BULLS&BEARS

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First Quarter 2022

2021

The S&P 500 was up 15% at midyear 2021 on optimism about the new administration, economic momentum, rising earnings, low interest rates, and relatively quiescent inflation. The challenges facing the market in the second half of 2021 unfolded gradually. Surging CPI and PPI numbers set off inflation alarm bells late in the spring. The supply-chain situation erupted into a full-blown crisis during the summer. In the fall, the Fed abruptly pivoted to a much more restrictive monetary policy via accelerated QE tapering and pledged rate hikes in 2022 and subsequent years.

Investors in 2021 were willing to let broad-based midyear gains ride into year-end, creating market momentum that padded returns even as challenges mounted. All these concerns -- rising inflation, persistent supply-chain challenges, labor scarcity, and a much more hawkish Fed – remain in place at the start of 2022.

After the market returns more than 20% in a 12-month span, as the S&P 500 did in 2021, investors might assume that a 'tired' market underperforms its average in the following year. Yet for all years since 1980 following a 20%-plus total-return year, the S&P 500 has delivered a better-than-average 11.7% total return. From the post-WWII era to now, the average gain on the S&P 500 for all years following a 20%-plus gain year is about 14%. We look for the S&P 500 in 2022 to be positive. Given rising interest rates, inflation, a still challenging supply-chain situation, and what is likely to be a very uncivil mid-term election, our expectations are for a mid- to high single-digit total return on the S&P 500, even as we anticipate an 'interesting' 2022 for stocks (i.e., high volatility).

Mid-Term Years

Of the four years in a presidential term, the second year (the mid-term election year) has been one the worst for investors. Since 1980, returns in the second year of a presidential term have averaged 5.6%, compared to average returns of 14.4% and 15.8%, respectively, in years 1 and 3. Why? The likely reason is uncertainty. Investors favor continuity, and a mid-term election offers a real opportunity for a change in direction, whether its fiscal policy, antitrust philosophy, or a certain regulatory focus. We note that incumbent parties typically lose seats in mid-term elections, and even the loss of a few Democratic seats in either the Senate or the House could tip the chamber to the Republicans. Currently, President Biden's approval rating is low. According to the latest CNN/SSRS poll, President Biden has a net negative approval rating of -9 points on the economy, which is lower than the -4 point ratings for both President Obama and President Trump. The odds for a Republican-controlled House are currently 5-1. But a lot can happen over the next 12 months.

Policy Pivot

Desiring to communicate better with the public, the Fed almost overshares its intentions. That made its recent policy pivot remarkable. After spending months preparing the markets for the onset of reducing its monthly asset purchases in November, officials gave short notice they likely would double that pace. That increase was announced in mid-December, along with accelerated projections for the first hike of the fed funds target range. A quarter-point hike could arrive as early as March, with possibly two more through the end of 2022. That's a considerable jump—as much as 75 basis points higher than September's dot plot. Even if economic growth is slowed by the omicron variant, the Fed's concerns about inflation should be enough to keep tightening on track.

As the Fed and many other central banks around the globe have begun to tighten their monetary policy, the risk of a policy error is rising. Though there are many other risks facing the markets such as Covid-19 and inflation, a monetary policy mistake has stepped to the front of the line.

Please contact us at 1-855-829-7192 if we may be of assistance.

Market Indicators

12/31/21 Year-to-Date Change	
S&P 500	28.71%
NASDAQ	22.18%
Russell 2000	14.82%

Interest Rates	6/30/21	12/31/21
10-Year Treasury Note	1.47%	1.51%
3-Month Treasury Bill	0.05%	0.05%

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