Quarterly Market Review

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Hey bud! Just thought I'd drop by and hang out for a bit. Hope you don't mind…

Remarkable resilience leads to record flows and record highs.

Stocks defiantly rose to all time highs in the fourth quarter as investors shrugged off the emergence of a new COVID variant, a hawkish Fed policy pivot, and political party in-fighting that held up passage of an infrastructure bill. The 11% advance by the S&P 500 was the best quarterly gain for the year and capped off a third straight year of solid double digit gains for the market. In the midst of a global pandemic which threatened lives and economic output, stocks have risen 21% on average for the past 3 years. In 2021 alone, stocks averaged a record high every 4 days. Market resilience was definitely aided by negative real yields which made the stock market the only viable alternative for investors to grow their wealth, regardless of risk tolerance. Indeed, equity inflows for 2021 exceeded the combined amount of flows for the past 19 years.

Omicron crashed Thanksgiving dinner but not the markets.

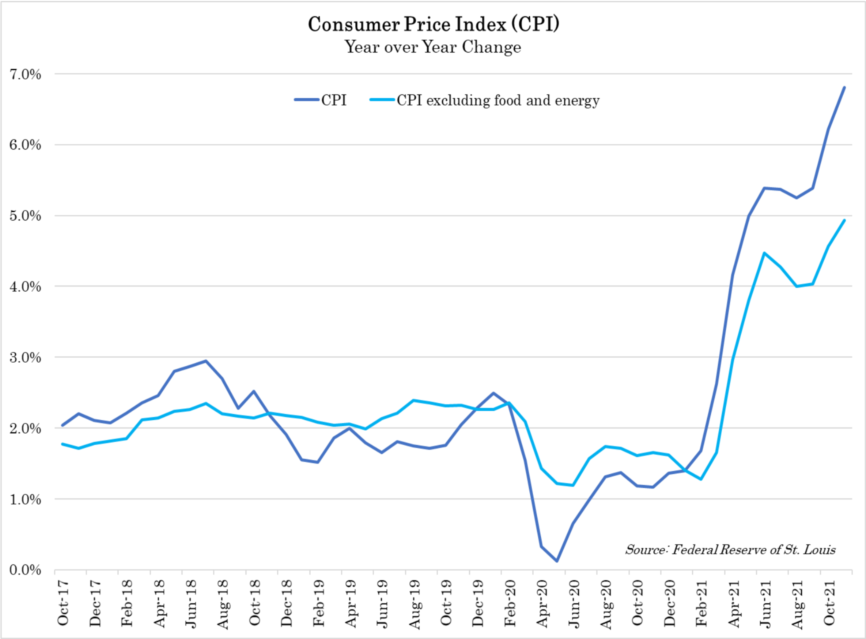
The fourth quarter started strong with a nearly 7% rise in October as evidence that the Delta variant of COVID-19 was waning sparked confidence in investors that the pandemic may be approaching an end. Unfortunately, the Omicron variant made a surprise appearance at Thanksgiving dinner sending the market in a retreat that erased all of November's gains. Despite the highly transmissible nature of this new variant, data showed that the symptoms observed in Omicron patients were much milder. By year end, the CDC had reduced the isolation period from ten days to five for those infected and experts suggested those infected would increase herd immunity from the more severe Delta variant. These developments, along with commitments from world leaders to avoid the types of lockdowns seen in 2020, encouraged investors to continue pushing stocks higher in December.

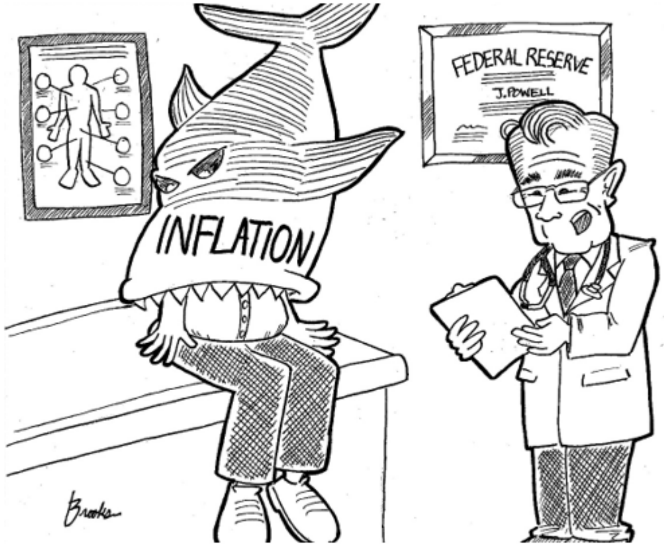
Market Performance

Index Returns (%)	1M	3M	12M
S&P 500	4.48	11.03	28.71
S&P MidCap 400	5.08	8.00	24.76
S&P SmallCap 600	4.53	5.64	26.82
Factor Returns (%)			
S&P 500 High Beta	3.51	8.30	40.95
S&P 500 Growth	2.48	13.37	32.01
S&P 500 Value	7.04	8.31	24.90
S&P 500 Momentum	2.73	7.29	22.79
Top 3 Sector (%) 2021			
Energy	3.08	7.97	54.64
Real Estate	10.23	17.54	46.19
Financials	3.33	4.57	35.04
Bottom 3 Sector (%) 2021			
Industrials	5.33	8.64	21.12
Consumer Staples	10.29	13.31	18.63
Utilities	9.64	12.93	17.67

Inflation observed in the economy and in the Fed's stance.

As the two-year fatigue of discussing COVID began to set in, inflation became the topic du jour in the fourth quarter. November's Headline CPI report showed the largest increase in nearly 20 years (+6.8% YOY). Other economic reports confirmed the persistence of rising prices though some of these concerns were offset by the also persistent signs of solid consumer spending and an improving labor market. In response to these numbers, the Fed made an increasingly hawkish pivot first announcing plans to start tapering its $120 billion bond buying program by $15B a month only to double that planned amount in its December meeting. The newly reappointed Fed Chair Powell retired the word "transitory" as an adjective used to describe inflation and the rest of the Fed gang implied agreement as the majority forecasted three rate hikes in 2022.





Alright, the data confirms that this problem isn't resolving itself. We may need to operate quickly…

Corporate optimism rises amid 'Peak Supply Chain' narrative.

Also helping the markets was the notion that supply chain issues are potentially peaking. Companies in the S&P 500 overwhelmingly reported earnings growth ahead of estimates even with the easy bar of 4Q2020 numbers taken into consideration. The tone of earnings calls changed from pessimistic acknowledgment of supply chain headwinds to optimism for profit margin tailwinds as labor and cost inflation showed signs of fading. Key industries such as automotive, semiconductor, and transport services reported production levels returning back to or near pre-pandemic levels. Retailers discussed healthier inventory levels along with increased success in hiring additional staffing. Consumers appreciated the extra capacity as evidenced by reports that holiday spending rose 8.5%, the largest annual increase in over 17 years.

Things ARE different this time…eventually.

The familiar investment refrain that "Markets don't go up forever" has failed to ring true for the past decade. During this time, markets have benefitted from an era of low rates and both fiscal and monetary stimulus. The Fed's recent tapering decisions, projections for rate increases, and the inability of government to agree on long-discussed legislation shows that past favorable factors may no longer portend future favorable returns. Last month's gains being led by the bond-like/defensive Staples, Utilities, and Real Estate sectors showed that investors are taking a defensive positioning heading into 2022. As the pandemic begins to wane or at least become a manageable endemic, economies will have the tailwind of lower costs to drive future earnings growth. However, investors would be wise to adopt a cautious posture to a market that has already priced in ten years' worth of record optimism.