.4%
2007	5.5%	1949	18.8%	1982	21.4%	2014	13.7%
2011	2.1%	1950	31.7%	1983	22.5%	2016	12.0%
2015	1.4%	1951	24.0%	1985	32.2%	2017	21.8%
		1952	18.4%	1986	18.5%	2019	31.5%
		1954	52.6%	1988	16.8%	2020	18.4%
		1955	31.5%	1989	31.5%	2021	28.7%
		1958	43.4%	1991	30.5%		
		1959	12.0%	1993	10.1%		
		1961	26.9%	1995	37.6%		

1929	-8.4%	1930	-24.9%
1932	-8.2%	1931	-43.3%
1934	-1.4%	1937	-35.0%
1939	-0.4%	1941	-11.6%
1940	-9.8%	1957	-10.8%
1946	-8.1%	1966	-10.0%
1953	-1.0%	1973	-14.7%
1962	-8.7%	1974	-26.5%
1969	-8.5%	2001	-11.9%
1977	-7.2%	2002	-22.1%
1981	-4.9%	2008	-37.0%
1990	-3.1%		
2000	-9.1%		
2018	-4.4%		
Down a Little (14 out of 96 years, 14.6%)		Down a Lot (11 out of 96 years, 11.5%)	

Up a lot > 10%, Up a Little > 0% <= 10%, Down a Little <0% >= -10%, Down a Lot < -10%

Source: Morningstar Ibbotson, FactSet, JAG Capital Management

Despite strong returns, markets ended 2021 with an undercurrent of justifiable anxiety. For our part, we maintain a cautiously optimistic view, but we expect higher volatility in the intermediate term. Last quarter we highlighted some of the key risks we are monitoring, along with some of our own observations. Several months ago, we noted that stock valuations remain elevated by most metrics. This is still the case, although somewhat less so given the surprising strength of corporate earnings. However, there has been a notable and rapid shift in Federal Reserve policy over the past several months, which may put pressure on near-term equity valuations. As recently as last June, the Fed was messaging that they did not expect to raise the Fed Funds rate in 2022. By November 30, Fed Chair Jerome Powell backed off his previous assertions that recently high inflation rates are "transitory" in nature. Additionally, in the December FOMC meeting minutes (released on January 5, 2022) the Committee indicated their intention to taper asset purchases and discussed accelerating their plan to normalize the Fed's balance sheet. All of this implies that, over a span of roughly six months, the Fed has moved to a relatively hawkish stance. Interest rate markets have responded accordingly. 10-year US Treasury yields have risen almost 50 basis points since last summer, to a recent 1.7%. Although rates are still quite low by historical standards, capital markets tend to be spooked by such rapid changes in interest rates. As we saw most recently in late 2018, a hawkish Fed and higher interest rates, can instigate unpleasant short-term volatility in capital markets. Some of this has already occurred over the past several weeks, as shares of many fast-growing companies have sold off, even as the major indices have thus far remained relatively stable.

All the above has been widely publicized and covered extensively by news outlets around the globe. This suggests that it has already been discounted — to some degree, at least — into capital markets for stocks and bonds. According to Bloomberg, as of January 5, 2022, more than 38% of stocks in the technology — and biotechnology-laden Nasdaq Composite index had declined at least 50% from their highs. Although this correction has thus occurred under the surface of market capitalization-weighted indices like the S&P 500, it buttresses the point that investors have already reacted to fears of rapid inflation and higher rates. And while we have no special insight into Fed policy or the path of interest rates, we think it is reasonable to believe that the rate of inflation will moderate over the course of the coming year. As related in an **excellent blog post** by investment manager Joachim Klement last fall, he notes that inflation measures a change in prices, and that the rate of inflation is heavily influenced by Energy prices (energy commodities comprised 33.3% of the U.S. Consumer Price Index (CPI), according to the Bureau of Labor Statistics November 2021 CPI release[1]. Oil prices have risen more than 80% over the past year, from c. $49/barrel at the end of 2021, to a recent level near $80/barrel[2]. Therefore, for the inflation rate to remain as elevated as it is currently (+6.8% year over year, as of November 2021), energy prices would also have to rise very substantially from current prices, probably to levels near $140/barrel. Taking a cue from Charlie Munger's famous admonition, "invert, always invert," Klement suggests one should ask oneself how likely it is that this will come to pass? He posts that, were oil prices to remain roughly flat in the coming year, the CPI is likely to decline meaningfully. This would likely ease investor concerns about runaway inflation.

We live in a fascinating period of societal change, innovation, and economic crosscurrents. In fact, in our team's long investment experience, change has been the one true constant. Investors and markets react to these changes along a spectrum ranging from ebullience to despair, which feeds into varying degrees and types of volatility. We are comfortable operating within this environment. Our investment discipline has been developed over the decades to allow us to adjust our investment positioning over time. JAG truly relishes the opportunity to help our clients achieve their long-term investment goals. Happy New Year! All our best to you and yours in 2022.

Warm regards,

Norm Conley
CEO, Chief Investment Officer &
Portfolio Manager

Mike Kimbarovsky
Managing Director &
Portfolio Manager

1. Source: https://www.bls.gov/news.release/cpi.nr0.htm
2. Source: https://www.macrotrends.net/2516/wti-crude-oil-prices-10-year-daily-chart

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