CAPITAL INVESTMENT SERVICES, LLC

2022 Market Outlook – It Is Going to Get Noisy!

Markets have exhibited very impressive resilience since the pandemic began and that remained the case throughout 2021, as the strength of the U.S. economy and corporate America helped produce another year of substantially positive returns in stocks. I anticipate that resilient nature will continue to support markets and the economy as we begin a new year. However, I also anticipate an increased level of volatility due to the following factors: (1) Transition of Federal Reserve Monetary Policy, (2) Inflation, (3) Pandemic Fears, (4) Political Risk and (5) An Earnings Vacuum.

Markets do not like uncertainty. The timing and pace of a monetary policy shift is accelerating which shifts the way all assets are priced. The tightening of monetary policy through the tapering of asset purchases and higher interest rates should have begun in early 2021 based on economic data and the forward outlook. Unfortunately, the Federal Reserve maintained course of extremely easy monetary policy which ultimately built a valuation bubble in the equity markets. From my perspective, the “Fed Bubble” accounts for a 9%-12% premium in the DJI, S&P500 and NASDAQ.

The transition to a tighter monetary policy will likely create headwinds on the economy and potentially corporate earnings, and while historically U.S. stocks have performed well during the initial phases of a Fed rate hike campaign, we will closely monitor the impact of rate hikes on economic growth and the corporate earnings outlook as we move through 2022.

The reason the Fed is more aggressively removing accommodative policies is because inflation surged to 30-plus-year highs in 2021. Positively, rising inflation did not have a negative impact on consumer spending or corporate earnings in 2021. But that risk remains as even optimists do not expect inflation to decline substantially in 2022.

COVID is not over. The Omicron variant, which is currently spreading across the globe, thankfully does not result in nearly as many severe cases as previous COVID variants, but it’s still impacting society and businesses via worker shortages and more supply chain disruptions.

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Politics will also be a source of volatility in the first quarter of 2022 and beyond. Democrats failed to pass the Build Back Better social spending bill in 2021, but the process is not over, and none of us should be surprised if that legislation passes in early 2022. From a market standpoint, investors will be focused on any potential tax increases that might reduce corporate profits or consumer spending. Given the current version of the bill, market-negative tax increases look unlikely, but the legislative process is unpredictable, and we'll continue to monitor the situation for any negative tax implications. The midterm elections in November are expected to continue influencing market volatility due to the divisiveness of the Country and the focus on fear across the various sources of media.

While markets face numerous risks as we start a new year, there remain powerful tailwinds on stocks and other risk assets. Corporate earnings remain incredibly strong and the performance of corporate America through the pandemic has been nothing short of amazing. Even though 2021 corporate earnings exceeded expectations, an earnings vacuum is anticipated due to higher cost pressures, slower economic growth, higher taxes and rising interest rates. These factors will lead company executives to reduce their outlook on future earnings and profits. Interest rates, while they will likely rise in 2022, remain very low and not yet close to levels that would historically be considered a headwind on economic activity. Personal savings remain high, unemployment remains low, and broadly speaking the U.S. economy is in strong shape.

As we consider all that has occurred in 2021 and look forward to 2022, one of the biggest takeaways from another unpredictable year in the markets is that a well-planned, long-term-focused and diversified financial plan can withstand virtually any market surprise and a related bout of volatility, including multiple COVID waves, inflation reaching 30-year highs, and the Federal Reserve removing historic accommodation.

At Capital Investment Services, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this still-challenging investment environment. It is critical for you to stay invested within your target risk profile and remain patient as the market experiences short-term volatility. We thank you for your ongoing confidence and trust. Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

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