

Market commentary notes

Monthly call notes
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Wealth
Management

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“Sixty years ago I knew everything; now I know nothing; education is a progressive discovery of our own ignorance.”

Will Durant (Nov. 5, 1885–Nov. 7, 1981)

Summary: December — finishing on a high note

The last four months have been rocky for our markets. The year had its ups and downs but mostly ups. In December, all of the major stock indexes were up—with the S&P 500 up 4.48%, Midcaps and small caps up a fraction more. The All Country ex-US index was also up 4.13%. This, despite Omicron, I think shows the resilience of the global economy. On the other hand, the investment grade bond index was down a little again—to finish the year down 1.29%. Commodities were up again in December to finish the year up 40.35%—mostly due to oil’s recovery.

Global stock indexes

Total Index	December %	YTD %	1 year %	2020 Est PE
S&P 500	4.48	28.71	28.71	29.3*
S&P Mid Cap	5.08	24.76	24.76	31.1
S&P Small Cap	4.53	26.82	26.82	Negative
FTSE All REIT	9.60	41.30	41.30	
MSCI All Country xUS	4.13	7.82	7.82	
MSCI Emerg Mkt	1.88	-2.54	-2.54	

Source: Morningstar as of Dec. 31, 2021. Estimated PEs are trailing 12-month values from S&P Dow Jones Indices, based on Operating Earnings, as of Feb. 26, 2021. Figures are provided for comparisons over time. * S&P 500 PE ratio as of Dec. 31, 2021 based on trailing 12-month earnings. <https://www.wsj.com/market-data/stocks/pe/yields>. Forward PE is 21.5 <https://www.yardeni.com/pub/stockmktperatio.pdf> Forward estimate for midcaps: 16.0. For small caps: 15.1.

Fixed income and alternatives

Total Return Index	December %	YTD %	1 year %
Bloom Agg Intermed	-0.12	-1.29	-1.29
ICE BofA US Convertibles	-1.17	3.87	3.87
S&P GSCI	7.59	40.35	40.35
Bloom US Corp HY	1.87	5.28	5.28

Source: Morningstar as of Dec. 31, 2021.

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Sector performance: With the S&P 500 up more than 27%, you can count on all the sectors having done well. However, some still did better than others. On a 12-month basis the best performing U.S. LC sectors were: energy (+46.5%), real estate (+44.3%) and financials (+34.3%). The worst three were still okay: utilities (+15.8%), consumer staples (+16.5%) and industrials (+20.1%). The last of these shows that just because Congress passed an infrastructure bill after much negotiation, doesn't mean those stocks necessarily benefit disproportionately. If you recall, the bill was under discussion for nearly a year. Its size changed from \$6 trillion to \$3.5 trillion over 10 years to half of that over five to seven years. In the meantime, the prices of industrials stocks probably priced in what was known about the bill's prospects and implications. Our emphasis on financials with some energy as well have paid off this year. [https://eresearch.fidelity.com/eresearch/markets_sectors/sectors/sectors_in_market.jhtml]

Commodity and food price changes, current month and YTD

Copper	5.1%	26.8%
Lumber	31.7%	31.1%
Cotton	1.2%	21.1%
Sugar	1.1%	21.4%
Coffee	-3%	77.2%
Wheat	-1.1%	20.3%
Corn	3.6%	22.4%
Oil	15.3%	55.4%

Source: <https://tradingeconomics.com/commodities>, Jan. 1, 2022

What else can we say about 2021? Crypto-currencies made a splash again. Meme stocks such as Gamestop (GME) demonstrated that a group of unorganized amateur investors could put a costly short squeeze on professionals such as Citadel.

Lessons and observations for the start of 2022

- Real growth may be slow in 1Q due to Omicron, picking up later in the year.
- The consumer seems ready to spend, however, which may be good for consumer discretionary and technology in particular.
- The Fed is likely to let intermediate rates float upward and by late spring might start raising short-term rates. That suggests weakness in bond prices (prices down, yields up) as well as a possibly rocky stock market quarter. That might be especially negative for debt-heavy sectors without a lot of discretionary purchases, such as utilities, and also for communications and real estate. This could also lead to a bit of appreciation for the U.S. dollar, which means that foreign investments will face a headwind (again).

- Corporate earnings may normalize after a poor 2020 and recovery in 2021. "Normal" could mean earnings increases of 8 to 10%. How will the market react? It ought to take this in stride as something to be expected. However, when we begin to see lower earnings increases, you may have some investors disappointed and rocky stock market performance.
- The employment picture, already tightening, may tighten further, leading to rising wages.
- Inflation, due to supply problems, may fade a bit over the course of the year, but inflation due to labor cost increases could replace it. We may have a year of 4–6% inflation.
- Energy prices have more or less normalized. Absent a political upheaval, they may stay around where they are now—between \$60 and \$75 dollars per barrel. That should be decent for energy sector earnings.
- Some version of Build Back Better may pass, but between that and the bipartisan infrastructure bill, it looks to me like the stock market impact is fully priced in. I wouldn't expect much of a bump from these in 2022.

U.S. Economy

New jobs

We haven't had a new release yet for December, so I can't say anything new about jobs. I can reiterate my previous observations that job creation this year has ranged from solid to extraordinary. That suggests that the trends in rising real wages are likely to continue a little longer and may fuel a little more inflation in 2022. It should also fuel healthy growth in consumer demand, which means continued economic expansion because consumption accounts for about 70% of our GDP. [<https://www.bls.gov/news.release/empsit.nr0.htm>]

U.S. PMI statistics

The U.S. Manufacturing PMI for mid-December, even with Omicron, was 57.8—a strong positive reading and similar to that of the last three months. Down a little from the 60-readings during the summer. [Trading Economics, PMI statistics 1 Jan. 2022] Our Services PMI came in at 57.5, also strong and about the same as the last three or four months. [Trading Economics, <https://tradingeconomics.com/country-list/services-pmi>] Capacity Utilization is around 76.8, where it has been more or less since May. [<https://tradingeconomics.com/united-states/capacity-utilization>] That is significant in two ways. First, this is well below the level where you'd expect to see demand-pull inflation, meaning businesses can easily meet demand currently, employment issues aside. Second, it means we have capacity to grow, which is always reassuring.

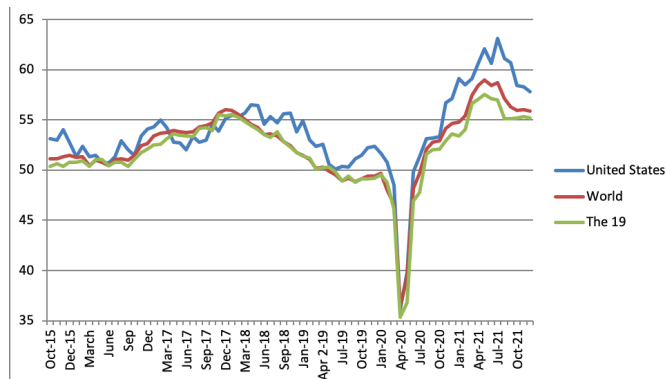
Holiday sales

For the end of the year, it looks like pent-up demand won over anxiety and Omicron: retail sales from Nov. 1 to Dec. 24 were up 8.5% over last year. Ecommerce sales, which were 20.9% of the total, were up 11% while physical store sales were up 8.1%. [<https://www.reuters.com/markets/us/us-holiday-retail-sales-rise-85-online-shopping-booms-mastercard-2021-12-26/>] That raises the prospects for the recovery of the all-important U.S. consumer in the first quarter of 2022. Good for consumer discretionary and technology sectors in particular.

International Manufacturing PMI

Every month I look at global Purchasing Managers Index (PMI) statistics. In December, 35 of 38 countries reported PMIs above 50, with the three, Brazil, Egypt, Mexico, just barely below. The average across the 38 countries was 55.9—basically constant over the last three months. For the 19 major countries that we track, two—Brazil and Mexico—were below 50 while the other 17 came in above. Their average, 55.2 is also about constant over the last three months—despite Omicron. I think this suggests a fundamental strength returning to the global economy. [<https://tradingeconomics.com/country-list/manufacturing-production>]

Here’s our updated graph of Manufacturing PMI’s:



Source: Author’s calculations based on published PMI statistics, as of Jan. 1, 2022.

Table summary

Region	Manu PMI	Last month	12 months ago
U.S.	57.8	58.3	57.1
19 majors	55.2	55.3	53.6
38 world	55.9	56.0	54.7
EU	58	58.4	55.2
China	50.3	49.9	53

Source: Author’s calculations based on published PMI statistics, Jan. 1, 2022

2022 market estimates

It’s time to outline what I think 2021 might bring us as underpinnings to our investment strategy. This, of course, follows a truly unprecedented year in 2020. I outline these below and follow with some implications.

Estimates for 2022

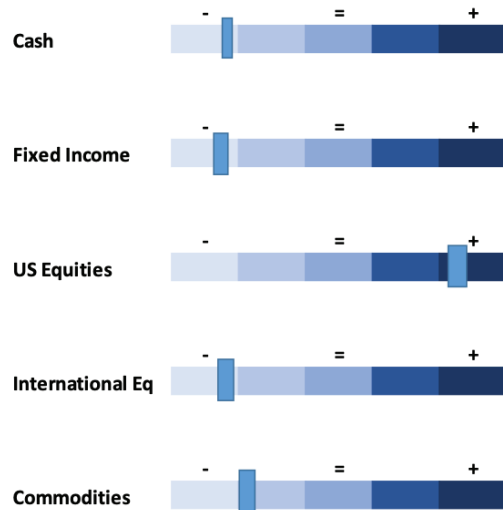
Category	Our estimates (GTAS, Y-Gen)
U.S. Real GDP	3.5%
Inflation	5%
Unemployment	3.4%
Fed Rate	50 bp
USD FX	Trade-weighted appreciation 3%
Global GDP	+3.1%
U.S. Equity (S&P)	S&P 500 +9% Ending approx 5200+ Sectors: Fin, Tech, Cons Discretionary EPS +8-10% SC>MC>LC
Developed Intl Equity (USD)	+9%
Emerg Mkts Eq	11% unhedged basis
U.S. Bonds – Yield Curve	10 yr 2.2%. Total ret -3%
U.S. Bonds – Credit	Hi Yield, bank Loans 0%
Real Estate	+3%
Gold	-5%
Commodities	Agric and base metals +10%
Oil	\$65 to \$75 eoy

Market and investment implications

The U.S. economy is recovering and even showing signs of overheating. I expect that 2022 will give us more of the same. Ex-international incidents, for example with respect to Ukraine, we should have a good global recovery this year. The U.S. is positioned to take better advantage of that than most of the rest of the world. I expect China to falter a bit due to their internal debates over the degree to which they want capitalism and export promotion to dominate internal consumption and wealth distribution. At its core that is a short-term versus long-term debate. Consumption promotion is needed for long-term growth because they are increasingly saturating international demand for their goods, but would slow short-term growth. From an investment standpoint, this implies that we will still favor the U.S. for equities. On the income side, preferreds are risky if longer term rates rise. Intermediate bonds are risky for the same reason. We'll probably do more short-term inflation protected bonds and wait out interest rate increases before buying more intermediate bonds.

GTAS Allocation Chart

GTAS Asset Allocation Dashboard



(+/-) represents our group's views over a 6- to 18-month time horizon concerning tilts relative to our strategic positions.

+ implies an overweight in that asset class.

= implies a weighting similar to our strategic weight.

- implies an underweight.

Index definitions

Past performance is no guarantee of future results. You cannot invest directly in an index.

Bar Agg Intermed — Bloomberg Barclays U.S. Aggregate Intermediate Total Return index is composed of the BarCap Government/Credit Index, the Mortgage-Backed Securities Index, and the Asset-Backed Securities Index. The returns for the index are total returns, which includes the daily reinvestment of dividends.

Bar U.S. Corp HY — Bloomberg Barclays U.S. Corporate High Yield Total Return index includes all fixed income securities having a maximum quality rating from Moody's Investor Service of Ba1, a minimum amount outstanding of \$100 million, and at least one year to maturity.

FTSE All REIT — FTSE Nareit All Equity REITs Total Return index is an index of publicly traded Real Estate Investment Trusts (REITs) that own commercial property. All tax-qualified REITs with common shares traded on the NYSE, AMSE or NASDAQ National Market List are eligible. Additionally, each company must be valued at more than US\$100 million at the date of the annual review.

ICE BofA US Convertibles — ICE BofA U.S. Convertible Bonds Total Return index tracks the returns of U.S.-traded convertible debt issued by companies with a significant presence in the United States. The index is composed of various combinations of convertible structure and credit quality, e.g. it includes investment-grade, speculative-grade, and non-rated issues. The returns for the index are total returns, which include reinvestment of dividends.

MSCI All Country xUS — MSCI All Country World Index Ex USA NR is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. The index consists of 48 developed and emerging market country indices. The returns for the index are total returns, which include reinvestment of dividends.

MSCI Emerg Mkt — MSCI Emerging Markets NR index consists of 26 developing economies including Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and the United Arab Emirates.

S&P 500 — S&P 500 Total Return index is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenues are based in the U.S.; it's often used as a proxy for the U.S. stock market. Total Return (TR) indexes include daily reinvestment of dividends.

S&P GSCI — S&P GSCI Total Return index is a composite index of the commodity futures. It represents unleveraged, long only investments in commodity futures that are broadly diversified.

S&P Mid Cap — S&P MidCap 400 Total Return index is comprised of stocks in the middle-capitalization range, and includes approximately 10% of the capitalization of U.S. equity securities. Total Return (TR) indexes include daily reinvestment of dividends.

S&P Small Cap — S&P SmallCap 600 Total Return index consists of 600 domestic stocks chosen for market size, liquidity, and industry group representation. Total Return (TR) indexes include daily reinvestment of dividends.



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