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REVIEW & COMMENTARY

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"The main thing to remember as one year ends and another begins is that markets go up a lot more than they are down."

Prediction Time Again – It Rarely Pays to be a Pessimist
2021 Wrap Up

Unless things change considerably this week, U.S. equity markets will once again have a strong year, with the S&P 500® Index ("S&P 500") again at all-time highs on December 27. Other major indices are up strongly as well. The year seems to be ending much as the way it began – optimism that Covid in its various iterations will cease to be the dominant factor driving economies and markets worldwide. The recent explosion in the Omicron version of Covid caused a late inning scare for equity markets, but even that may be waning as data suggests it spreads quickly but is generally not severe, especially for vaccinated people.

As always, there are many things to worry about. This coming year some of the bigger ones include:

What effect will the removal of the double "punch-bowl" of low interest rates and copious liquidity caused by Federal Reserve action and the various economic stimulus measures by the federal government have on markets? If interest rates rise too much or too quickly, equity markets could suffer. Bonds have not provided an attractive alternative to stocks for several years. With U.S. 10-year treasury rates at 1.48% (December 27), they don't now. This could change but negative "real" returns favor equities. Equity market values are at fairly high levels (S&P 500 at about 22X expected 2022 earnings of $213.96 on December 27 according to S&P Capital IQ), so a rise in rates could make stocks, especially high-multiple high-growth ones suffer as future earnings are discounted by higher rates.

However, if one believes a traditional definition of inflation, "too much money chasing too few goods," higher interest rates and less liquidity could cause falling demand and eventually falling prices for goods like real estate that have largely driven the past year's high inflation. The cost of labor seems to be less likely to moderate in coming months, however, especially for workers in service industries, such as transportation, but also in manufacturing. This should tend to keep inflation up.

Global geo-politics are always worth worrying about. Two obvious hot spots now include Ukraine and Taiwan. No one knows how much markets already anticipate trouble in both areas and thus is already priced-in to valuations, but one could guess that markets worldwide would suffer from significant turmoil in either area. The Chinese economy itself could pose a threat to world markets as recent reports suggest it is slowing. If true, a slowdown in China could cause lower demand and prices for many commodities such as oil, natural gas and copper and other industrial metals.

The main thing to remember as one year ends and another begins is that markets go up a lot more than they are down. In the 62 years since 1960, markets fell 13 times and rose 42 times. In percentage terms, this is 79% up and 21% down. Quarterly numbers show similar trends, in the 135 quarters since 1987 markets fell 34 times and rose 102 times, for a 75% up and a 25% down average. This data is shown in the table on the following page.

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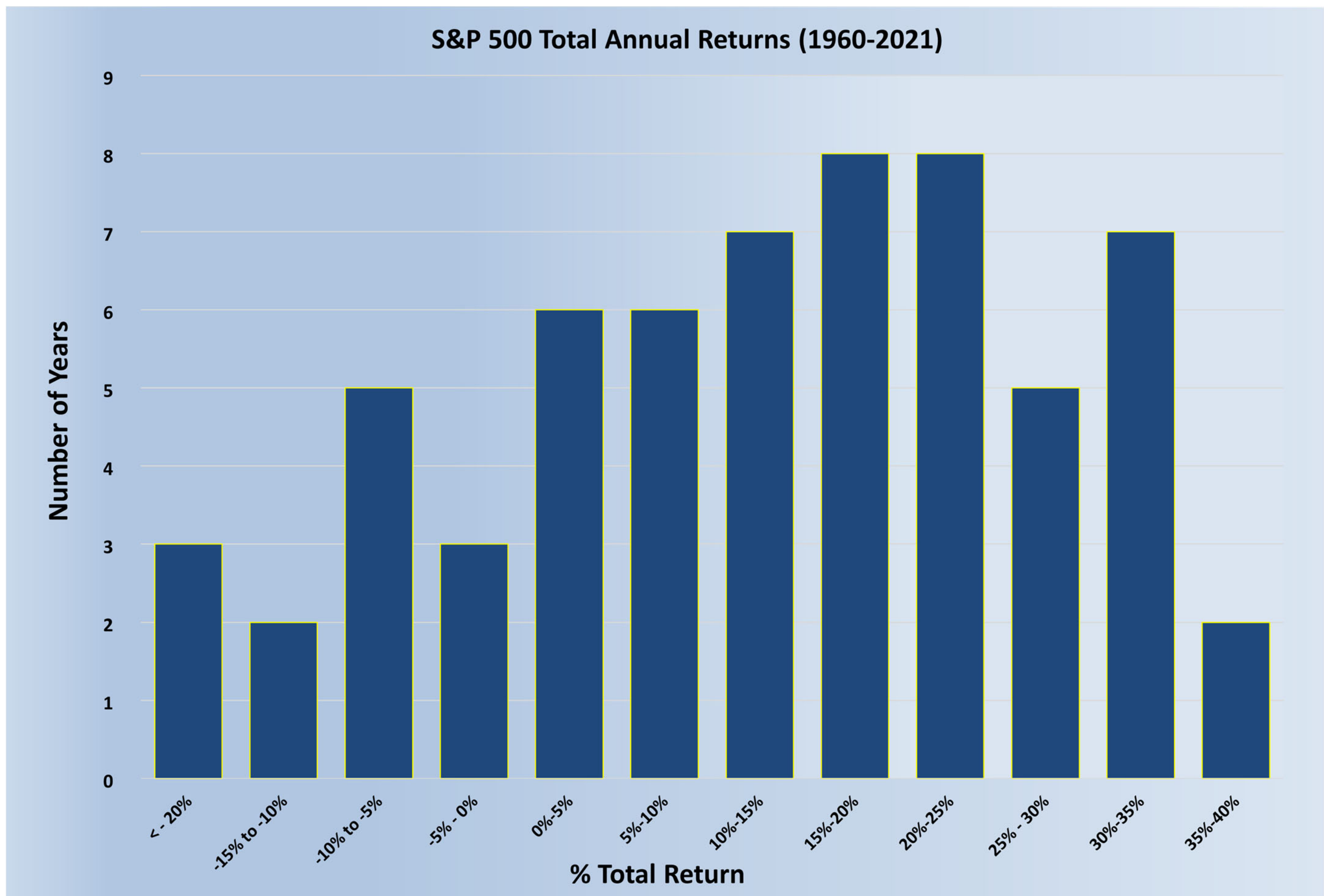

Chart Source: NYU Stern School of Business

"A 10% correction happens every few years or so, a 20% correction every 5-10 years and we seem to get a 30% or more correction about once a decade."

Markets do fall, of course. A 10% correction happens every few years or so, a 20% correction every 5-10 years and we seem to get a 30% or more correction about once a decade. Another reasonable question to ask yourself is what kind of return am I likely to get after three strong years (2019, 2020, 2021)? The data is mixed – before 1970 it was fairly rare for markets to go up more than four years consecutively. Since 1970, it has not been uncommon at all to see markets remain strong after three up years. So, as you think about your investments going into the new year, you should ask yourself whether a 20%-30% drop in equity markets would make you change your lifestyle significantly. If so, maybe some reallocation of assets is in order even if it means forgoing some returns.

We are always ready to listen and help.