

JANUARY 2022

## The Wall Chapter 1: Inflation – The One Form of Taxation Imposed Without Legislation

---

When Will Smith was 11 years old, his father decided he needed a new wall in front of his shop. It would be an enormous wall- roughly 12 feet high by 20 feet long. The old wall was crumbling, and he was sick of looking at it, but rather than hire a contractor, he thought it would be a good project for Will and his brother, Harry. After his father did the demolition, Will remembers looking at that gaping hole in excruciating disbelief. He was certain there would never be a wall there ever again. Every day, for nearly a year, he and his brother would go to his father's shop to work on that wall. He made them do everything themselves- they dug the footing, mixed the mortar, and carried the buckets. They laid every brick by hand, using only a level (the one with the little bubble in the middle). To say that this was difficult labor would be a vast understatement (today, any kid or observing parent would probably call child protective services).

Will's father could have hired a mason, and the wall would have been completed in a day or two. So why make his two sons labor for a year to complete the same work? No matter how much they complained or how bad the weather was, he made the boys continue to toil. One day, when Harry and Will were in a particularly bad mood, their father heard them, came over, and grabbed a brick out of Will's hand. "Stop thinking about the damn wall! There is no wall; there are only bricks! Your job is to lay this brick perfectly, then move on to the next one and lay it perfectly. Don't worry about the wall; your only concern is one brick."<sup>1</sup>

You all know how much I love analogies, and this one is now up there with my favorites. It shows us that the difference between a seemingly insurmountable task, and

one that is doable, is merely a matter of perspective. What a great lesson for life; what a great lesson for business; what a great outlook as we forge ahead to 2022.

### Predictions for 2022

As Malcolm Gladwell defines in his book, a tipping point "is a threshold, critical mass, boiling point moment that leads to sudden, dramatic, radical change."<sup>3</sup> There is no doubt that the Covid-19 pandemic tipped our world and will be the catalyst for many more evolutions and revolutions in 2022. Here are just a few:

- 1. Artificial Intelligence (A.I) starts to consciously direct our lives (and we are ok with it).** Covid-19 forced us to accept the need for more automation and faster decisions for near-instant delivery. Pick any industry- food retail, healthcare, 5G networks, cybersecurity- A.I. will sit at the heart of these industries' logistics, operational models, and even core processes. A vast majority of tasks can be conditionally programmed around combinations of choices, making A.I. the perfect solution for faster, more efficient execution in these businesses. This holds especially true in financial markets, where Instinet (the system that matches market trades) now functions with 95% of all transactions and trades happening without human interactions.<sup>4</sup> As we've written about in these pages before, the fact that the market is now primarily run by algorithms has its advantages and its risks. It is also why a tour of the New York Stock Exchange is more like the tour of a T.V. set than seeing the raw example of pure capitalism it once exemplified. In 2022, more industries will be dependent on A.I. to do the base thinking for them, and we will



### By Michael Merlin, Founder of Merlin Wealth Management

Michael's focus has always been on demystifying financial, estate, investment, and philanthropic planning for his clients. With extensive experience in multi-generational planning and advisory techniques, as well as asset management, Michael leads MWM and its clients to partner together and create customized wealth plans that are steeped in the values and best practices of each family. Having built an institutional-quality asset management practice inside MWM, Michael and his team can even align their clients' investment plans with these same best practices.

---

## In 2022, more industries will be dependent on A.I. to do the base thinking for them, and we will be surprisingly comfortable with this dynamic...

---

be surprisingly comfortable with this dynamic, much like we've gotten so comfortable with social media infringing on our privacy and Amazon delivering our unmentionables to our doorsteps in less than a day. Soon, A.I. will be handling our medical records, making our purchase decisions, and unsticking our supply chains; and we will be happy about it. The leading companies in the A.I. space - Apple (MWM CORE, MWM INC), Meta (Facebook) (MWM CORE, MWM ERA), and Microsoft (MWM CORE, MWM INC), appear to be poised for a strong year in 2022, coming off of a year where they underperformed the S&P 500 Index for the first time since the financial crisis. Additionally, Nvidia (MWM ERA) is running away as the leader in semiconductor chips explicitly designed for A.I. and Metaverse applications. Nvidia was up +125.41% in 2021<sup>5</sup>, and we believe there is potential for more upside ahead for the company.

The biggest concern in the transition to more automation is the displacement of workers. The combination of A.I., automation, and robotics makes it inevitable that we will have factories in the United States running nearly human-free. We hope that this inevitable evolution will be another tipping point for reimagining workforce deployment and training in the United States. Low-cost labor in our country has been badly mishandled for decades: long hours, poor pay, and little to no life training or work skills. Our hope is that in 2022, more companies will follow the lead of Amazon (MWM CORE) and McDonald's and redefine the relationship between labor and employer around education and professional life development.

**2. The Federal Reserve Bank begins developing a "digital dollar."** Many people want to believe that the current stable of cryptocurrencies will become widely accepted to transact commerce across the globe. They point to companies like AT&T, PayPal, and Starbucks, who accept Bitcoin as a means of payment for products or services as foreshadowing of full adoption of these digital currencies by mainstream consumers and businesses. I don't see it this way.

Instead, I think the United States, the keeper of the world's currency, the U.S. Dollar, will launch

a tokenized dollar in 2022. The United States has blazed a path of innovation throughout its history. The Apollo space program to building the Internet, U.S. technological achievements have typically been carried out through a series of partnerships between the private and public sectors.

Launching a tokenized digital dollar is a logical and critical next step to future-proof the dollar and preserve its democratic principles in the future of money. In May 2020, Accenture and The Digital Dollar Foundation (a non-profit organization) partnered on the Digital Dollar Project to advance the exploration of a central bank digital currency. In their 50 page report presented to the Senate Banking Committee, the Project posed that, "a new technological age is unfolding, bringing with it the digitization of things of value that can be tokenized, programmable, and decentralized. Across the globe, governments and private entities are experimenting with tokenized commodities, contracts, legal titles, and, most critically, commercial and central bank digital currencies. This wave of digital currency innovation is still gaining momentum. The questions for the United States are what role it will play in this innovation and to what degree will its core values be brought to bear. We believe the United States should take a leadership role in this new innovation."<sup>6</sup>

Also, the digital dollar will be a more environmentally friendly currency than Bitcoin, which is now responsible for using more energy to manage and mine the currency than Google uses in a year to run its entire company!

**3. The truth about Facebook finally comes to rest. We stop blaming it for our own shortcomings.** Walter Cronkite said, "the profession of journalism ought to be about telling people what they need to know - not what they want to know." I, admittedly, don't have a Facebook (MWM Dynamic Core) account. Still, from what I've seen, there is no way to categorize someone's cat dressed in a Christmas sweater or thirteen pictures of the dolphin someone saw on vacation in Hawaii, as journalism by Cronkite's definition. In fact, nowhere in Facebook's mission statement do they claim to be journalists. Facebook was founded to be a place where people can connect casually. For those of us that went to college before the internet dominated our lives, we received a "face book" our freshman year which put faces with names so that you might have an easier time identifying a fellow classmate in the quad, in class, or at a party. 2 billion users later, Facebook has now been thrust into the negative spotlight, saddled with the impossible responsibility of metering its users' posts as fake, true, nice, or not nice. How did this become Facebook's cross to bear? Lumping Facebook in with Google, Amazon, or Apple for using people's personal

information for target advertising is fair. There should be better transparency when personal data is used for these purposes. However, if I log in to a Microsoft Teams meeting on my Dell Computer, using a Comcast high-speed internet connection, and in that meeting, someone spouts a hateful, racist diatribe, do I blame Microsoft, Dell, and Comcast? In 2022, the taunting and indictment of Facebook dissipate as we realize it is our personal responsibility to manage what we digest on digital platforms at an individual level.

**4. In 2022 China continues to pose a clear public threat.** The United States and China make up 45% of the global economy, with less than 15% of the world's population. In 2022 the tension between the two countries will become unbearable as the complexity of this strained relationship extends itself to government policies, trade, and companies' ability to work fluidly in both places. There can be no denying that China plays a key role globally across several areas: cyberattacks, economic scale (the largest automotive market in the world), natural resources purchasing, and military investments, just to name a few. In 2022 CEOs will need to make challenging decisions about how they handle China in the same way governments worldwide will be challenged again by China's aggressive and self-serving behavior. As we've written about in these pages, China's economy is built on a mountain of debt that makes it susceptible. The EverGrande bankruptcy is just the most recent evidence. With an economy that stands like a house of cards, will the United States and its allies be willing to yank one of those cards should China's predatory actions continue to hurt American companies and threaten the safety of American citizens?

## The U.S. Economy: A Picture of Resilience

If there is one lesson we've learned over the years, it is this: Don't underestimate the resilience of the U.S. economy and stock market. We've seen that theme time and again over the last two and a half decades, and the resilience is strikingly evident still. "When the Covid-ravaged economy contracted in 2020, it was just the 19th time since 1920 in which real gross domestic product declined year over year. Nine of those years came between 1930 and 1949, a result of the Great Depression or post-World War II demobilization."<sup>7</sup>

Some of our world's most significant innovations and disruptions occurred (or some may say were spurred)

by these market and economic setbacks. The Ford Motor Company, Hewlett Packard, and the Walt Disney Company are just a few of the pioneering firms catapulted to greatness during hard times. Their innovations transformed the way Americans lived at the time, much the same way as the innovations that have literally saved our way of life during the last two years. Today's names may be slightly different- Moderna, Pfizer, Tesla, Microsoft, Amazon, and Apple, to name a few- but the impact their resilience, innovation, and products and services have had on the world's population is equally as profound.

Thus, heading into 2022, it still feels like we are riding a wave of innovation and easy money provided by the government and the Federal Reserve Bank that some believe must come to an end. Headlines from market legends like Michael Burry (of Big Short fame), Jeremy Grantham, Leon Cooperman, and Stan Druckenmiller calling for an epic market crash are, to us, referencing a small portion of the market or sub-market that are ripe with speculators. Meme stocks and cryptocurrencies, which we've written about in the past, are certainly trading with no attention paid to the elements of a quality business.

However, we feel that there is a tale of two markets to be told. The former will, and probably should end with significant pain inflicted on stakeholders. On the other hand, those investors that still maintain a long-term focus on quality businesses have an opportunity to be handsomely rewarded in the coming year. Investors are generally taught that owning a concentrated portfolio of equities means taking on more risk, but that is not always be the case. In our experience, the apparent risk of holding a concentrated portfolio can be counterbalanced by owning high-quality investments. A portfolio focused only on the highest quality companies can potentially take meaningfully less risk than the market while generating greater long-term performance.

## Quality, Quality, Quality

"Data shows that owning financially superior and competitively advantaged businesses can offer a margin of safety in almost any market."<sup>8</sup> That is a core tenant of the Merlin Wealth Management Investment Discipline: "Consistent earnings growth is the primary driver of intrinsic value and long-term stock appreciation. Investing in businesses with exceptional earnings growth, driven by a sustainable competitive advantage, superior

---

**If there is one lesson we've learned over the years, it is this:  
Don't underestimate the resilience of the U.S. economy and stock market.**

---

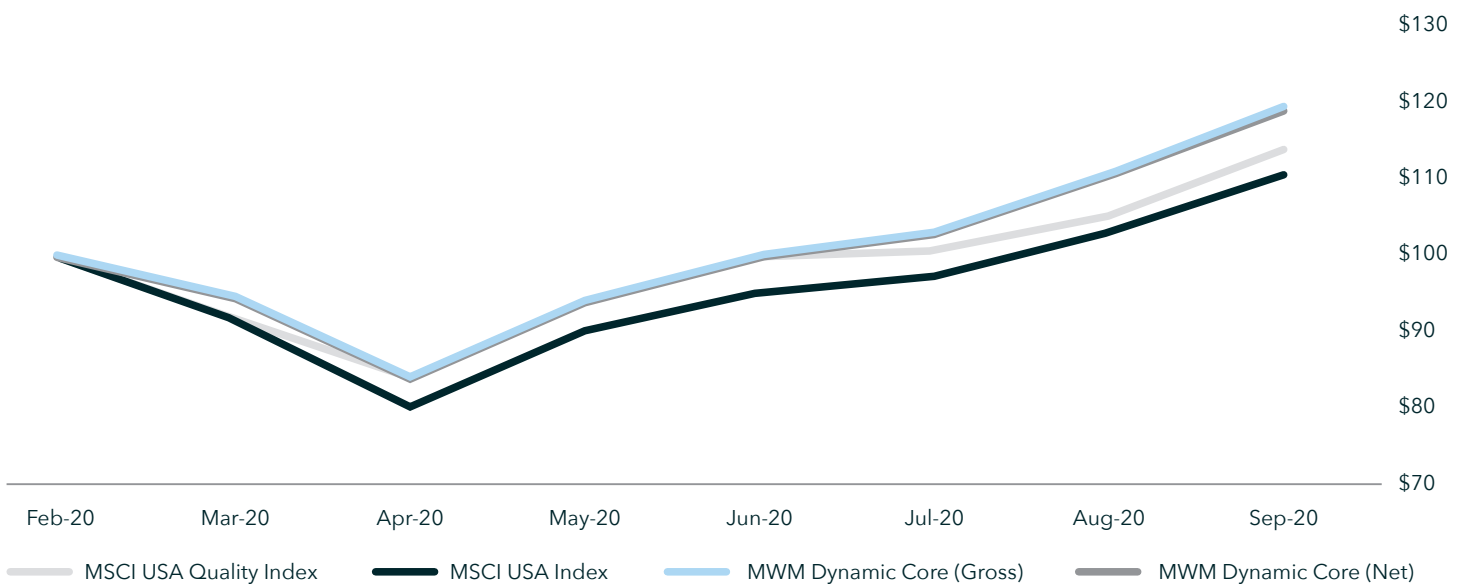
financial strength, proven management teams, and powerful products and services is the key to long-term investment success. Further, we hold the view that such exceptional companies not only have the potential to achieve outsized returns but are also inherently less risky. Their superior earnings stability and financial strength serve as a "margin of safety" that typically results in less volatility in declining markets as well."<sup>9</sup>

Characteristics like earnings power, financial stability, and competitive moats can allow companies to weather tougher times and can enable them to power through a crisis faster and stronger than competitors. By creating a concentrated portfolio of what we believe are the best

businesses in the world, we believe we have the potential to be well positioned to deliver sustainable, above-average earnings over the long term. Additionally, we believe that if we are headed into a period of market decline, these same companies will offer resilience amid the downturn.

Let's look at the performance of the MSCI USA Index, the MSCI USA Quality Index (a more concentrated version of the index that focuses on the top 20% to 30% of companies that have the highest return on equity, lowest financial leverage, and stable year-over-year earnings growth), and the MWM Dynamic Core Strategy during the Covid-19 Crisis:<sup>10</sup>

### Cumulative Growth of \$100



Source: GIPS Data and Bloomberg

Quality provided better capital protection and rebounded stronger than the broader market. We acknowledge that this data represents a short period of performance, with the drawdown and recovery occurring within an unusually compressed window. Still, we expect that MWM's higher bar for quality will continue to provide a clear path to compelling long-term outcomes.

### The Biggest Brick of 2022: Inflation

I purposely have not mentioned the Omicron variant of Covid-19 in the first chapter in our "The Wall" series of letters, as I am convinced that we are at the cusp of deescalating this virus from pandemic to endemic. On Friday, January 14th, Dr. Scott Gottlieb referenced a scientific study that confirms the Omicron variant as

much less severe than prior Covid variants. With 85% of the U.S. population vaccinated with at least one dose and millions more with antibodies from prior Covid infection, it is likely that future variants of the Covid-19 virus will begin to mimic the flu virus- unpleasant but not deadly.

So, if we remove Covid-19 as an exogenous risk factor for the markets and the economy, it is clear that the most significant risk to both in 2022 is inflation. Inflation is not a political issue; it is an issue that affects businesses, individuals, and entire sectors of our economy.<sup>11</sup>

"The Consumer Price Index starts 2022 in the 6.5 - 7.0% range, a level not seen since the 1980s. The consensus is that it will slow to 2.7% over the course of this year, but we think inflation will continue to run at the 4.0% level while supply chains remain strained. One former Federal Reserve official said that the current Federal Reserve is trying to

---

## Inflation is not a political issue; it is an issue that affects businesses, individuals, and entire sectors of our economy.

---

tell the market that they are now serious about inflation, but they are straining their credibility with each passing day since they should have gone cold turkey with Q.E. at the December meeting. He surmised that a 10 to 15% correction in the stock market would scare the current Fed to again stray from its price stability mandate. Ultimately, the Fed may decide to tolerate 3% or 4% inflation."<sup>12</sup>

Nonetheless, the Fed's recent hawkish turn has sparked volatility in equity markets, particularly in growth-oriented sectors such as technology and communication services. The question is whether or not this tightening cycle will end this equity bull market run?

Over the past 40 years, Fed tightening cycles usually coincided with periods also characterized by solid economic and corporate earnings growth. Such environments typically provide a strong underpinning for U.S. equity performance. "In fact, the average cumulative total return for the S&P 500 over the past six rate hike cycles was just over 21%, with an average tightening cycle lasting for less than two years."<sup>13</sup> Thus, while rising rates may contribute to temporary bouts of market volatility, many of the same conditions that create the necessity for higher interest rates also contribute to more robust corporate earnings growth. Strong corporate earnings support stock prices and earnings multiples, so it makes sense that after an initial "gut reaction" to rising rates characterized by sharp and indiscriminate selling of growth-oriented companies, those same businesses should maintain strong earnings growth in a stable economy and should therefore rally strongly into the second half of the year.

As we've communicated to many of you, our expectation is for a sharp but short-lived decline in both the stock and bond markets as a reaction to the end of accommodative Fed policy and benign inflation. Once investors, and the market, focus back on the business fundamentals, we expect quality growth businesses to produce solid earnings and revenue growth. As a result, their stock prices should be rewarded.

### In Sum

It's hard to imagine a more transformative year for America. Short-term factors have buffeted the economy since the onset of the Covid-19 pandemic in 2020. This year, long-term fundamentals should reemerge as the most important driver of economic and financial performance. [Excerpt from **Welcome to 2022: The Winds of Change**]<sup>14</sup>

*"First, the obvious: COVID and COVID-related rules should have much less influence on our lives twelve months from now than they do today. Vaccine or not, it seems like the Omicron variant is everywhere. People are testing positive, cases are at record highs, but hospitalizations and deaths are not, which is an important and positive difference between Omicron and past variants.*

*Second, President Biden's Build Back Better plan seems mired in the D.C. muck. The reluctance of moderate Democrats (or any Democrat in a tight reelection race) to vote for tax increases in an election year is growing by the day.*

*Third, the mid-term election in November could severely limit the ability of the Biden Administration to get much done in 2023-24. The markets tend to like gridlock in Washington.*

*Fourth, look for an economic tug-of-war between declining fiscal stimulus, rising employment, and recovering inventories. The excess demand (especially in Consumer Discretionary spending) from massive government spending will decline in 2022, while supply chains appear to be healing. While less-easy money could be a headwind for the market, the organic lift the economy should receive from more jobs and regularly functioning supply chains should offset the loss of additional fiscal policy interventions.*

*Fifth, the Federal Reserve is in a difficult spot. Its' most recent "dot plot" suggests four rate hikes this year (25 basis points each), and the futures market agrees. The key question is whether Fed policymakers have the guts. We think the Fed will only raise rates twice this year, so we'll bet on the "under."*

*Sixth, it's important to watch profits, which are at an all-time high. We still expect strong profit growth in 2022, but well below what we saw in 2021. Remember, some of Corporate America's powerful performance last year was due to temporary government spending programs. Meanwhile, lower unemployment, and a lower participation rate could mean higher wages take a slice out of corporate earnings. We are carefully monitoring how inflation (labor and raw materials) is affecting our portfolio companies, and continue to favor businesses with capital light structures and pricing power."*

In short, after a stimulus-fueled year that had the S&P 500 Index making 70 new closing highs, this year will be more of a grind.

**"Play Every Match Like It May Be Your Last"** [Excerpts from "The Blink of an Eye" by Rabbi Elliott Cosgrove. Park Avenue Synagogue]

*"On Rosh Hashanah, the Jewish New Year 5782, the Rabbi of New York City's Park Avenue Synagogue delivered a "who shall live, who shall die" sermon several friends thought I should read. The sermon encompassed two chilling stories that illustrate the fragility of life and make you ask "Why?" and "What if?" In the first story, a rising college senior and member of that congregation was in a car accident in Chicago. The accident was so severe that he had to be taken from his vehicle with the "jaws of life." Miraculously, the young student escaped with only bruises! Regardless, he was taken to a nearby hospital for an MRI to ensure there was no concussion, which proved to be the case. However, the MRI, unexpectedly, detected a rapidly growing brain tumor that would have soon become inoperable, threatening that young man's chances to survive. The student was operated upon and was in the Rabbi's congregation in September. If the student had not been in the accident, it is unlikely he would still be alive.*

*In the second story, two weeks after the accident in the first story, a rising college junior, also in Chicago, was*

*in his car driving when a stray bullet hit him. The bullet severed his spinal cord, from which there could be no recovery. Three days later, that young student lay paralyzed in a hospital bed, unable to breathe without a ventilator and able to communicate "yes" or "no" only by blinking his eyes responding to an alphabet board. With his family and friends at his bedside, he signaled his mom by blinking that he was ready to die."<sup>15</sup>*

How can anyone make sense of these two events, where such a narrow margin determined who lived and who died. "In the first instance, were it not for the accident, the tumor would not have been discovered, and the student probably would have died. In the second, if the student had taken an extra second to tie his shoelace, fumbled for his keys, or taken a call on his cell phone, he would still be alive!"<sup>16</sup>

"Play every match like it may be your last," was how Novak Djokovic, perhaps the greatest tennis player ever, noted in an interview this year at the U.S. Open in New York City. "The blink of an eye" is what the Rabbi tells us is the difference between life and death. Novak tells us not how we want to die but how we want to live. In 2022, hopefully, we can all live the way we want, without restrictions, as none of us need to be reminded that we should take nothing for granted.

---

**In 2022, hopefully, we can all live the way we want,  
without restrictions, as none of us need to be reminded that  
we should take nothing for granted.**

---



[rcm.rockco.com/merlin](http://rcm.rockco.com/merlin)

3560 Lenox Road, Suite 1100 | Atlanta, GA 30326

Date approved 2/1/2022

1. [Will](#) by Will Smith (Author) with Mark Manson, November 9, 2021
2. [22 Predictions For 2022, And Why This is Malcolm Gladwell's Tipping Point Year](#) by Michael Gale, January 1, 2022, [www.forbes.com](http://www.forbes.com)
3. [The Tipping Point: How Little Things Can Make a Big Difference](#) by Malcolm Gladwell, January 7, 2002
4. [22 Predictions For 2022, And Why This is Malcolm Gladwell's Tipping Point Year](#) by Michael Gale, January 1, 2022, [www.forbes.com](http://www.forbes.com)
5. [www.bloomberg.com](http://www.bloomberg.com)
6. US Senate Committee on Banking, Housing and Urban Affairs, *"The Digitization of Money and Payments"* June 30, 2020 Testimony of Hon. J. Christopher Giancarlo
7. [Lesson of the Century: Don't Underestimate the Resilience of the U.S. Economy](#) by Kenneth G. Pringle, December 27, 2021, [www.barrons.com](http://www.barrons.com)
8. [The Quality Quotient in Long-Term Alpha](#), November 16, 2021, [www.polencapital.com](http://www.polencapital.com)
9. [Taking the complex and making it simple](#) by Merlin Wealth Management at Rockefeller Capital Management, August 2021
10. [The Quality Quotient in Long-Term Alpha](#), November 16, 2021, [www.polencapital.com](http://www.polencapital.com)
11. CBS News, Face the Nation, Dr. Scott Gottlieb, January 16, 2022
12. First Trust Economics Blog by Brian Wesbury and Bob Stein, December 20, 2021, [www.ftportfolios.com](http://www.ftportfolios.com)
13. [How do stocks typically perform when the Fed raises interest rates?](#) By Jim Baird, Eric Dahlberg, Tricia Newcomb, January 20, 2022, [www.plantemoran.com](http://www.plantemoran.com)
14. [Welcome to 2022: The Winds of Change](#) by Brian Wesbury, Robert Stein of First Trust Advisors, January 3, 2022, [ww.advisorperspectives.com](http://ww.advisorperspectives.com)
15. ["The blink of an Eye"](#) by Rabbi Elliott Cosgrove, September 7, 2021, Park Avenue Synagogue, [www.pasyn.org/sermon/blink-eye](http://www.pasyn.org/sermon/blink-eye)
16. [Ron Baron's Baron Funds 3rd Quarter Shareholder Letter](#) by Sydnee Gatewood, October 27, 2021, [www.gurufocus.com](http://www.gurufocus.com)

**Important Information.** The information contained herein is solely for informational and discussion purposes only and does not constitute an offer to sell or a solicitation to buy any security or investment product mentioned herein. The views and opinions expressed are the opinions and views of Rockefeller Capital Management's Merlin Wealth Management and are as of the date herein.

The information and opinions herein should not be construed as a recommendation to buy or sell any securities, to adopt any particular investment strategy, or to constitute accounting, tax, or legal advice.

Forward-looking statements, including those presented here, are inherently uncertain, as future events may differ materially from those projected, and past performance is not a guarantee of future performance. No investment strategy can guarantee a profit or avoidance of loss. The information and opinions presented herein have been obtained from, or are based on, sources believed by Rockefeller Capital Management to be reliable, but Rockefeller Capital Management makes no representation as to their accuracy or completeness. Although the information provided is carefully reviewed, Rockefeller Capital Management cannot be held responsible for any direct or incidental loss resulting from applying any of the information provided. This material may not be reproduced or distributed without Rockefeller Capital Management's prior written consent.

Rockefeller Capital Management is the marketing name for Rockefeller Capital Management L.P. and its affiliates. Investment advisory, asset management and fiduciary activities are performed by the following affiliates of Rockefeller Capital Management: Rockefeller & Co. LLC, Rockefeller Trust Company, N.A. and The Rockefeller Trust Company (Delaware), as the case may be. Rockefeller Financial LLC is a broker-dealer and investment adviser dually registered with the U.S. Securities and Exchange Commission (SEC). Member Financial Industry Regulatory Authority (FINRA); Securities Investor Protection Corporation (SIPC). The registrations and memberships above in no way imply that the SEC has endorsed the entities, products or services discussed herein. Additional information is available upon request. Products and services may be provided by various affiliates of Rockefeller Capital Management.

© 2022 Rockefeller Capital Management. All rights reserved. Does not apply to sourced material.