WHERE DO WE GO FROM HERE?

The final quarter of 2021 was quite strong with the S&P 500 rising 11% and posting a remarkable 28.7% gain for the year. Much of this success can be attributed to impressive corporate profits. A year ago, the consensus expectation was for a 22% increase in earnings per share on the S&P 500 in 2021. Assuming fourth quarter estimates are accurate, growth for the year will be around 45%, stronger even than the 40% rise in 2010, after the global financial crisis. **Much of this success is due to the unprecedented financial support during the pandemic**. Governments around the world spent more than $10 trillion to keep consumers flush with spending money and businesses afloat.

As expected, fixed income markets generally produced negative returns as interest rates rose. Ten-year Treasuries fell by 3.6%. **Keeping maturities short proved beneficial and most likely will again in 2022.**

Leadership in the stock market has become extremely concentrated, which is a mild warning flag. Goldman Sachs reported that **the five biggest stocks in the S&P 500 account for more than half of the gain since April**. There is even an argument that there has been a correction for the average stock. **Near the end of the quarter more than 200 of the companies in the S&P 500 were down at least 10% from recent highs, with close to 90 off at least 20%. On the positive side many of the most speculative areas in the investment world have corrected sharply without panicking the broader market.** Our strong preference is for market breadth to broaden once again in 2022. If this happens stocks could record another strong year.

On November 5th the House of Representatives passed a five-year, $1 trillion bill to repair and upgrade America's aging infrastructure, which represents an additional $550 billion in new spending and is a positive for the US's future competitiveness. The bill allows for private investors to join the government's efforts, which could both expand total spending and impose more financial discipline.

Other important developments in the quarter surrounded the Federal Reserve (Fed). President Biden nominated Jay Powell to serve a second term as chair of the Fed, opting for continuity as inflation proves less transitory than originally expected. Importantly, **the Fed now expects to end its massive monthly bond buying program in March and to have three rate hikes in 2022 to combat rising inflation.**

The economy should probably handle the removal of Fed support since fundamentals are strong. Household balance sheets are in terrific shape. Americans have added $28 trillion in net worth since the end of 2019. In late December the Atlanta Fed GDPNow model estimate for real GDP growth in the fourth quarter of 2021 is 7.6%.

Returns in 2022 will most likely be dependent on inflation. If the Fed's actions fail to bring the current elevated figures down, interest rates could rise, negatively affecting risk assets. Supply chain disruptions and higher labor costs may ding profits in 2022. Estimates for the S&P 500's operating margins stalled out in October making the upcoming earning season more precarious.

We felt it was prudent to raise a little cash late in the fourth quarter due to the narrowing stock market rally, increased daily volatility and the Fed's plan to tighten monetary conditions in 2022. Since the financial crisis the stock market has experienced long periods of calm trading conditions interspersed with sharp bouts of volatility. This cautious move may be a bit premature if the market broadens out as hoped, but **our goal is to reduce portfolio volatility and have some cash to redeploy during the next pullback.**

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