Crossvault Capital Management, LLC
7373 Broadway, Suite 107
San Antonio, Texas 78209
ph 210-223-6929
fax 210-223-5852

4Q2021

As we look forward to 2022, we are reflecting on three significant changes that occurred in the fourth quarter of 2021, from both a societal and monetary policy perspective: 1) the announcement that the Federal Reserve would taper its bond buying more rapidly; 2) the Fed announcement that they would raise interest rates three times in 2022 to curb inflation; and, 3) the spread of the Omicron variant of the Corona virus. While this variant is more contagious, it seems to be less virulent. Nevertheless, it has disrupted the real economy and the financial markets. For the quarter, the S&P was + 11.03%, and +28.71% for the year. For the year the Dow closed + 18.65%, and the NASDAQ was +21.39%. The yield on the closely watched 10-year Treasury bond closed out the year at 1.51%. It started 2021 at .91%. Oil prices were volatile as well, finishing the year at $73/barrel. This is a change from the pandemic panic low in 2020 when for the first time in history oil traded below $0/barrel. The rise in the price of a gallon of gasoline is a significant contributing factor to inflation.

The upward move in energy prices, coupled with a government induced labor shortage, as well as supply chain issues, all pushed inflation higher in 2021. This is something we will be watching over the next six to twelve months as it could continue to pressure stock prices, particularly those companies that have higher price to earnings multiples. For years the Fed was trying to manage inflation to 2% without success. Today we have much higher inflation due in large part to the aforementioned challenges. We see the Fed taper as long overdue since we are no longer in an economic crisis; quite the contrary. The consumer and corporations are flush with cash, and orders for goods remains strong, though we believe the current level of inflation will moderate in 2022. We expect the labor force participation rate to rise as government support payments are withdrawn, supply chain shortages to ease, and consumption trends shift to some extent, back toward services and away from goods. Productivity gains will also help contain inflation. Consumer and capital spending will continue to drive the economy next year, and we should return to a more normal GDP growth rate of about 3% from this year's level of more than 5%. The one area where inflation could remain sticky is energy. This is due to the current administration's posture toward fossil fuels, and we will be monitoring this input cost closely.

At Crossvault we are generally optimistic about the equity market in 2022 despite a less accommodative Federal Reserve. Our portfolios are well balanced with exposure to some interesting and exciting trends, as well as companies that benefit from an increase in inflation, or those that can prosper regardless of inflationary trends, such as healthcare and pharmaceuticals. America still tops the list when it comes to innovation and the ability to capitalize on it. Software, the Internet of Things, artificial intelligence, machine learning and the general digital revolution continue to drive efficiencies and improve the quality of life for billions of people around the world. Medicine and healthcare are adopting these technologies to become increasingly personalized, thereby improving outcomes. We remain committed to being nimble in the portfolios during these changing times, while adhering to our long-term oriented strategy and investment disciplines. As always, we thank you for your continued confidence in Crossvault and look forward to working with you in 2022.

Laura Ehrenberg-Chesler Marilou Moursund, CFA Sarah Calvert Doerr