Investment Watch

4th Quarter, 2021

What Now?

After two long years of a global pandemic, three years of soaring equity markets, 15 years of low inflation, and 35 years of declining, still ultra low, interest rates, what will the future bring? Normally we rely on our history and our past experiences to peer into the future, but the pandemic blindsided the world. With no experience to rely on, this unseen and unknown enemy has blurred our vision and baffled Baby New Year!

- ⇒ Will the equity markets continue soaring to new heights or come back down to earth?
- ⇒ Will recent price explosions result in an inflationary spiral or will these price surges dissipate when global supply chains untangle?
- ⇒ Will the Fed's plan to raise short-term interest rates in 2022 stall US growth or will Americans' voracious spending propel the economy forward?
- ⇒ Will the extremely transmissible Omicron variant infect the world and prolong the pandemic or will it end it by leaving a blanket of immunity in its wake?

Forecasters' view of the future is blurred by this unimagined global condition and so too are split on the answers. We have no template for a pandemic economic recovery. But the past is clear, and as recapping the old year is part of our New Year's tradition, it may calm our spirits and prepare us to face this uncertain future.

2021 marked the **third** year of outsized stock market gains (Chart upper right). The S&P 500 index gained a whopping **26.9%** in **2021**, capping three years of amazing returns. The S&P 500 is a capitalization weighted index comprised of the 500 largest US companies which is dominated by trillion dollar tech giants - Apple, Microsoft, Google, and Amazon. Boosted by the pandemic, these behemoths' powerful punch pushed the S&P 500 to **70** daily record highs during the year, second of all time. The S&P 500 index beat the other major indexes only for the 6th time ever.

Corporate profits drive stock prices. After a 34% decline during the 2020 pandemic lockdowns, rip-roaring corporate profits skyrocketed 45% this year. Companies learned how to keep more money in their pockets after expenses with a record-breaking 2nd quarter net profit margin of 13.1% as tallied by Factset.

Much of last year's financial gains were powered by the American consumer who represents nearly 70% of the US economy. Flush with pandemic stimulus cash, low interest rates, easy money policies, and rising home values, the American consumer was the engine driving both the global economy and the US GDP upward. The Conference Board estimates 5.6% growth for 2021 and

projects 3.5% growth in 2022. The consumer, with record durable goods order purchases, has clogged US ports with one-fifth more container volume than pre-pandemic levels, disrupting global supply chains.

Inflation surged 6.8% in November, the highest since 1982. Excluding food and energy, the core CPI was up 4.9%, which itself was the sharpest pickup since 1991. Driving this decade-high inflation is excess demand, worker shortages, the pandemic, and a burgeoning money supply. The Fed is doing its part by cutting their bond purchases to temper the growth in the money supply. But with Americans eager to spend and ongoing worker shortages due to COVID, higher inflation will be difficult to tame. Bonds lost about 1.5% last year. The Fed rate hikes in 2022, along with the prospect of higher inflation, will continue to put pressure on bond prices which go down when interest rates rise.

The highly-mutated, hyper-contagious Omicron variant is spreading like a wildfire. Thankfully, research shows that cases are milder. Even though Omicron may carry a lower risk of hospitalization, the sheer number of cases will cause hospitals to again be overwhelmed. Omicron has now supplanted the more virulent Delta as the leading variant in the US. The New York Times explains that Lab Studies suggest that "*antibodies produced during Omicron infection protected against Delta. If Omicron dominates in the real world, that could lead to a less dire future*".

The triple threat of a tenacious pandemic, Fed rate hikes, and surging inflation creates a murky outlook for investors. But a strong economy, flush consumers, low unemployment, and rising wages bode well for long-term investors. Lofty expectations of an extension of last year's outsized gains won't be realized, but we would all be thankful if 2022 is a more normal year.

December 31, 2021

ĒkonBenefits
YOUR TRUSTED PARTNER
4940 Washington Blvd.
St. Louis, MO 63108