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Wealth Advisory Market Update

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Market Update

Happy New Year! Unfortunately, we aren't surprised to see a volatile start to 2022. Much of this volatility is due to the Federal Reserve's New Year positioning, raising interest rates and the existing employment struggles. On Wednesday, the Federal Reserve released their highly anticipated minutes from its December meeting. While they did not contain anything surprising to us, the more hawkish tone of the minutes did have a big effect on the markets. Long duration stocks were sold, while old economy stocks saw big inflows. There was also a massive pivot in the direction of interest rates, which are now near 52-week highs across the curve.

On the payroll side, so far, the data has been mixed. ADP reported strong payroll growth in the month of December exceeding expectations with a print of 800K jobs. However, on Friday, the U.S. Bureau of Labor Statistics (BLS) announced that their numbers came in well below expectations, 199k vs 400k expected. They also reported the unemployment rate fell to 3.9%. We don't think this weaker than expected number will give the Fed pause as of yet because the surge in Omicron cases heavily affected, and continue to affect, employment. Positioning among money managers also impacted the market at the beginning of the year. For the first time in months, managers are buying quality/value at the expense of high growth tech.

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. If we look at historical market multiples relative to the market, this is one of the best opportunities to invest in sectors such as energy, materials, industrials and financials. These sectors possess pricing power to deal with inflation along with an already strong stream of cash flows which have been ignored for years now.

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. Although inflation will continue to run hot, we believe the overall economy will do better in 2022 than most expect. In this scenario the sectors we mentioned earlier - energy, materials, industrials and financials, should widely outperform their growth counterparts.

As most of you are aware, we have been focused on short duration since the summer of 2020 as we expected rates to increase due to the economy reopening along with inflation being stickier than what the Federal Reserve indicated. This remains the case. However, with rates now approaching yearly highs and the 10-year Treasury now paying more than the yield of the S&P 500, bonds are starting to look more attractive. We are going to begin to reposition our fixed income holdings and extend out our duration from current levels, buying more securities in the belly of the yield curve.

The trends we see in the first week of the year are not necessarily going to last. 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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