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Wealth Advisory Market Update

January 26, 2022

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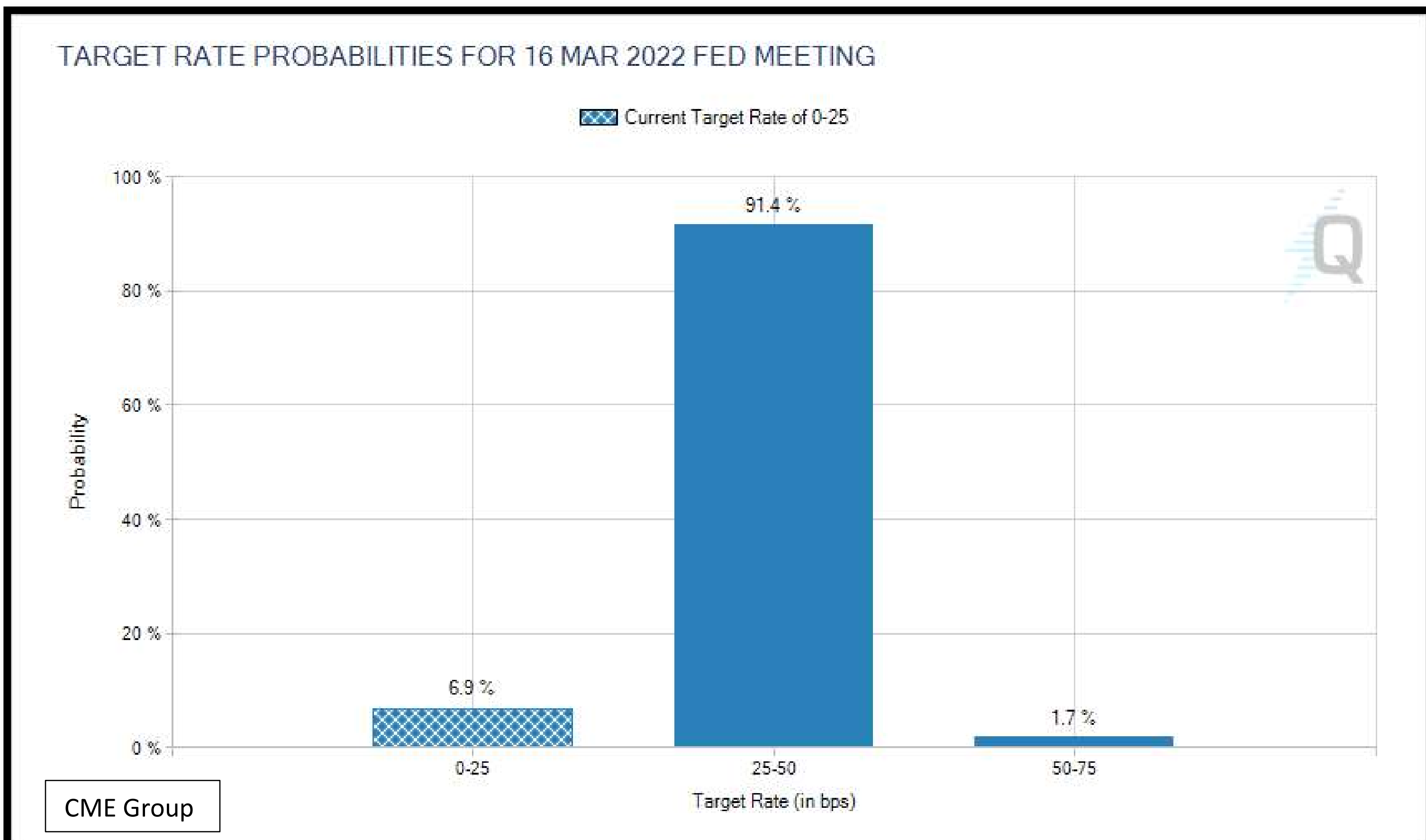
Market Update

As we reach the end of January 2022, market volatility continues to be front and center in the news, as we saw on Monday with the whipsaw in the market, followed by the Tuesday selloff. This is a continuation of the volatility over the last few weeks with the new economy stocks taking the hardest hits. As we stated in our last newsletter, this comes as no surprise to us, and we feel it is important to restate: “In our opinion, the valuations of the new economy stocks, in a lot of ways, parallels the dot-com bubble, mirroring the absurd multiples off of expected cash flows 10-plus years from now. These companies benefited greatly from a slow growth, low interest rate and deflationary environment where market participants were willing to pay anything for a company with growth. This led to one of the largest drawdowns in history of value vs. growth companies. We also believe that last year may turn out to have been the blow-off top in these growth companies that we have been waiting for.” Even so, we expected a bounce back rally from oversold levels and we saw that on both Monday and Tuesday of this week.

Of course, much of this volatility can be attributed to the Federal Reserve’s positioning. For example, the market is currently pricing in four rate hikes this year along with the tapering of asset purchases. With this hawkish stance, market participants are trying to reposition themselves for a world without unlimited liquidity injections from the Federal Reserve. The Fed also sounds more hawkish in their recent speeches as inflation has continued to surge. With the Federal Reserve seemingly behind the curve, we believe we will see a 50bps hike in March. This is also what the futures market is pricing in as you can see below. The FOMC meeting wraps up today and here are the key points to take from it: The FOMC will end QE in March 2022, Rate hikes will likely start in March and balance sheet run-off (Quantitate Tightening) will start thereafter. This is what we expected but as we mentioned in our last letter, we believe this puts the Fed further behind the curve based on current economic circumstances.



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So far, the reaction to the FOMC announcement has been muted but that can change in a hurry. It is easy to focus only on the Federal Reserve but there are other issues at work, as well. Economic data has started to roll over. This may be due to the spike in Omicron over the last couple of months, or perhaps the roll over is a part of a longer-term slowdown. We will be watching this closely. This is an important indicator because it may cause the Fed to pause its tightening which would then change our positioning in the equity markets.

We are also monitoring current geopolitical risks, which have been escalating quickly. The situation with Ukraine and Russia is of major importance on a global scale. Currently, the U.S. and other NATO members have issued strong statements about this crisis. The U.S. is reportedly considering sending troops to the region along with levying stiff economic sanctions against Russia. Adding to the Ukraine confusion is that some NATO members such as Germany, have decided to not allow the sale of weapons to Ukraine. Estonia, a NATO member, was going to make a direct sale to Ukraine, but because the weapons were produced in Germany, this sale is currently being held up. Adding to the situation, Germany receives 32% of its natural gas from Russia and that cannot be replaced in the short-run. This one example shows that, when viewed from a geopolitical scale, the many layers make for a complex state of affairs. We will watch carefully as this situation unfolds.

In summary, our thoughts from our last letter still apply, "As we move forward in 2022, we believe a couple of themes will arise. Old economy stocks with strong cash flows and pricing power are going to be in favor for the first time in a decade. As rates rise, market participants in our opinion will not want to own companies that are trading off expected cash flow 25 years from now; rather, they will want to invest in companies that are currently providing a strong cash flow stream and trading at a multiple well below the market."

This is a snapshot of the current trend and it does not mean current conditions will continue. Economic data coming out in the near future could alter our outlook. If this occurs, we will be quick to assess and make adjustments to our portfolios. As always, we continue to navigate this difficult environment as ably as possible. We at AMB thank you for your support and for allowing us to partner with you in reaching your financial goals.

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