

Weekly Market Insights

December 13, 2021

Confidence returns!

Equity markets moved back to their record setting pace this past week. The Dow gained 4.0%, the S&P rose 3.8% and the NASDAQ gained 3.6%. We have been writing for some time now that the primary driver of global equity markets has been, and remains, the progression of the COVID pandemic. This past week did a lot to prove our point. Not much changed from the week prior. Investors still believed that the Federal Reserve, along with the European Central Bank (ECB), are on the verge of tightening monetary policy, and that inflation is accelerating. Both conditions are often trigger points for investors to bail out of the equity market. That didn't occur. The reason, of course, is the good news concerning the Omicron variant. We will write more about inflation in the economic portion of this paper, but the fact that COVID trumped economic statistics argues for a positive market outcome.

Economics

Although we wrote earlier that COVID trumps all other concerns in investors' minds, the threat of inflation remains a very important factor. We have written a number of times about this particular economic cycle and why it is so difficult to predict.

Most of the world's economies were in the midst of an upswing when COVID struck. This interrupted the cycle and economies rapidly fell into recession. Normally, a recession is caused by one of a number of reasons (i.e. Central Bank tightening or the economy over-heating). This was not the case. What does this mean for the current bout of inflation? The current rise in inflation is primarily

caused by a shortage of supply. This is not surprising and has been a common cause of inflation in the past. What is different is there is plenty of spare productive capacity. How can there be excess demand while there is spare capacity? The cycle did not run its course, primarily caused by repetitive COVID-induced disruptions. Clearly, a lot depends on the course of COVID. Alas, no one really knows what the future holds, but, as COVID recedes, supply chains will resuscitate, distribution channels will free up, and supply will come back, ultimately relieving inflationary pressures.

Another interesting phenomenon has occurred during this interrupted economic cycle. It is within the employment cycle. Although employment is rebounding, it appears as if many people have dropped out of the employment base. This, of course, begs for an explanation, and scholars are working on it.

Another truly interesting observation is when polls query people how they think the U.S. economy is going, they are inclined to respond quite negatively. Then, when asked how their own finances are, they are very positive. Although this seems strange, perhaps it shouldn't be surprising. During election cycles when voters are asked what they think of Congress as a whole, their ratings are usually very low. However, when asked about their own congressional representatives, their ratings are very high. One explanation may be that individuals rate their position in reality while macro judgements are made from headlines. This interesting observation may be the reason consumer spending has held up.

Weekly Market Insights (cont'd)

Two explanations have been offered so far to explain the labor market complications. The first is that many people were unfulfilled in their jobs, both financially and professionally, and the second is that many have decided to retire early. The hope is that most will return. The dissatisfied workers may find the jobs they aspire to are not available to them, and the early retirees may discover that they miscalculated and really cannot live the life in retirement they hoped for. It is all quite interesting.

Conclusion

Nothing happened this past week to alter our view. Indeed, it was reinforced. Over time, the economy should continue to grow modestly, and inflation should slow. Overall, this can be an excellent environment for equities, but, as always, we are selective and mindful of valuations and growth sustainability.

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