Bad Bulb or Blown Fuse

In 2021, nearly all artificial trees now come pre-lit, but it wasn't too long ago when wrestling with a few strands of light could age a man or woman a few years. Lights were often passed down from prior generations and could be as "finicky" as an eight-year-old at a Chinese buffet for the first time. Determining the cause of a strand not working involved patience and could take hours. Was it a bad bulb or a blown fuse?

The recent market selloff has parallels to the humbling moments of days gone by, wrestling with those lights. And a similar question can be posed: is this market broken or is it just needing a breather? Is this a market to walk away from or to show patience?

To get at the answer, let's first diagnose the crux of the question. Since the Global Financial Crisis, investors have been waiting on the next "big one." After all, many would agree that the pain that ensued a dozen plus years ago should be avoided at all costs. The Spring of 2020, although it temporarily wreaked havoc on the markets, came and went with remarkable speed. Its behavior more resembled a natural disaster than a "normal" market correction. For those unwilling to panic, 2020 would end up to be an above average year for equities.

Today we sit nearly 20 months since Covid-19 first landed on US soil. The supply chain is a mess, confidence in scientists and politicians is equally low, regulation and taxes are feared to be headed higher, and inflation is at 30-year highs. This certainly presents as troubling. ***A key question to ask, however, is whether these issues are improving or getting worse.*** Recall in the middle of 2020 when the virus had most of the country in lockdown, the stock market began its ascent. Why--because it was looking ahead to see what was next.

As we sit today, unemployment has improved remarkably from its pandemic lows. The

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supply chain is slowly healing. Although we now face a new variant in Omicron, we also have approved vaccines and many viable treatments for those afflicted. We aren't flying blindly!

Regarding supply chain challenges, nearly all the issues involve increased demand rather than low output. A shift in spending toward service and away from goods will alleviate some of these challenges, as will the resumption of normal production in Asian nations (thanks, in large part, to high vaccination rates). Producer productivity continues to make strides.

Cost of capital remains historically cheap (not to mention the Trillions of global stimulus in response to the virus). Political wrangling, as it most often does, has led to an increased probability that gridlock will resume after the 2022 mid-term elections. While inflation feels uncomfortably high and seems to be prevalent everywhere, it was only 2 years ago that we faced the threat of deflation. Technological advances continue to take costs out of the system (think back to a $300 VCR to $200 DVD to $150 Blue Ray to now streaming it all).

And as for the stock market, when one looks at valuations for the S&P 500 in 2021, earnings growth has outpaced the market's gains over the last year. Analysts at JP Morgan and Goldman Sachs expect double-digit earnings growth again in 2022 and 2023. ***Despite an above-average YTD move by the S&P 500, it's less expensive than when we entered the year!*** Consensus remains that corporate balance sheets are in better shape than ever (as are consumer balance sheets), bond defaults are near all-time lows, and companies continue to reinvest in share buybacks and dividends.

Given the backdrop of a 10-year US Treasury below 1.5% and expected 3^{+}% inflation in 2022, we believe investors should continue to maintain a tilt toward equities. As such, part of owning equities is enduring periods when they "misbehave." Recent volatility, while not enjoyable, is also quite normal. Our team's responsibility is to stay informed, manage risk, and help you tell the difference between a bad bulb and a blown fuse.

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