ON OUR MINDS

View from the Crow's Nest

Michael A. Tyler, CFA®, Chief Investment Officer

Thomas Bussone III, Fixed Income Strategist

Allen Laine, CFA®, Equity Analyst

Jia Min, CFA®, Equity Analyst

Tim Garvey, CFA®, Investment Officer

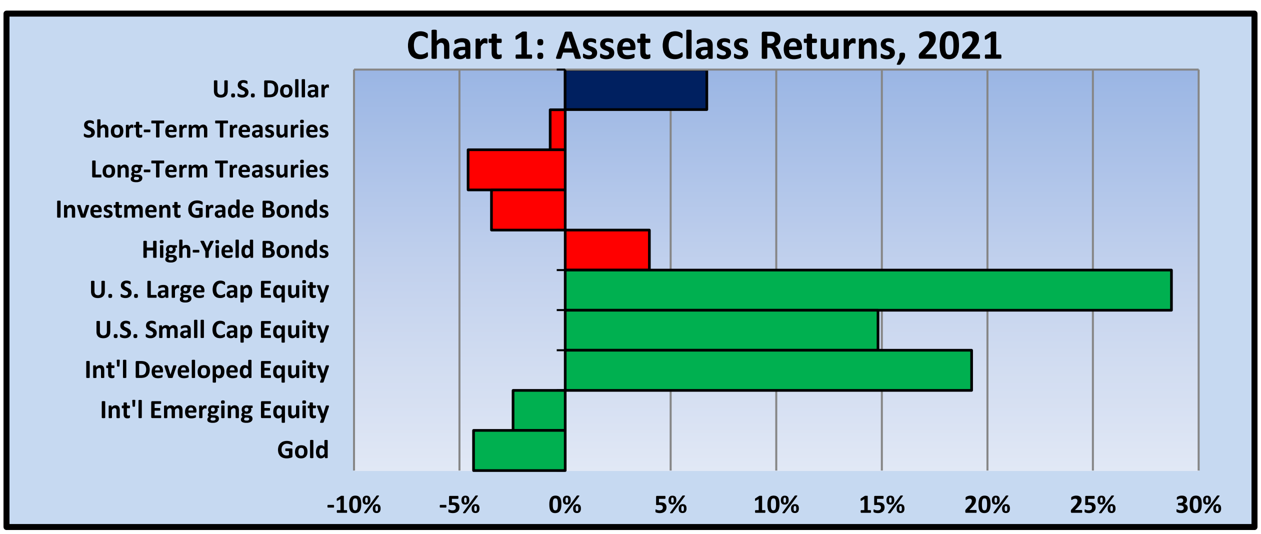
Ananya Pierce, Investment Associate

January 24, 2022

In financial markets and elsewhere, January is a time of fresh beginnings; everything is reset to zero. This year, the reset process feels more like a *rewind* instead: We seem to be in almost the same place as we were a year ago. Just as in 2020, stock markets had a great year in 2021 while bonds were lackluster; Covid still dominated the headlines; and the economy made great strides but was still millions of jobs short of pre-pandemic levels. Even our asset allocation decisions this month are eerily similar to those we made a year ago. Every day is a winding road, perhaps, but last year turned out to be quite a tortuous journey. Before we assess what the road through 2022 looks like, we think it's important to take one final look backward to assess how we handled the past year – and then to turn our eyes forward to our current portfolio positioning.

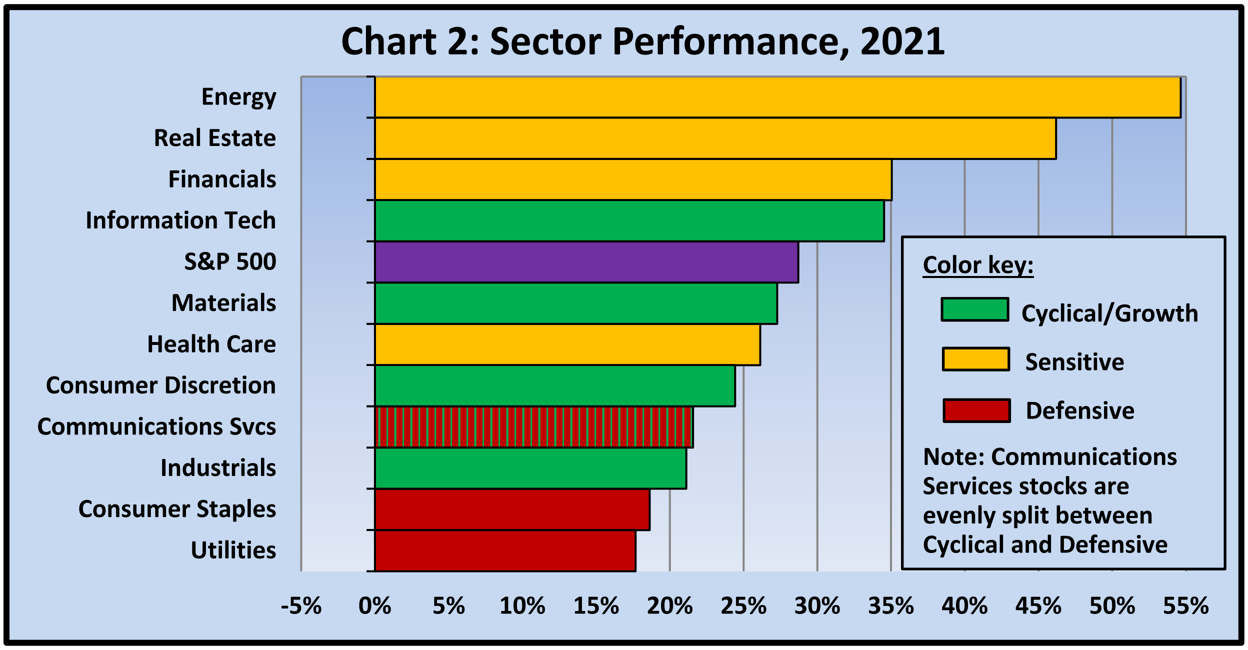
2021 Markets Review

Financial markets were surprisingly calm last year, despite the challenges of Delta and Omicron, supply chain disruptions and inflation, and a federal government at war with itself. Stocks had a great year, following dramatic earnings recoveries; bonds lost ground as investors grappled with rising inflation; and some commodities soared while others languished. Chart 1 shows a scorecard of major asset classes for the year.



Source: FactSet

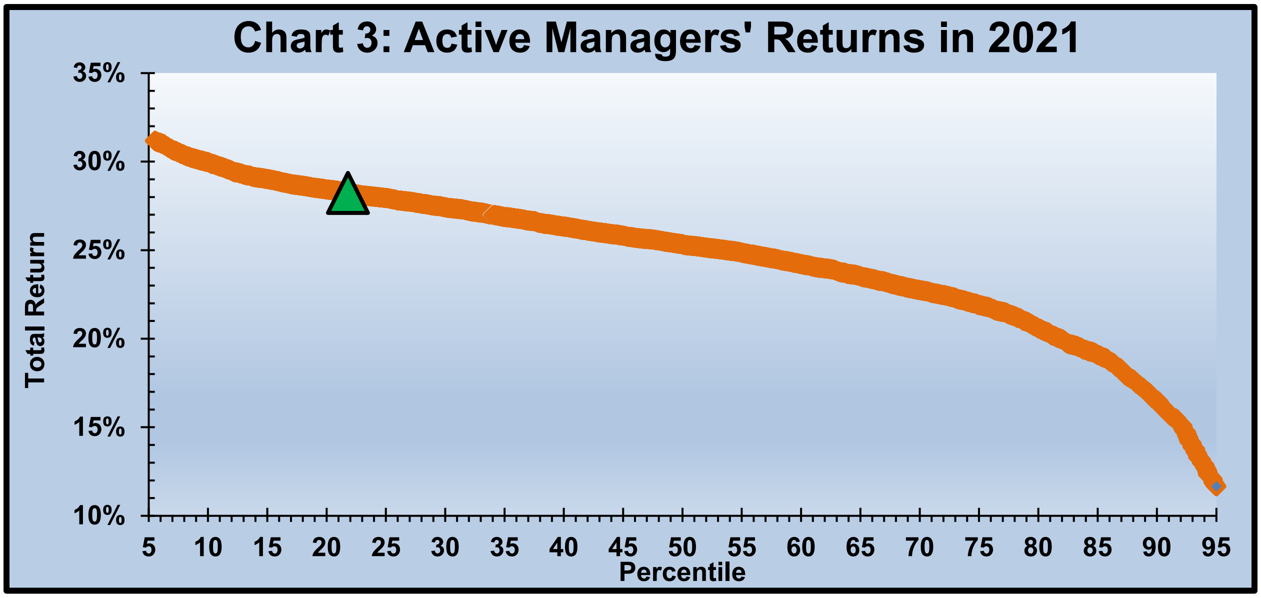
Domestic equities. Large-cap U.S. equities returned 28.7% last year, including dividends, registering their third consecutive double-digit return. The 2019-21 period marked only the third time since World War II that stock prices doubled in less than three years. Gains were spread across all sectors of the economy, as shown in Chart 2; in fact, 2021 was the first time in the S&P 500's history that *every* sector produced double-digit gains. Smaller stocks also did well, although they weakened in the face of the Delta and Omicron surges.



Source: FactSet

Markets were led by the energy sector, which rebounded sharply from its awful 2020 performance, as the supply/demand dynamics of the oil business turned abruptly. Three factors drove the change: People started emerging from lockdown; they felt more safe and sound in private automobiles than in potentially Covid-exposed trains and buses; and producers limited output in response to the 2020 glut. And while climate change activists wanted us to soak up the sun and wind power, the economy still runs primarily on fossil fuels; hence the 64% bounce in oil prices in 2021, and attendant gains in energy sector performance. Meanwhile, the market's laggards were concentrated mainly in defensive sectors, as investors sought participation in the ongoing economic recovery.

It was a year in which individual stock selection mattered greatly: The range of returns among active U.S. large-cap managers was substantial, as shown in Chart 3. In this chart, the orange line represents the individual returns of about 3,500 active large-cap mutual fund managers surveyed by Morningstar, arrayed from best to worst. Managers in the tenth percentile saw a 30% return, while those in the 90th picked up only 16% last year. The S&P 500 return is highlighted with a green triangle in Chart 3; that the passive index finished in the 17th percentile indicates that the vast majority of active managers mostly missed out on a strong year. (The chart leaves off the top 5% and bottom 5% of managers to exclude outliers that could otherwise skew the data.)

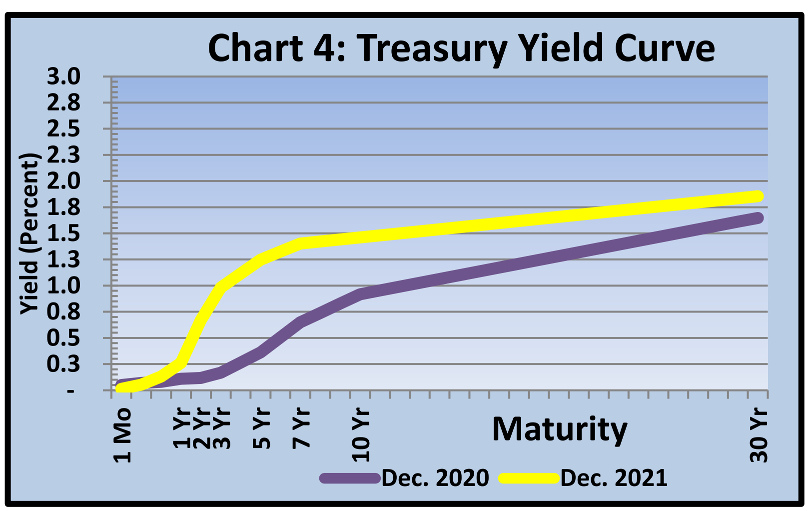


Source: Morningstar, Eastern Bank Wealth Management

Global equities. For the tenth time in the last eleven years, international stocks badly lagged domestic equity markets in 2021. European, Japanese, and other major developed markets remained hamstrung by negative interest rates, more restrictive Covid lockdowns, and political upheaval. China – which constitutes about one-third of emerging markets indexes – softened noticeably, sagging under the weight of political repression, government crackdowns on private sector companies, unsustainable real estate debt, and Covid-related supply chain problems. For U.S. investors, foreign market returns were further punished by the stronger U.S. dollar.

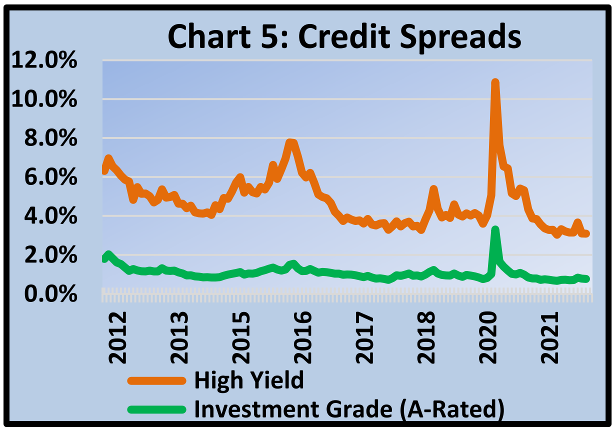
Fixed income. Bond markets struggled through a choppy year, ultimately finishing with small losses. The markets and the Fed engaged in an awkward tango, each sending signals to the other about their preferred course of monetary policy. For most of the year, markets were effectively telling the Fed to start hiking interest rates; but when the Fed finally got the message, bond investors recoiled. If it makes you happy, the Fed seemed to be saying, we'll plan on three rate hikes in 2022 *and* a faster end to tapering our bond purchases *and* an early start to rolling maturing bonds off our balance sheet. Bond markets cringed, fearing the Fed's pendulum had swung too far into hawkish territory.

Chart 4 shows that yields rose across the maturity spectrum in 2021, with the most pronounced change in the 3-10 year range.



Source: FactSet

The steeper front-end and flatter back-end of the yield curve give us a good clue as to the mood of the bond markets over the course of last year. Investors are clearly expecting high inflation to stick around for a while, hence the upward move in intermediate rates; but they are concerned that the Fed will be overly aggressive and push the economy into recession, hence the stability in long-term rates. Higher yields are another way of saying lower prices, and the relationship is amplified with longer maturities; it is no surprise that longer-term Treasury debt was the worst asset class shown in Chart 1.

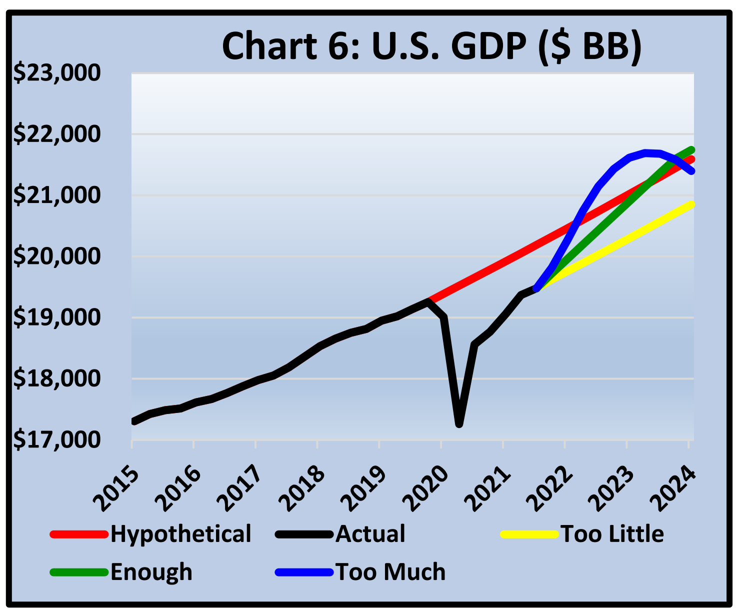


Source: Bank of America Merrill Lynch

As investors fled the Treasury markets, they went hunting for yield elsewhere – mainly in the credit markets. With the economy emerging from Covid and ample government support, investors have concluded that corporations are not very likely to default on their debt. Chart 5 shows that this confluence of factors has caused credit spreads (the difference between corporate bond yields and those of comparable-maturity Treasury bonds) to collapse. As both investment-grade and high-yield spreads have fallen, corporate bonds have held their value better than Treasuries. At year-end, investment-grade corporate bonds traded at barely 1% above Treasury debt, while high-yield spreads were under 4%. Whether intended or not, the Fed's actions clearly pushed investors into riskier assets.

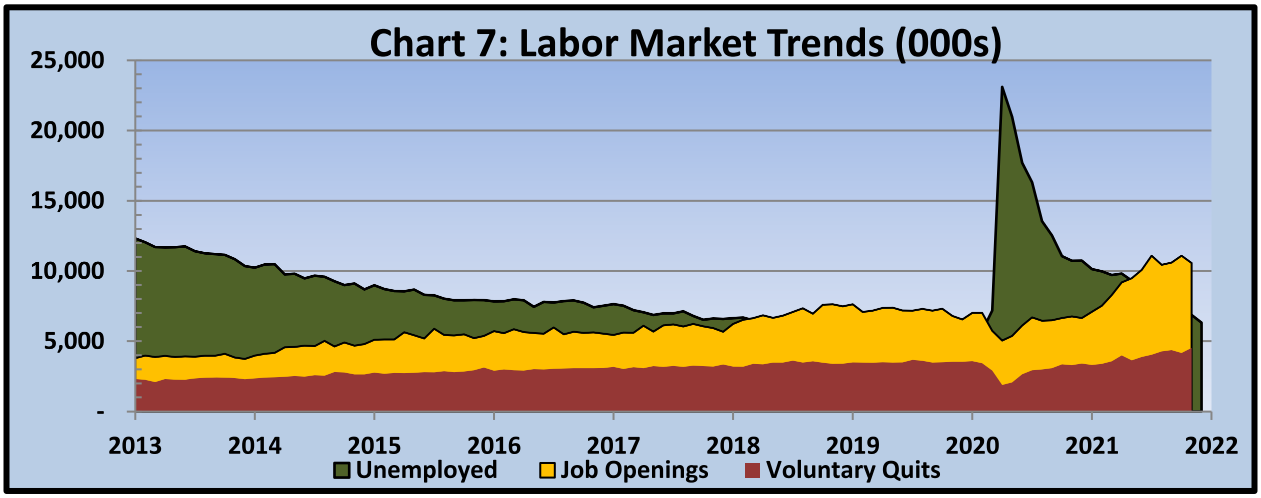
2022 Economic Outlook

The U.S. economy has come a long way since the pandemic-induced lockdowns of 2020. As Chart 6 shows, inflation-adjusted gross domestic product (GDP, the sum of economic activity in the country, shown in black) now has surpassed the pre-pandemic 2019 peak. This has been achieved on the back of trillions of dollars of fiscal support, including the American Rescue Plan and the Infrastructure Investment and Jobs Act last year. Yet the economy is still well behind where it would have been, absent Covid; the red line in Chart 6 shows our estimate of the productive capacity of the U.S. economy were Covid never to have happened.



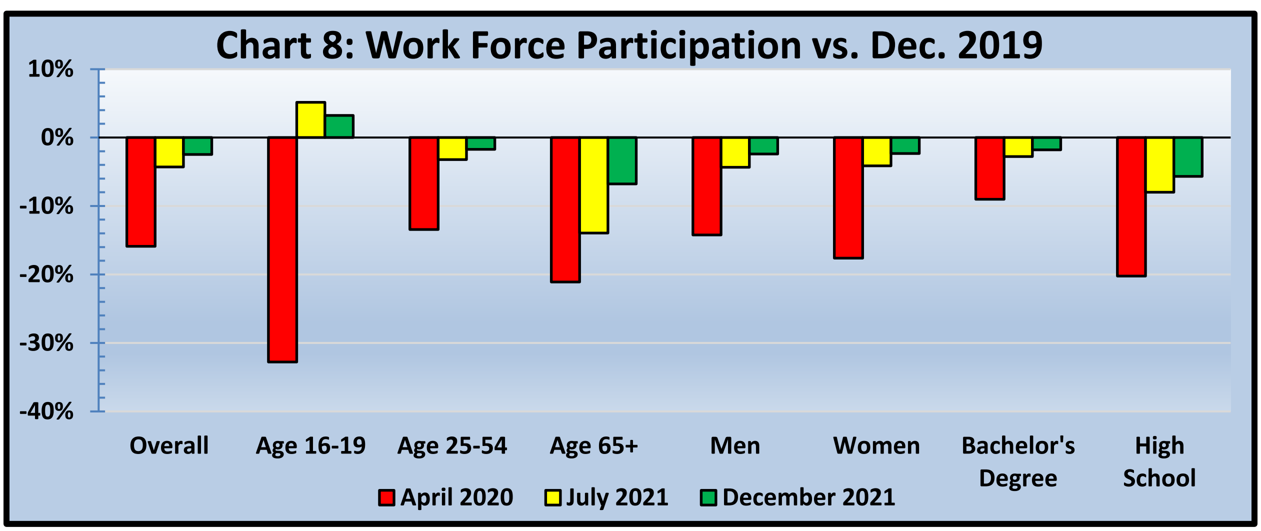
Source: Commerce Department, Eastern Bank Wealth Management

Perhaps the most important gauge of the economy today is the labor market – and it is also the most confusing. Chart 7 provides a snapshot view of the jobs market today. Unemployment (in green) has come down sharply since the pandemic peak two years ago, and is currently tracking as if the pandemic had never happened: The unemployment rate of 3.9% is almost exactly where it was just before the pandemic, as is the total of about 6 million people looking for work.



Source: Bureau of Labor Statistics

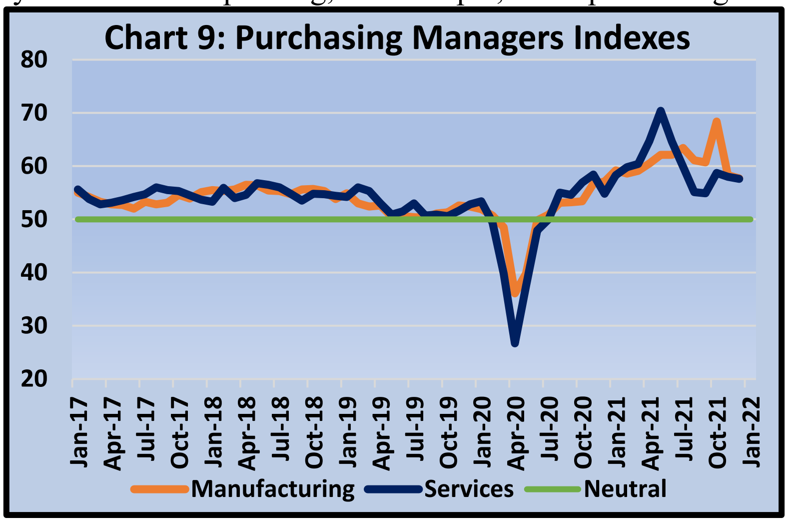
Yet the economy still has 2.9 million fewer jobs than it did before the pandemic. This apparent contradiction (lower unemployment but also fewer jobs) exists because many people have left the work force, as shown in Chart 8. This "great resignation" was initially most acute among younger and less educated workers in low-skill jobs. Since the economy began to reopen, however, these jobs have returned and young workers have readily filled them. Older workers, by contrast, have stayed on the sidelines. These workers have taken their considerable skills, credentials, and experience out of the work force, leaving employers scrambling to fill open slots for high-skill jobs that are critical to supply chains. The brown area of Chart 7 above shows this great resignation, and the yellow area shows the resulting record high number of open job slots.



Source: Bureau of Labor Statistics

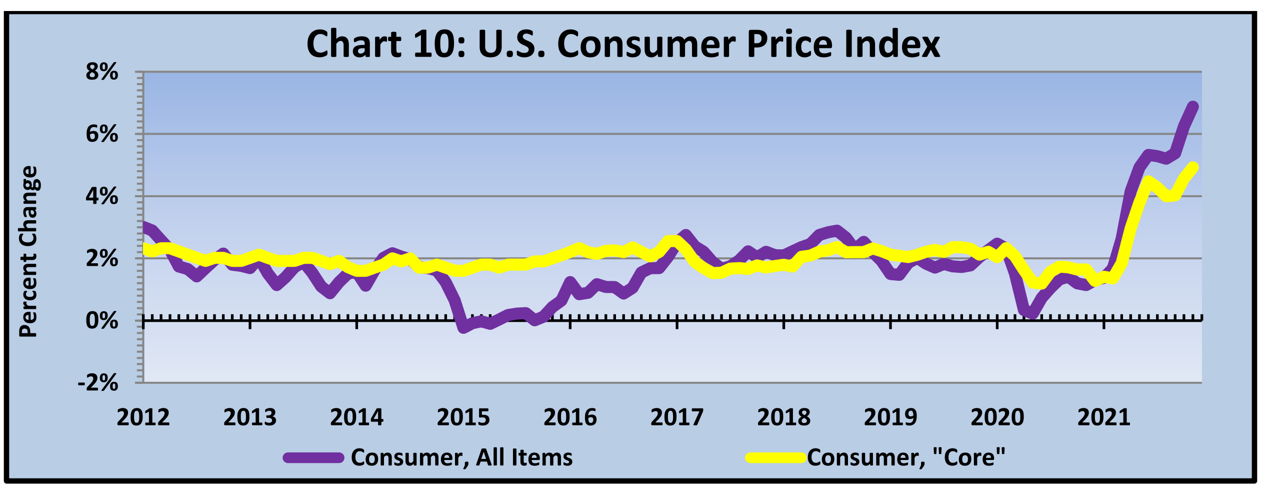
Faced with millions of job openings and few takers, employers have begun to pay more for workers; average hourly wages crept up by about 4.5% last year. Workers know they have more leverage, and have been using it; the spike in voluntary quits shown in Chart 7 could only happen if workers have confidence that they will land somewhere else with a better pay package.

The jobs recovery has paralleled significant improvement in other "hard" measures of the U.S. economy, including gains in capital spending, retail sales, travel, dining, industrial production, and many other categories. One proxy for industrial spending, for example, is the purchasing manager index data published by IHS Markit, shown in Chart 9. Although activity has slowed since Delta and Omicron came on the scene, spending remains strong; survey respondents remain optimistic about the future direction of the economy.



Source: IHS Markit

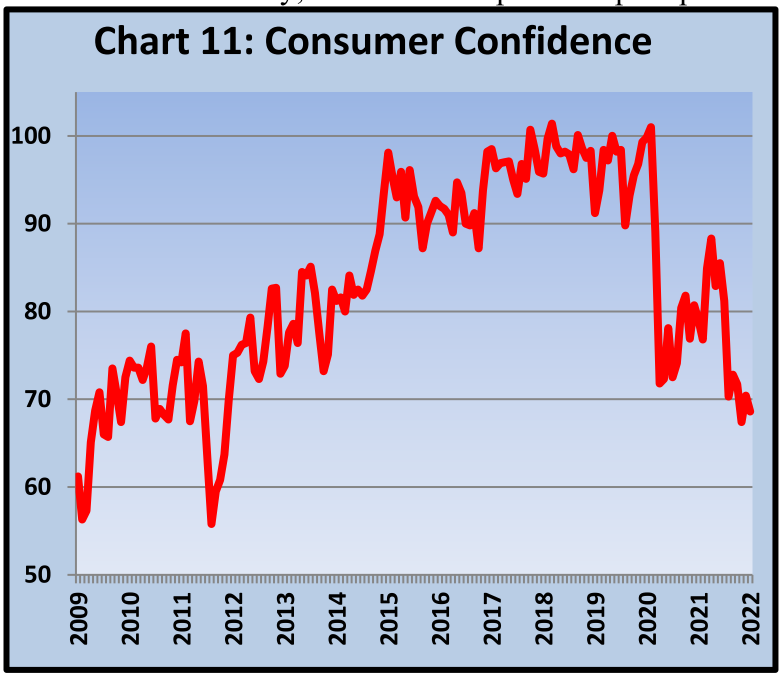
But as companies scramble to meet rising demand, supply chains remain tangled due to Covid rules, worker shortages, political concerns, and other factors. This has led to shocking levels of inflation, as the Consumer Price Index hit levels not seen in 40 years (Chart 10). Most of the spike comes from the transportation and energy sectors, as semiconductor shortages have stalled automobile manufacturing just as consumer demand for vehicles has skyrocketed. Those factors will dissipate over time, but more insidious pressures are beginning to be felt in the housing sector. If rents begin to catch up with home sale prices, the CPI may remain elevated for a long time to come.[1]



Source: Commerce Department

[1] For more on this topic, please see "Powell's High-Wire Act – Tyler's Version," published November 24, 2021.

We think inflation is indeed likely to remain high, for longer than most investors expect, mainly because of higher housing prices. Consumers seem to have absorbed the notion that elevated inflation is here to stay; how else to explain the precipitous drop in consumer confidence over the past few months? Despite very strong GDP growth and plentiful jobs, the University of Michigan consumer sentiment index shown in Chart 11 suggests that consumers are more worried today than at any point since the financial crisis a dozen years ago – even more that they were at the outset of the pandemic. The drop in spending hasn't yet affected consumer spending; the immense fiscal and monetary support of the past two years has put plenty of money into consumers' wallets, and it's being used. We can't cry anymore, consumers seem to be saying, so let's just spend some money.



Source: University of Michigan

2022 Tactical Asset Allocation

Against this backdrop, we can identify the key elements to our 2022 economic forecast, and then construct client portfolios based on that forecast. In our view, six factors will drive investment returns this year:

- **Covid.** We cannot predict whether Omicron will be the last surge, or how public health responses may evolve. But it does seem clear to us that the U.S. economy is regaining its momentum as consumers increasingly return to pre-pandemic habits. If our collective perception of Covid transitions from lethal pandemic to mild and endemic, we will learn to live with the virus, not in fear of it – much as we do regarding influenza.

- **Supply chains.** After three years of problems with supply chains – dating to the imposition of tariffs on many imported goods, and certainly including Covid lockdowns – we think that supply chains may finally unkink in 2022. Employers may be forced to raise compensation levels to lure back workers, and China's strict Covid policies may still present some challenges, but the overall prospect is for some improvement.

- **Inflation.** In most respects, inflation is likely to fade in 2022: Diminishing component shortages should ease the pressure on new and used car prices; renewed drilling activity will alleviate oil prices; and higher year-ago price levels will reduce "base effect" anomalies. But we still fret that a tight housing market and rising wages can still spread to other areas of the economy, boosting inflation for longer than most economists expect.

- **Earnings growth.** We think the prospects for corporate earnings growth are quite strong. Demand continues to grow as consumers return to pre-pandemic ways of living; inflationary pressures can boost revenue growth and, for many companies, lead to fatter profit margins. (Many other companies may see some cost pressure, however.) Our review of capacity utilization, durable goods orders, and other data suggest that companies still have slack in their operations; incremental profit margins should remain very healthy. We would not be surprised by double-digit profit growth this year.

- **Federal Reserve policy.** The central bank has already committed to a more hawkish policy, including three rate hikes, the end of quantitative easing (bond and mortgage purchases), and possibly quantitative tightening (letting maturing bonds roll off the balance sheet without replacing them, thereby absorbing excess cash from the banking system). We think the Fed's forecast is probably right, though it may temper its pace if the economy begins to show signs of weakness.[2]

- **U.S. dollar.** After years of marching in lockstep, the Fed and its counterparts in other countries are beginning to diverge. As the Fed tightens, most other major central banks are sticking to their easy money policies. We think this will draw more foreign capital into the U.S., lifting the value of the dollar. A strong dollar helps consumers by lowering import costs, but it also hurts manufacturers by making exports less competitive. On balance, we think modest dollar appreciation won't hurt U.S. capital markets.

This outlook leaves us with two central questions: How will the bond markets respond to the Fed's shift toward less accommodative policy? And will earnings growth outpace anticipated P/E contraction in the stock market? We readily admit that we don't know the answers; no one said it would be easy, after all. But we have constructed our clients' investment portfolios based on our assessment of a range of reasonable responses to these two core questions.

Taking these factors into consideration, we think stocks are modestly more attractive than bonds – although we think returns in both asset classes will be subdued. We retain equity positions 5% above their long-term targets for 2022, reflecting our perception of value and outlook for each major asset class. This 5% tilt toward equities should be viewed within our policy framework that allows tactical weightings to be as much as 20% over or under the long-term target.

For comparison, we started 2020 at neutral (no tilt in either direction) and 2021 at a 6% tilt toward equities. In both years, soaring stock markets raised the equity allocation uncomfortably close by year-end to our policy limits, so we trimmed stocks the following January to reach our tactical targets. In 2021, for example, the 6% initial overweight to equities grew to 13% by year-end. Thus, we entered January 2022 needing to reduce stocks from a 13% positive tilt down to a 5% bias over our long-term targets.[3]

---

[2] The Fed's first meeting of 2022 takes place this week. Much of the stock market's fierce selloff this month can be attributed to panic that the Fed might move even faster than it has telegraphed so far. Chair Jerome Powell's press conference on Wednesday will be closely watched; we think he will attempt to tamp down fears of hasty action.

[3] It may seem counterintuitive to be trimming the asset class we favor, but that's just the way the arithmetic works.

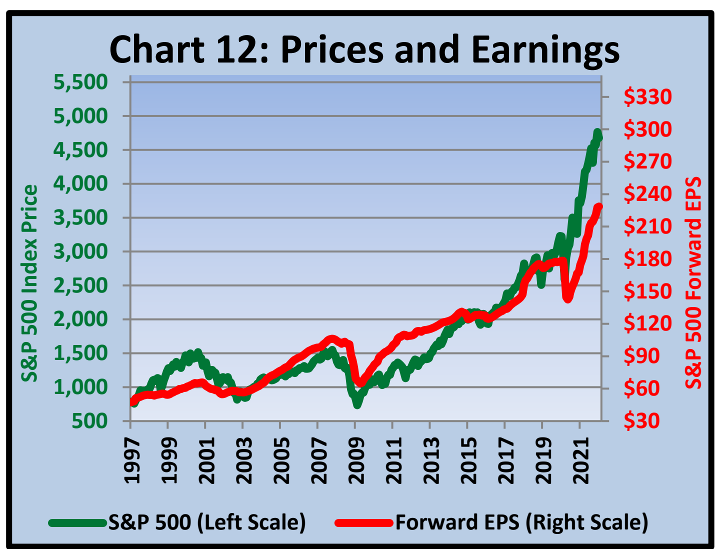
2022 Portfolio Construction

We start with the recognition that the first cut is the deepest: Investors reacted sharply in early January to the Fed's initial indications of tighter policy, but we expect the markets to respond more favorably to actual implementation of rate hikes and balance sheet reduction. The Fed has now telegraphed its intentions quite explicitly, so investors won't be surprised (and shouldn't be concerned) as the central bank puts its words into action. Investors should also remember that under Chair Jerome Powell, the Fed does not operate on autopilot; it has already altered its policy trajectory several times as economic conditions have evolved.[4]

Fixed Income. Bond prices are undeniably expensive. Even after the recent selloff, Treasury yields remain low by historical standards, and credit spreads are near record lows (Chart 5, above). We think it will be very difficult for investors to earn good returns in fixed income this year, but some quarters of the market will likely be better than others. In our view, short-duration high-yield debt is the most attractive fixed income category this year; short-duration instruments are less vulnerable to interest-rate shocks, and lower-quality issuers are unlikely to default in a strong U.S. economy. Within the short-duration high-yield category, bank loans are especially appealing because their coupons vary in line with the prime rate; these instruments benefit from rising interest rates, while bonds with fixed coupons lose value when yields rise.

Municipal debt is overpriced, as their tax-equivalent yields are below Treasury debt yields across the maturity spectrum despite carrying more risk; that anomaly arose when high-income taxable investors began to fear that President Biden's domestic agenda would be funded through tax increases. Now that Build Back Better legislation is all but dead, the appeal of municipal bonds has dissipated. If you are investing in munis to save taxes, a change would do you good: You'll earn better after-tax returns by using corporate debt and paying tax on the coupon income.

Equities. Chart 12 shows S&P 500 prices contrasted with expected year-ahead earnings. In the past three years, the S&P 500 index (in green) has nearly doubled, but earnings per share (in red) have grown even faster, by 145%. In other words, P/E ratios have *fallen* even as prices have soared; compared with trailing earnings, stocks are cheaper now than they have been in the past several years. On the other hand, valuations based on future earnings are still somewhat stretched, particularly if the Fed puts paid to its promises to raise interest rates.

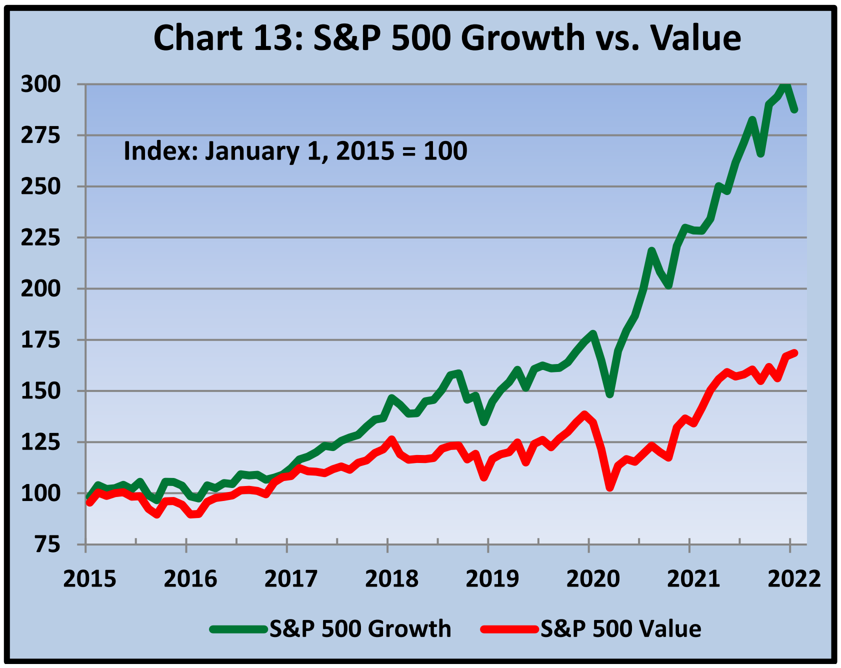


Source: FactSet

[4] Perhaps this indicates a lack of forecasting ability on the part of the Fed's army of economists, but it also indicates an institutional willingness to retain open minds; that's a tradeoff we'll gladly accept.

We anticipate rising earnings growth will continue to outpace shrinking P/E ratios, leading to modest price gains for the U.S. market. If we are wrong, it will probably be to the downside: We think there is more risk that P/E ratios and other valuation metrics will shrink faster than we expect, or that earnings might come up short; it's less likely that earnings will outstrip forecasts or that valuations will expand. Consequently, we caution not to let the extraordinary market returns of 2019-21 cloud judgment regarding responsible investment and spending practices.

Equity returns are not likely to be evenly spread across all sectors of the markets. Investors often split the market into "growth" and "value" stocks; the former typically boast faster earnings growth but also sport much loftier valuations, while the latter typically command lower P/E ratios on slower but steady growth. After four straight years of superior returns, growth stocks stalled in 2021 while value awoke (Chart 13). This change of market leadership was partly a function of improving earnings prospects among value stocks as the economy reopened, but a larger factor was the Fed's increasingly hawkish stance: Higher interest rates translate into lower values for earnings many years into the future. Growth stocks' high P/E multiples therefore tumbled when the Fed tacked, while value stocks' low P/Es were relatively unscathed. We think the gap between growth and value is still quite wide, leaving plenty of room for value stocks to continue riding improving earnings prospects into market leadership. We tipped our equity portfolios toward value last year, mainly by increasing our investments in the financials, manufacturing, retail, dining, and hospitality industries. We still think these sectors are poised to recover more of their lost ground in relation to technology, social media, and similar growth stocks.



Source: FactSet

For clients with global portfolios, we are retaining our participation in foreign markets at current levels, in line with their benchmarks. The U.S. stock markets have outperformed global markets in ten of the past eleven years, mainly because the U.S. economy has been more dynamic (especially in technology) and because the U.S. stock markets are less oriented to energy and financial companies. But as Europe begins to emerge from the paralytic shocks of Brexit and Covid, we think developed (mature) foreign markets have potential to improve. Within the international tranche, we have shifted slightly back toward developed markets; we are concerned that the strong dollar, in conjunction with China's many current problems, will make it difficult for emerging markets to shine this year.

Chart 14 provides a summary of our current positioning in comparison to this time last year. We do not attempt to portray here the effects of market drift during the year.[5] Overall, our asset allocation looks very similar to our stance a year ago. Yet although the changes here appear quite modest, they engendered substantial trading activity this month because market drift had, in fact, taken the actual portfolios quite far away from their original allocations. This was not by accident; we made conscious decisions every day about whether to trim back equity positions as the stock market powered through the year.

Chart 14: Asset Allocation	2022	2021	Change
Tactical Equity Weighting	**+5.0%**	**+6.0%**	-1.0%; smaller tilt toward equity
U.S. Equities:			
U.S. Large-Cap Stocks	75.5%	72.0%	+3.5%; tip toward value stocks
U.S. Mid/Small-Cap	4.5%	5.5%	-1.0%; interest rate vulnerability
Sector Funds	3.0%	6.0%	-3.0%; trim tech, cut industrials
Total U.S.	**83.0%**	**83.5%**	-0.5%; stay close to neutral
Benchmark	~83.0%	~83.0%	
International Equities:			
Developed ETFs/Funds	13.0%	9.0%	+4.0%; valuations & sector mix
Emerging ETFs/Funds	4.0%	7.5%	-3.5%; strong dollar hurts
Total International	**17.0%**	**16.5%**	+0.5%; stay close to neutral
Benchmark	~17.0%	~17.0%	
Fixed Income:			
U.S. Investment Grade			
Individual Bonds	75.0%	75.0%	0.0%; nine-year ladder
Short-Term Corp. ETF	0.0%	0.0%	0.0%; replaced by ladder
Intermed. Corp. Fund	13.5%	15.0%	-1.5%; reduce duration risk
Other U.S. Funds			
Senior Loan Fund	5.0%	2.0%	+3.0%; increase credit exposure
High-Yield Bond ETF	2.5%	4.0%	-1.5%; reduce duration risk
Preferred Stock Fund	4.0%	4.0%	0.0%; no change

Chart 14 shows targeted allocations for our Multi-Asset model using actively selected individual stocks and corporate bonds. We have developed comparable models for client portfolios that use only mutual funds and ETFs instead of individual securities, and for variants of Multi-Asset including our Core, ESG Sustainability, and Catholic styles. All model portfolios are derived from the same economic analysis and market interpretation, and therefore have analogous asset allocation targets. Individual client portfolios often differ from these models because of factors unique to each client, so Chart 14 should be read as only as a guideline for client portfolios.

[5] Market drift simply refers to the way an asset class's allocation will rise or fall just because of price changes in comparison to those of other asset classes.

2021 Report Card

Finally, we think it is appropriate to evaluate our investment decisions through the course of 2021. This evaluation necessarily must cover only hypothetical guideline models: Since each client's portfolio is unique, it would be impossible to judge any individual client accounts here. Instead, we look back to our *On Our Minds* 2021 preview, "20/20 Vision and Walking Around Blind," published January 20, 2021, to review our predictions and judge our work. On the whole, we think the results were quite good:

- <u>U.S. economy.</u> The headline of our preview article said it all: We were "walking around blind," because no one could know in advance the path of the virus or its possible mutations, nor whether vaccines would be both widely accepted and effective in changing consumer behavior. Nonetheless, we laid out a base case for economic growth to slow through the year, even as consumers would begin to return to pre-pandemic spending patterns. We expected employment to recover but to remain below 2019 levels, and we didn't think the flood of stimulus money would stoke inflation until consumers' animal spirits returned. For the most part, that forecast was accurate. Our only missteps were in misjudging the difficulty of rebuilding supply chains, and in underestimating the vigor of consumer appetites as America reopened; consequently, we were surprised by the surge and persistence of inflation.

- <u>Asset allocation – by asset classes.</u> We pared our equity positions last January as a measure of risk management, although we remained overweight compared with our benchmark indexes. We liked the confluence of rapid earnings recovery combined with reasonable valuations, and we believed that ultra-low interest rates would make for a difficult year in fixed income. We then let the markets do all the work: With stocks up 29% and bonds down 3% on the year, our overweight to stocks was a huge contributor to performance throughout the year.

- <u>Asset allocation – by geography.</u> After years of keeping our international equity allocations well below the benchmark's 18% weighting, we finally closed the gap with a neutral allocation last year. Unfortunately, we were too early, as the U.S. markets handily beat foreign markets yet again. Developed markets, as measured by MSCI's EAFE index, rose 19%, about nine percentage points behind the S&P 500. Emerging markets were even worse, down 4%, and our investments in that geography were a major reason our Multi-Asset equity portfolios fell short of their benchmarks for the year. We had considered reducing our emerging markets holdings periodically through the year, as China's political crackdowns accelerated and its real estate problems mounted. C'mon, c'mon, we thought, China's ruling elites have always rallied around the markets soon enough. This time was different, and China's large weighting in the emerging markets indexes pulled the entire asset class down.[6]

[6] All I wanna do here is reflect candidly on our thought process as we navigated a challenging year in emerging markets. (Congratulations if you've read this far and found ten Sheryl Crow song titles embedded within this article; you may be relieved to know that this was the last one.)

- Equity stock selection – Core. Our Core model slightly lagged the S&P 500, snapping a four-year winning streak against the index. In 2021, the Core model returned 27.9% including dividends, compared with 28.7% for the S&P 500; we trailed by 81 basis points. Chart 15 shows the individual stocks that were the most significant contributors to, and detractors from, performance against the index last year. The numbers in the chart denote the basis point contribution to performance relative to the S&P 500 index, rather than contribution to absolute return. Although we trailed the benchmark S&P 500 index last year, the Core model nonetheless outpaced our peer group of U.S. large-stock active managers for the fifth straight year, and for the seventh time in the past nine years.[7] Our 27.9% total return was about 140 basis points ahead of the 25.3% gain for the median manager in the peer group. Finally, it is worth noting that our ESG Sustainability overlays to the Core model produced slightly better returns than Core itself.

Chart 15: Core Portfolio Stock Selection vs. S&P 500

Contributors	Basis Points	Detractors	Basis Points
Applied Materials (+)	+92	Global Payments (+)	-98
Conoco Phillips (+)	+69	NVIDIA (-)	-83
Alphabet (+)	+54	Autodesk (+)	-48
Broadcom (+)	+42	Walmart (+)	-47
IQVIA Holdings (+)	+41	Visa (+)	-42
Walt Disney Co. (-)	+38	FedEx (+)	-40
Motorola Solutions (+)	+38	Tesla (-)	-32
Advanced Micro Devices (+)	+35	American Electric Power (+)	-30
Thermo Fisher Scientific (+)	+26	Akamai Technologies (+)	-28
Eaton (+)	+24	Stryker (+)	-27

Note: A plus sign indicates the security was held in the portfolio for at least part of 2021, while a minus sign indicates that the security was not held at all during the year.

Note: Alphabet includes both Class A and Class C shares.

Source: FactSet, Eastern Bank Wealth Management

- Equity stock selection – other models. Our Dividend Plus equity model smashed its benchmark, returning 30.3% in comparison to the 26.1% gain for the Morningstar Dividend Composite index. We focused Dividend Plus on “value” companies in sectors of the economy that looked poised to reopen in 2021, and our strategy paid off handsomely. Chart 16 shows the securities that had the largest impact on the Dividend Plus model against the Morningstar benchmark for the year. We take larger sector positions against the benchmark in this model than we do in Core (in part because we concentrate the portfolio in somewhat fewer individual stocks); last year, our sector positioning was a major contributor to return against the index, as our tilts to technology, financials, and health care paid off.

[7] More than 83% of all active large-cap equity managers lagged the S&P 500 index last year. It was not a good year for stock pickers.

Chart 16: Dividend Plus Stock Selection vs. Morningstar Dividend Composite			
Contributors	**Basis Points**	**Detractors**	**Basis Points**
Broadcom (+)	+82	Bank of America (-)	-37
KLA (+)	+77	Sysco (+)	-32
Accenture (+)	+66	Merck (+)	-31
Motorola Solutions (+)	+60	American Electric Power (+)	-30
PNC Financial (+)	+44	Kimberly-Clark (+)	-25
Eaton (+)	+41	Ameren (+)	-20
Paychex (+)	+40	Apple (-)	-18
Pfizer (+)	+39	TJX Companies (+)	-18
Home Depot (+)	+34	Johnson & Johnson (+)	-16
Microsoft (+)	+26	Lowe's Companies (-)	-14
Note: A plus sign indicates the security was held in the portfolio for at least part of 2021, while a minus sign indicates that the security was not held at all during the year.			

Source: FactSet, Eastern Bank Wealth Management

- Fixed income. We positioned fixed income portfolios last year to capture credit risk but avoid duration risk; in other words, we didn't want to expose portfolios to rising interest rates, but we did want to take higher yields associated with riskier companies. This posture created substantial value for our clients, as our fixed income portfolios held their value while the broader bond markets lost money last year.

All in all, 2021 was another outstanding year for investors who had the intestinal fortitude to stay fully engaged even when stock prices pushed into record-high territory. Our asset allocation navigated the pandemic and recovery exceptionally well. Our equity stock selection was superior to that of our peer competitors, but it could have been better against the S&P 500 index. Our focus on avoiding duration risk while taking credit risk in fixed income portfolios helped our clients avoid the pitfalls of that asset class.

We approach 2022 with hope for what can go right, but also with keen awareness that prices are high and much can go wrong. We begin anew each January at zero. We thank you for placing your trust in our stewardship of their financial assets, and we hope to see you all in the new year.