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MARKET COMMENTARY March 28, 2022

Dow Jones Industrial Avg 36,338.30
2021 (YTD) +20.95% 4th Qtr. +7.87%

Standard and Poor's 500 4766.18
2021 (YTD) +28.68% 4th Qtr. + 11.02%

Wise Advice for 2022? – "It was never my thinking that made big money for me. It was always my sitting. Got that? My sitting tight." Jesse Livermore – Early 20th century stock trader and speculator.

Strong finish - In spite of the physical and psychological drag resulting from the persistence of the COVID virus during 2021, the economy and the stock market exhibited surprising resistance to the feared economic impact of the virus. Stock market results easily surpassed initial projections for the year capped off by an impressive eleven percent gain in the fourth quarter. However, as the year ended investor and consumer sentiment began to falter due to increasing evidence of surging inflation. The evidence of pricing pressure was widespread ranging from big ticket items such as real estate, cars and trucks to the more mundane items such as food, gasoline and heating oil. Mask mandates continued to dampen business activity, especially in the restaurant, travel and entertainment industries. Few economic experts foresaw the strength of the economy, which registered growth of seven percent annualized in the fourth quarter after an anemic 2.3 percent gain in the third quarter. Results in the final quarter benefited from what was perceived to be an economic crisis, the well-publicized supply chain event. Images of ships at anchor off west coast ports waiting weeks to off load cargo from China and other Asia countries. Inadequate domestic trucking capacity also proved to be a bottleneck. It seems apparent consumers accelerated their holiday purchases out of concern they would be unable to find their desired goods in time. This artificial shopping rush helped provide a welcome boost to holiday spending.

Inflation Looms - During the quarter, stock and bond markets were beginning to feel the impact of rising interest rates as the Fed was forced to concede inflation was not transitory as they had been suggesting for some time. This necessitated they take direct action to alleviate the growing inflationary pressures. The fact they waited so long to act means the task will take longer and be more difficult to achieve. What kind of actions can be expected? The main policy change they will initiate is a series of interest rates increases. In theory, these increases will slow economic growth and eventually allow inflation to subside. Recently, the Federal Reserve (the Fed) revealed its intention to increase the federal funds rate one quarter of one percent at each of their next six open market committees. The "fed funds rate" is the rate the Fed charges banks to borrow money that in turn influences the rate banks charge their borrowers. This filters through to borrowers of all stripes, including government at all levels; businesses of every size; and consumers big and small. Many consumers took notice when mortgage rates began to push higher after years of relative stability.

Although stocks ended the year on a high note, the numbers were somewhat misleading because the majority of stocks lagged the averages by a significant margin. In fact, many small capitalization funds did quite poorly in the latter part of the year. Leadership, which only numbered about a dozen stocks, accounted for approximately 30 percent of the market's gain, and those stocks were all mega-large cap stocks. Technology stocks were at the top of the list. Many individual investors adopted a defensive stance as soon as the new year began leading to a pronounced drop in stock prices during January. As has been the case for some time, stock valuations remain rich, yet corporate earnings have helped to justify the price gains. Considering the mounting economic challenges, investors can be expected to be more cautious in their approach.

Dog chasing Tail – The "easy money "policy pursued by the United States Treasury has been a continuation of the lax policies of the previous two administrations. This "easy money" came into being as the Treasury bought securities from banks and added the securities to its own portfolio. The worrisome detail is they didn't pay for these securities with their own resources. They paid for them with new money, not hot off the press, but as an addition to the national debt. The simple objective was to stimulate the economy by encouraging more lending by keeping interest rates exceedingly low. This approach succeeded in benefiting borrowers and risktakers. Some success was achieved as can be seen in the returns generated in real estate and the stock market over the past few years.

Unfortunately, this bias toward growth resulted in a revival of inflation. Inflation concerns became more evident to consumers during this quarter as heating oil and natural gas prices began their seasonal upward swing, yet it became readily apparent with prices in many sectors of the economy. Energy prices began their persistent rise almost as soon as President Biden took office. During his first days in office, he signed a wave of executive orders, which included canceling the XL pipeline and blocking new drilling leases on federal lands. The administration has continued to limit any fossil fuel production while emphasizing electric vehicle expansion as part of his green energy crusade. There is one main flaw to his vision, the transformation will require an inordinate amount of time. There is a huge power gap between what the new, intermittent sources (wind and solar) will generate and the existing capacity provided by fossil fuels and nuclear. What will provide the base power when the intermittent sources are idle – no sun or wind? How much will it cost to fund this conversion? Stifling the oil and gas industry before more progress is made in this transformation means consumers will be forced to cope with higher energy prices for the foreseeable future.

Investor Challenges – Although the economic backdrop at the beginning of the year was positive, it appeared moderate growth would continue. Investors had reasons to be optimistic, but they had to have some hesitancy because of the growth of inflation and the war that the Russians started in Ukraine. The bond market has provided little competition for stocks for quite some time. However, the tide may be changing, especially considering recent Federal Reserve pronouncements. Investors who currently have holdings of bond funds must remember as interest rates rise, bond prices will fall. Long maturities will be hurt the most, so the best way to protect principal is to shorten maturities. The safest approach is to focus on short maturities (two years or less) and avoid long-term bond funds altogether.

The stock market is also susceptible to added risk with the resurgence of inflation and war in Europe dominating the headlines. Valuations have been at the upper end of their historic range for the past few years, so given this stressful backdrop now is a good time to be cautious. On market weakness, there may be attractive opportunities for establishing long-term positions, but it may also make sense to realize some profits from the gains accrued over the past few years. If some of the proceeds are kept as a reserve for future purchases, they can be expected to provide a gradually increasing income stream based on the Fed's announced rate increases over the balance of the year.

Tax Planning – With the dreaded tax filing deadline less than a month away, investors should regard their completed tax return as a useful planning tool for the current year. Try to determine if there are ways you can manage your income numbers, your tax preparer may be able to provide you some suggestions.

We Can Help - If you have any questions about your investments or have other financial concerns, we are here to assist. If you require more detailed guidance, such as financial planning, Carie Carney, who is a Certified Financial Planning Professional (CFP®), can create a plan tailored to your needs.

As spring approaches and greenery reappears, we hope things settle down in Europe and the economy remains on its growth trajectory. Enjoy the better weather. JML