Accredited Wealth Management

“Live the Life You’ve Imagined”

Investment Commentary

December 2021

Global stocks retreated in November. Against a backdrop of still-rising inflation and supply chain worries, the emergence of the Omicron variant pressured stocks. The resulting increase in stock market volatility and a flight to safety helped U.S. Treasury bond performance for the month.

- According to FactSet, 82% of S&P 500 companies exceeded their third-quarter earnings targets. However, annual inflation reached a 31-year high, threatening the outlook.
- The unemployment rate dropped to 4.6% in October, the lowest rate since March 2020. Weekly jobless claims fell to a pandemic low, however, the labor force participation rate remains well below pre-pandemic levels.
- Large-cap U.S. stocks advanced quarter to date, but small-caps declined slightly. Growth stocks outperformed value in the large-cap space but underperformed in the small-cap arena.
- Amid new coronavirus restrictions and economic uncertainty, foreign stocks declined and underperformed the U.S.
- Long maturity Treasury yields ended the month lower as investors flocked to quality at month-end. Gains for Treasuries helped the core bond index finish up slightly for the month.

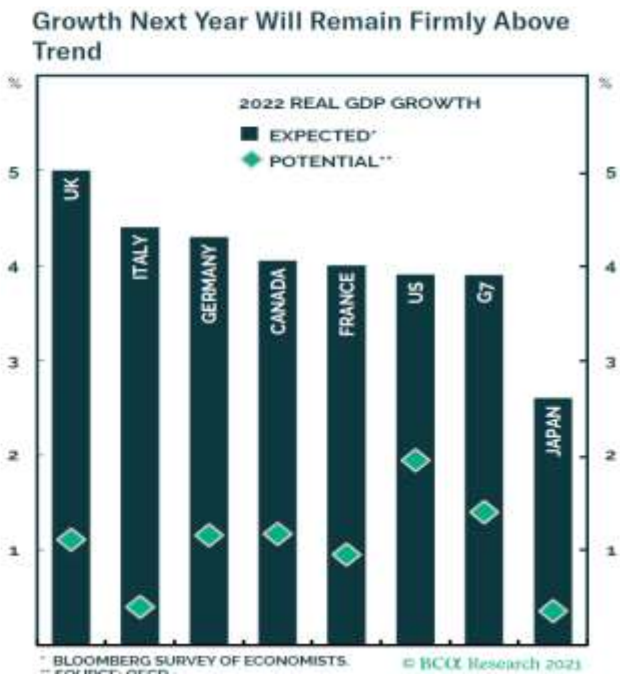
Return (%)	1 MO	3 MO	YTD	1 YR
S&P 500	-0.69	1.32	23.18	27.92
Russell 2000	-4.17	-3.04	12.31	22.03
MSCI EAFE	-4.64	-5.04	6.32	11.28
MSCI Emerging Markets	-4.07	-6.92	-4.07	3.03
Bloomberg Barclays U.S. Aggregate Bond	0.30	-0.60	-1.29	-1.15
Bloomberg Barclays Global Aggregate Bond	-0.29	-2.30	-4.57	-3.29

Data as of 12/6/2021, Performance in USD. Source. FactSet.

This month we take a look at the slowdown in global growth; how the Omicron variant could turn out to be a positive; whether crypto currencies have gone hyperbolic; our market outlook and key risks we are watching.

Global Growth: Slowing but from a High Level

Real (after inflation) global growth should remain well above its potential rate (long-term trend estimate) in 2022. The chart on the next page shows the expected 2022 growth rates compared to potential growth rates for the G7 countries (green diamonds). Assuming the vaccines and antiviral drugs are able to keep Omicron and other potential strains at bay, global growth should remain a positive for global stock markets. As a general rule, it pays to stay optimistic on stocks unless a recession is around the corner. At this time a recession in 2022 looks like a low probability event, however, those odds may start to increase in 2023.



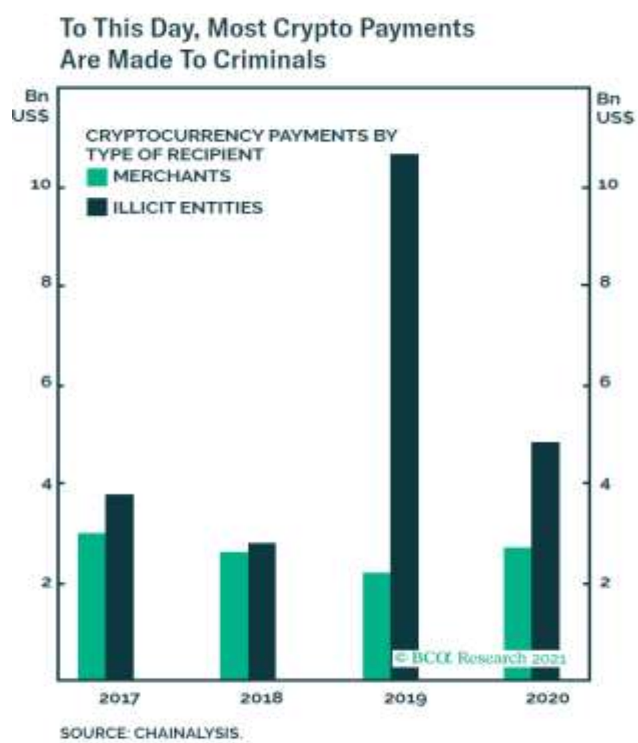
Could the Omicron Variant be a Positive?

While it’s too early to tell, early reports are suggesting that the Omicron variant is more transmissible than earlier variants, but that it may also be less virulent (deadly). If this turns out to be the case it would fit the historical pattern of previous respiratory virus pandemics and virus evolution. This occurs when a less severe and more transmissible virus quickly crowds out more severe variants and helps to transform a deadly pandemic into something more similar to the flu. It may be too early to make this call until more data is available, which could take several weeks. However, given the barrage of negative news, we thought it was important to communicate there is a potential positive scenario from the spread of Omicron. We’ll be following the data closely for definitive signals in either direction.

Has Crypto Gone Hyperbolic?

There’s a good chance the easy money in the crypto space has already been made. According to BCA, Bitcoin doubled in price seven times since the start of 2016, and if it doubles just one more time to $120,000 (Bitcoin was around $60,000 at the time of the study), it would be worth $2.2 trillion, equal to the entire stock of U.S. dollars in circulation. For perspective, you can see in the chart to the right there is actually very little use of crypto today for online purchases, and most transactions are for illegal activities.

Proponents for crypto-assets like to say that the supply of cryptos is finite, suggesting that scarcity will drive demand and create value. While this may be true for individual cryptocurrencies, it is certainly not true for the sector as a whole. The chart on the next page shows the hyperbolic growth in new cryptocurrencies created in the past few years, close to 8,000 have been created. Our advice is there is nothing wrong with speculating in some crypto assets, just don’t overdo it!



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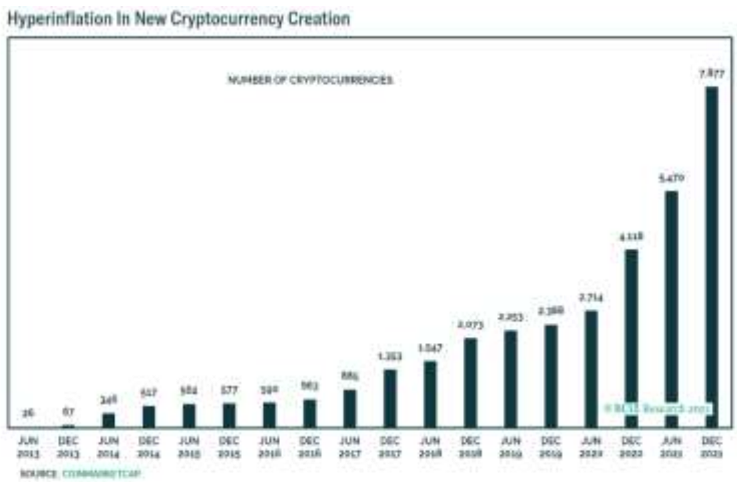

2022 Investment Strategy

In general, we believe global stocks will remain in a favorable environment in the year ahead, but returns will be more modest due to higher starting valuations. The economy will slow but remain well above its potential and earnings should continue to be positive. We expect central bank policy to remain broadly accommodative despite Fed tapering (buying fewer bonds), and the Fed will likely remain more dovish than current expectations ahead of U.S. midterm elections. Given these factors we remain constructive on stocks and based on valuations would favor: cyclical stocks; small-cap stocks over large-cap; value stocks over growth; and foreign stocks over U.S. stocks. We expect interest rates to gradually increase in 2022 and core bond returns to be very low. Investment-grade corporates and high-yield bonds may outperform core bonds in the year ahead, however, we find the risk vs. reward trade-off to be unfavorable. In general, we would stay underweight bonds and maintain a shorter than benchmark duration in portfolios. We expect to become more cautious on stocks as the economy nears full employment and the Fed becomes more restrictive on monetary policy.

Risks We Are Watching

At this stage of the economic cycle, we have to be more cognizant of potential risks and the impact they may have on our outlook. The list is extensive, here are some of the risks that concern us the most:

- Omicron and other variants are resistant to vaccines and more virulent, leading to restrictions
- Inflation becomes entrenched and long-term inflation expectations start to turn up
- A Goods Recession: the pandemic reallocated spending from services to goods. Will that reverse?
- Higher real bond yields or a Fed mistake
- The impact of higher tax rates
- A weaker Chinese economy and ongoing regulatory crackdowns
- Geopolitical conflicts and/or cybersecurity events

If you have any questions on this commentary or would like to discuss your investment strategy, please give us a call.

Best regards,

Steve Giacobbe, CFA, CFP®