# Investment Review & Outlook

January 2022

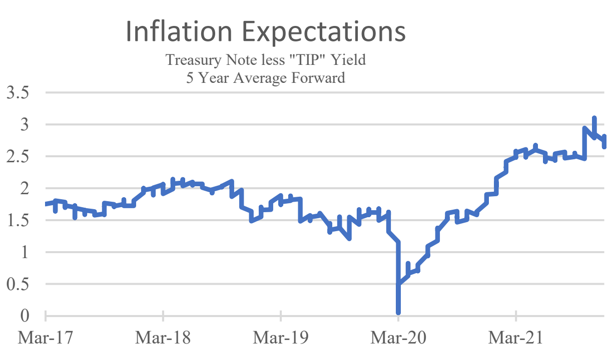
## Review

The US equity market delivered solid results for the fourth quarter and the full year. Asian markets and emerging markets trailed their western counterparts by a significant margin. In general, markets are transitioning to expectations of slower, more sustainable economic growth.

| Real GDP | | | | | | |
|---|---|---|---|---|---|---|
| | FY 2021 | FY 2022 | 1Q:22 | 2Q:22 | 3Q:22 | 4Q:22 |
| United States | 5.7 | 3.7 | 1.5 | 4.0 | 3.5 | 2.5 |
| Canada | 4.6 | 3.6 | 3.5 | 3.5 | 3.5 | 3.0 |
| Japan | 1.8 | 3.6 | 6.5 | 3.0 | 1.5 | 1.0 |
| China | 7.8 | 4.9 | 5.0 | 7.0 | 5.5 | 5.5 |
| Euro Area | 5.2 | 4.6 | 2.0 | 6.5 | 5.0 | 3.5 |
| United Kingdom | 7.2 | 4.5 | 3.5 | 3.6 | 2.4 | 2.4 |

Source: JP Morgan, Global Data Watch, January 7, 2022

The Federal Reserve has abandoned its use of the word “transitory” in reference to the rate of inflation. Given that the Consumer Price Index has spiked to north of 6% that makes a lot of sense. But you must keep in mind that inflation is a rate of change measurement.




Source: Bloomberg, Dec 31, 2021

The Fed will reduce its purchases of Treasuries and Mortgage securities by $30 billion per month with the “quantitative easing” program to be completed in March 2022. We can expect at least three Fed Funds interest rate increases beginning in March 2022, taking the over-night interest rate to at least 1% by year-end. More increases are expected in 2023 with the over-night interest rate going to at least 1.65%. We think that the economy can continue to withstand the pace of those modest increases.

## Global Markets

The Real Estate (REITs) and Technology sectors led the S&P 500 higher during the fourth quarter. Communication Services and Financials were the weakest performers.

The Treasury yield curve has begun to steepen in response to the Fed initiating a plan to end their large-scale asset purchasing program. The upward move in short-term interest rates is widely expected to begin in March.

The US Dollar was strong against a basket of 10 major currencies during the second half of 2021.

**Equity Market Performance**
**To 31-Dec-2021, in US Dollars**

| | 4th Quarter 2021 | 12 Months 12/31/2021 |
|---|---|---|
| MSCI World Index | 7.8% | 21.8% |
| | | |
| EMU | 3.7% | 13.5% |
| France | 7.1% | 19.5% |
| Germany | 0.8% | 5.3% |
| Switzerland | 12.8% | 19.3% |
| United Kingdom | 5.6% | 18.5% |
| Japan | -4.0% | 1.7% |
| Pacific, ex Japan | -0.1% | 4.7% |
| EAFE | 2.7% | 11.3% |
| USA | 10.0% | 26.5% |
| Emerging Markets | -1.3% | -2.5% |

Source: Morgan Stanley Capital International,
Total return, dividends less withholding tax reinvested

 *Continued on page 2* 

*Continued from page 1*

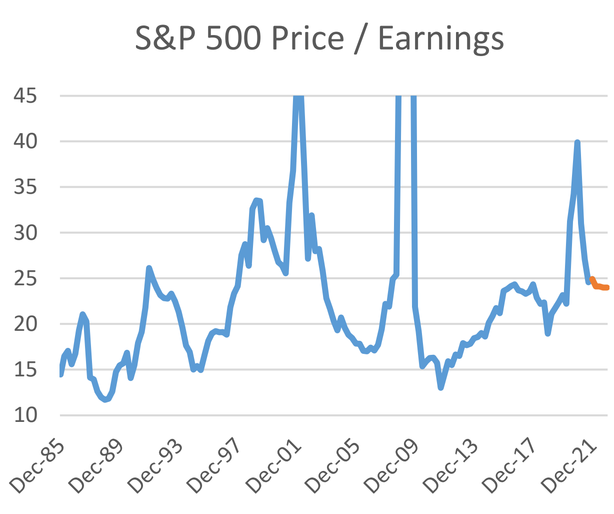
# Outlook

We expect 2022 to be a transition year, following the dramatic fiscal and monetary policy moves seen in 2020 and 2021. Economic growth can be expected to continue, but at a decelerating pace. Money supply growth has peaked. Household savings rates are coming off record highs but remain elevated mitigating the impact of the reduction of fiscal stimulus. Supply chain issues remain but should become increasingly manageable.

| Standard & Poor's 500 | | | | |
|---|---|---|---|---|
| | Annual Earnings | %Change Y-o-Y | Price/ Earnings | Year-end Price |
| Dec-13 | 100.20 | 15.8% | 18.5 | 1848.36 |
| Dec-14 | 102.31 | 2.1% | 20.1 | 2058.90 |
| Dec-15 | 86.53 | -15.4% | 23.6 | 2043.94 |
| Dec-16 | 94.55 | 9.3% | 23.7 | 2238.83 |
| Dec-17 | 109.88 | 16.2% | 24.3 | 2673.61 |
| Dec-18 | 132.39 | 20.5% | 18.9 | 2506.85 |
| Dec-19 | 139.47 | 5.3% | 23.2 | 3230.78 |
| Dec-20 | 94.13 | -32.5% | 39.9 | 3756.07 |
| Dec-21e | 191.25 | 100.0% | 25.0 | 4766.18 |
| Dec-22e | 209.79 | 9.7% | 24.0 | 5035 |

Source: Standardandpoors.com Dec 31, 2021, SlateStone Wealth

The market correctly anticipated the dramatic increase in S&P 500 earnings over the course of 2021. But the growth rate will slow as we return to more normal levels of economic activity. We think the S&P 500 can support a price / earnings ratio of 24X over the course of 2022.




Source: Standardandpoors.com Dec 31, 2021, SlateStone Wealth

The resilience of consumers in the face of a severe purchasing power squeeze from rising inflation reflects strong gains in wage growth and healthy household balance sheets. Supports from pent-up labor demand as well as excess savings should remain in place and facilitate a rebound in GDP next quarter, once the current Omicron wave subsides.

The pickup in global industrial activity is concentrated in Asia, the source of much of last year's supply crunch. The regional bellwethers of Mainland China, Korea, and Taiwan all posted significant gains to their manufacturing output in December.

What if the rise in inflation persists beyond the next few months, leading to the dreaded "wage price spiral"? This is not our current thinking, but of course it could happen. It would not be attractive, but the Fed knows how to tame an inflationary spiral. They would drive interest rates higher sufficiently to cause a recession. Recent movement in the yield curve does not suggest that this is a meaningful risk. While shorter maturity yields have increased reflecting the coming end of "quantitative easing" long dated interest rates are little changed. This suggests that a "wage price spiral" is a diminishing risk, rather than an increasing one. It is widely expected that the Fed will begin to increase the Fed Funds rate beginning in March and continue to increase in 0.25% increments through 2024.

We remain positive in our outlook for the health care sector, as a function of modest Price / Earnings ratios, accelerating research and development expenditures, and ageing demographics on a global scale. Although the democratic majority in Congress increases the political threat, it is offset to some degree by the power of the "big pharma" lobby. We have increased our exposure to the "value" sector in recent weeks, seeking a more defensive posture.

On the fixed-income side, our conservative approach to bond investments in the context of credit quality remains in place. The yield curve has steepened over the course of recent months. "Real" inflation adjusted interest rates are negative across the globe. We do not expect to make any "real" money in bonds but will endeavor not to lose any.

Jupiter, FL
January 2022
(800) 773 9282