2022

Investment Commentary

withum
WEALTH MANAGEMENT

2021 Review

We hope this letter finds you healthy and fresh off another holiday season.

2021 might be remembered for vaccine rollouts and administration, a “sort of” return to normalcy, supply chain woes, a changing of the tides with regards to future Federal Reserve policy and inflation headwinds. As we look to 2022, we want to highlight several top-of-mind concerns and how these may affect your investments in the months and years ahead.

2022 Outlook

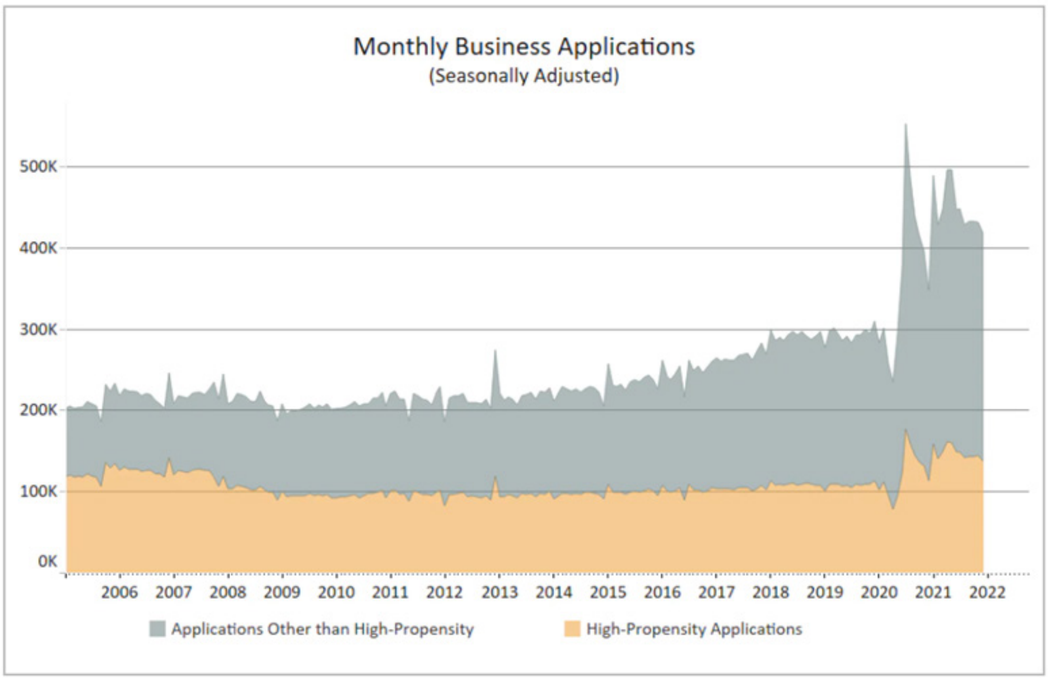
TIGHT LABOR MARKET + SUPPLY CHAIN ISSUES = INFLATION

When we think about portfolio positioning, we look ahead to what the future may hold and devise a strategy to take advantage of that landscape. One of the largest headwinds in the second half of 2021 was rising inflation, which we believe will continue into 2022.

While many forecasted a surge of price increases last summer due to pent-up demand and year-over-year comparisons with the 2020 recession, many economists and market pundits did not foresee inflation staying this high for this long. Fundamentally, inflationary pressures should be expected due to the immense fiscal and monetary policy stimulus that was implemented to combat COVID and the lockdown-induced recession of 2020. With more dollars created, the value of our current dollars erodes. What many were not expecting, however, is that the supply chain crises would continue as long as they have. No one could have predicted the Evergiven container ship getting stuck in the Suez Canal, but with shipping and delivery times delayed and still elevated consumer demand, we had a perfect storm of factors that led to the highest inflation the country has seen in 40 years.

Recent data has shown that the savings rate has come down to normal levels and stimulus has waned which should return the “pent-up” nature of last years demand shock to more normal levels. As we continue to learn to live with COVID, supply chains should improve and adapt to function closer to full speed. What was once believed to be a “transitory” phenomenon may stick around a bit longer.

COVID has pulled forward many trends — we spend more time on screens, we shop more online, and workspaces and methods for conducting meetings are more flexible. COVID has also brought about a surge of new business applications. During one of our darkest moments, with millions of jobs lost and nowhere to go, America's talented individuals and entrepreneurial spirit shined bright. This however has made it hard to staff openings in certain industries like retail, hospitality, manufacturing, and construction.

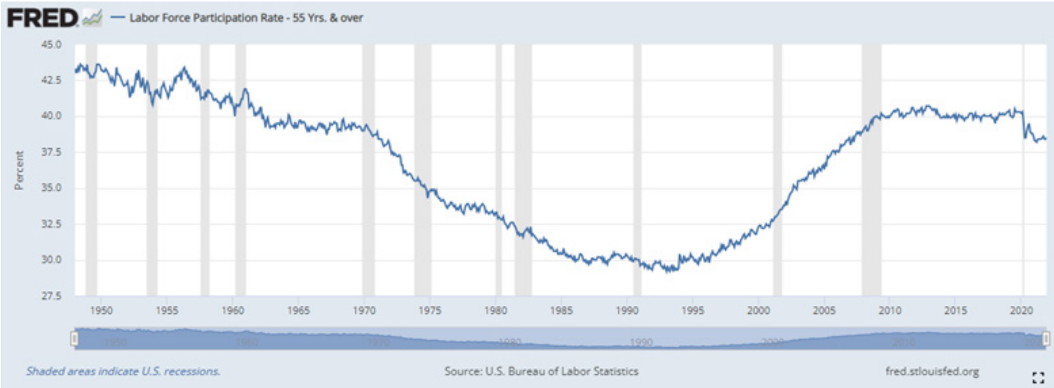


Source: US Census Data

Monthly Business Applications boomed post-COVID and remain elevated.

Source: U.S. Bureau of Labor Statistics

Quit Rate at record highs.



Source: U.S. Bureau of Labor Statistics

55 Years and Over Labor Force not returning to work.

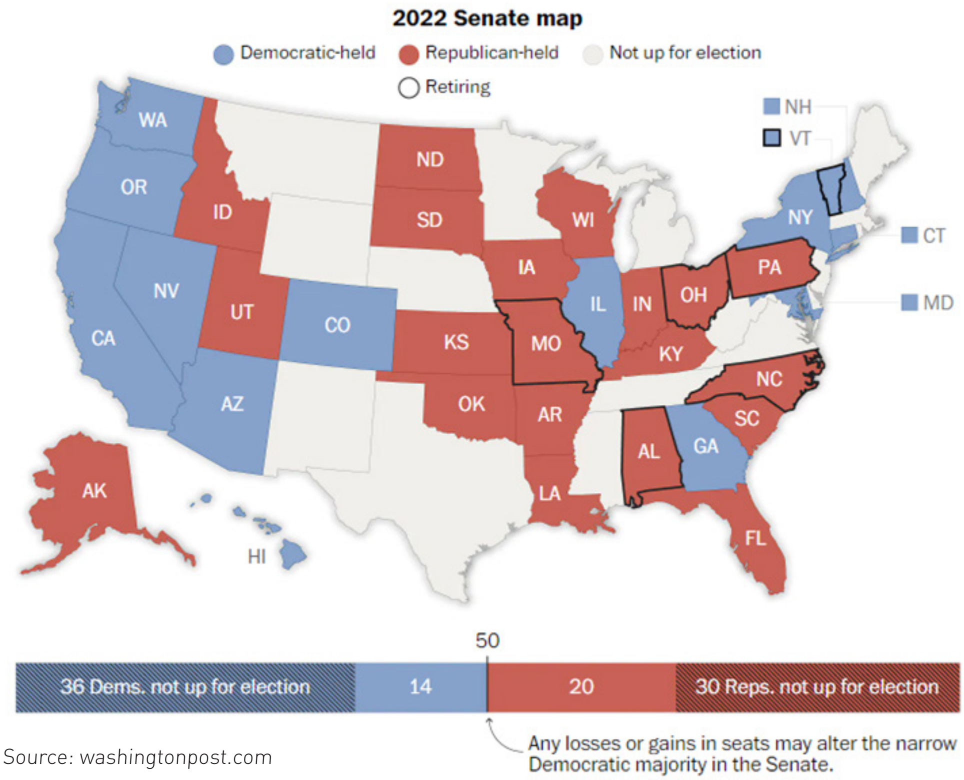
"Help Wanted" signs are becoming commonplace in nearly every store. Not only have many more people started their own businesses, but Americans are quitting at the highest rate since the statistic started being measured in 2000. While nearly every segment of the workforce saw a major drop-off in people leaving the workforce the Baby Boomer generation is the one area that has not come back to work. Given the stock market's success and positive impact on retirement assets, coupled with the increased risk of going into a crowded office setting, this cohort is hanging up the cleats at a perhaps faster rate than before. Others may simply be burnt out. 60minutes even had a segment on what they dubbed "The Great Resignation" and highlighted a woman who, yes, had bills to pay, but was "just too burnt out" to continue working her job. She wanted higher pay and more flexible work conditions and found them elsewhere.

On the surface, the good news is that job openings are also at the highest level since 2000, with more job openings than people looking for work! The problem is that many jobs are either lower paying, or in the aforementioned areas that people do not want to work in right now given higher risks and exposures to COVID. Eventually companies need to attract workers somehow, and generally that comes through increased pay. Wage growth from the lowest earners has grown faster than highest earners since the 2020 recession. This is generally good for wealth equality in the long run but can impact inflation negatively. Wage increases are "sticky" meaning they are not easily undone, like pent-up demand or supply chain issues that we touched on earlier.

Fiscal and Monetary Policy Changes Ahead

Between artificial booms in demand, supply chain backlogs and unusual employment phenomena, we expect inflation to be an economic headwind longer than initially was believed. The Federal Reserve has expressed similar thoughts and has changed from their ultra-accommodative stance. Over the last several Fed meetings, it was announced that they would not only begin to reduce their stimulative asset purchases, but subsequently accelerated that slowdown and even began the discussion of reducing their balance sheet, or what is referred as "balance sheet runoff". This, coupled with a more aggressive than anticipated interest rake hiking schedule, caused market and interest rate volatility to close out 2021 that has already showed signs of continuing into 2022.

The Fed is projecting three rate hikes in 2022, however before inflation ran hot all fall, the Fed expected no rate hikes in 2022. Higher interest rates can be a headwind for ultra-high growth companies, many of which were popular "story" stocks (Zoom, Peloton, etc.) like we've written about in the past. The good news is that historically, markets can rise as interest rates also rise, up to a certain point. Based on historical data, a negative correlation between interest rates and stock markets (interest rates rise and stocks fall) might not develop until interest rates are north of 3%. In other words, we believe there is room for the market and economy to continue growing for the time being. If this headwind continues to strengthen, targeting undervalued areas of the economy that are less impacted by higher rates could be beneficial to portfolios. Dividend oriented companies are also a natural hedge against inflation as historically, dividends have grown faster than the rate of inflation.



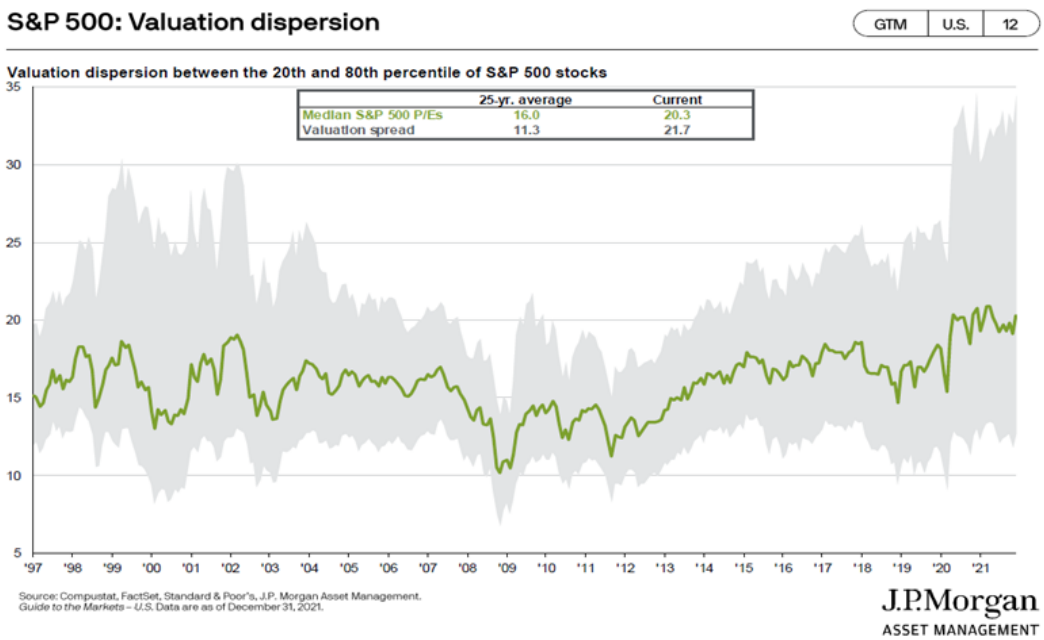
Source: *washingtonpost.com*

On the fiscal side of our 2022 outlook, we have midterm elections this fall. Structurally, midterm results tend to favor the opposing party of the President. There are more republican seats up for relection in 2022, however given the Senate is split 50/50, we expect republicans to regain control, and possibly even gain control of the House based on the outcome of some recent gubernatorial races. With Biden still in office for at least two more years, this could mean gridlock once again. Gridlock is something we, as citizens, get all too frustrated with, but fortunately for markets and the economy, this allows big businesses to invest without the threat of sweeping legislative changes.

Market Bifurcation

Ultimately, while gridlock may be good on the fiscal side, monetary policy shifts could lead to more volatility. The start of 2022 has seen a massive rise in interest rates like Q1 2021. This led tech stocks to lag the market while value-oriented companies led the charge. Since the Great Financial Crisis in 2008/2009, there have been global, coordinated accommodative monetary policies adopted by central banks which have led to incredible valuation dispersion among companies.

Interestingly, the gap between high valued and low valued companies is the widest since the technology bubble in 1999 and 2000. This fall, while mega cap technology companies were climbing and keeping the S&P 500 index afloat, the average stock in the Russell 1000, a broad large cap index, was down over 20%. This is not healthy for the markets and the issue may resolve itself if there is a significant shift in interest rates that lead to tech company valuations coming back to earth.



Source: J.P. Morgan Asset Management

Closing Thoughts

We believe the volatility experienced this fall and so far in 2022 is here to stay and may accelerate this coming year. A notable trend of consumer and investor sentiment deteriorating could have negative effects on the economy, however it could also serve as a contrarian signal as it has many times in the past. Investors can still be successful in volatile times as opportunities arise and markets fall, only to rebound just as quickly. Looking under the hood and investing in companies with stable cash flows at reasonable valuations while avoiding "story" stocks will continue to anchor our portfolios.

We wish you all a healthy and prosperous 2022 and as always, if you have any questions, comments or concerns, please let us know.

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Need More Information? Please do not hesitate to contact a member of the Withum Wealth Management Team with any questions or concerns:

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